CONTENT

CONDENSED FINANCIAL STATEMENTS

30.6.2007

At the meeting of the Board of Directors held on August 29, 2007, the unaudited consolidated financial statements of Israel Discount Bank Ltd. for the first half of 2007, ended June 30, 2007 were approved.
The interim financial statements were prepared on the basis of the same accounting principles applied in the preparation of the audited financial statements as of December 31, 2006 (except as detailed in Note 1 (c) to the condensed financial statements).
The independent auditors of the Bank have reviewed the interim financial statements as of June 30, 2007. The said review is limited in scope, in accordance with procedures determined for this purpose by the Institute of Certified Public Accountants in Israel, and does not constitute an audit in accordance with generally accepted auditing standards. Accordingly, the auditors did not render an opinion on the said financial statements.

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY

GENERAL

In the first half of 2007, the gross national product increased at an annual rate of 6.6%, higher than the growth rate of 6.0% in the first half of 2006. The business product increased at the rate of 7.9%, compared to 8% in the first half of 2006. Export of goods and services increased at the rate of 8.3%, compared to 7.9% in the first half of 2006, and import of goods and services increased at the rate of 15.5%, compared to 2% in the first half of 2006. Regarding domestic products, in the first half of 2007 private consumption increased at the rate of 7.5%, compared to 3.9% in the first half of 2006; investment in fixed assets increased at the rate of 5.9%, compared to 5.5% in the first half of 2006, and public consumption increased at the rate of 1.5%, compared to 1.8% in the first half of 2006.
According to the trend's data, unemployment continued to decrease during the first five months of 2007 to a level of 7.6% in May 2007, compared to a level of 7.9% in December 2006 and 8.9% in May 2006. Improvement trends were also recorded in the number of employed Israelis and in their average wage. During the first five months of 2007, the number of positions of employed Israelis increased at an annualized rate of 2.5%, and in May 2007 their number was 3.6% higher than that of May 2006 standing at 2.7 million. The average wage increased during the first five months of the year at an annualized rate of 4.7%, and in May 2007 was 3.0% higher than that of May 2006 standing at NIS 7,627.

DEVELOPMENTS IN GLOBAL ECONOMY

The growth rate of the larger world economies was moderated during the first quarter of 2007: the US economy recorded a low growth rate at an annualized rate of merely 0.7% (compared to 2.4% in the last quarter of 2006), the growth rate at the Euro block was 2.4% (compared with 3.6% in the last quarter of 2006) and the Japanese economy grew at an annualized rate of 3.3% (compared with 5.4% in the last quarter of 2006). In the second quarter of 2007, the United States economy grew by 3.4%, the Euro block economy grew by 1.2% and the Japanese economy grew by 0.5% (all data in annual terms). The US interest rate remained unchanged in the first half of 2007 at a level of 5.25%, while in Japan the interest rate increased by one quarter percent to 0.5% and the Euro block recorded an increase of one half of a percent to a level of 4%.

DEVELOPMENTS IN THE ISRAELI ECONOMIC SECTORS

The average monthly turnover of the commercial and services sectors was 9.6% higher in the first six months of 2007 than in the corresponding period last year. The trend's data show that the increase in turnover of the commercial sectors continued to grow rapidly: in the period from April to June 2007 the turnover of the commercial and services sectors increased at an annualized rate of 9.7%, as a continuation to 11.1% in the period from January to March 2007.

In the first six months of 2007, the monthly industrial output was 6.5% higher than the first six months of 2006. The trend's data shows that in the second quarter of 2007 the industrial output demonstrated stability compared to a decrease at an annualized rate of 0.7% in the first quarter of 2007.

The effects of the war in the north of Israel were still noticeable in hotel sector, and the number of bed/nights in the first six months of 2007 was 1.9% lower compared with that of the corresponding period last year, following a decrease of 3.9% in the number of tourist bed/nights. Notwithstanding, the monthly trend data shows an impressive recovery in the number of tourist bed/nights and in the number of bed/nights generally since the war in the North in the summer of 2006, from a bottom level of 1.48 million bed/nights in July 2006 to a level of 1.78 million bed/nights in June 2007.

The construction industry is still characterized by high volatility and the volume of sales of new residential housing units in the first five months of 2007 was 6.4% lower in comparison to the corresponding period last year, standing at 5,634 units. Concurrently, the number of residential housing units available for sale continued the downward trend and their number in May 2007 was 13.9% lower than the corresponding month last year.

ECONOMIC DEVELOPMENTS AS AGAINST OVERSEAS MARKETS

In the overall foreign trade (goods and services), exports grew in the first quarter of 2007 at an annualized rate of 6.5% amounting to US$16.6 billion – an increase of 12.3% compared to the corresponding period last year. Imports grew at an annualized rate of 3.5% amounting to US$16.7 billion – an increase of 12.9% compared to the corresponding period last year. The balance of trade amounted accordingly to a minimal deficit of US$24 million. In the foreign trade in goods, export of goods in the first half of 2007 grew by 11.9% in comparison to the corresponding period last year, amounting to US$22.2 billion. Concurrently, the import of goods grew by 10.8% amounting to US$25.6 billion, the trade deficit amounting accordingly to US$3.4 billion – an amount higher by 3.9% compared to that of the first half of 2006. The trend's data reveal that during the first half of 2007 exports and imports continued to grow, exports grew at an annualized rate of 19% and imports at an annualized rate of 33.2%.

The Bank of Israel data shows that in the first half of 2007 investments in Israel by foreign residents amounted to US$5.3 billion, compared to US$13.6 billion in the corresponding period last year. Direct investments in Israel by foreign residents in the first six months of the year amounted to US$3.7 billion, while foreign residents' investment in trading securities amounted to US$1.5 billion, compared to US$4.3 billion and US$7.1 billion, respectively, in the corresponding period last year. Investments abroad by Israeli residents in the first half of 2007 amounted to US$11.3 billion, compared to US$18.7 billion in the corresponding period last year.

DEVELOPMENTS IN INFLATION AND FOREIGN EXCHANGE RATES

The Consumer Price Index (CPI) increased during the first half of 2007 by 1%. Prices of items that increased most noticeably were transportation and communications (3.2%) apparel and footwear (1.4%) and foodstuffs excluding fruits and vegetables (1.4%). These increases were partly offset by reductions in prices, the most noticeable of which were fruit and vegetable (-1.8%) and housing (-0.4%).

In terms of the annual cumulative change in the CPI (the last 12 months) inflation continued to decline and deviated in the first half of the year from the lower limit of the inflation rate targeted by the Government, which stands at 1%. At its peak, inflation was at a negative rate of -1.3%, 2.3% lower than the said targeted inflation rate. The expected inflation rate for the year ahead, derived from the capital market (gross), reached in the first half of the year a low of 0.5% in April (monthly average). However, the strengthening of the US Dollar since the middle of May 2007 brought about higher inflationary expectations for the year ahead reaching 1.8% in June.

The index for wholesale prices of industrial output intended for the domestic market increased during the first half of 2007 by 4.1%, completing in June 2007 a cumulative annual increase of 0.6%.

FISCAL AND MONETARY POLICY

The State budget showed in the first half of 2007 a surplus of NIS 5.6 billion (excluding the net granting of credit) compared to a surplus of NIS 4.6 billion the corresponding period last year. The cumulative surplus since the beginning of the year derives mainly from an increase in the State's income, both from direct taxes (7.6%) and from indirect taxes (4.9%), and reflects the high level of activity in the economy.

On background of the continued strengthening of the US Dollar, the high correlation between the exchange rate and the CPI and the desire to increase the prospects of the inflation returning to the official targeted range still in 2007, the Bank of Israel decreased the interest rate in January by 0.5% and by an additional 0.25% in each of the months of February, April, May and June down to a level of 3.5% in June. As a result thereof, the negative differential between the Bank of Israel interest rate and the interest rate of the US Federal Bank continued to grow reaching a level of 1.75% in June 2007. In its announcements, the Bank of Israel repeatedly noted that the falling prices result mainly from the weakening of the Shekel as against the US Dollar, and further emphasized that the level of the "domestic prices" (which are not directly affected by the foreign exchange rates) continue to increase at rates of over 3%.

CAPITAL MARKET

The vigorous activity on the capital market continued in the first half of 2007 and the general share index (shares and convertibles) increased at the rate of 22.1%, following an increase of 5.8% for the whole of 2006. The total market value of shares and convertibles on the Tel-Aviv stock Exchange reached NIS 861 billion at the end of the first half of 2007, in comparison to NIS 578 billion at the end of the first half of 2006. The average daily trade turnover continued to grow from a level of NIS 1.5 billion in 2006 to a level of 2 billion in the first half of 2007.

The sharp increases in share prices in the first six months of 2007 encompassed all economic sectors, excluding the oil prospecting sector, which declined at the rate of 1.8%. Particularly sharp increases were recorded in prices of shares of investment companies (32.2%), industrial shares (26.8%) and real estate shares (22.9%). The "TA 25" index increased at the rate of 20.1%, the “TA 100” index increased at the rate of 19.6% and the “Tel-Tech” index increased at the rate of 16.5%.

The asset portfolio held by the public grew during the first four months of 2007 by 7.2%, its total value amounting to NIS 1,993 billion, in comparison to NIS 1,860 billion at the end of December 2006. The weight of domestic shares in the total portfolio also continued to grow during the said period (from 21.9% to 24.7%), while the weight of foreign shares decreased slightly (from 3.7% to 3.6%).

The general bond index covering all traded bonds increased during the first half of 2007 by 4.1%, price increases being recorded in all bond channels. The daily trade turnover in bonds on the Tel-Aviv Stock exchange increased dramatically from NIS 1.7 billion in 2006 to NIS 3 billion in the first half of 2007. This to a large extent was the result of the reform made in the Government bond market and the introduction of “market makers” to the trade.

The CPI linked Government bonds index increased during the first half of 2007 by 5.3%, in continuation to 4.1% in 2006. In redemption periods of up to two years, prices increased by 3.4%, in redemption periods of between two to five years prices increased by 6%, in redemption periods of between five to seven years prices increased by 6.2%, and in redemption periods of between seven to ten years prices increased by 5.1%. The non linked Government bonds index increased during the first half of 2007 by 2.6% in continuation to 6.4% in 2006. Prices of the fixed interest bonds of the “Shachar” class increased by 2.6% and prices of the non-linked Government bonds of the “Gilon” class increased by 2.8%, while short-term notes (MAKAM) recorded a price increase of 2.4%.

The corporation bond market continued to grow on background of small fund raising by the Government. The total registered capital of traded and non-traded corporation bonds increased from NIS 200 billion in December 2006 to NIS 227 billion in May 2007. A sharp increase was also recorded in the number and volume of bond offerings on the Tel-Aviv Stock Exchange. In the first half of the year bond offerings to the public numbered 112 (compared to 87 in the whole of 2006) and the total amount raised thereby amounted to NIS 21 billion (compared to NIS 13.6 billion during the whole of 2006). The number of bond offerings to institutional bodies numbered 74 (compared to 89 during the whole of 2006) and the total amount raised thereby amounted to NIS 25.9 billion (compared to NIS 24.3 billion in the whole of 2006).

The mutual fund market recorded in the first half of 2007 a net inflow of cash amounting to NIS 884 million in the equity funds, NIS 24.6 billion in the bond funds and NIS 889 million in the Shekel funds. In contrast, the foreign market funds recorded net redemptions of NIS 1.7 billion. In total, the first half of 2007 saw a net positive inflow of cash in the amount of NIS 24.7 billion, compared to net redemptions of NIS 18.4 billion in 2006.

The first six months of 2007 saw a continued vigorous activity in the options trade on the “TA 25” index and the average daily trade turnover amounted to approximately 370 thousand contracts in comparison to 305 thousand contracts in 2006.

THE BANKING INDUSTRY

The average effective return on the total non-linked Shekel applications at the seven major banks declined during the first half of 2007, from a level of 7.03% in December 2006 to a level of 5.96% in June 2007.

The average effective cost of the total non-linked Shekel resources at the seven major banks declined during the first half of 2007, from a level of 3.88% in December 2006 to a level of 2.86% in June 2007.

The financial margin(1) in the non-linked Shekel segment at the seven major banks declined during the first half of 2007, from a level of 3.09% in December 2006 to a level of 2.95% in June 2007.

PRINCIPAL ECONOMIC DEVELOPMENTS IN JULY AND AUGUST 2007

The CPI increased in July 2007 by 1.1% completing an increase of 2.1% since the beginning of the year. Noticeable price increases were recorded in the housing (3.8%), transportation and communication (1.3%) and education, culture and entertainment (1.2%). On the other hand, closing and footwear decreased by 3.5%.

During the month of July the Shekel appreciated as against the US Dollar at the rate of 1.3% and at the end of that month the exchange rate was NIS 4.31 to one Dollar.

In July, foreign investments in Israel amounted to US$298 million and Israeli investments abroad amounted to US$447 million.

The Bank of Israel interest rate for July 2007 remained unchanged at a level of 3.5%, and in August increased the interest rate by 0.25%, to a level of 3.75%.

In July 2007, the general share and convertibles index increased by 0.3%, the "TA 100" index increased by 0.1% and the "TA 25" index increased by 0.7%.

Since July share prices have decreased sharply on capital markets in Israel and worldwide, in response to information regarding expected extensive losses in the housing loan market in respect of problematic borrowers (sub-prime). Decrease in apartment prices in the U.S. and increase in interest and current repayments resulted in cessation of repayments by a significant part of borrowers exposing investors to losses. Accordingly, the risk premium increased, not only in the sub-prime sector and in related instruments, but in capital markets worldwide.

FORWARD-LOOKING INFORMATION

Some of the information detailed in the directors' report, which does not relate to historical facts, comprises forward-looking information, as defined in the Securities Law, 1968.

Actual results of the Bank might differ materially from those indicated in the forward-looking information, due to a large number of factors, including, among other things, macro-economic changes, changes in the geo-political situation, regulatory changes and other changes not under the control of the Bank, and which may result in the non-realization of the estimates and/or in changes in the business plans of the Bank.

Forward-looking information is typified by terms and words like: "believe", "anticipate", "estimate", "intends", "prepares to...", "might" and similar expressions, in addition to nouns such as: "desire", "anticipation", "intention", "expectation", "assessment", "forecast", etc. Such forward-looking expressions involve risks and uncertainties as they are based on evaluations by management as to future events, which include, among other things, evaluations as to the state of the economy, public preferences, domestic and foreign interest rates, inflation rates, etc. as well as regarding the effects of new legislative and regulatory provisions relating to the banking industry and the capital market and to other fields that have an impact on the activity of the Bank and on the environment in which it operates, and that by the nature of things, their realization is uncertain.

The information presented below relies, among other things, on information in the hands of the Bank, inter-alia, publications by other entities such as the Central Bureau of Statistics, the Ministry of Finance, the Bank of Israel, the Ministry of Housing and other entities that publish data and assessments as to the Israeli and global financial and capital markets.

(1) Based on the assumption that the cost of the surplus assets equals the real-term cost of "Sagee" bonds.

The above reflects the point of view of the Bank and its subsidiaries at the time of preparation of the financial statements as to future events, based on evaluations that are uncertain. The evaluations and business plans of the Bank and its subsidiaries are derived from such data and assessments. As stated above, actual results might differ materially and impact the realization of the business plans or bring about changes in these plans.

PRINCIPAL DATA TAKEN FROM THE CONSOLIDATED FINANCIAL STATEMENTS

PROFITABILITY

	For the six months ended June 30		Rate of
	2007	2006	change
	In NIS millions		in %
Income from financing activities before provision for doubtful debts	1,938	1,825	6.2
Provision for doubtful debts	254	251	1.2
Income from financing activities after provision for doubtful debts	1,684	1,574	7.0
Non-financing income	1,324	1,192	11.1
Non-financing expenses	2,393	2,630	(9.0)
Operating income before taxes	615	136	352.2
Operating income (loss) after taxes	379	(32)	-
Net income from extraordinary items, net of taxes	395	426	(7.3)
Net income	832	444	87.4
Net income disregarding certain components*	492	333	47.9
Net earnings per one share of NIS 0.1 par value	0.85	0.45	
The return on shareholders' equity, in %**	21.4	13.5	
The return on shareholders' equity, in %, disregarding certain components*	12.4	10.1	

* For details regarding the components that had been eliminated, see "Income and Profitability" hereinafter.

** For details of the amendment of in the public reporting instructions, regarding the computation of return of net earnings on shareholders' equity, and its effect on reported data, see ÒMiscellaneousÓ item hereunder.

BALANCE SHEET

	June 30, 2007	June 30, 2006	December 31. 2006	Rate of change in % Compared with	
				June 30	December 31
	In NIS millions			2006	2006
Total assets	169,658	159,577	162,538	6.3	4.4
Credit granted to the public	94,667	88,450	90,175	7.0	5.0
Securities	39,794	40,648	38,914	(2.1)	2.3
Deposits from the public	135,574	129,435	130,517	4.7	3.9
Shareholders' equity including minority interests	8,988	7,611	8,367	18.1	7.4
Shareholders' equity	8,868	7,148	7,965	24.1	11.3

FINANCIAL RATIOS

	June 30, 2007	June 30, 2006	December 31. 2006
		In %	
Capital resources in relation to total assets	5.3	4.8	5.1
Ratio of capital to risk assets	10.48	9.81	10.45
Ratio of the provision for doubtful debts to credit to the public	0.51	0.53	0.59
Ratio of credit to the public to total assets	55.8	55.4	55.5
Ratio of credit to the public to deposits of the public	69.8	68.3	69.1
Ratio of deposits of the public to total assets	79.9	81.1	80.3
Ratio of operating income to operating expenses	55.3	45.3	47.0
Total income relative to operating expenses	136.3	114.7	122.5

MARKET SHARE

Based on data relating to the banking industry as of March 31, 2007, published by the Bank of Israel, the Discount Bank Group's share in the total of the five largest banking groups in Israel was as follows:

	March 31, 2007	December 31, 2006	December 31, 2005
		In %	
Total assets	17.6	17.8	18.1
Credit to the public	15.4	15.5	15.3
Deposits of the public	17.8	18.0	18.6
Earnings from financing operations	18.2	17.0	16.6
Provision for doubtful debts	26.9	18.9	22.9
Operating income	17.9	17.2	17.5
Operating expenses	21.4	21.0	19.8

INCOME AND PROFITABILITY

Israel Discount Group's net income for the first half of 2007 totalled NIS 832 million, compared with NIS 444 million in the corresponding period last year, an increase of 87.4%.

Net Income disregarding certain components, as detailed hereunder, would have amounted in the first half of 2007 to NIS 492 million, compared to NIS 333 million in the corresponding period last year, an increase of 47.9%.

Following is an analysis of the effects (net of tax effect) of certain components on the net profit (in NIS millions):

	For the six months ended on June 30	
	2007	2006
Reported net income	832	444
The bonus paid to the employees in respect of the sale of the controlling interesting the Bank	-	221
Expenses in respect of encouragement of early retirement	4	25
The effect of half of the provision in respect of the wage agreemtent on the increase in liabilities provisions for wage related expenses	34	51
The cost of implementing improvements and examinations in IDB New York	16	21
Profit from the sale of Ilanot Discount	-	(256)
Reversal of the provision for impairment in value of the investment in the First International Bank recorded in 2003	-	(173)
Gain on the sale of the provident fund activity	(394)	-
Net income disregarding certain components	492	333
The return on shareholders' equity disregarding certain components	12.4%	10.1%

Return on shareholders' equity for the first half of 2007 reached a rate of 21.4%, on an annual basis, compared with a rate of 13.5% for the corresponding period last year, and 11.7% for all of 2006. (For details regarding the amendment to public reporting instructions with respect to "the computation of the return of net earnings on shareholders' equity" and its impact on the reported data, see hereunder in the item "Miscellaneous").

The return on equity disregarding certain components, as detailed above would have reached in the first half of 2007 a rate of 12.4% compared with 10.1% in the comparative period last year, and a rate of 9.3% in all of 2006.

Net earnings per one share of NIS 0.1 par value amounted for the first half of 2007, to NIS 0.85, compared with NIS 0.45 for the first half of 2006.

Net earnings per one share of NIS 0.1 par value disregarding certain components as detailed above would have reached in the first half of 2007 NIS 0.50, compared to NIS 0.34 in the comparative period last year.

Following are the main factors that had an effect on the business results of the Group in the first half of 2007, compared with the corresponding period last year:

(a) An increase of 6.2% in income from financing activities before provision for doubtful debts.

(b) An increase in operating and other income at the rate of 11.1% that was affected by an increase in operating commissions at the rate of 14.2%, and an increase of 8.0% in gains from investments in shares that were set off in part by an decrease of 2.5% in other income.

(c) Decrease in operating and other expenses at the rate of 9.0%, that was affected mainly by the decrease in salary and related expenses at the rate of 18.2% (mainly as a result of a decrease in the amount of NIS 232 million, in respect of a bonus to employees relating to sale of the controlling interest in the Bank, that was paid in the corresponding period of the previous year), that was partially off set from an increase in other expenses at the rate of 3.8%, and an increase of 18.2% in expenses in respect of maintenance and depreciation on buildings and equipment.

(d) The Bank's share in earnings from ordinary operations of affiliates in the first half of 2007 totalled NIS 88 million, compared with NIS 98 million in the corresponding period last year, a decrease of 10.2%, mainly as a result of the sale of the investment in Harel Insurance Investments Ltd.

(e) Net gain on sale of the provident fund activity in the amount of NIS 394 million (in the first half of 2006 includes income in the amount of NIS 173 million in respect of cancellation of a provision for impairment of the Bank's investment in First International Bank and net gain in the amount of NIS 256 million from the sale of the shares of Ilanot Discount).

DEVELOPMENTS IN INCOME AND EXPENSES

Income from financing activities before provision for doubtful debts amounted to NIS 1,938 million in the first half of 2007, compared with NIS 1,825 million in the corresponding period last year, an increase of 6.2%, mainly in respect of the rise in volume of operations and the increase in other financing income, net, as detailed hereunder.

Total interest margin, including the effect of other derivatives (in hedge transactions and ALM), reached a rate of 1.57% in the first half of 2007, compared with a rate of 1.87% in the corresponding period last year.

The hedging activity implemented by the Bank in order to set off the fluctuations in the provision for tax derived from changes in the value of the investment in subsidiaries abroad, as a result of devaluation or increase in value of exchange rates, resulted in a decrease of NIS 70 million in income from financing activities in the first half of 2007. The effect of this hedging activity was set off in full against taxes on income. The hedging activity commenced after the Bank utilized the balance of the losses for tax purposes in respect of which deferred taxes receivable were not recorded.

For details as to income from financing operations according to the linkage sectors see “Financing income and expense rates” in the Management Review hereunder.

Commissions from financing operations and other financing income, net, amounted in the first half of 2007 to NIS 268 million, compared with NIS 3 million in the corresponding period last year. The increase derives mainly from an increase in gains on sale of available-for-sale bonds, net totalling NIS 57 million, and the rise in interest income on problematic debts, in the total amount of NIS 29 million and from a decrease in net income in the corresponding period last year, which resulted mostly from the net negative exchange differences recorded in respect of monetary asset and liability balances in a consolidated subsidiary abroad, the income in respect of which is recorded as a part of the commission from financing operations and other financing income. (see Appendix A to the financial statements, Part D).

Effect of Non-Performing Debts. One of the factors that considerably affected the income from financing activities was the volume of non-performing debts. The balance of such debts, as at June 30, 2007, was NIS 2.5

billion compared to NIS 2.6 billion as at June 30, 2006, and compared with NIS 2.5 billion as at December 31, 2006 (the average annual rate of return on credit in the Bank in the various linkage segments in the first half of 2007 was between 6.66% and 10.0%).

Provision for doubtful debts. The provision for doubtful debts in the first half of 2007 totalled NIS 254 million, compared with a provision of NIS 251 million in the corresponding period last year, an increase of 1.2%.

The annualized provision for doubtful debts, as a ratio of credit to the public, was 0.51% in the first half of 2007, compared with 0.53% in the corresponding period last year.

The balance of the provision for doubtful debts, which includes the specific provision, the general provision and the supplemental provision, but not including provision for off-balance sheet credit risk, totalled NIS 5,724 million in the first half of 2007. The balance of this provision constitutes 5.70% of the credit to the public, compared with a balance of the provision in the amount of NIS 5,886 million, constituting 6.24% of the credit to the public at the end of the corresponding period last year.

The specific provision for doubtful debts amounted to NIS 255 million in the first half of 2007, compared with NIS 268 million in the corresponding period last year, a decrease of 4.9%.

The specific provision was made on a conservative basis, in accordance with management's assessment of expected losses in the credit portfolio, based on an examination and monitoring of the condition of debtors and their business activity, an assessment of the risks related to their financial condition and in relation to the type and value of the collateral.

The annual rate of the specific provision in relation to the credit to the public (consolidated) was 0.51% in the first half of 2007, compared with 0.57% in the corresponding period last year.

For details as to the components of the specific provision for doubtful debts, see Appendix "B" to the condensed financial statements.

The supplemental provision for doubtful debts. The supplemental provision for doubtful debts is based on the quality of the credit portfolio in accordance with risk characteristics, as determined by the Proper Banking Management Directives. The decrease in the expense in respect of the supplemental provision for doubtful debts of the Bank and of its banking subsidiaries in Israel amounted, in the first half of 2007, to NIS 6 million, compared with an increase of NIS 2 million in the corresponding period last year.

Following are details of the quarterly development in the provision for doubtful debts (in NIS millions):

	2007		2006			
	Second Quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
Specific provision	162	93	217	158	130	138
Supplemental provision	(4)	3	(40)	(16)	(21)	4
Total	158	96	177	142	109	142
Rate of specific provision from credit granted to the public:						
Balance sheet*	0.65%	0.39%	0.90%	0.66%	0.55%	0.59%
Off balance sheet*	0.93%	0.56%	1.37%	1.07%	0.89%	1.01%

* Annualized.

Income from financing activities after provision for doubtful debts amounted to NIS 1,684 million in the first half of 2007, compared with NIS 1,574 million in the corresponding period last year, an increase of 7.0%.

Non-financing income in the first half of 2007 amounted to NIS 1,324 million, compared with NIS 1,192 million in the corresponding period last year, an increase of 11.1%.

Income from capital market activity in the first half of 2007 amounted to NIS 291 million, compared to NIS 315 million in the corresponding period last year, a decrease of 7.6%.

In this context: Income from provident fund management fees and reimbursement of expenses in the first half of 2007 amounted to NIS 97 million, compared to NIS 93 million in the corresponding period last year, an increase of 4.3% (for details as to the sale of the provident fund activity, see Note 11 to the condensed financial statements). Due to the sale of Ilanot Discount, the Bank had no income from mutual fund management in comparison to NIS 98 million in the first half of 2006.

Income from distribution fees earned from mutual fund managers amounted to NIS 29 million in the first half of 2007.

Commissions totalled NIS 1,071 million in the first half of 2007, compared with NIS 938 million in the corresponding period last year, an increase of 14.2% which derives mainly from an increase in account management fees, commissions on customers' securities transactions, handling of loans and preparation of loan agreements, and computerized services, data and confirmations and from an increase in income from credit cards.

Gains on investment in shares, net, amounted to NIS 54 million in the first half of 2007, compared with NIS 50 million in the corresponding period last year. The said earnings include, among other things, a dividend of NIS 52 million in the first half of 2007 received by the Bank and Mercantile Discount Bank from a company, the shares of which served as security for a loan granted to a certain borrower, compared with NIS 29 million in the corresponding period last year. (For details of the directive of the Supervisor of Banks, which required that the balance of the loan to the said borrower be classified as a "security" being part of the "available-for-sale securities portfolio", see Note 3 C to the financial statements as of December 31, 2006, p. 285).

Other income in the first half of 2007, totalled NIS 199 million, compared with NIS 204 million in the corresponding period last year, a decrease of 2.5% largely due to a decrease in income from mutual funds and income from a subsidiary that was sold during the second quarter of 2006, that were partially off set from an increase in income from the Bank's severance pay fund.

Non-financing expenses totalled NIS 2,393 million in the first half of 2007, compared with NIS 2,630 million in the corresponding period last year, a decrease of 9.0%.

Salaries and related expenses amounted to NIS 1,428 million in the first half of 2007, compared with NIS 1,745 in the corresponding period last year, a decrease of 18.2%.

Salary expenses for the first half of 2006 include a bonus of NIS 232 million paid to the employees in respect of the sale of the controlling interest in the Bank.

The expenses for the first half of 2007 include the full increase in liabilities with respect to provisions for salary related expenses in the amount of NIS 112 million, with respect to provisions for salary related expenses, with respect to a provision for a wage agreement signed by the Bank, compared with NIS 108 million that were included in the corresponding period last year, following the wage agreement for the Bank and the Group for 2006.

Salary and related expenses, excluding voluntary retirement, the effect of half of the provision in respect of the wage agreement on the provisions for severance pay, vacation pay and jubilee award (June 30, 2006: also excluding the bonus in respect of the sale of the controlling interest) amounted in the first half of 2007 to NIS 1,366 million compared with NIS 1,416 million in the corresponding period last year, a decrease of 3.5%.

The decrease stems from the fact that in the first half of 2007 the profits in the Bank's severance pay fund covered the total amount of the increase required in the provision for severance pay in respect of the provision for the Bank's salary agreement, while in the first half of 2006 the profits in the Bank's severance pay fund covered only part of the said provision.

Program for the encouragement of early retirement (2006). In December 2006, the Board of Directors approved a plan for the encouragement of early retirement of employees. (For further details, including additional alternatives for receipt of severance pay offered to employees, see the 2006 Annual Report, pp. 164-165). The financial statements as of December 31, 2006, include a provision of NIS 70 million in respect of the said program. During the first half of 2007 117 employees retired, of which 99 took early retirement, according to the said program.

Early retirement plans at IDB New York. The Board of Directors of IDB New York decided during the first half of 2007 on a plan for the encouragement of early retirement of some 120 employees. The financial statements as of June 30, 2006 included a provision of NIS 40 million in respect of the said plan (see "Discount Bancorp, Inc." in the chapter "Main investee companies" below).

Depreciation and maintenance of building and equipment expenses totalled NIS 384 million in the first half of 2007, compared with NIS 325 million in the corresponding period last year, an increase of 18.2% particularly due to a rise in depreciation expenses, caused by a decline in the cost of software whose development was completed.

Other expenses totalled NIS 581 million in the first half of 2007, compared with NIS 560 million in the corresponding period last year, an increase of 3.8%.

The ratio of non-financing income to non-financing expenses was 55.3% in the first half of 2007, compared with 45.3% in the corresponding period last year, and 47.0% in all of 2006.

The cover ratio of non-financing expenses by non-financing income, disregarding certain components, as detailed above, would have reached 57.5% in the first half of 2007, compared with 52.6% in the corresponding period last year, and compared with a rate of 51.4% in all of 2006.

Operating income before taxes totalled NIS 615 million in the first half of 2007, compared with NIS 136 million in the corresponding period last year, an increase of 352.2%.

Provision for taxes totalled NIS 236 million in the first half of 2007, compared with NIS 168 million in the corresponding period last year, an increase of 40.5%.

In the first half of 2006, the Bank did not record current tax expenses in the amount of NIS 32 million in respect of current taxable earnings and timing differences due to the use of carry forward tax losses in respect of which deferred tax assets had not been recorded. It should be noted that during 2006, the Bank exhausted the tax losses carried forward, in respect of which deferred tax assets were not recognized in the past.

Operating income after taxes totalled NIS 379 million in the first half of 2007, compared with a loss of NIS 32 million in the corresponding period last year.

The Bank's share in operating income of affiliated companies after taxes totalled NIS 88 million in the first half of 2007, compared with NIS 98 million in the corresponding period last year, a decrease of 10.2%, particularly as a result of the sale of holdings in Harel Insurance Investments Ltd.

Net operating income totalled NIS 437 million in the first half of 2007, compared with NIS 18 million in the corresponding period last year.

Net earnings from extraordinary operations, after taxes, amounted, in the first half of 2007, to NIS 395 million, of which a net gain of NIS 394 million, from the sale of the provident fund activity, compared with NIS 426 million in the first half of 2006, of which an amount of NIS 173 million were due to the reversal of a provision for impairment in value of the investment in the First International Bank, recorded in 2003 at the instruction of the Supervisor of Banks, and a net gain of NIS 256 million, from the sale of Ilanot Discount shares.

The ratio of operating income before taxes to shareholders' equity, including minority interest, was an annualized rate of 18.0% in the first half of 2007, compared with a rate of 4.9% in the corresponding period last year, and a positive rate of 9.4% in all of 2006.

The ratio of operating income after taxes to shareholders equity, including minority interests, reached an annualized rate of 10.9% in the first half of 2007, compared with a negative rate of 1.2% in the corresponding period last year, and 3.5% in all of 2006.

Net income in the first half of 2007 amounted to NIS 832 million, compared with NIS 444 million in the corresponding period last year, an increase of 87.4%.

Net Income disregarding certain components, as detailed above, would have amounted in the firs half of 2007 to NIS 492 million, compared to NIS 333 million in the corresponding period last year, an increase of 47.9%.

Return on shareholders' equity reached an annualized rate of 21.4% in the first half of 2007, compared with 13.5% in the corresponding period last year, and 11.7% in all of 2006.

The return on equity, disregarding certain components, as detailed above, would have reached in the first half of 2007 a rate of 12.4%, compared with 10.1% in the comparative period last year, and a rate of 9.7% in all of 2006.

Net earning per one share of NIS 0.1 par value amounted, in the first half of 2007, to NIS 0.85, compared with NIS 0.45 in the corresponding period last year.

Net earnings per one share of NIS 0.1 par value, disregarding certain components, as detailed above, would have reached in the first half of 2007 NIS 0.50, compared to NIS 0.34 in the comparative period last year.

Net Income in the second quarter of 2007 amounted to NIS 627 million, compared to NIS 205 million in the first quarter of 2007, an increase of 205.9%, and compared to NIS 417 million in the corresponding period last year, an increase of 50.4%.

Net Income in the second quarter of 2007 disregarding certain components, as detailed above, amounted to NIS 228 million, compared to NIS 264 million in the first quarter of 2007, a decrease of 13.6%, and compared to NIS 170 million in corresponding quarter last year, an increase of 34.1%.

Return on shareholders' equity in the second quarter of 2007 reached a rate of 33.6%, on an annual basis, compared to 10.7% in the first quarter of 2007, and compared to 26.6% in the corresponding quarter last year.

Return on shareholders' equity in the second quarter of 2007, disregarding certain components, as detailed above, reached a rate of 11.4% on an annual basis, compared with 13.9% in the first quarter of 2007, and compared to a rate of 10.3% in the corresponding quarter last year.

DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at June 30, 2007, amounted to NIS 169,658 million, compared with NIS 162,538 million at the end of the preceding year, an increase of 4.4%.

Following are the developments in the principal balance sheet items:

	June 30, 2007	December 31, 2006	rate of change
	in NIS millions		in %
Assets			
Cash and deposits with banks	26,135	25,406	2.9
Securities	39,794	38,914	2.3
Credit granted to the public	94,667	90,175	5.0
Liabilities			
Deposits from the public	135,574	130,517	3.9
Deposits from banks	8,157	8,099	0.7
Debentures and subordinated capital notes	6,614	6,302	5.0
Shareholder's equity	8,868	7,965	11.3

Credit granted to the public as at June 30, 2007, totalled NIS 94,667 million, compared with NIS 90,175 million at the end of the preceding year, a decrease of 5.0%.

Following publication of the public reporting format for credit card companies, the definition of "credit to the public" in the public reporting directive was amended to include also "debit balances of the public resulting from credit card transactions" (for additional details, see Note 1 B to the condensed financial statements). The said amendment resulted in an increase in the balance of "credit to the public" as of June 30, 2006 in an amount of NIS 4,107 million, with a concurrent increase in the "other liabilities" item.

Following are data on the composition of credit granted to the public by linkage segments:

	June 30, 2007		December 31, 2006		
	in NIS millions	% of total credit to the public	in NIS millions	% of total credit to the public	rate of change in %
Non-linked shekels	42,141	44.5	40,520	44.9	4.0
CPI-linked shekels	17,749	18.7	17,793	19.7	(0.2)
Foreign currency and foreign currency-linked shekels	34,777	36.8	31,862	35.4	9.1
Total	94,667	100.0	90,175	100.0	5.0

Credit in the foreign currency and foreign currency-linked shekel segment grew by 9.1%, representing an increase of US$643 million from December 31, 2006.

Following are data as to the overall credit risk at the responsibility of the Group as regarding problematic borrowers net of provision for doubtful debts[1] (in NIS millions):

	June 30,		December 31,
	2007	2006	2006
Non-performing debts	2,539	2,623	2,529
Reorganized debts[2]	165	274	286
Debts due for reorganization[3]	112	136	143
Debts temporarily in arrears	388	472	327
Debts under special supervision[4]	3,872	4,591	3,771
Total balance sheet credit to borrowers	7,076	8,096	7,056
Off-balance sheet credit risk regarding problematic borrowers[5]	963	913	928
Debentures of problematic borrowers	1	1	1
Other assets in respect of derivative instruments of problematic borrowers	2	2	10
Total overall credit risk concerning problematic borrowers	8,042	9,012	7,995

Footnotes:
(1) Not including problem debts regarding which the collateral received is available for set-off with respect to the limitations on indebtedness of a single borrower or of a group of borrowers (Proper Banking Management Directive No. 313).
(2) Credit reorganized during the current year as well as credit reorganized in prior years with waiver of income.
(3) Credit to borrowers, for which a Management decision exists to be reorganized, but which reorganization has not yet been implemented.
(4) Of which: debts of NIS 962 million, presented net of specific provision made thereof, and housing loans of NIS 201 million, in respect of which a provision according to the period of default exists (June 30, 2006: NIS 1,131 million and NIS 218 million, respectively; December 31, 2006: NIS 893 million and NIS 210 million, respectively). Including credit reorganized in prior years without waiver of income.
(5) As computed for the purpose of limitations on indebtedness of a single borrower or of a group of borrowers, except for guarantees granted by a borrower to secure a third party indebtedness.

Draft directive regarding: "Measurement of provisions and disclosure of problematic debts". On April 22, 2007 the Bank of Israel transmitted to banking corporations for their review an updated draft directive regarding "Measurement and disclosure of problematic debts and provisions for doubtful debts, in financial statements of banking corporations".

The draft directive is based on accounting pronouncements published in the United Statements and directives of the United States Securities and Exchange Commission relating to banking corporations. The principles on which the draft directive is based constitute a material change in the present directives – regarding classification of problematic debts and measurement of provisions for credit losses in respect of these debts.

The principal changes in the draft directives, compared to the existing directives, are as follows:

- Banking corporations are required to record provisions for impairment of assets, in respect of problematic credit and loans, according to a "specific provision" or "group provision", as follows:
  - "Specific provision for credit losses" – In respect of provision for impairment of problematic credit and loans with a credit ranking (as required in requirements for appropriate banking management) and for provisions in respect of other identified problematic receivables (for which the impairment provision is not included in the "group provision").

    The specific provision for credit losses will be recorded based on expected discounted cash flows from the debtors, or according to the fair value of the collateral to secure such credit.

- "Group provision for credit losses" – In respect of provisions for impairment of homogeneous credit groups, composed of credit in relatively small amounts, (e.g. credit relating to credit cards, housing loans, consumer credit in installments, etc), and relating to other credit examined specifically and not classified as "problematic". The group provision for credit losses will be recorded based on documented loss rates in the past for each of the homogeneous groups.

- New kinds of problematic debts are defined, e.g. –
  - "Substandard credit risk" – Credit that is not protected sufficiently by collateral and/or the borrower's repayment ability, so that the Bank may be required to absorb a certain loss in respect of this credit in the event that the deficiency is not amended.
  - "Impaired debt" – Credit that, in the estimate of the banking corporation, will not be collected in a timely manner, and for which the provision for credit loss will be determined as a specific provision.

    According to the draft directives, the above mentioned classification will be applicable also for credit in arrears exceeding 90 days, debts that were restructured and current account balances exceeding the credit framework, which were defined as problematic debts in arrears in accordance with Section 4(c) of Proper Banking Management Directive No. 325, relating to management of credit frameworks in respect of current accounts.

    According to the draft directives, corporations are prohibited from recording interest income (not including linkage increments and exchange differences on debt reserve) on the accrual basis in respect of impaired debts.
  - "Negative classified credit risk" – Problematic credit group (including credit risks) including all credit classified as substandard credit risk and impaired debts.

- The directives regarding accounting erasure of problematic debts were tightened, inter alia, the draft directives in this regard determine as follows:
  1. Any debt that is deemed non-collectible, or any debt with very minimal value, whose determination as an asset is unjustified, is required to be erased for accounting purposes.
  2. Any part of a debt exceeding the value of the collateral, which is identified as an uncollectible amount, should be erased immediately for accounting purposes (against provision for credit loss).
  3. Accounting erasure of a deb, for which a provision for credit loss was recorded, should not be deferred, unless specific events are expected that will increase the value of the debt; such deferral will not continue, in most circumstances, more than two years.

- Regarding problematic debts, the provision for which is measured based on a group provision –
  1. Overdue debts secured by collateral that does not constitute real estate, or debts that are not secured, will be erased for accounting purposes in the event that the period of arrears exceeds 150 days.
  2. Debts of individuals from bankruptcy or of entities for which a liquidation order was issued, will be erased for accounting purposes within 60 days from the date of the bankruptcy or liquidation order, as relevant.

- Requirements for disclosure of problematic debts in the financial statements were expanded; according to the draft directives, banks will be required to provide, inter alia –
  1. Details of the accounting policy in all matters relating to methods and procedures that the banking corporation will implement to determine the amount of the provisions for credit losses, the basis on which

the groups were categorized for purposes of the group provision for credit losses, methods according to which loss rates in the various groups were determined, the effect of changes in environmental factors on the loss rates, classification of impaired debts, provisions for erasure of debts and policy in all matters relating to recognition of interest income in respect of impaired debts.

2. Details in the directors' report regarding changes in the reporting period in all matters relating to each component of the provision for credit losses, explanation (insofar as applicable) regarding the reasons for any difference (if such exists) between the provision for credit losses and the original estimate, details regarding changes in the quality of the credit portfolio of the banking corporation in the reporting period, and explanation regarding the effect of such changes on the provision for credit losses.
3. Detailed quantitative disclosure regarding impaired debts including, inter alia, information regarding balances of impaired debts according to various cut-offs, including differentiation between accrued impaired balances and non-accrued impaired balances, details of balances of impaired according to each track for recording provision for credit losses, and details regarding average balances of impaired debts in the reporting period. Quantitative data will include interest income actually charged in the reporting period and interest income chargeable according to the original loan agreement.

- Provisions were determined regarding required procedures, documentation and internal controls for purposes of identification, measurement and reporting on problematic debts and provision for credit losses thereon. These provisions include, inter alia, the following requirements for banking corporations -
  1. Development of a method for determination of provision for credit losses utilizing a consistently-applied methodological procedure. The method will be documented in writing, including explanations and analyses.
  2. Periodic review by management of the method for determination of credit losses, validation of the data and documentation of the relationship between the findings from the periodical review of the credit portfolio and between the balance of the provision for credit losses.
  3. Updating procedures regarding the method for determination of credit loses, taking into consideration, inter alia, methods for distribution of the credit portfolio, methods for identification of problematic debts the provision for which is measured on a specific basis, existing methods for measurement of provision for impairment and method for determination of the optimal method for each kind of problematic credit, methods for determination of homogeneous groups, method for determination of rates of provisions for credit losses on group basis, effect of environmental factors on rate of provisions for credit losses, etc.
  4. Documentation of entities and position holders involved in determination of the provision for credit losses.
  5. Documentation of all existing systems including IT, credit ranking, identification of problematic debts, recording provisions for credit losses – which ensure the appropriateness of provisions for credit losses.
  6. Documentation of internal controls to ensure that the process of determination of provisions for credit losses reconciles with public reporting requirements.
- The internal controls system should include credit controls that will ensure: an effective system to rank credit that will be implemented consistently and will identify risk characteristics relating to the quality of the credit, inclusion of comprehensive relevant data accrued in review of the loans – in the process of determination of the provision for credit losses, and communication and coordination between all entities involved in the process of determining and reporting provisions for credit losses.

On April 26, 2007, the Supervisor of Banks informed the banking corporations that the requirements for the new measurement and reporting (that are not yet binding) are required to be implemented not later than January 1, 2009. In addition, the banking corporations are required to formulate a program that will ensure completion of the preparations for implementation of the new directives as of the required dates. The program should take into consideration, inter alia, involvement of the Board of Directors and/or the Audit Committee in the said preparations, determination of a member of management to bear responsibility for formulation and implementation of the program, timetables for milestones – on a quarterly basis, required computer resources (hardware and software), required procedural changes and internalization thereof, and mechanisms for implementation and updating of the program (insofar as required). The banking corporations are required to formulate a preliminary draft of the preparatory program not later than June 28, 2007, and to transfer the program to the Supervisor of Banks.

On June 28, 2007, the Bank submitted to the Supervisor of Banks its primary comments regarding this issue.

The new directives require each banking corporation to formulate a methodology regarding issues, e.g. methods for distribution of the credit portfolio, methods for determination of homogeneous groups and adaptation of the rate of the provision for credit losses for each group, etc. Accordingly, and since the guidelines in the preliminary draft directives distributed by the Bank of Israel have not yet been finalized, the implications of implementation of the draft directives, when approved, on the Bank's future operating results, cannot be estimated at this time.

The following is a review of developments in the average balance of credit to the public, by segments of operations:

	June 30, 2007		December 31, 2006		Rate of
	In NIS Million	% of total credit to public	In NIS million	% of total credit to public	change in %
Retail – household segment	20,859	22.7	16,141	19.1	29.2
Retail – small business segment	9,347	10.2	10,968	12.9	(14.8)
Corporate banking segment	35,856	39.0	32,857	38.8	9.1
Middle market segment	21,664	23.6	21,504	25.4	0.7
Private banking segment	4,093	4.5	3,227	3.8	26.8
Total	91,819	100.0	84,697	100.0	8.4

Cash and deposits with banks - totalled NIS 26,135 million as at June 30, 2007, compared with 25,406 million as at end of the preceding year, an increase of 2.9%.

Securities totalled NIS 39,794 million as at June 30, 2007, compared with NIS 38,914 million at the end of the preceding year, an increase of 2.3%.

Following is the composition of the securities portfolio by linkage segments:

	June 30, 2007		December 31, 2006		rate of
	in NIS millions	% of total securities	in NIS millions	% of total securities	change in %
Non-linked shekels	14,514	36.5	13,669	35.1	6.2
CPI-linked shekels	2,241	5.6	1,946	5.0	15.2
Foreign currency and foreign currency-linked shekels	21,327	53.6	22,092	56.8	(3.5)
Non-monetary items	1,712	4.3	1,207	3.1	41.8
Total	39,794	100.0	38,914	100.0	2.3

Until the year 2006, the Bank adopted a conservative policy regarding the composition of investments held in its "nostro" portfolio. This was the result, among other things, of the Bank's capital adequacy ratio, which was near the limit of 9%. Most of the Shekel investments were in Government bonds while most of the foreign currency investments were in bank deposits. The major part of the portfolio served to cover the interest rate exposure resulting from deposits. As regards the other part of the portfolio, interest rate exposure was anticipated on the basis of forecasts indicating that the return on Shekel investments is taking a downward trend. Following the improvement in capital adequacy in 2006, the Bank plans to expand the range of its investments and to gradually increase the exposure to corporate bonds in Israel and abroad, to investment alternatives and others.

The Bank's securities portfolio as of June 30, 2007 includes investment in debentures secured by mortgage backed securities in the amount of US$2.3 billion, which are held by a subsidiary abroad. Over 99% of the mortgage backed securities portfolio is comprised of debentures of various federal agencies (Ginnie Mae, Fannie Mae, Freddie Mac). The portfolio is ranked AAA in the United States, and does not include exposure to the Sub-Prime market. It should be noted the value of the said portfolio, less realizations, was not impaired in the period from June 30, 2007 until close to the date of publication of the report (August 20, 2007).

Deposits from the public as at June 30, 2007, totalled NIS 135,574 million, compared with NIS 130,517 million at the end of the preceding year, an increase of 3.9%.

Following is data on the composition of deposits from the public by linkage segments:

	June 30, 2007		December 31, 2006		
	in NIS millions	% of total deposits from the public	in NIS millions	% of total deposits from the public	rate of change in %
Non-linked shekels	53,260	39.3	49,722	38.1	7.1
CPI-linked shekels	11,220	8.3	12,095	9.3	(7.2)
Foreign currency and foreign currency-linked shekels	71,094	52.4	68,700	52.6	3.5
Total	135,574	100.0	130,517	100.0	3.9

Deposits from the public in foreign currency and in foreign currency linked Israeli currency increased at the rate of 3.5%. In dollar terms the deposits from the public increased by US$472 million, compared with December 31, 2006.

The following is data on the composition of deposits from the public, by segments of operations:

	June 30, 2007		December 31, 2006		
	In NIS Million	% of total deposits from the public	In NIS million	% of total deposits from the public	Rate of change in %
Retail – household segment	56,818	43.2	56,189	42.9	1.1
Retail – small business segment	8,384	6.4	7,876	6.0	6.4
Corporate banking segment	16,368	12.4	14,838	11.3	10.3
Middle market segment	13,959	10.6	13,102	10.0	6.5
Private banking segment	36,040	27.4	39,036	29.8	(7.7)
Total	131,569	100.0	131,041	100.0	0.4

The ratio of total credit to the public to deposits from the public was 69.8% as at June 30, 2007, compared with 69.1% at the end of the preceding year.

CAPITAL RESOURCES

COMPONENTS OF CAPITAL

The Bank's capital resources as at June 30, 2007, including minority interest, totalled NIS 8,988 million, compared with NIS 8,367 million at the end of the preceding year, an increase of 7.4%

Shareholders' equity as at June 30, 2007, totalled NIS 8,868 million, compared with NIS 7,965 million at the end of the preceding year, an increase of 11.3%.

The ratio of shareholders' equity, including minority interest, to total assets as at June 30, 2007, reached a rate of 5.3%, compared with a rate of 5.1% as at the end of the preceding year.

Ratio of primary capital to risk assets as of June 30, 2007, reached a rate of 8.11%, compared with 7.91% at the end of the preceding year.

Ratio of original Tier I Capital to risk assets, i.e., ratio after elimination of Hybrid Tier I Capital (see hereunder), reached 7.22% as of June 30, 2007, similar to the end of the previous year.

It should be noted that the Board of Directors of the Bank resolved, with respect to the issuance of the Hybrid Tier I Capital, to adopt a capital adequacy policy according to which the Bank will maintain, at all times, an original primary capital adequacy ratio (excluding Hybrid Tier I Capital) of at least 6.5%.

The ratio of capital to risk assets, as defined in the directives of the Supervisor of Banks, reached a rate of 10.48% on June 30, 2007, compared with 10.45% at the end of the preceding year.

Hybrid Tier I Capital constitutes capital notes recognized as part of Tier I Capital (see Note 14 to the financial statements as at December 31, 2006 pp. 325-327). The Bank's Hybrid Tier I Capital as of June 30, 2007 amounted to NIS 1,033 million. The amount of the Hybrid Tier I Capital is limited to 15% of the overall primary capital (the total of the primary capital as defined in Proper Banking Management Directive No. 311, including the Hybrid Tier I Capital). As of June 30, 2007, the Hybrid Tier I Capital amounted to 10.94% of the overall primary capital (December 31, 2006: 8.7%). The balance of the Hybrid Tier I Capital that may be issued until the limit is reached was NIS 383 million as of June 30, 2007 (December 31, 2006: NIS 640 million). It should be noted that mobilization of additional Hybrid Tier I Capital will require an increase in the Bank's authorized share capital.

Tier II Capital. The Bank's Tier II Capital totalled NIS 4,115 million as at June 30, 2007, including NIS 254 million of general provision for doubtful debts. The extent of subordinated capital notes is limited to 50% of the primary capital that was not allocated against market risks. At June 30, 2007, the said ratio was 40.9% (December 31, 2006: 43.8%).

The balance of the subordinated capital notes, which the Bank may issue until reaching the limit amounted to approximately NIS 862 million as of June 30, 2007. Reaching this limit would have increased the capital adequacy ratio to 11.22%.

The said ratio does not include the effect of the expected gain from the consummation of the agreement for the sale of Kahal (see Note 12 to the condensed financial statements), the impact of the disposal of the Bank's share in the rights issue of the First International Bank, (see Note 10 to the condensed financial statement), as well as the effect of the gain expected from the sale of 51% of the provident fund activity of Mercantile Discount Bank (see Note 11 B to the condensed financial statements).Taking into account the abovementioned factors as well as exhausting the limit for raising of Tier II Capital, the capital adequacy ratio, in terms of June 30, 2007, would have reached 11.25%.

Tier III Capital. According to the directives of Bank of Israel, the Tier III capital serves as part of the capital components for the purpose of calculating the ratio of capital to risk assets, but which may be related to market risk only. As at June 30, 2007, capital notes amounting to NIS 7 million were defined as Tier III capital, with the approval of Bank of Israel.

ISSUE OF SUBORDINATED CAPITAL NOTES

Issuance of Capital Notes in 2007. An amount of NIS 402 million of capital notes issued in the past will be deducted in the course of 2007 from the secondary capital of the Bank, used in calculating the ratio of capital to risk assets. In the first half of 2007, the Bank raised Tier II Capital in the overall amount of NIS 350 million.

PUBLICATION OF PROSPECTUS – LISTING FOR TRADING OF DEFERRED CAPITAL NOTES (SERIES A)

According to a decision of the Board of Directors of the Bank of December 10, 2006, on December 31, 2006 deferred capital notes were allocated in the amount of NIS 750 million in a private offering, and on May 13, 2007 an additional NIS 250 million was allocated to investors in a private offering. The Governor of the Bank of Israel approved that the said deferred capital notes will be deemed complex capital instruments and will be recognized as part of the Bank's primary (tier I) capital.

In accordance with the conditions of the note, the Bank paid an additional 1.25% over the annual interest rate payable in respect of the capital notes, for the period until the date of listing of the capital notes for trading on the stock exchange.

On May 31, 2007 the Bank published a prospectus for listing for trading of the above-mentioned capital notes.

RATING THE BANK'S LIABILITIES

Ma'alot – The Israeli Securities Rating Company Ltd., rated the Bank with an "AA-/Stable" rating with respect to deposits with the Bank and subordinated capital notes issued by the Bank, directly and through Discount Manpikim Ltd.

Midroog Ltd. rated the Bank with an "Aa2" rating with respect to deposits with the Bank and subordinated capital notes issued by the Bank, directly and through Discount Manpikim Ltd.

S&P rated the Bank, based on public information, with a "BBpi" long term local currency rating. Moody's rated the Bank, based on public information, with an "A1" rating with respect to long-term deposits in local currency, with an "A2" rating on long-term foreign currency deposits and with a "P1-" rating with respect to short-term deposits in foreign currency. Moody's also rated the Bank with a "C-" rating for the financial stability parameter.

Ma'alot ranked as "A/Stable" the subordinate capital notes (series "A"), constituting the Hybrid Tier I Capital. Midroog ranked the said capital notes as "A1". Ma'alot and Midroog emphasized that this ranking is based, inter alia, on the decision of the Board of Directors of the Bank regarding the subordinate capital notes, in accordance with which the Board adopted a capital adequacy policy according to which the Bank will maintain, at all times, an original Tier I Capital adequacy ratio (excluding Hybrid Tier I Capital) of at least 6.5%. Midrug also noted that the determined ranking is based on the Bank's overall capital adequacy ratio.

"Ma'alot" ranked an "AA-" rating to the subordinated capital notes (Series "A") issued by Mercantile Discount Bank. In its most recent update, "Ma'alot" subjected the present rating to the maintenance until December 31, 2007, of capital adequacy ratio of not less than 11%. As of June 30, 2007, the capital adequacy ratio of Mercantile Discount Bank was 12.7%.

DIVIDENDS

In recent years, the Bank did not distribute dividends to its shareholders, except on the Cumulative Preference Shares of the Bank, in an annual amount of £24 thousand (see Note 13 B to the financial statements as of December 31, 2006, p. 314), which the Bank distributes regularly.

The main limitation affecting the ability of the Bank to distribute a dividend in the past few years was the capital base limitation.

For details as to the limitation on the distribution of a dividend out of gains from a possible future sale of IDB New York, see "Employees Agreement" under "Control of the Bank" in the 2006 Annual Report (pp. 185-189). As to details regarding a limitation set by the Governor of the Bank of Israel in the permit issued to the Bronfman-Schron Group for the acquisition and holding of means of control in the Bank, see "The Governor of the Bank of Israel's permit for the control and holding of means of control in the Bank" under "Control of the Bank" in the 2006 Annual Report (pp. 173-176) and Note 32 B to the financial statements of December 31, 2006 (p. 403).

Further to the Bank's application for recognition of the subordinate capital notes issued in May 2007 as hybrid tier I capital, the Bank informed the Supervisor of Banks on May 30, 2007, that in the event that the matter of a dividend distribution in the period up to December 31, 2009, would be tabled for discussion by the Bank's Board of Directors, a notice of at least 30 days would be given to the Supervisor prior to passing of a resolution in the matter.

LIQUIDITY AND THE RAISING OF RESOURCES IN THE BANK

GENERAL

During the second quarter of 2007, the Bank of Israel continued its policy adopted at the end of 2006, of increasing the liquidity of the banking industry. The interest rate was reduced to a relatively low level, the volume of the resources made available to the banking industry through the daily and weakly tenders was maintained at a relatively high level and the infusion of net liquidity by way of short-term debt (MAKAM) – the volume of new series issued was reduced in relation to the volume of the redeemed series and the balance held by the public continued to decline.

A new clearing system of real-time gross settlement (RTGS) went into operation in the banking industry during the third quarter of 2007. This system will require the banks to operate a daily liquidity market.

(For details regarding the reform in the system of banking payments and settlement, see “miscellaneous” item below).

Following are the principal factors affecting the asset portfolio held by the public in the second quarter of 2007:

1. High fluctuations of the Shekel exchange rate against the US Dollar – at the end of the second quarter a devaluation at the rate of 2.1% was recorded following an appreciation of 5.7% during the period from the beginning of the second quarter to the middle of May. Namely, from the middle of May to the end of the quarter a devaluation of over 8.0% was recorded.
2. Bank of Israel interest rate: within the framework of the efforts to raise the inflationary environment as against the appreciation in the exchange rate, which continued since the beginning of the year to the middle of May of 2007, the Governor of The Bank of Israel reduced the interest rate from a level of 4.0% in March 2007 to a level of 3.50% in June 2007. As a result, the short-term interest differential between Israel and the United States reached a negative record of 1.75% in June 2007.
3. Volume of fund raising – the volume of fund raising by the Government on the local bond market continued to decline during the quarter, while in contrast, the increase in corporation bond issuance continued to accelerate.
4. The Israeli equity market – a sharp rise of 10.8% in equity prices was recorded during the second quarter of the year.

The change trend in the structure of the asset portfolio held by the public in the first half of 2007 reflects mostly the sharp increase in equity prices on the local market during the period and the sharp devaluation in the NIS exchange rate relative to the US Dollar exchange rate at the end of the second quarter. Following are the changes recorded in the structure of the portfolio during the first half of 2007:

1. Increase in the weight of equity investments from 25.6% at the end of 2006 to a rate of 28.2% at the end of June 2007. The increase is primarily related to the local equity component.
2. Decline in the non-linked assets from a rate of 29.3% at the end of 2006 to a rate of 26.9% at the end of June 2007.
3. Decline in the CPI linked assets from a rate of 29.9% at the end of 2006 to a rate of 29.6% at the end of June 2007.
4. An increase in the foreign currency linked assets from a rate of 15.1% at the end of 2006 to a rate of 15.3% at the end of June 2007.

THE BANK

During the first half of 2007, the Bank maintained a volume of liquid assets larger than the total of its liquid liabilities.

Following are the changes in the composition of deposits of the Bank during the first half of 2007:

The non-linked segment. The volume of non-linked deposits of the public with the Bank reached, at the end of June 2007, an amount of NIS 43.1 billion, compared with NIS 40.5 billion at the end of 2006, an increase of 6.4%.

The CPI-linked segment. The volume of CPI-linked deposits of the public with the Bank amounted to NIS 9.4 billion at the end of June 2007, compared with NIS 9.7 billion at the end of 2006, a decrease of 3.1%.

The foreign currency and foreign currency linked segment. The volume of deposits of the public with the Bank in or linked to foreign currency amounted to US$8.8 billion at the end of June 2007, compared with US$8.2 billion at the end of 2006, an increase of 7.3%.

Raising of capital. The Bank raised during the second quarter of 2007 Hybrid Tier I Capital in the amount of approximately NIS 250 million.

EXPOSURE TO RISKS AND RISK MANAGEMENT

GENERAL

The Bank's activity as a financial broker involves risk taking, the principal of which are: credit risks, market risks and liquidity risks. Such risks are accompanied by operational and legal risks.

The risk management policy is intended to increase the profit expectancy as part of the means to attain the Bank's business targets, while maintaining an approved and controlled risk level.

A risk management committee operates at the Bank, headed by the Bank's Risk Manager. As from May 13, 2007, Mr. Ehud Arnon, Head of the Corporate Banking Division, fills the position of the Bank's Credit Risk Manager. Mr. Arnon replaced Mr. Giora Ofter, President and CEO, who filled the position of Deputy Credit Risk Manager in the Bank after the retirement of Mr. Rony Hizkiyahu on December 31, 2006.

DESCRIPTION OF EXPOSURE TO AND MANAGEMENT OF MARKET RISKS

Market risk. Market risk is the risk of impairment of the Bank's equity deriving from changes in financial markets, which have an effect on the assets or liabilities of the Bank: interest rates, foreign exchange rates, inflation, prices of securities, product prices, the fluctuations in these parameters and in other economic indices.

(1) BASE RISK EXPOSURE

The exposure to base risk is reflected in the loss which may incur as a result of changes in exchange rates or in the consumer price index, due to the difference between the value of assets and liabilities, including the effect of forward transactions and the effect of options embedded in the base exposure. The base risk exposure is measured in each of the linkage segments: the CPI linked segment, the foreign currency and shekels linked to foreign currency segment and the non-linked shekel segment.

Shown below is the actual distribution of the Bank's available capital (unconsolidated) in comparison to the limitations set by the Board of Directors:

		Second quarter 2007				
Segment of operations	Limitations	Quarter's end	Quarter's maximum	Quarter's minimum	Quarter's average	December 31, 2006
Non-linked Shekel	140%-(30%)	83%	96%	44%	71%	106%
CPI linked Shekel	120%-(40%)	16%	33%	5%	18%	(6%)
Foreign currency	50%-(50%)	1%	45%	0%	11%	0%

No deviations from the limitations were recorded in the second quarter of 2007.

Sensitivity of the Bank to changes in exchange rate. The sensitivity of the Bank to changes in exchange rate is presented in the following table, which provides details regarding the impact of changes in exchange rates of the major currencies on the Bank's equity as of June 30, 2007 (in NIS million):

Segment	Maximum increase in market factors**	Profit and loss* as a result of changes in exchange rates (in NIS Millions) 10%	5%	-5%	-10%	decrease in market factors**
USD	***	84	41	-34	-73	***
EUR	***	10	5	-4	-8	***
GBP	***	12	6	-6	-12	***
CHF	***	3	2	-2	-3	***
JPY	1	1	-	-	-1	***

* In economic value of the Bank.
** Scenario for maximum daily changes during last ten years: Yen – increase of 14% in October 1998.
*** No higher daily rate of change was ascertained.

(2) INTEREST RISK EXPOSURE

Interest risk is the risk of impairment of the Bank's capital and earnings as a result of changes in market interest rates. The risk derives from the exposure to future changes in interest rates and their effect on the present value of assets and liabilities of the Bank. Management of interest risk exposure is performed for each of the linkage segments separately.

The limitation determined by the Board for interest risk exposure in the various linkage segments relates to the maximum permitted erosion of economic capital as a result of concurrent movement in the yield curve of 1% in each segment.

Following is the actual exposure of the Bank (unconsolidated) to interest risk, compared to the limitations determined by the Board of Directors (not including trading activities; in NIS million):

		Second quarter 2007				
Segment of operations	Limitations	Quarter's end	Quarter's maximum	Quarter's minimum	Quarter's average	December 31, 2006
Non-linked Shekel	180	73	88	63	76	96
CPI linked Shekel	180	11	39	*4	17	*58
Foreign currency	100	*3	*5	0	2	*4
Total segments	320	87	124	70	95	158

* Obtained under a scenario of reduction in interest.

The Bank complied with the limitations during the second quarter of 2007.

(3) OPTION RISKS

Option risks relate to a possible loss deriving from changes in the parameters affecting the value of options, including standard deviation.

The Board of Directors of the Bank has set out guidelines regarding the permitted activity in options both as regards overall volume and as regards the maximum loss in extreme scenarios and in moderate scenarios. The scenarios relate to simultaneous changes in exchange rates and in the volatility of base assets. In addition, the dealing room procedures include limitations on maximum changes in the value of the option portfolio in terms of sensitivity indices ("GREEKS").

(4) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

The Board of Directors has determined the mode of operation of the Bank in derivative financial instruments, volume of activity and the range of financial instruments in which the Bank may engage (whether on behalf of customers or for the bank itself). Also were determined frameworks for transactions in structured instruments.

(5) LIQUIDITY RISK

Liquidity is defined as a situation in which the Bank is able meet its obligations in an acceptable course of business – to finance an increase in assets or repay liabilities without encountering difficulties and without sustaining a loss.

A liquidity risk is the risk of the Bank finding it difficult to meet its liabilities due to unforeseen developments, and being forced to raise funds in a way that would cause it a significant loss.

The Bank manages its liquidity risk according to an internal model for assessing liquidity risk, which examines the impact of various scenarios regarding developments in assets and liabilities on the liquidity of the Bank, as required in Proper Banking Management Directive No. 342.

Limitation on the exposure to liquidity risks. The limitation determined by the Board of Directors prescribes that the total liquidity resources should not fall below possible liquidity requirements (under an extreme scenario). During the second quarter of 2007, the Bank complied with the limitations on exposure to liquidity risks.

|MEASUREMENT OF MARKET RISKS

(1) THE VALUE AT RISK (VAR)

General. The VAR serves as a central indicator of the extent of exposure of the Bank to market risk. An analysis of its results and examination of the changes therein over a period of time, enables Management to receive information regarding the level of market risk involved in all operations of the Bank.

The VAR assesses the maximum damage that might be caused to the Bank as a result of market risks being materialized in a given time period and at a defined statistical security level. This damage reflects erosion in the value of the Bank (in fair value terms).

The VAR is computed according to a parametric model based on the historical behavior of various market risk factors in the period preceding the computation (one year), assuming normal distribution of the changes in the parameters.

The Board of Directors of the Bank determined a limitation according to which the VAR of the Bank's portfolio (for a range of ten days and at a precision level of 99%) should not exceed 3% of the Bank's equity.

	Second quarter of 2007				
	At quarter's end	Quarter's average	Quarter's maximum	Quarter's minimum	December 31 2006
Estimate of VAR amount (in NIS million, the Bank)	55	44	56	33	44

Analysis of the VAR results shows that the main risk derives from the interest rate exposure of the Bank in the CPI linked shekel segment, and, in the non-linked shekel segment. The weight of the VAR in relation to the shareholders' equity of the Bank as of June 30, 2007, is 0.6%, similar to the end of 2006.

The Bank plans to expand the range of its investments and to gradually increase the exposure to corporate bonds in Israel and abroad, to investment alternatives and others.

During the months of July and August 2007, a significant increase occurred in the VAR assessment on the background of the sharp volatility of the markets.

(2) LOSS ANALYSIS IN EXTREME SCENARIOS (STRESS TESTS)

Global and domestic markets are subject to periodic instability resulting from extraordinary events. Such events may be related to a general crisis or to turbulence in financial markets, and are reflected in material changes in interest rates, exchange rates, and/or in exceptional fluctuations in these factors, which deviate from general historic behavior. Even though the VAR is the most suitable measurement tool for assessing the overall exposure to market risk, it does not provide information as to losses that may occur in "abnormal" market situations, which exceed the clear levels which had been determined.

Stress Tests enable the examination of the possible implications of such extreme events.

The Board of Directors determined at of the end of 2006 a limitation on the maximum economic loss in the event of an extreme scenario. The limitation determines that the decrease in the economic value of the equity should not exceed 12.5% of the Bank's equity.

During the second quarter of 2007, the bank complied with this limitation.

For further details as to exposure to market risks and the way they are being managed, see the Annual Report for 2006 (pp. 49-62).

CREDIT RISKS

The Bank's policy in granting credit to the public is intended, inter alia, to secure the quality of the credit portfolio and diversify the risks thereto.

Credit risks are diversified by, inter alia, spreading the credit portfolio over a large number of borrowers, in various economic sectors, with different segments of linkage and over different geographic regions.

The policy of dispersal of the credit portfolio over a large number of borrowers is focused on the relative weight of medium and small borrowers, including expanding the credit to non-business customers in the private banking segment such as households, VIP customers and the international private banking centers.

The Bank grants credit to its customers against various types of collateral, including liquid assets, fixed assets, and various liens and guarantees.

The scope and/or the quality of the collateral is derived from the level of risk which the Bank is ready to accept when granting the credit, while putting a special emphasis on the repayment ability of the borrower. In certain cases, where circumstances justify, the Bank grants credit without collateral and/or subject to conditions of various kinds.

The policy of collateral management and determining the value for security purposes of the various types of collateral, is based on rules and principles determined as part of the Bank's procedures for granting credit.

The collateral is adapted to the type of credit it is supposed to secure, while relating to the time frame, linkage base, the nature of the credit and its purpose.

Determining the value of the security for collateral is derived from their quality and the ability to realize them quickly, including changes in their value as a result of slowdown or growth situations in the business sector of the borrower.

In granting credit for construction via the "project financing" method, the Bank generally relies for collateral, inter alia, on the amount of equity and on the ownership rights to the land on which the project is built.

With regard to its exposure to foreign currency credit risks, the Bank minimizes the risks stemming from possible fluctuations in the shekel exchange rate, inter alia, by sensitivity tests of foreign currency borrowers to changes in exchange rates. As to borrowers who have a high exposure to changes in foreign exchange rates, the Bank takes steps, to the extent possible, to reduce the exposure by strengthening the collateral, demanding coverage and hedging transactions and by applying stricter criteria for the approval of credit denominated in foreign currency.

Credit management and the follow-up of the business condition of borrowers are performed at three different levels of activity: Preliminary examination and approval procedures prior to making credit decisions', the use of control tools, current analysis and reporting for follow-up and identification of credit risk; and loan review procedures.

Credit risk in certain economic sectors. The Bank controls and monitors on periodic basis developments in the various economic sectors that are typified by a relatively high sensitivity to the impacts of an economic slowdown in the domestic and in the global markets.

Control procedures are being implemented despite the continued improvement in borrower repayment ability in most economic sectors.

Credit risk involved in derivative financial instruments. The control of credit risk involved in derivative financial instruments is effected in the Bank by computer systems designed to measure the exposure at transaction and customer levels. Principles and operating procedures were adopted for determining the required level of collateral for these transactions, including the procedures required to close off the exposure as regards the transaction and the customer.

BASEL II

The updated version of the Basel II guidelines was published by the BIS in June 2006. Among its targets were: assuring the stability of the financial system, more comprehensively addressing risks, and the development of capital requirements that would match the risk level of each individual bank.

The innovations in Basel II recommendations focus on improving the risk measurement by banking corporations, and in particular procedures for identifying, evaluating, controlling and reporting. The guidelines deal in particular with credit and operational risks, and the allocation of capital in their respect. In contrast to the existing situation where capital allocation is required in respect of credit and market risks only, the Basel II recommendations require the allocation of capital also in respect of exposure to operational risks. The Basel II recommendations also allow the use of advanced models for the allocation of capital in respect of credit risk.

The recommendation is composed of three tiers:

- Pillar I - minimum capital requirements – the aim is to expand and improve the existing framework of measurement determined in 1988.
- Pillar II - expanding the examination process of bank supervisors, including capital adequacy of the financial institution, its management processes and risk assessment.
- Pillar III - fair disclosure – by expanding public information as to the risks to which a bank is exposed.

Draft instructions regarding Basel II. At the end of March 2007, the Supervisor of Banks distributed draft instructions in the matter of an amended working framework for the measurement of capital and capital standards (Basel II), relating to standard approaches to the computation of the minimum capital requirements with respect to credit risk, market risk and operational risk, as determined by the Basel Commission.

The standard approach to the measurement of capital requirement in respect of credit risks is based upon outside ratings performed by credit rating companies, while capital requirements in respect of operational risks, required for the first time by Basel II, are based on the standard approach relating to gross earnings according to lines of business.

The Supervisor of Banks has informed of his intention to require ,as from 2009, every banking corporation in Israel to implement the guidelines of Basel II. At the initial implementation, each banking corporation will implement the approach most appropriate to its level of preparation. Notwithstanding, each banking corporation is required to take steps that will ensure that in 2009 it would be ready to implement Basel II.

Concurrently with the publication of the said instruction the Supervisor issued a draft directive that includes the suggested stages for the adoption of the disclosure requirements included in the third layer of Basle II in the public reporting directive.

Preparations of the Bank for the implementation of the requirements of Basel II. The Risk Management Committee of the Bank is in charge of the Bank's preparations. The Bank utilizes outside consulting services to advance its preparations.

In view of the attitude of the Supervisor of Banks towards the implementation in Israel of Basel II, the Bank accelerated its preparations in order to comply with the required time schedule for the implementation in 2009 of the standard approach.

According to the Bank's assessment, the preparation will require the investment of considerable resources. Changes and adjustments will be required, inter alia in work procedures and infrastructure systems, in completion and collection of data, establishment of data bases, development of various models and internalization of new systems for the implementation of capital requirements.

For details concerning the Bank's preparations in operational risk management see below.

For further details see the Annual Report for 2006 (p. 65-66).

OPERATIONAL RISKS

An operational risk is defined in the directives of the Bank of Israel as a loss risk resulting from faulty data processing systems, human error and the lack of proper checks and controls.

Following the publication of the “Basel II” guidelines, the Bank accelerated its inner preparations regarding operational risks. The principle guiding the Bank with respect to operational risks is that readiness to this matter is essential, even without considering the allocation of capital for this purpose that would be required in the future. Furthermore, the application of advanced measuring systems, as required by the said guidelines, would require the assembly of extensive and sufficiently comprehensive information over a number of years.

In this framework the Bank aspires to achieve broad reporting procedures that include events that did not bring about financial damage. This is in an effort to create a wide database that will enable future use of advanced models for evaluating operational risks.

Operational risk management policy. During 2004, the Bank set the “Operational risk management policy”, which was approved by the Bank’s Management and Board of Directors.

Risk mapping. This year, following three years since the carrying out of a risk mapping review, the Bank has began with the assistance of an outside expert in this field, a new extensive mapping of operational risks based upon business processes. The products of this mapping are to be updated to a new information system for the management of operational risks, which is to be implemented at the Bank during the year.

The operational risks forum, headed by the operational risks manager and with the participation of divisional risk controllers meets regularly during the year, discusses events representing the realization of operational risks and deals will furthering and coordination of operations for the absorption of the policy in practice.

LEGAL RISKS

A legal risk is defined in the Directives of the Bank of Israel as the risk of a loss resulting from the lack of ability to enforce the performance of an agreement by legal means.

Among the principal legal risks that may affect the ability of the Bank to enforce an agreement by legal means, the following may be noted:

- Lack of authority and/or lack of legal competence of a party to the agreement;
- Absence of appropriate documents or improper documentation;
- Illegality;
- Insolvency of a party to an agreement with the Bank (a credit risk that exposes the Bank to a situation of legal risk);
- Disappearance of the base asset.

The Bank is taking steps towards collecting and assembling information regarding legal risks, findings regarding these risks and the handling thereof, the formation of processes, design of procedures and the creation of routine reporting.

For further details see the Annual Report for 2006 (p. 67).

REGULATION RISKS

The Bank and its subsidiaries are exposed to frequent changes in legislation and in various regulatory directives, under which limitations are imposed on the areas of activity and sources of income, at times even retroactively (as in the "Gal Law", in the legislation concerning local authorities and in the Class Action Suit Law). In addition, these directives may impose various obligations, the implementation of which involves significant costs.

COMPLIANCE RISKS

The activity of the Bank and of its subsidiaries is subject to legislative and regulatory directives both in the field of banking and in other areas (see in the section "Legislation and supervision" in the Annual Report for 2006, (pp. 190-199). Frequent changes in legislation and the many regulatory directives that apply to the Bank and to its subsidiaries, require changes in their mode and fields of operation and expose the Bank and its subsidiaries to risks involved in the frequent changes in work procedures, to costs involved in the preparations for the implementation of the new directives and to the exposure stemming from the possibility of non-compliance with the provisions of the law and the various regulatory authorities.

Within the framework of the legislation passed in recent years, and in particular the new legislation passed in the wake of the Bachar Committee (see Note 33 to the financial statements as of December 31, 2006, (pp. 407-415) and Note 2 to the condensed financial statements), the various regulatory authorities were granted extensive powers to order instructions and guidelines to the entities regulated by them and even impose monetary sanctions on them in case of violation. This state of affairs exposes the Bank and its subsidiaries also to the risk of monetary sanctions in material amounts.

The Bank operates according to a detailed system of procedures, intended to bring about the enforcement of compliance with the various legal and regulatory demands. The procedures are updated from time to time according to the legislative and regulatory directives. Concurrently, the systems supporting the operations are also updated and the employees are trained accordingly.

Compliance with the provisions of the law and the procedures is enforced on a regular basis by means of various control and supervision systems. Some other control factors also exist, such as the internal audit, the compliance officer and the officer in charge in accordance with the Prohibition of Money Laundering Law and the Prohibition of Terror Financing Law.

For further details see the Annual Report for 2006 (pp. 67-68).

ACTIVITY OF THE GROUP ACCORDING TO PRINCIPAL SEGMENTS OF OPERATION

GENERAL

A question and answer file published by the Supervisor of Banks in July 2005 clarified that the data for the international operations segment is to be presented similarly to the segment data presentation of the operations of the Discount Group in Israel. In view of the fact that the subsidiary in New York was not, organized to provide the necessary details until several months ago, the Supervisor of Banks agreed that the Bank would continue to present the international operations in one column.

IDB New York completed it preparations for presenting the data according to the required segmentation, so that beginning with the financial statements as of December 31, 2006, the data for the international operations segment is presented in the same format as the operations of the Group in Israel. In addition a disclosure is included regarding the said operations in the item “International Operations”.

The comparative figures for the three and six month periods ended June 30, 2006 were reclassified, in order to represent the changes that occurred in the presentation of the data, as detailed above.

The Bank is installing a management information system to manage profit centers according to customers, products and additional profiles (the cost and profit centers). Preparation of the segment data is based on the data supplied by the cost and profit centers system. It should be noted that since the system has not yet been completed and implemented as a whole its use as a management tool has begun, though at this stage only partially. Furthermore, as the organizational structure of the Bank does not fully coincide with the reported segments of operations, the model used for providing the data is based on various assumptions and estimates. In addition, in view of the frequent changes in the definition of segments along with the fact that the system is not able to provide retroactive data, a periodic series of segmented data has not yet been created, which is essential for basing the assumptions and estimates. In the future, once the information produced by the system is studied and analyzed over a period of time, and concurrently with the process of implementation of the system, certain changes in the said assumptions and estimates may be made.

Whereas, as stated, the system is in its development stage, and has not as yet been fully integrated at the Bank as a management control tool, certain changes are being made from time to time in the manner of determining assessments and in the way of allocating expenses, so that comparison between periods might be flawed.

RETAIL SEGMENT – GENERAL

The Bank presents two retail segments: the household segment and the small business segment. These segments include customers of the Bank’s retail division, excluding customers of the international private banking centers. For further details regarding “Retail Segment – General”, see the Annual Report for 2006 (pp. 74-77).

RETAIL BANKING SEGMENT - HOUSEHOLD SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank’s Retail Division who are private customers, and are defined as salaried employees, growth, and VIP customers (the definition excludes customers of the private banking centers). The segment also includes the household segment customers of the Mercantile Discount Bank - private customers

of Mercantile Discount Bank, whose activities are typical of those of households, including credit not exceeding NIS 200 thousand and deposits of a volume not exceeding NIS 500 thousand.
As from 2006, the segment also includes the international operations data in the household segments.

DEVELOPMENTS IN THE SEGMENT

Tender for provision of services to government employees. On April 1, 2007, the Bank was informed of its success in a tender issued by the Accountant General at the Ministry of Finance, for the granting of loans, credit facilities and other banking services to State employees (these services are being provided at present by Bank Yahav for State Employees Ltd.). The period of this engagement is for seven years beginning on January 1, 2008. On May 10, 2007 the Bank signed the agreement putting this into effect.
Within the framework of this tender, the Bank will establish a special deposit for seven years in the amount of NIS 1.036 billion, for the purpose of granting loans and credit facilities to State employees. At the end of the period the principal amount of the deposit will be repaid to the Bank together with CPI linkage increments. (The Accountant General is entitled to interest in respect of the loans and credit facilities granted out of the deposit funds, as well as interest on the balance of the deposit).
Loans to State employees entitled to subsidized loans shall be granted under subsidized terms (the interest rate determined is the lower between two thirds of the prime rate and two thirds of the cumulative amount of the nominal inflation rate, with the addition of 2%) out of funds of the deposit. The Bank is also obligated to provide credit facilities of up to an amount of NIS 7,000 (out of the deposit funds) under the same terms, to each State employee who opens a current account with the Bank and has his monthly salary credited to this account. The Bank is entitled to provide credit in amounts exceeding NIS 7,000 out of Bank funds, at an interest rate not exceeding the prime rate + 1.4%.
Under the terms of the tender, the charges that the bank is entitled to collect are restricted to the amounts stated in an annex to the tender; a large part of the retail banking services must be provided free of charge. As to other services not stated in the agreement, the Bank may collect a maximum of 70% of the amount of the charge stated in the tariff of the Bank.
According to the terms of the tender, the Bank is to provide services to State employees at at least 50 branches located at places determined in the tender terms. Also, the Bank is required to provide banking services, within four months from the date of the government's providing the location for the Bank's use, in four branches located in government buildings in government centers, as detailed in the agreement, and in three branches located in hospitals. In these locations, Bank Yahav branches are presently located. The agreement does not include the government's commitment to vacate these branches.
The Bank estimates following its success in winning the tender, a competition may develop between the Bank and "Yahav" Bank regarding the provision of services to State employees.
Commencement of operations under the terms of the tender is to begin on January 1, 2008, and until such date the Bank must make the necessary preparations in order to be able to provide the prescribed services to State employees, in the scope, terms and quality defined in the terms of the tender.
The Bank has begun preparations which involves for the most part the modification of the computer systems of the Bank to the operations required by the tender, and to a lesser extent the establishment of the branches. The Bank believes that it will abide by the time schedules determined.

The Bank estimates the cost of the preparations for providing the said services at approximately NIS 22.5 million, inter-alia, in order to comply with the terms of the tender, the Bank will be required to open six additional branches until the beginning of 2008.

These data constitutes forward-looking information, based on assumptions and estimates available to management of the Bank. These data may change in the event that the scope of the investment in construction or in recruitment and training of personnel differs from estimates of the Bank's management as of the date of publication of the financial statements.

The said terms also entitle the Accountant General, at his own discretion, to transfer to the Bank the existing portfolio of loans to State employees, in whole or in part. No notice has as yet been given to the Bank in this respect.

According to the documentation disclosed in the tender, the number of State employees (including retirees) entitled to receive the subject services of the tender is estimated at 150,000, of whom retirees number some 46,000. As of March 2006, salaries of about 87,000 employees are deposited with current accounts managed at Bank Yahav.

The Bank estimates that the success in obtaining the said tender would serve as a quality platform for the increase of its share in retail banking.

Preparations by the Bank. The Bank has decided to grant to State employees, whether they are new customers or long-standing customers of the Bank, the full benefits due to them in terms of the tender, already at this stage. The Bank has started an extensive marketing campaign, in the framework of which many State employees were attracted as new customers.

As part of the marketing activity a special center was established for State employees interested in receiving information about the activities of Discount Bank. In addition, a specialized website has been launched providing comprehensive information regarding the conditions and benefits offered to State employee customers. Through this website, State employee customers can also arrange consultation meetings and refer various questions.

Under the requirements of the tender, the Bank is preparing to appoint as from the beginning of September 2007, 25 teams at Government office centers and at public health centers. The Bank is also preparing for the opening of branches at Government office centers and at public health centers in coordination with the Accountant General, and it also intends to augment three additional branches located in the vicinity of Government office centers.

A motion with the High Court of Justice. On July 25, 2007, Yahav Bank filed a motion with the High Court of Justice against the Minister of Finance, the Accountant General at the Ministry of Finance, the Supervisor of Banks and Israel Discount Bank requesting the Court for an order nisi as follows:

a. An order directed at the Minister of Finance and the Accountant General at the Ministry of Finance for the withdrawal of the demand issued to Yahav Bank to vacate its branch offices located at Government offices.

b. An order directed at the Minister of Finance, the Accountant General at the Ministry of Finance and the Supervisor of Banks – requesting them to instruct Israel Discount Bank to refrain from providing banking services by teams operating outside the branches of the Bank, namely at places of work of State employees.
   Alternatively, Yahav Bank motions for an order giving Yahav Bank a fair and equal opportunity to operate teams similar to those Israel Discount Bank is permitted to operate.

c. An order against the instruction of the Ministry of Finance for the termination of the arrangement whereby

Yahav Bank was entitled to recover loans and deposit sums in savings accounts by way of withholding such amounts from salaries of State employees.

Yahav Bank also motioned for an urgent interim order that would prevent the issue of an authorization to Israel Discount Bank to operate teams providing banking services outside Discount Bank branches until a final ruling is given in the motion, unless Yahav Bank will also be authorized to operate teams according to the same format. The main argument of Yahav Bank is that the Accountant General grants Discount Bank preferential rights that are not obligatory under the terms of the tender.

Yahav Bank further claims in its appeal that by doing so, the Accountant General is unlawfully intervening in the competition in the banking industry, and that succeeding in its competition with Discount Bank to win over the state employee segment is vital to it.

On August 15, 2007 the court determined that the petition will be heard before a panel, during September 2007. Furthermore, the court determined that, in light of government clarifications and the "convenience balance", an interim order as requested will not be issued at this stage.

The teachers' tender. On July 11, 2007, the Bank was informed of its success in the tender issued by the Accountant General for the granting of subsidized loans to teachers and of conditional loans to education students (Services provided at present by First International Bank of Israel Ltd). The loans will be granted at the Bank's responsibility.

The engagement period is for five years, as from November 1, 2007.

Within the framework of the tender, the Bank will transfer to a special deposit an amount of NIS 360 million for five years, which is to serve for the granting of loans to teachers only. At the end of the period, the principal amount will be repaid to the Bank together with CPI increments (the Accountant General will be entitled to interest on the loans granted out of the deposit funds as well as interest on the balance of the deposit). Loans to students, granted out of the State budget, are conditional and would be converted into grants according to criteria of the Ministry of Education.

The target population numbers about 120 thousand teachers and 25 thousand education students.

"Subsidized mortgage" campaign. For details as to the campaign for the marketing of mortgages, see below "Mortgage activity – housing loans", under "Further details regarding activity in certain products".

Concept Branches. In the first half of 2007 the "Oron" household Discount branch was opened, complementing the four existing household Discount branches.

"Discount Rapid" branches. In the first half of 2007, 8 Discount Rapid branches were opened, bringing the total number of "Discount Rapid" branches to 22.

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 497 million, compared with a profit of NIS 198 million in the corresponding period last year, an increase of 151%.

Disregarding the effect of certain components (see hereunder), the segment's income for the period would have amounted to NIS 170 million, compared with NIS 89 million in the corresponding period last year, an increase of 91%.

Provision for doubtful debts in this segment amounted to NIS 60 million in the first half of 2007, compared with NIS 53 million in the corresponding period last year, an increase of 13.2%.

Following are the principal data relating to the operations of the household segment (in NIS millions):

	domestic operations					International operations	
	Banking and financing	Credit cards	Capital market	Mortgage	Total	Banking and financing	Total
	For the three months ended June 30, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From externals	(665)	47	7	46	(565)	2	(563)
- Intersegmental	893	(13)	(2)	(16)	862	-	862
Total income from financial activity	228	34	5	30	297	2	299
Operating and other income	120	179	104	11	414	-	414
Total Income	348	213	109	41	711	2	713
Provision for doubtful debts	21	9	-	1	31	-	31
Net income	27	28	381	10	446	1	447
Net income disregading certain components*	23	28	35	10	96	1	97

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the three months ended June 30, 2006						
Income (loss) from financing activities before provision for doubtful debts	203	25	(3)	30	255	1	256
Operating and other income	79	156	114	13	362	-	362
Total Income	282	181	111	43	617	1	618
Provision for doubtful debts	14	8	-	2	24	-	24
Net income (loss)	(5)	19	238	9	261	1	262
Net income (loss) disregading certain components*	(14)	17	17	9	29	1	30

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

The principal data relating to the operations of the household segment (in NIS millions) (continued):

	domestic operations					International operations	
	Banking and financing	Credit cards	Capital market	Mortgage	Total	Banking and financing	Total
	For the six months ended June 30, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From externals	(700)	98	8	84	(510)	3	(507)
- Intersegmental	1,141	(27)	-	(25)	1,089	-	1,089
Total income from financial activity	441	71	8	59	579	3	582
Operating and other income	239	357	189	22	807	-	807
Total Income	680	428	197	81	1,386	3	1,389
Provision for doubtful debts	37	19	-	4	60	-	60
Net income	29	51	401	15	496	1	497
Net income disregading certain components*	44	52	58	15	169	1	170

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the six months ended June 30, 2006						
Income from financing activities before provision for doubtful debts	412	47	1	67	527	1	528
Operating and other income	155	303	229	25	712	-	712
Total Income	567	350	230	92	1,239	1	1,240
Provision for doubtful debts	29	14	-	10	53	-	53
Net income (loss)	(105)	33	253	16	197	1	198
Net income (loss) disregading certain components*	(16)	35	52	17	88	1	89

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The Bank operates within the framework of laws regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance, the Commissioner of Restrictive Trade Practices, the Securities Authority, Supervisor of Prices at the Ministry of Industry, Trade and Labor etc. The principal restrictions applicable to this segment are briefly described hereunder.

A directive concerning the treatment of credit facilities in current accounts. On February 8, 2005, the Supervisor of Banks issued a directive with regards to credit facilities granted within the framework of creditory and debitory current accounts. The directive is intended to stop the practice, prevalent in Israel, of having current accounts that often, and for long periods, show overdrawn balances over and above the approved credit facilities.

The directive provides, inter alia, that:

- Banks have to determine credit facilities in accordance with the needs of the customer, his repayment ability and the collateral provided by him, based on a documented analysis performed for the purpose of approving the credit facility by the authorized credit officer at the bank;
- Determination of the credit facility in an educated manner can be achieved also according to characteristics of groups of customers, and the bank may fix different threshold amounts for groups of customers in respect of which general criteria are to be defined for the documented analysis of credit requirements;
- The credit facility would be established in a written agreement specifying both parties' obligations – the customer and the Bank – to transact business within the limits of the credit facility, only, without any deviation therefrom;
- The bank may grant to a customer having an approved credit facility (that has been determined in a written agreement with him) or to a group of such customers, an additional unilateral credit line, for a limited time, provided that the bank informs the customer accordingly. Such unilateral credit line shall not carry a commission charge, and the rate of interest in respect thereof shall not be in excess of the interest rate in respect of the most recent credit line agreed in writing with the customer and signed by him;
- In cases where the customer asks the bank to honor a charge to his account that would result in him exceeding the approved credit facility, and the bank consents to such request, an appropriate credit facility, even though temporary, shall be agreed in advance and in writing, in line with the requested additional credit;
- Charging the customer with an excessive interest rate and with special commissions in respect of an account that has exceeded the credit limits, shall be permitted only in cases where the bank had been unable to prevent the account from being overdrawn, and, even in this case, only with respect to accounts classified by the bank as problematic debts (in default);
- No interest income is to be recognized in respect of overdrawn amounts in accounts classified as problematic, until such income is in fact collected (and the overdraft settled). (This item came into effect on July 1, 2006);
- A credit facility agreement may be signed at a branch of the bank, at the customer's home or via the Internet.

The new directive became effective on January 1, 2006; however, the Bank had been entitled to grant a customer a unilateral credit facility, even without a written agreement, at an interest rate charged by the Bank to similar customers, until July 1, 2007. Until July 1, 2006, the Bank was permitted to allow an overdraft on current accounts and to charge exceptional interest in respect thereto. In respect of current account credit facilities in foreign currency the directive came into effect on January 1, 2007. An amendment of December 2006 enables banks not to apply the directive with respect to short-term overdrafts not exceeding NIS 1,000. The amendment also applies to customers who had not arranged for a credit facility.

As part of the preparations by the Bank, the unilateral credit facilities had been extended, using the computer system, up to June 30, 2007. Concurrently, the Bank has mailed new current account credit facility agreements to a predetermined population of customers, requesting them to sign and return the agreements to the Bank.

It should be noted that since December 2005, a decrease is evident in the number of private customers' current accounts with unauthorized debit balances, from a rate of 11.22% at the end of December 2005 to a rate of 5.46% at the end of December 2006. The amount of the unauthorized debit balance of private customers decreased from 12.59% at the end of December 2005 to 4.90% at the end of December 2006. However, with the end of the grace period and cancellation of the unilateral credit frameworks the number of private customers' current accounts with unauthorized debit balances rose at the end of June 2007 to a rate of 6.99% and the amount of the unauthorized debit balance of private customers increased to a rate of 5.38% (as of August 21, 2007 the said rates decreased to 6.30% and 3.78% respectively).

Commissions. During the years 2004-2005, various issues relating to commissions charged by the banks were put on the public's agenda. Following prolonged discussions in the matter by the Economics Committee of the Knesset, with a view of reaching some sort of a "package deal" between the banks and the various regulatory bodies, the Supervisor of Banks and the banks reached an arrangement in July 2005, with respect to commissions charged to household customers. On July 14, 2005, the Supervisor of Banks issued to the banking corporations a letter detailing the principles for the implementation of the "package deal" concerning commissions on current accounts of private customers.

As from October 1, 2005, the Bank offers its customers three tracks:

- A basic track – NIS 10 basket (the Bank of Israel basket);
- An extended track – NIS 18 Basket (the Knesset Economics Committee basket);
- "Discount Fix" track – a basket which costs NIS 30.

The application of the "commission baskets" adversely affected the Bank's income from service fees charged to private customers, at an amount of NIS 38 million (per year).

The application of "commission baskets" also impaired Mercantile Discount Bank's income from account management fees, which declined in the first nine months of 2006 by NIS 5 million.

The Amendment of the Banking Law (Customer Service) in the matter of bank charges was issued at the beginning of July 2007. This Amendment grants the Governor of Bank of Israel and the Supervisor of Banks extensive supervisory authority regarding the prices of bank services as well as the authority to determine a list of bank services in respect of which banks would be entitled to collect charges and the manner of their computation ("Tariffs").

The Governor is entitled to declare certain services as subject to price control if one of the causes determined in the Law applies. It should be mentioned that the list of causes is not final and under certain circumstances, the Governor may add additional control causes.

A banking corporation shall not be entitled to collect a charge from its customers unless it is in respect of a service appearing in the tariffs.

The Governor may determine types of services to which the tariffs would not apply (such as securities operations etc.).

The Law regarding price control is effective immediately from date of publication thereof in the Official Gazette (namely, July 5, 2007).

Bank of Israel was given a period of three months in which to determine the tariffs, which period may be extended by three additional months (by application to the Economics Committee of the Knesset). Banking corporations were granted a preparatory period of three months from the date the tariffs are determined. This period may also be extended by three additional months by application to the Supervisor of Banks and with the approval of the Economics Committee of the Knesset.

On July 9, 2007, the Supervisor delivered to the banks a first draft of the tariffs as part of determining the banking service rules. The draft includes less than one hundred types of services in respect of which charges may be collected as well as a proposal for discerning types of banking operations justifying the collection of charges.

Negotiations are presently conducted between the banks and the Supervisor with respect to the tariffs draft.

The Bank expects that this process will adversely affect the income of the Bank from operating commissions, though at this stage, so long as the tariffs have not been determined and the supervision in its new format has not yet been put into operation. it is not possible to assess the loss or quantify its effects.

For additional details see “Legislation proposals and arrangements regarding banking commissions” under “Legislation and Supervision” hereunder and Note 19 to the condensed financial statements.

For details as to the consequences of the Capital Market Reform, see “Capital market activity” hereunder in the Section “Additional details regarding activity in additional products”, Note 33 to the financial statements as of December 31, 2006 and Note 2 to the condensed financial statements.

MERCANTILE DISCOUNT BANK HOUSEHOLD SEGMENT

As part of the implementation of the policy of Mercantile Discount Bank, which views this segment as a principal target of its business development, Mercantile Discount Bank took during the reported period several steps with the aim of improving the availability of the service provided to customers of this segment and to increase its share of this market. Among other things, the operating hours of branches in certain areas have been extended (in order to adapt them to the lifestyle of the population of such areas). It has been decided also to open several new branches during 2007, in areas having a high potential of providing banking services to the household segment, including three branches in the Nazareth and Acco regions, which have a majority non-Jewish population. During the first half of 2007, two branches were opened in the Acco and Nazareth regions.

For further details regarding the “Retail Banking Segment – Household Segment”, see the Annual Report for 2006 (pp. 77-85).

RETAIL BANKING SEGMENT – SMALL BUSINESS SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank’s Retail Division which are defined as small companies and small businesses with borrowings of up to NIS 5 million. The segment also includes the customers of Mercantile Discount Bank in that bank’s small businesses - business customers segment (individuals and corporations) whose granted volume of credit does not generally exceed NIS 1 million.

DEVELOPMENTS IN THE SEGMENT

Opening of a fifth credit center. The Jerusalem and Southern Region credit center was opened in June 2007, at the Malcha Technological Park with a southern extension in the South at the Town Center branch building in Beer Sheva. The Jerusalem and Southern Region Center is the fifth Credit Center joining the Sharon, Tel-Aviv, Haifa and Northern Region and the Plain, and South Tel-Aviv Centers. For further details regarding the Credit Centers, See the Annual Report for 2006 (p. 87).

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 114 million, compared with an income of NIS 33 million in the corresponding period last year, an increase of 245.5%.

Disregarding the effect of certain components (see hereunder), the segment’s net income for the period would have amounted to NIS 94 million, compared with NIS 55 million in the corresponding period last year, an increase of 70.9%. **Provision for doubtful debts** in this segment amounted to NIS 73 million in the first half of 2007, compared with NIS 67 million in the corresponding period last year, an increase of 9%.

Following are the principal data relating to the operations of the small business segment (in NIS millions):

	Domestic operations					
	Banking and financing	Credit cards	Capital market	Construction and real estate	Mortgage	Total
	For the three months ended June 30, 2007					
Income (loss) from financing activities before provision for doubtful debts						
- From externals	86	4	(1)	18	6	113
- Intersegmental	61	-	-	(1)	(2)	58
Total income (loss) from financial activity	147	4	(1)	17	4	171
Operating and other income	71	7	16	4	-	98
Total Income	218	11	15	21	4	269
Provision for doubtful debts	37	-	-	8	1	46
Net income	47	4	30	7	1	89
Net income disregading certain components*	44	4	6	6	1	61

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the three months ended June 30, 2006					
Income from financing activities before provision for doubtful debts	112	2	8	15	4	141
Operating and other income	57	4	8	2	-	71
Total Income	169	6	16	17	4	212
Provision for doubtful debts	27	-	-	4	1	32
Net income (loss)	20	-	31	4	1	56
Net income disregading certain components*	15	1	7	4	1	28

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

The principal data relating to the operations of the small business segment (in NIS millions) (continued)::

	Domestic operations						
	Banking and financing	Credit cards	Capital market	Construction and real estate	Mortgage	Total	
	For the six months ended June 30, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From externals	256	4	-	37	14	311	
- Intersegmental	16	-	-	(5)	(3)	8	
Total income from financial activity	272	4	-	32	11	319	
Operating and other income	133	10	25	8	1	177	
Total Income	405	14	25	40	12	496	
Provision for doubtful debts	59	-	-	10	4	73	
Net income	60	4	33	15	2	114	
Net income disregading certain components*	64	4	9	15	2	94	

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the six months ended June 30, 2006						
Income from financing activities before provision for doubtful debts	224	3	9	28	12	276	
Operating and other income	120	7	21	6	1	155	
Total Income	344	10	30	34	13	431	
Provision for doubtful debts	58	-	-	7	2	67	
Net income (loss)	(15)	1	32	12	3	33	
Net income disregading certain components*	25	2	12	13	3	55	55

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

For further details regarding the “Retail Banking Sector – Small Business Segment”, see the Annual Report for 2006 (pp. 85-88).

CORPORATE BANKING SEGMENT

SEGMENT CUSTOMERS

The segment in the Bank includes mainly companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 50 million. The segment also includes customers of the corporate segment of the Mercantile Discount Bank. Up to December 31, 2006 the definition of the corporate banking segment at Mercantile Discount Bank included corporations whose annual business turnover generally exceeds NIS 150 million and public companies handled by the corporate division of Mercantile Discount Bank. Following an organizational change implemented in Mercantile Discount Bank, within the framework of which customers with a scope of transactions less than NIS 150 million and a scope of credit exceeding NIS 15 million were transferred to the responsibility of the Corporate Banking division, the definition of this segment was changed in Mercantile Discount Bank to also include such customers.

As from the financial statements for 2006, the segment also includes the international operations data in the corporate banking segment.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 199 million, compared with NIS 129 million in the corresponding period last year.

The sector's income includes a dividend in the amount of NIS 37 million received in respect of shares that were utilized as collateral for loans received by a certain borrower, compared with NIS 21 million in the corresponding period last year (see Note 3 C to the financial statements as of December 31,2006, p. 285).

Disregarding the effect of certain components (see hereunder), the segment's net income for the period would have amounted to NIS 204 million, compared with NIS 163 million in the corresponding period last year, an increase of 25.1%.

Provision for doubtful debts in this segment amounted to NIS 65 million in the first half of 2007, compared with a provision of NIS 62 million in the corresponding period last year, an increase of 4.8%.

Following are the principal data relating to the operations of the corporate banking segment (in NIS millions):

	Domestic operations				International operations			
	Banking and financing	Capital market	Construction and real estate	Total	Banking and financing	Construction and real estate	Total	Total
	For the three months ended June 30, 2007							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	476	1	179	656	189	6	195	851
- Intersegmental	(338)	-	(94)	(432)	(141)	-	(141)	(573)
Total income from financial activity	138	1	85	224	48	6	54	278
Operating and other income	14	7	6	27	7	2	9	36
Total Income	152	8	91	251	55	8	63	314
Provision for doubtful debts	7	-	47	54	2	-	2	56
Net income	58	6	13	77	16	3	19	96
Net income disregading certain components*	54	4	13	71	19	3	22	93

*The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York the principal data relating to the operations of the corporate banking segment (in NIS millions) (continued):

	Domestic operations				International operations			
	Banking and financing	Capital market	Construction and real estate	Total	Banking and financing	Construction and real estate	Total	Total
	For the three months ended June 30, 2006							
Income from financing activities before provision for doubtful debts	137	-	68	205	47	4	51	256
Operating and other income	43	5	3	51	8	-	8	59
Total Income	180	5	71	256	55	4	59	315
Provision for doubtful debts	19	-	12	31	(3)	1	(2)	29
Net income	41	3	29	73	36	-	36	109
Net income disregading certain components*	37	1	28	66	40	-	40	106

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

	Banking and financing	Capital market	Construction and real estate	Total	Banking and financing	Construction and real estate	Total	Total
	For the six months ended June 30, 2007							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	648	-	265	913	199	11	210	1,123
- Intersegmental	(376)	-	(123)	(499)	(124)	-	(124)	(623)
Total income from financial activity	272	-	142	414	75	11	86	500
Operating and other income	87	15	11	113	8	3	11	124
Total Income	359	15	153	527	83	14	97	624
Provision for doubtful debts	21	-	39	60	4	1	5	65
Net income	118	8	47	173	21	5	26	199
Net income disregading certain components*	121	6	48	175	24	5	29	204

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

	Banking and financing	Capital market	Construction and real estate	Total	Banking and financing	Construction and real estate	Total	Total
	For the six months ended June 30, 2006							
Income from financing activities before provision for doubtful debts	250	-	128	378	68	7	75	453
Operating and other income	63	10	9	82	12	-	12	94
Total Income	313	10	137	460	80	7	87	547
Provision for doubtful debts	13	-	47	60	1	1	2	62
Net income	55	4	31	90	38	1	39	129
Net income disregading certain components*	82	2	36	120	42	1	43	163

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

DEVELOPMENTS IN BUSINESS ACTIVITIES IN THE FIRST HALF OF 2007

The expansion in economic activity continued in the first half of 2007 at an annual rate equal to that of 2006. Expansion was recorded in most economic sectors excluding real estate. Expansion continued, mostly, on the background of the increase in domestic demand, private consumption and the increase in the demand level on foreign markets, as a result of the continued growth of global markets.

The macro-economic trend data issued for the first half of 2007 reflect a continued increase in demand, in private consumption and in the volume of industrial output.

- The combined index for evaluating the state of the economy rose during the first half of 2007 at an annualized rate of 7.5% compared to the corresponding half of last year, reflecting the continued rapid growth of the product of the business sector.
- The turnover of the commercial and services sectors in the period from January to May 2007 increased at an annualized rate of 8.9% compared to the corresponding period last year, reflecting the continued accelerated growth of private consumption and domestic demand.
- The total revenues of the marketing chains increased in the first half of 2007 by an annualized rate of 4.1% compared to the corresponding period last year.
- The industrial output index for the months of January to May 2007 rose by an annualized rate of 7.9% compared to the corresponding period last year.

DEVELOPMENTS IN THE OFF-BANKING CREDIT MARKET

- The increase in credit granted to the business sector continued in the first half of 2007, a trend that commenced at the beginning of 2004 as a result of the improvement in the state of the economy and the growth of the business product.

  The increased demand for credit was fully supplied by the off-banking credit market, mainly through a wide public offerings of corporation bonds on the local and foreign markets, while the banking credit portfolio showed a moderate declining trend.
- In the first half of 2007 corporation bond offerings raised an amount of NIS 45 billion in comparison to NIS 52 billion during the whole of 2006.

The above two trends contributed to the decline in the share of the commercial banks in the credit portfolio to the business sector from 57% at the end of 2006 to approximately 55% at the end of June 2007. The trend of decline in the rate of bank credit is expected, according to estimates, to continue until the end of 2007.

The developments in the off-banking credit market contributed to an increase in the risk level of the banking credit portfolio concurrently with the increase in the credit risk of the capital market, mostly due to the following:

- Considerable repayment of loans by large corporations having a high credit rating, which obtained alternative credit on the capital market.
- The pricing of corporation bonds issued by companies having a medium financial soundness at levels that do not correspond with their risk level.

Estimates for 2007 reflect continued expansion of economic activity at a rate similar to 2006, which will be affected by continued growth in the business sector in most areas of the economy.

The expected continued growth in economic activity is based the following developmental indicators:

- Increase in gross domestic product at an annual rate of 5% - 5.1%, similar to 2006.

- Increase in business product at a rate of 6.2%, compared to 6.3% in 2006.
- Increase in exports at an annual rate of 5.1%, similar to 2006, notwithstanding estimates regarding a slowdown in the scope of activity in the United States' economy. The increase in export will be affected by continuing high growth rates in developing markets in Southeast Asia, and improvement in growth rates in Japan and in Western Europe, which will contribute to expansion of global trade. Advanced technology and the security industry will lead the growth in export sectors.
- Increase in investment in fixed assets at a rate of 5.8%, compared to 6.1% in 2006.

These data constitute estimates that may not be realized in the event of a decrease in the level of domestic demand as a result of worsening in the security – political situation, moderation of the economic growth rate in Israel and/or in global markets, material increase in interest rates worldwide and domestically, and other macro-economic developments that are not under the Bank's control.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

Limitation of "Related Persons". As of date of the financial statements and date of their issue there is no deviation from the related persons limitations.

For further details regarding the "Corporate Banking Segment", see the Annual Report for 2006 (pp. 88-96).

MIDDLE MARKET BANKING SEGMENT

SEGMENT CUSTOMERS

This segment in the Bank includes mainly companies with annual turnovers exceeding NIS 30 million and/or total indebtedness of NIS 5 – 50 million. The segment also includes Mercantile Discount Bank's commercial banking customers (individuals and corporations) having a medium level of activity, whose granted volume of credit exceeds NIS 1 million and who do not belong to the corporate banking segment of Mercantile Discount bank.

As from 2006 the segment also includes the international operations data in the middle market banking segment.

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 95 million, compared with a loss of NIS 8 million in the corresponding period last year.

Disregarding the effect of certain components (see hereunder), the segment's net income for the period would have amounted to NIS 84 million, compared with NIS 39 million in the corresponding period last year, an increase of 115.4%.

Provision for doubtful debts in this segment amounted to NIS 48 million in the first half of 2007, compared with NIS 68 million in the corresponding period last year, an increase of 29.4%.

Following are the principal data relating to the operations of the middle market banking segment (in NIS millions):

	Domestic operations						International operations			
	Banking and financing	Credit cards	Capital market	Construction and real estate	Mortgage	Total	Banking and financing	Construction and real estate	Total	Total
	For the three months ended June 30, 2007									
Income (loss) from financing activities before provision for doubtful debts										
- From externals	(81)	1	-	28	13	(39)	74	185	259	220
- Intersegmental	157	(1)	-	(18)	(8)	130	9	(140)	(131)	(1)
Total income from financial activity	76	-	-	10	5	91	83	45	128	219
Operating and other income	32	1	11	1	-	45	10	3	13	58
Total Income	108	1	11	11	5	136	93	48	141	277
Provision for doubtful debts	4	-	-	6	3	13	3	3	6	19
Net income	21	-	26	4	1	52	29	18	47	99
Net income disregading certain components*	20	-	5	2	1	28	31	21	52	80

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	For the three months ended June 30, 2006									
Income from financing activities before provision for doubtful debts	68	-	1	9	3	81	42	22	64	145
Operating and other income	73	-	7	9	-	89	(13)	(2)	(15)	74
Total Income	141	-	8	18	3	170	29	20	49	219
Provision for doubtful debts	32	-	-	5	1	38	(9)	(5)	(14)	24
Net income (loss)	12	-	8	4	1	25	(9)	-	(9)	16
Net income (loss) disregading certain components*	(8)	-	2	2	1	(3)	19	7	26	23

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

The principal data relating to the operations of the middle market banking segment (in NIS millions) (continued):

	Domestic operations						International operations			
	Banking and financing	Credit cards	Capital market	Construction and real estate	Mortgage	Total	Banking and financing	Construction and real estate	Total	Total
	For the six months ended June 30, 2007									
Income (loss) from financing activities before provision for doubtful debts										
- From externals	87	1	-	42	17	147	115	195	310	457
- Intersegmental	63	(1)	-	(18)	(11)	33	16	(125)	(109)	(76)
Total income from financial activity	150	-	-	24	6	180	131	70	201	381
Operating and other income	65	1	17	4	1	88	20	5	25	113
Total Income	215	1	17	28	7	268	151	75	226	494
Provision for doubtful debts	28	-	-	9	2	39	5	4	9	48
Net income	11	-	27	11	3	52	23	20	43	95
Net income disregading certain components*	15	-	6	10	3	34	26	24	50	84

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	For the six months ended June 30, 2006									
Income from financing activities before provision for doubtful debts	144	-	1	16	5	166	115	45	160	326
Operating and other income	98	-	16	11	-	125	1	-	1	126
Total Income	242	-	17	27	5	291	116	45	161	452
Provision for doubtful debts	56	-	-	8	4	68	-	-	-	68
Net income (loss)	(28)	-	9	7	-	(12)	2	2	4	(8)
Net income (loss) disregading certain components*	(12)	-	4	6	-	(2)	32	9	41	39

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

For further details regarding the “Middle Market Banking Segment”, see the Annual Report for 2006 (pp. 97-99).

PRIVATE BANKING SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank’s Retail Division, individuals and corporations, whose accounts are maintained under the private banking centers’ responsibility. These customers are generally Israeli customers having deposits of NIS 2 million and over, as well as foreign residents.

As from 2006, the segment also includes the international operation data in the private banking segments.

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 27 million, compared with NIS 45 million in the corresponding period last year.

Disregarding the effect of the privatization bonus and the effect of the wage agreement on the increase in liabilities in respect of provisions for salary related expenses, the segment's net income for the period would have amounted to NIS 32 million, compared with NIS 69 million in the corresponding period last year, a decrease of 53.6%.

Following are the principal data relating to the operations of the private banking segment (in NIS millions):

	Domestic operations			International operations			
	Banking and financing	Capital market	Total	Banking and financing	Capital market	Total	Total
	For the three months ended June 30, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From externals	(488)	1	(487)	(681)	-	(681)	(1,168)
- Intersegmental	513	-	513	735	-	735	1,248
Total income from financial activity	25	1	26	54	-	54	80
Operating and other income	9	12	21	6	12	18	39
Total Income	34	13	47	60	12	72	119
Provision for doubtful debts	-	-	-	3	-	3	3
Net income	6	2	8	18	1	19	27
Net income disregading certain components*	6	4	10	19	-	19	29

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	Domestic operations			International operations			
	Banking and financing	Capital market	Total	Banking and financing	Capital market	Total	Total
	For the three months ended June 30, 2006						
Income (loss) from financing activities before provision for doubtful debts	21	(1)	20	50	-	50	70
Operating and other income	8	10	18	26	22	48	66
Total Income	29	9	38	76	22	98	136
Net income	6	4	10	14	13	27	37
Net income disregading certain components*	2	1	3	25	16	41	44

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

The principal data relating to the operations of the private banking segment (in NIS millions) (continued):

	Domestic operations			International operations			
	Banking and financing	Capital market	Total	Banking and financing	Capital market	Total	Total
	For the six months ended June 30, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From externals	(500)	1	(499)	(602)	-	(602)	(1,101)
- Intersegmental	548	-	548	701	-	701	1,249
Total income from financial activity	48	1	49	99	-	99	148
Operating and other income	18	23	41	15	16	31	72
Total Income	66	24	90	114	16	130	220
Provision for doubtful debts	-	-	-	4	-	4	4
Net income (loss)	8	4	12	17	(2)	15	27
Net income (loss) disregading certain components*	10	6	16	19	(3)	16	32

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	Banking and financing	Capital market	Total	Banking and financing	Capital market	Total	Total
	For the six months ended June 30, 2006						
Income from financing activities before provision for doubtful debts	40	1	41	108	-	108	149
Operating and other income	14	21	35	38	32	70	105
Total Income	54	22	76	146	32	178	254
Net income (loss)	(1)	5	4	27	14	41	45
Net income disregading certain components*	10	4	14	38	17	55	69

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

For further details regarding the “Private Banking Segment”, see the Annual Report for 2006 (pp. 99-102).

FINANCIAL MANAGEMENT SEGMENT

SEGMENT DEFINITION

This segment includes activities that are characterized as banking operations, but do not involve customers of the Group (except for the dealing room). These activities are mainly comprised of operations of the Bank, Mercantile Discount Bank and IDB New York involving securities and other banks for their own account, as well as management of market and liquidity risks and dealing room operations, including those involving financial derivatives. This segment also includes the Bank’s share in the income of the First International Bank and its share in the income of its affiliated companies which operate in a supporting capacity.

The segment also includes the non-financial corporations’ sub-segment, which includes the Discount Group activity in non-financial investments. This sub-segment's main activity was the Bank's investment in Harel (most of which was sold during 2006) and investments made by the subsidiary Israel Discount Capital Markets and Investments ("DCMI") and by the Bank directly.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net loss of the segment in the first half of 2007, not including the activity of the non-financial companies sub-segment, amounted to NIS 104 million, compared with an income of NIS 27 million in the corresponding period last year.

Disregarding the effect of certain components (see hereunder), the segment's net loss for period would have amounted to NIS 96 million, compared with a loss of NIS 102 million in the corresponding period last year.

Total revenues amounted in the first half of 2007 to NIS 46 million, compared with NIS 96 million in the corresponding period last year, and they include three major components:

1. Earnings from "nostro" operations in Israel (mainly securities and bank deposits) in the net amount of NIS 101 million, including a gain of NIS 35 million from the sale of securities and from adjustments to fair value of available-for-sale securities, as compared to NIS 95 million in the corresponding period last year, net, after subtracting a loss of NIS 11 million from the sale of securities and fair value adjustments of negotiable securities.
2. Net loss of NIS 35 million from position management and from trading and brokerage transactions in currencies and in financial derivatives, compared to a gain of NIS 26 million in the corresponding period last year.
3. Net loss from international operations in the amount of NIS 20 million, compared to a loss of NIS 25 million in the corresponding period last year.

Following are the principal data relating to the operations of the financial management segment (in NIS millions):

	Domestic Operatins	International Banking	Total
	For the three months ended June 30, 2007		
Loss from financing activities before provision for doubtful debts	(25)	(95)	(120)
Operating and other income	29	(4)	25
Total Income	4	(99)	(95)
Provision for doubtful debts	-	3	3
Net loss	(53)	(76)	(129)
Net loss disregading certain components*	(55)	(74)	(129)

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

The principal data relating to the operations of the financial management segment (in NIS millions) (continued):

	Domestic Operatins	International Banking	Total
	For the three months ended June 30, 2006		
Income (loss) from financing activities before provision for doubtful debts	74	(2)	72
Operating and other income	32	(69)	(37)
Total Income	106	(71)	35
Provision for doubtful debts	1	(1)	-
Net income (loss)	69	(140)	(71)
Net income (loss) disregading certain components*	65	(134)	(69)

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the effect of the reversal of the provision for impairment in value of the investment in the First International Bank

	Domestic Operatins	International Banking	Total
	For the six months ended June 30, 2007		
Income (loss) from financing activities before provision for doubtful debts	42	(22)	20
Operating and other income	24	2	26
Total Income	66	(20)	46
Provision for doubtful debts	-	4	4
Net loss	(55)	(49)	(104)
Net loss disregading certain components*	(50)	(46)	(96)

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	Domestic Operatins	International Banking	Total
	For the six months ended June 30, 2006		
Income (loss) from financing activities before provision for doubtful debts	58	49	107
Operating and other income	63	(74)	(11)
Total Income	121	(25)	96
Provision for doubtful debts	1	-	1
Net income (loss)	145	(118)	27
Net income (loss) disregading certain components*	10	(112)	(102)

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the effect of the reversal of the provision for impairment in value of the investment in the First International Bank.

For further details regarding the “Financial Management Segment”, see the Annual Report for 2006 (pp. 103-105).

NON-FINANCIAL COMPANIES SUB-SEGMENT

SUB-SEGMENT DEFINITION

This sub-segment includes the Group's operations in non-financial investments. The greater part of the sub-segment's operations relate to investments undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd. (hereinafter: "DCMI"), direct investments by the Bank itself and investments by Mercantile Discount Bank.

Until the sale of the holdings in Harel Insurance Investments, the investment therein constituted an important component in the activity of the sub-segment (for details regarding the sale of the holdings in Harel, see and Note 6 H to the financial statements as of December 31, 2006 pp. 308-309).

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SUB-SEGMENT

As of June 30, 2007, the amount of the Bank's investment in non-financial corporations was less than the restricted amount pursuant to Section 23A of the Banking Law (Licensing). For further details see the Annual Report for 2006 (p.106).

The legislation passed in the wake of the Bachar Committee recommendations included limitations on the holdings of controlling interests in non-financial corporations which are insurers, corporations controlling an insurer or holding over 25% of the equity of an insurer. For additional details, including details regarding the necessity for the Bank to reduce its holdings in Harel Insurance Investments Ltd., in view of the Bank's decision to engage in pension consultation, see Note 33 to the financial statements as of December 31, 2006 (pp. 411-412) and Note 2 to the condensed financial statements. For details regarding the sale of the Bank's holdings in Harel, see hereunder.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

Net income of the sub-segment in the first half of 2007 amounted to NIS 4 million, compared with NIS 20 million in the corresponding period last year, a decrease of 80%.

Following are the principal data relating to the operations of the non-financial company segment (in NIS millions):

	For the three months ended June 30		For the six months ended June 30	
	2007	2006	2007	2006
Loss from financing activities before provision for doubtful debts	(11)	(7)	(12)	(14)
Operating and other income	5	7	5	11
Total income	(6)	-	(7)	(3)
Net income (loss)	(2)	8	4	20

INVESTMENTS OF GROUP IN PRIVATE INVESTMENT FUNDS AND VENTURE CAPITAL FUNDS

DCMI participated in a number of private investment funds and venture capital funds. As of June 30, 2007, the investments of DCMI in these funds amounted to US$74.7 million. As of June 30, 2007, the future commitment of DCMI for investment in these funds amounted to US$88.3 million.

In addition to the investment in funds through DCMI, the Bank has made a direct investment in an additional fund. As of June 30, 2007, the investment of the Bank in the said fund amounted to US$18.6 million. As of June 30, 2007 the future commitment of the Bank for investment in this fund amounted to US$4.2 million. (It should be noted that the Bank invested in the past in two additional funds, the investment in which was transferred to DCMI in effect as from April 1, 2007).

Furthermore, Mercantile Discount Bank is committed to an investments in five venture capital funds. As of June 30, 2007, the investment of Mercantile Discount Bank in these funds amounted to US$5.1 million. As of June 30, 2007, the maximum commitment for the future investments in these funds amounted to US$0.8 million.

NON-FINANCIAL INVESTMENTS POLICY

In the first half of 2007, the Bank's Board of Directors approved a non-financial investments policy based, inter alia, on the following principles:

- Combining of the Bank's non-financial investments activity under DCMI and defining sectors of investment activity;
- In the first stage, investments will be implemented with a scope of up to 90% of the maximum permitted framework in accordance with legal restrictions, at a ratio of 60% for investments in Israel and 40% for investments abroad (including existing portfolio);
- Investments abroad will include investments in real estate, based on strategic partnerships with entities active in real estate and large investment houses specializing in real estate, investments in private equity, through direct fund investments and through gatekeepers, and other investments.

The non-financial investments policy also includes, among other things, a recommended scenario for volume of investments in the years 2007 – 2009.

DEVELOPMENTS IN THE SUB-SEGMENT

The sale of holdings in Harel. On November 1, 2006, the transaction for the sale of 10.1% of the share capital of Harel came into effect and on May 28, 2007 the transaction for an option to sell all the remaining shares that the Bank holds in Harel, comprising 5.79% of the share capital of Harel, came into effect. The Bank has decided not to exercise the said option for the sale of 5.79% of the equity in Harel that it holds.

Investment in Europort Ltd. In March and April 2007, Discount Israel Capital Markets and Investments Ltd acquired 13.34% of Europort Ltd., in consideration for US$ 2 million. Europort is expected to engage in initiation of rental real estate projects in Eastern Europe. In May 2007, Europort mobilized NIS 57 million on the stock exchange to finance its activity.

Investment in Apax VII Fund. In May 2007 Discount Israel Capital Markets and Investments Ltd committed to invest Euro 7.4 million in the Fund, which amounts to Euro 10 million. The Fund was established recently as a European private equity fund in the Apax Group, and is expected to operate mainly in Europe.

Investment in Menif Financial Services Ltd. ("Menif"). DCMI owns approximately 19.6% of the equity of Menif. DCMI's board of directors has approved a commitment of guarantees for projects up to an amount of US$17.3 million. In July 2007, DCMI signed an agreement for the acquisition of control in Menif, in consideration for an immaterial amount. Under this agreement DCMI committed to provide additional guarantees with respect to construction projects, to replace the guarantees given by the seller (an additional facility of US$17.3 million, of which an amount of NIS 33 million had already been granted). Consummation of the transaction is subject to approval of the Bank of Israel.

Investment in Plenus III Fund. In August 2007, DCMI committed to invest in the Fund an amount of US$15 million, out of over US$100 million which the Fund intends to raise. The Fund is a venture lending fund of the Dovrat Group, and is engaged in granting loans and credit facilities to technology companies.

Investment in a real estate fund. In August 2007, DCMI committed to invest US$5 million in an investment fund of the Brack Capital Group, which is to focus on real estate investments in India and China. The expected volume of the fund is US$110 million.

Investment in a European real estate fund. In July 2007, DCMI committed to invest Euro 10 million in a European real estate fund of approximately Euro 400 million, managed by the French AXA Group.

Negotiations for investment in activities abroad. DCMI is conducting advanced negotiations for entering as a strategic investor into the operations abroad of two companies, acquiring 20% of the equity of each of the companies. The total investment framework in these companies is to reach Euro 70 million.

The other shareholder in the two companies is expected to invest an amount pro-rata to his share in the equity of these companies (80%).

This engagement is subject to the signing of an agreement and to approval of the Bank's Board of Directors.

For further details regarding the "Non-financial companies sub-segment", see the Annual Report for 2006 (pp. 106-110).

FURTHER DETAILS AS TO ACTIVITY IN CERTAIN PRODUCTS

CREDIT CARD OPERATIONS

The activity of the Bank in the credit card field is being conducted both through Israel Credit Cards Ltd. (hereinafter – "ICC"), a credit card company owned 71.8% by the Bank, and by the issue of ICC credit cards to customers of the Bank, as part of the services and products basket offered by the Bank.

The income of the Bank from the credit card operations includes, primarily, various commissions related to the credit card activity of ICC (both as an issuer of credit cards and as a clearing agent for credit cards), as well as the financing income from credit granted to transactions effected through off-banking credit cards. In addition, the Bank derives income from payments transferred to it in respect of credit cards issued to its customers by ICC, at the initiative of the Bank.

GENERAL INFORMATION ON THE OPERATIONS

The income of ICC in the first half of 2007 amounted to NIS 90 million, compared with NIS 61 million in the corresponding period last year, an increase of 47.5%.

The company's activities are concentrated in two main areas, issuing and clearing. With regard to the company's issuing operations, credit facilities are made available to its customers.

Following are quantitative data regarding the activity of ICC:

NUMBER OF VALID CARDS[3]

	June 30, 2007	December 31, 2006
	(in thousands)	
Bank cards[1]	938	950
Off-banking cards[2]	422	397
	1,360	1,347

TRANSACTIONS TURNOVER[4]

	In the three months ended June 30 2007	In the six months ended June 30 2007	In the year ended December 31, 2006
		in NIS millions	
Bank cards	7,451	14,866	29,437
Off-banking cards	1,836	3,661	6,661
	9,287	18,527	36,098

Notes:
1. "Bank card" – A credit card issued jointly with the banks in the arrangement.
2. "Off-banking card" – A credit card issued by ICC, separately from the banks.
3. "Valid card" – A valid credit card which is not blocked.
4. "Transactions turnover" – Includes transactions made using the credit card and debits in respect of transactions payable in installments, less the credits made to the banks or their customers in respect of the use of credit cards during the same period and commissions collected for the banks or for ICC. The transaction turnover does not include withdrawals of cash through the automatic teller machines in Israel.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in the first half of 2007 amounted to NIS 55 million, compared with 34 million in the corresponding period last year, an increase of 94.1%.

Net income, disregarding the effect of certain components, as detailed below, would have amounted to NIS 56 million in the first half of 2007, compared to NIS 37 million in the corresponding period of the previous year, an increase of 51.3%.

Provision for doubtful debts in this segment amounted in the first half of 2007 to NIS 19 million, compared with NIS 14 million in the corresponding period last year, an increase of 35.7%.

Following are the principal data relating to the credit cards operations (in NIS millions):

	Domestic operations			
	Households	Small Businesses	Corporate Banking	Total
	For the three months ended June 30, 2007			
Income (loss) from financing activities before provision for doubtful debts				
- From externals	47	4	-	51
- Intersegmental	(13)	-	-	(13)
Total income from financial activity	34	4	-	38
Operating and other income	179	7	1	187
Total Income	213	11	1	225
Provision for doubtful debts	9	-	-	9
Net income	28	4	-	32
Net income disregading certain components*	28	4	-	32

* The following components have been disregarded: gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the three months ended June 30, 2006			
Income from financing activities before provision for doubtful debts	25	2	-	27
Operating and other income	156	4	-	160
Total Income	181	6	-	187
Provision for doubtful debts	8	-	-	8
Net income	19	-	-	19
Net income disregading certain components*	17	1	-	18

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

	For the six months ended June 30, 2007			
Income (loss) from financing activities before provision for doubtful debts				
- From externals	98	4	1	103
- Intersegmental	(27)	-	(1)	(28)
Total income from financial activity	71	4	-	75
Operating and other income	357	10	1	368
Total Income	428	14	1	443
Provision for doubtful debts	19	-	-	19
Net income	51	4	-	55
Net income disregading certain componen*	52	4	-	56

* The following components have been disregarded: gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

The principal data relating to the credit cards operations (in NIS millions) (continued):

	Domestic operations			
	Households	Small Businesses	Corporate Banking	Total
	For the six months ended June 30, 2006			
Income from financing activities before provision for doubtful debts	47	3	-	50
Operating and other income	303	7	-	310
Total Income	350	10	-	360
Provision for doubtful debts	14	-	-	14
Net income	33	1	-	34
Net income disregading certain components*	35	2	-	37

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

REGULATIONS, LEGISLATION AND ARRANGEMENTS

General. The activities of ICC are regularized under the Credit Card Law, 1986 and various rules under the general law also apply to it. In addition, due to the fact that ICC is a subsidiary of a banking corporation, it is defined also as an "auxiliary corporation" under the Banking Law (Licensing), 1981, and as such, a set of Laws, Regulations and Orders under the banking laws also apply to it.

Commissioner of Restrictive Trade Practices. The Commissioner of Restrictive Trade Practices is involved extensively in the field of credit card activity. For details as to the arrangements between the credit card companies and the three way agreement for cross clearing, which was submitted for approval of the Antitrust Court, see hereunder.

Prohibition of money laundering and the financing of terror. In December 2006 an amendment to the Prohibition of Money Laundering Order (Obligation for identification, reporting and maintenance of records by banking corporations for the prevention of money laundering and the financing of terror) was published. The Order came into effect six months after being published. The amendment also applies to credit card companies' obligations for identification, maintenance of records and reporting to the Prohibition of Money Laundering Authority in all matters concerning credit card holders and businesses with whom the companies have clearing agreements, subject to certain terms and granting certain relief to credit card companies as compared with banking corporations. At the request of the credit card companies, the Supervisor of Banks postponed the effective date of certain sections of the Prohibition of Money Laundering Order to September 12, 2007. ICC is preparing to act in accordance with the requirements of the amended Order.

A commission of examination with respect to market failures in the credit card field. In February 2007, the report of the inter-ministerial commission, headed by the Accountant General at the Ministry of Finance, which dealt with the examination of market failures in the credit card field in Israel, was published. The commission recommended that the clearing market should be regularized by way of the Banking Law (Licensing). According to the recommendations of the commission, engaging in clearing would require a license from the Governor of the Bank of Israel (existing clearing agents shall be entitled to a license). The Supervisor of Banks shall be authorized to compel cross clearing among the three existing credit card companies and with any new company in this field, and to compel a large card issuer to allow all clearing agents to clear its cards. The supervisor of Banks shall be authorized to supervise clearing agents and to issue directives as to their operation, including the recommendation to the price commission, established under the Supervision of Commodities and Services Law, as to the maximum cross commissions, and to determine instructions requiring a clearing agent to enter into agreements with discount companies and not to discriminate between them.

Additional legislation and arrangement initiatives. Various State agencies have recently voiced opinions according to which the credit card companies should be separated from the banks. These positions brought about private bills tabled by members of the Knesset. To the best knowledge of ICC and the Bank, the Government has not yet formed its position with regards to such initiatives.

For additional details, see the Annual Report for 2006 (pp. 113-115).

DEVELOPMENTS IN THE SEGMENT

A joint issuance agreement between ICC and the First International Bank and between ICC and the Bank. Among other distribution agreements signed by ICC (including Diners) with several banks, are also agreements signed with the First International Bank for the joint issue of VISA and Diners credit cards to customers of the First International Bank for a period of six years as from August 1, 2000, at the end of which the agreement would be renewed for an additional period of three years. However, as from February 2006, each of the parties is entitled to terminate the engagement at any time giving prior notice of six months.

The First International Bank announced on August 17, 2006, the cancellation of the said agreements in their present format, at the end of six months from the date of the announcement. At the same time, the First International Bank informed ICC of its wish to conduct, as early as possible, a rapid negotiation for the renewal of the engagement between them, based on existing agreements and their annexes, without granting preference to credit cards issued by ICC, and including additional changes that might arise through the negotiation.

The existing joint issue agreement was extended until September 15, 2007. ICC and the First International Bank are at present negotiating the extension of the joint issue agreement for the coming years.

CAL entered into an agreement with the Bank that is similar to the agreement with the First International Bank. As of date of approval of the financial statements, CAL and the Bank are conducting negotiations regarding the change in the agreement conditions.

A tri-party Cross Clearing agreement. On October 30, 2006, the Commissioner, the credit card companies and the banks owning the credit card companies entered into an agreement for the Cross Clearing of Visa and MasterCard credit cards (hereinafter – "the Agreement"). The agreement came into effect upon the granting of a provisional permit by the Antitrust Court on October 31, 2006, and will both expire on July 1, 2013 (hereinafter: "the period of the Agreement") unless the Court rules otherwise at a prior date.

Five objections to the agreement were submitted. ICC has not yet submitted its response to these objections.

The Agreement specifies, among other things, the rates of the Cross Clearing commissions and the structure of the categories of the Cross Clearing commissions applying to the credit card companies during the effective period. The Agreement outlines a gradual decrease in the rates of the Cross Clearing commissions down to a rate of 0.875% starting on July 1, 2012, alongside the reduction in the number of categories over the effective period.

The Agreement specifies general guidelines that prohibit, among other things, the inter-dependence between various types of credit cards being cleared by a business with each of the credit card companies. The guidelines also prohibit the deterioration in the terms of clearing following a reduction in the number of credit card types being cleared by a particular business.

The Agreement specifies further rules that, among other things, do not permit banks that control credit card companies to link between the services provided to the business and the terms of engagement with the clearing entity. Further rules prohibit banks from discriminating between customers of a bank holding a credit card issued by that bank and other customers of that bank who do not hold credit cards issued by it.

Within the framework of the Agreement, certain provisions were determined according to which, under certain circumstances, the Commissioner would withdraw the declaration of IsraCard as a monopoly with regards to the clearing of IsraCard and MasterCard credit cards, forcing IsraCard to determine under certain circumstances identical commission rates for a business that clears transactions of IsraCard and MasterCard, and an undertaking of the parties to apply to the Court for approval of a cross clearing commission for the period following the termination of the arrangement, in case they would request the continuation of the cross clearing.

The Agreement further provides that until May 30, 2007, a joint interface would be established and operated to enable the three credit card companies to effect the clearing of VISA and MasterCard credit card transactions. The joint interface went into operation in the beginning of June 2007.

Following the signing of the new Agreement, IsraCard joined the local agreement for cross clearing existing between ICC and LeumiCard with respect to the VISA brand, and consequently, the competition in the field of VISA credit card clearing is also expected to grow in the future.

Since June 2007, ICC also started the clearing of MasterCard in accordance with the tri-party cross clearing agreement.

At this stage it is not possible to assess all of the implications of the Agreement. On the one hand, a gradual decline is expected as stated in the rate of the cross commission, though on the other hand, the Bank and ICC believe that the Agreement will drive the market to open competition and will reduce the uncertainty in this field, among other things, due to the ability of ICC (as well as LeumiCard) to operate in the field of clearing MasterCard credit cards in Israel.

Extension of franchise agreement with Diners. An agreement was recently signed between Diners and Diners International, entitling Diners to sole rights in Israel until 2017.

Establishment of joint company with Harel. On May 14, 2007, CAL entered into an agreement with Harel for the establishment of a joint company in which CAL will hold 51% of the shares, and which will be engaged in granting credit to clients based on a unique credit card that will be issued by the joint company for this purpose. Shortly after signing the agreement, the Commissioner of Restrictive Trade Practices requested clarifications from CAL regarding the agreement. Therefore the joint company has not yet commenced activity.

Acquisition of a company in the United States. ICC is in the process of advanced negotiations for the acquisition of a company in California engaged in credit card clearing. The price of the acquisition might reach an amount of US$16-17 million.

The transaction was approved by ICC's Board of Directors and will be brought before the Bank's Board of Directors. Among other things, the transaction is subject to the signing of a detailed agreement and to obtaining regulatory approvals in Israel and abroad.

For further details regarding the credit card operations, see the Annual Report for 2006 (pp. 110-122).

OPERATIONS IN THE CAPITAL MARKET

The operations in the capital market include securities activity (excluding activity for the Bank's nostro account), portfolio management, mutual funds, supplementary training funds, provident funds and severance pay funds. The operations include the activity of the Bank's securities sub-division, as well as the operations of specialized subsidiaries: Tachlit Investment House, Discount Gemel (Formerly: Discount Management of Provident Fund Ltd.) and Kahal, and the operations in the capital market of Mercantile Discount Bank. Until June 30, 2006, the activities included those of the specialized subsidiary Ilanot Discount, that has been sold.

TREND OF EVENTS AND DEVELOPMENTS IN THE MACRO-ECONOMIC ENVIRONMENT

The mutual funds market. The assets of mutual funds amounted at the end of June 2007 to some NIS 143.3 billion, an increase of 25.4% in comparison to the corresponding period last year. Most of the increase was recorded in the weight of the CPI linked mutual funds, which as of June 2007 constitute about 48% of the market. The assets of the CPI linked funds increased in absolute terms from a level of NIS 42.8 billion in June 2007 to a level of NIS 69.4 billion. The weight of the foreign currency mutual funds declined of 26.0% from a level of NIS 2.3 billion to a level of NIS 1.7 billion. The share of the foreign currency funds in the total mutual funds value as of the end of June 2007 was about 1% (compared to 2% at the corresponding period last year). Assets of the non-linked funds increased from a level of NIS 33.6 billion to a level of NIS 34.9 billion, their relative share of the mutual fund market declining from a level of 29% to a level of 24%. The assets of the equity funds (including convertibles) grew from a level of NIS 9.2 billion to a level of NIS 13.4 billion, their relative share of the market rising from a level of 8% to a level of 9%.

Mutual funds specializing in bonds continued to attract investors' interest, and in June 2007 deposits amounting to NIS 3.9 billion (NIS 24.6 billion in the first half of 2007). The trend was reversed in the Shekel funds and net redemptions of some NIS 2 billion were recorded following deposits of NIS 2.9 billion since the beginning of the year. The trend was also reversed in funds investing abroad, and deposits of NIS 0.6 billion were recorded following net redemptions of NIS 0.5 billion in the period from January to May 2007. Equity funds recorded little activity in June 2007.

The provident funds market. The provident fund market was characterized by the continuing trend of shifting resources to provident funds managed by private entities.

Change of ownership. Soon after the publication of the legislations adopted following the recommendations of the Bachar Commission, the banks began to sign agreements to sell ownership or the operations of the mutual funds and/or the provident funds management companies, operating within the banking groups to which they belong. In most of the cases transactions were entered into between the banks and the major insurance groups operating in Israel. In the course of 2006 and the first half of 2007, a part of the transactions were consummated, while others are still in the process of being completed. In view of the intensity of the change in ownership, the short period of time since such change in ownership (in cases where the sale transaction has been consummated) and the fact that certain transactions have not as yet been completed and the activity of the banks as pension consultants has not yet begun, it is not yet possible to assess the impact of the said events upon the Israeli capital market.

Basket certificate market. The volume of public holdings in basket certificates increased in the second quarter of 2007 by 25% from a level of NIS 16.0 billion in March 2007 to a level of NIS 20.0 billion in June 2007. Most of the growth derived from a sharp increase in the activity of basket certificates following the performance of basket certificates following share indices in Israel and abroad as well as from the development of basket certificates following bond indices in Israel and abroad. Since the beginning of the year the holdings of the public in the field of bond indices increased by NIS 4 billion. Another field which developed was the issuance of “short” certificates, assessed at about NIS 1 billion.

In the second quarter of 2007, the volume of trade in basket certificates continued to grow as a result of new series being offered as well as the increase in trade turnover in existing series. At present, some 170 basket certificated are traded on the Tel-Aviv stock Exchange, half of which follow a variety of international indices. The trade turnover in basket certificates comprises about 19% of the total trade turnover in shares.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE OPERATIONS IN THE CAPITAL MARKET

The main restrictions that are expected to affect the operations are those that will be applied to banks under the legislation enacted following the Bachar Committee recommendations. For details see “Reform in the structure of the capital market in Israel and in the activity of banks and other players in the capital market field” under “Legislation and regulation” hereunder, as well as Note 33 to the financial statements as of December 31, 2006 (pp. 407-415).

Among other things, the legislation regularized the following issues:

- The gradual detachment of provident funds and mutual funds from the banks;
- Separation of the activities of an advisor who is not connected to the entities generating the products, and the activities of a marketer who has an affinity to the entities generating the products he sells to customers;
- The gradual entry of the banks into the pension and life insurance product distribution market.

As for details regarding limitations on the deposit and withdrawal of funds with provident funds, in effect as from January 1, 2006, see “Amendment No. 3 to the Income Tax Regulations (Rules for the Approval and Management of Provident Funds)” in the Annual Report of 2006 (p. 198). For details as to the guidelines regarding information as to the needs and instructions of a customer seeking investment advice and draft regulations regarding the documentation of consulting see “Legislation and Supervision” in the Annual Report for 2006 (p. 196).

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in the first half of 2007 amounted to NIS 471 million, compared with NIS 317 million in the corresponding period last year, a rise of 48.6%.

Disregarding the effect of certain components (see hereunder), the operations’ net income for the period would have amounted to NIS 83 million, compared with NIS 91 million in the corresponding period last year, a decrease of 8.8%.

Following are the principal data relating to the operations in the capital market (in NIS millions):

	Domestic operations						International operations	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the three months ended June 30, 2007							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	7	(1)	1	-	1	8	-	8
- Intersegmental	(2)	-	-	-	-	(2)	-	(2)
Total income (loss) from financial activity	5	(1)	1	-	1	6	-	6
Operating and other income	104	16	7	11	12	150	12	162
Total Income	109	15	8	11	13	156	12	168
Net income	381	30	6	26	2	445	1	446
Net income disregading certain components*	35	6	4	5	4	54	-	54

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the three months ended June 30, 2006							
Income (loss) from financing activities before provision for doubtful debts	(3)	8	-	1	(1)	5	-	5
Operating and other income	114	8	5	7	10	144	22	166
Total Income	111	16	5	8	9	149	22	171
Net income	238	31	3	8	4	284	13	297
Net income disregading certain components*	17	7	1	2	1	28	16	44

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the six months ended June 30, 2007							
Income from financing activities before provision for doubtful debts								
- From externals	8	-	-	-	1	9	-	9
- Intersegmental	-	-	-	-	-	-	-	-
Total income from financial activity	8	-	-	-	1	9	-	9
Operating and other income	189	25	15	17	23	269	16	285
Total Income	197	25	15	17	24	278	16	294
Net income (loss)	401	33	8	27	4	473	(2)	471
Net income (loss) disregading certain components*	58	9	6	6	6	85	(2)	83

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

The principal data relating to the operations in the capital market (in NIS millions) (continued):

	Domestic operations						International operations	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the six months ended June 30, 2006							
Income from financing activities before provision for doubtful debts	1	9	-	1	1	12	-	12
Operating and other income	229	21	10	16	21	297	32	329
Total Income	230	30	10	17	22	309	32	341
Net income	253	32	4	9	5	303	14	317
Net income disregading certain components*	52	12	2	4	4	74	17	91

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS:

- **Securities.** On June 30, 2007, the balance of securities held for customers amounted to NIS 101.5 billion, including NIS 13.1 billion of non-marketable securities, compared to NIS 82.1 billion as at December 31, 2006, including NIS 9.8 billion of non-marketable securities, an increase of 23.6%. (For details as to income from security activities, see Note 24 to the financial statements as of December 31, 2006, p. 382).
- **Investment portfolio management.** On June 30, 2007, Tachlit was managing 1,618 investment portfolios, which together were valued at approximately NIS 2,480 million, as compared to 1,692 portfolios valued in total at approximately NIS 2,308 million as at December 31, 2006. The above data point to a decrease of 4.3% in the number of portfolios managed and to an increase of approximately 7.5% in the monetary value of the managed portfolios.

  In addition, Mercantile Discount Bank, through a subsidiary of that bank, manages investment portfolios for its customers. On June 30, 2007 the total monetary value of managed portfolios was approximately NIS 1,339 million, an increase of approximately 60% in comparison to December 31, 2006.
- **Basket certificates.** Tachlit has expanded its activities in the basket certificates field, in which it operates in coordination with companies of the Michael Davis Group, and has issued additional such certificates. The total position held by Tachlit in basket certificates amounted, on June 30, 2007, to NIS 6,306 million, compared with NIS 3,815 million at the end of 2006, an increase of 65.3%.
- **Provident funds**. See below for details regarding the sale of the provident fund activity and the signing of distribution, operating and services to members agreements.

  The sold provident funds are: Tamar, Gefen, General Severance Pay Fund, Shikma, Eshkolot, Toar, Hadas, Central Severance Pay Fund and Edmond de Rothschild Discount Overseas.
- **Employees' Supplementary training funds.** "Kahal" – Employees' Supplementary Training Fund Ltd. and "Kahal Maslulim" are jointly managed by the Bank and Bank Leumi Le-Israel Ltd.

In addition, Mercantile Discount Bank manages, both directly and through its subsidiary, eight additional provident funds, including severance pay funds and a supplementary training fund. As of June 30, 2007 total fund assets amounted to approximately NIS 4 billion, compared with NIS 3.8 billion at the end of 2006, an increase of 4.7%. For details regarding the sale of Mercantile Discount Bank's provident fund operations see hereunder.

DEVELOPMENTS IN THE OPERATIONS

The sale of the provident fund operations. On January 29, 2007, the Bank and its subsidiary Discount Gemel Ltd. (Formerly: Discount Management of Provident Fund Ltd.; hereinafter: "Discount Gemel") signed an agreement with Clal Insurance Company Ltd. (hereinafter: "Clal Insurance") according to which Clal Insurance will acquire from the Bank and from Discount Gemel their provident fund management activity.

The consideration for the assigned rights and liabilities was fixed at NIS 621 million, subject to adjustments.

On June 19, 2007, the transaction was consummated following the fulfillment of qualifying conditions in accordance with the sale agreement.

Concurrently with the consummation of the transaction, agreements were signed between the Bank and subsidiaries of Clal Insurance for the distribution, operation and services to members.

The sold provident funds are: Tamar, Gefen, General Severance Pay Fund, Shikma, Eshkolot, Toar, Hadas Central Severance Pay Fund and Edmond de Rothschild Discount Overseas.

The consideration paid to the Bank with respect to the assigned rights and liabilities, net adjustments as agreed between the parties, amounted to NIS 607 million.

As stated, the net gain to the Bank from the sale of the provident fund activity amounted to NIS 394 million and was recognized under "Net income from extraordinary items, net of taxes" in the financial statements as of June 30, 2007.

For further details, see Note 11 to the condensed financial statements.

The sale of KAHAL. On May 26, 2006, the Bank, Bank Leumi Le'Israel B.M., KAHAL – Employee Training Fund Ltd. (hereinafter – "KAHAL") and KAHAL Training Fund Management (1996) Ltd. (hereinafter – "KAHAL Management"), entered into an agreement with Migdal Capital Markets (1965) Ltd. on behalf of a company controlled by it and Migdal Insurance Holding and Finance Ltd. on behalf of a company controlled by it (hereinafter – "the Purchaser") for the sale of goodwill, management rights, additional rights and the means of control of the banks in KAHAL, and for the sale of goodwill, operations, assets and liabilities connected to the training funds managed by KAHAL Management, everything in consideration of an amount of NIS 264 million, subject to adjustments.

The Bank's share of the consideration amount to approximately NIS 114 million.

The transaction was consummated on July 15, 2007, after all conditions for its execution had been fulfilled, in accordance with the terms of the sale agreement.

At consummation date, agreements were signed between the Bank, KAHAL and Migdal Gemel Platinum Ltd., whereby the Bank will distribute the training funds sold as well as other provident funds under their control, in consideration for a distribution fee as stated in the Regulations. The Bank will also provide services to members of the sold training funds.

The Bank estimates that the net gain to be derived from this transaction may reach approximately NIS 73 million, and it would be recognized in the third quarter of 2007.

(For additional details see Note 19 C 20 to the financial statements as of December 31, 2006 pp. 358-359, and Note 12 to the condensed financial statements).

Preparations towards pension consulting. In the second quarter of 2007 the Bank continued preparations towards providing pension consulting to its customers.

The preparations are at a comprehensive level in the Bank as a whole including, inter alia, recruitment and training of professional personnel in the pension consulting field, construction of computerized systems that will support the consulting and distribution of pension products, and signing distribution agreements with manufacturers of pension products, all in accordance with the strategic and business importance of the pension consulting field to the Discount Group.

Concurrently, the Bank is in the process of finalizing all required legal conditions for entry into the pension consulting field, and expects to obtain a license and to commence activity in the pension consulting field immediately after compliance with all preliminary statutory conditions. The Bank believes that the license would be granted by the end of 2007. The above is considered a forward-looking information, based upon the Bank's assessments as of date of issue of the report, based, inter-alia, on the timing of completion of the preparations for providing pension consultation, and the period of time required for obtaining the required regulatory approvals for the completion of the sale of the control in the provident fund activity of Mercantile Discount Bank.

The main material condition requiring Bank compliance is finalization of sale of control of the mutual fund activity of Mercantile Discount Bank. In 2007 the Bank finalized following steps required by law: the sale of the mutual fund activity and the sale of the Bank's part in "Kahal" as detailed above. This follows the completion of the Bank's sale of its holdings in Ilanot Discount and Harel.

It should be noted in this respect that on March 11, 2007, the Ministers Committee on Legislation decided to support a private Bill "Law Proposal for the Supervision of Financial Services (Engaging in Pension Consultancy and Pension Marketing) (Amendment – Encouragement of Competition in the Banking and Pension Consultancy Fields), 2007", according to which banking corporations having an equity not exceeding NIS 10 billion (including the Bank) shall be given preference by way of deferment of the date on which the large banks would be entitled to engage in pension consultancy.

On July 20, 2007, the Commissioner of Capital Market, Insurance and Savings in the Ministry of Finance informed that an agreement with Bank Hapoalim was reached, according to which Bank Hapoalim will be authorized to provide pension consulting to salaried employees in another three years, i.e. as from August 1, 2010. Until the said date, and following, Bank Hapoalim's preparations, including finalization of sale of its provident funds, Bank Hapoalim will be authorized to provide pension consulting to self-employed customers (that are not salaried employees), to customers up to the age of 18 (minors that saved in provident funds) and to customers age 55 years or more that are not salaried employees, and as long that they are not salaried employees (mainly early retirees who do not work).

In the framework of the said agreement, the Supervisor announced that the Treasury department will initiate, during 2007, proposed government legislation that will enable banks to provide consulting regarding life assurance products (as defined in the Pension Consulting Law), and to collect in respect of such products distribution commissions equivalent to distribution commissions in respect of mutual fund and pension products. It has been announced accordingly, that the Ministry of Finance intends to include, within the framework of the Economic Arrangements Law for 2008, an amendment of this nature to the Law and Regulations.

In contrast, a private Bill was tabled by several members of the Knesset, whereby the authority of the

Commissioner is to be limited as would be the discretion granted to him, thereby enabling a delay in the entry of the large banks into the pension consulting market.
For further details see the Annual Report for 2006 (pp.128-129) and Note 2 to the condensed financial statements.

CHANGES IN CAPITAL MARKET ACTIVITY OF MERCANTILE DISCOUNT BANK

Preparation for pension advisory services. Mercantile Discount Bank started preparations for entry into the pension advisory services market. As part of these preparations, Mercantile Discount Bank trained some 35 investment consultants to engage in this field, and at the same time applied to the Commissioner of the Capital Market, Insurance and Savings for a license to engage in pension consulting. According to understandings reached with the Commissioner of the Capital Market, Insurance and Savings, Mercantile Discount Bank, would be permitted to engage in pension advisory services in the interim period (until August 2011), on condition that it does not control a provident fund management company.
In view of the said understandings, Mercantile Discount Bank (hereinafter – "Mercantile") entered into an agreement on July 30, 2007, whereby Mercantile together with its subsidiary will sell the control (51%) in the provident fund activities of Mercantile to a group of investors (most of whom foreign residents) headed by Mr. Isaac Sitton, in consideration for NIS 79 million, subject to adjustments. This amount reflects a rate of 4.25% of the volume of assets amounting to NIS 3.7 billion, managed by the provident funds of Mercantile.
The remaining share in this activity (49%) will be sold by Mercantile to the purchasers in August 2011, at the latest (hereinafter – "the final realization date"), at a price to be derived mainly from a rate of 4.25% of the volume of the assets of the provident funds and from the average rate of management fees in effect at the above date.
Within the framework of the agreement, the purchasers granted Mercantile two option, as follows:

- An option for an early realization of the remainder of the activities at a price to be derived from the price determined for the final realization date, subject to adjustments. Notwithstanding, the realization price will be reduced at rates of between 15% and 20% if Mercantile decides to exercise this option during the first two years following the consummation of the transaction.
- An option to continue holding up to 10% of the activity even after the final realization date, which comprises the maximum rate of holdings permitted by Law to a pension consultant. In the event that Mercantile would decide to exercise this option, the price payable at the final realization date will be reduced accordingly.

Consummation of the transaction is subject to certain regulatory approvals, including approvals by the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance as well as the Commissioner of Restrictive Trade Practices.
The expected net gain (after tax) from the first stage of the transaction amounts to approximately NIS 50 million, subject to adjustments. The gain will be recognized in the quarter in which the transaction is consummated. Additional gains are expected to be recognized upon the exercise of the option.
Global management of investments. In July 2007, Mercantile Discount Bank and its partners established Mercantile- Goldhar Global Investment Management Ltd., a company to engage in global investment management for institutional and private customers. Mercantile Discount Bank will hold 51% of the equity in the new company, and the remaining shares will be held by the partners. The company has not yet started operations.
For further details regarding the operations in the capital market, see the Annual Report for 2006 (pp. 122-131).

CONSTRUCTION AND REAL ESTATE ACTIVITY

This activity includes customers of the Bank's various divisions whose industry classification is construction and real estate. This activity also includes customers of the construction and real estate segment of the Mercantile Discount Bank, and the loans for the purchase or building of commercial property segment at Discount Mortgage Bank and the building project finance segment at Discount Mortgage Bank.

DEVELOPMENTS IN MARKETS OF ACTIVITY

Stability was noted in the activity of the real estate sector during the first half of 2007. The volume of investments in housing construction declined alongside the increase in investments in construction other than housing and infrastructure.

Positive developments in most of the sectors, which began already at the beginning of 2006, continued further during the first half of 2007.

Residential construction. Demand for residential housing by young couples and those wishing to improve their housing continued to grow, mostly in demand areas in the center of the country and in the periphery. The increase in sale of luxury apartments continued, these comprise 10% of all apartments sold, mainly in Jerusalem and in Tel-Aviv and mostly to foreign residents. The increase in demand which was not supported by a similar increase in supply resulted in price increases, the luxury apartment segment recording considerable price increases.

Rental property for offices. Stability is noted in prices of quality office space in demand areas in Tel-Aviv and the center of the country, this following a price increase trend noted as from 2005.

Rental property for commercial use. The increase in the purchase of shopping malls by private investors and institutional entities continued, mainly in cheap commercial centers of the "power center' type, which was followed by a rise in prices and a decline in returns.

Real estate activity abroad. Acceleration is noted in the expansion of income generating and entrepreneurial real estate activities abroad, mainly in the field of residential and commercial construction in central, Eastern and Western Europe, India and China, due to the investments characterized by high rates of profitability and return on capital.

Estimates for 2007 indicate a moderate increase in the scope of investments in real estate, at a rate of 2% - 3%, which will be reflected in the residential construction sector and in other construction activity.

Directions of developments in the sector:

- Continued increase in demand for inexpensive commercial centers, which will be accompanied by increase in prices and decrease in return on investments.
- Continued increase in prices of new apartments, mainly in areas of demand in the center of the country, as a result of stability in inventories of apartments for sale, increase in demand on a background of increase in available income, decrease in interest on housing loans, increase in construction price indices and strengthening of the Israeli currency.

These data constitute estimates that may not be realized in the event of a decrease in the level of domestic demand as a result of worsening in the security – political situation, moderation of the economic growth rate in Israel and/or in global markets, material increase in interest rates worldwide and domestically, and other macro-economic developments that are not under the Bank's control.

SCALE OF OPERATIONS AND NET INCOME

Business activity continued to expand in the first half of 2007, which was reflected in the granting of new credit facilities for the purchase of land and project financing for housing projects in demand areas in the center of the country and in the periphery, in line with the Bank's policy. An increase is noticed in the granting of credit facilities to Israeli companies operating abroad, the credit granted serving the expansion of their activity in the income generating and entrepreneurial real estate field.

Net income from operations in the first half of 2007 amounted to NIS 98 million, compared with NIS 63 million in the corresponding period last year, an increase of 55.6%

Disregarding the effect of certain components (see hereunder), the income from these operations would have amounted to NIS 101 million compared with NIS 65 million in the corresponding period last year, an increase of 55.4%.

Provision for doubtful debts in the first half of 2007 and totalled NIS 63 million, similar to the corresponding period last year.

Following are the principal data relating to the construction and real estate operations (in NIS millions):

	Domestic operations				International operatins			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the three months ended June 30, 2007							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	18	179	28	225	6	185	191	416
- Intersegmental	(1)	(94)	(18)	(113)	-	(140)	(140)	(253)
Total income from financial activity	17	85	10	112	6	45	51	163
Operating and other income	4	6	1	11	2	-	2	13
Total Income	21	91	11	123	8	45	53	176
Provision for doubtful debts	8	47	6	61	-	3	3	64
Net income	7	13	4	24	3	18	21	45
Net income disregading certain components*	6	13	2	21	3	21	24	45

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

The principal data relating to the construction and real estate operations (in NIS millions) (continued):

	Domestic operations				International operatins			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the three months ended June 30, 2006							
Income (loss) from financing activities before provision for doubtful debts	15	68	9	92	4	22	26	118
Operating and other income	2	3	9	14	-	(2)	(2)	12
Total Income	17	71	18	106	4	20	24	130
Provision for doubtful debts	4	12	5	21	1	(5)	(4)	17
Net income	4	29	4	37	-	-	-	37
Net income disregading certain components*	4	28	2	34	-	7	7	41

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the six months ended June 30, 2007							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	37	265	42	344	11	195	206	550
- Intersegmental	(5)	(123)	(18)	(146)	-	(125)	(125)	(271)
Total income from financial activity	32	142	24	198	11	70	81	279
Operating and other income	8	11	4	23	3	5	8	31
Total Income	40	153	28	221	14	75	89	310
Provision for doubtful debts	10	39	9	58	1	4	5	63
Net income	15	47	11	73	5	20	25	98
Net income disregading certain components*	15	48	10	73	5	23	28	101

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the six months ended June 30, 2006							
Income from financing activities before provision for doubtful debts	28	128	16	172	7	45	52	224
Operating and other income	6	9	11	26	-	-	-	26
Total Income	34	137	27	198	7	45	52	250
Provision for doubtful debts	7	47	8	62	1	-	1	63
Net income	12	31	7	50	1	2	3	53
Net income disregading certain components*	13	36	6	55	1	9	10	65

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

For further details regarding the construction and real estate activity, see the Annual Report for 2006 (pp. 132-136).

MORTGAGE AND HOUSING LOAN ACTIVITY

CUSTOMERS

This activity includes mortgage operations of the Discount Group in Israel (Mercantile Discount Bank and Discount Mortgage Bank). This segment includes the granting of loans for housing purposes (purchase, construction etc.) and the granting of business loans and loans for any purpose secured by a mortgage on a residential apartment or other property.

SECTORS OF OPERATION

Loans for the purchase or building of housing units. Loans for the purchase or building of housing units (by private individuals). The loans are generally granted to private individuals (households). These loans constitute most of the activity in the mortgage loan field.

Multi purpose loans secured by a mortgage on a housing unit. These loans are granted not in the course of purchasing or building of a housing unit but by using it as collateral. Discount Mortgage Bank offers house owners whose property is free of a mortgage or with a relatively low mortgage loan compared to the value of the property, to use the property as collateral for raising funds for use of the household, similarly to the conduct of business entities.

Providing services to the State. Discount Mortgage Bank provides entitled individuals, credit and grants out of State funds according to guidelines of the Ministry of Construction and Housing and the Accountant General at the Ministry of Finance. The volume of this activity is diminishing due to the policy of the Finance Ministry to has reduced the scope and advantage of the loans to entitled individuals.

In recent years, the Accountant General has reduced the commission paid to the banks for handling loans to entitled individuals. The said reduction caused the commission income of the Group in respect of new loans from State funds to become immaterial. The agreement between Discount Mortgage Bank and the Ministry of Finance as regards loans to entitled individuals was to expire on June 30, 2007. In May 2007, the Ministry of Finance informed in a letter of the extension of the agreement for an additional year, up to June 30, 2008.

Issuance of rental grants to entitled recipients of State budget funds, in accordance with guidelines issued by the Ministry of Housing and by the Accountant General in the Ministry of Finance, were implemented in the past by mortgage banks, including Discount Mortgage Bank, and were terminated in June 2006 according to a Ministry of Finance directive.

Discount Mortgage Bank’s income from commissions for the above mentioned services amounted to NIS 1.4 million in the first six months of 2006.

Mortgage related insurance. As an additional security for credit granted by Discount Mortgage Bank, this bank requires its customers to purchase property insurance and in some of the cases life insurance.

For many years, Discount Mortgage Bank offered its customers to purchase insurance by means of that bank, serving as an insurance broker for this purpose. The customer could choose using the services of that bank or of any other insurance agent. As of January 1, 2006, Discount Mortgage Bank no longer offers the sale of these insurance schemes as a broker. Discount Mortgage Bank continues to maintain the existing customer insurance portfolio.

Discount Mortgage Bank formed a subsidiary, **Discount Mortgage Home Insurance Agency (2005) Ltd.,** which acts as an insurance broker. This subsidiary operates independently and sells insurance through a telephone service separate from that bank’s telephone service. Discount Mortgage Bank believes that this subsidiary will show operating losses in the first years of operation.

In the first half of 2007, the insurance agency recorded a loss in the amount of NIS 218 thousand.

Some of the information given in this section is "forward-looking information". As to the meaning of this term, see above in the Section "forward-looking information".

SCALE OF OPERATIONS AND NET INCOME

Net income of the segment in the first half of 2007 amounted to NIS 20 million, similar to the corresponding period last year and compared with NIS 19 million, a decrease of 5.3%.

Disregarding the effect of certain components (see hereunder), the segment's income for the period would have amounted to NIS 20 million, similar to the corresponding period last year.

Provision for doubtful debts amounted in the first half of 2007 to NIS 10 million, compared with NIS 16 million in the corresponding period last year, a decrease of 62.5%.

Following are the principal data relating to the mortgage and housing loan operations (in NIS millions):

	Domestic operations			
	Households	Small Businesses	Middle Market Banking	Total
	For the three months ended June 30, 2007			
Income (loss) from financing activities before provision for doubtful debts				
- From externals	46	6	13	65
- Intersegmental	(16)	(2)	(8)	(26)
Total income from financial activity	30	4	5	39
Operating and other income	11	-	-	11
Total Income	41	4	5	50
Provision for doubtful debts	1	1	3	5
Net income	10	1	1	12
Net income disregading certain components*	10	1	1	12

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	For the three months ended June 30, 2006			
Income from financing activities before provision for doubtful debts	30	4	3	37
Operating and other income	13	-	-	13
Total Income	43	4	3	50
Provision for doubtful debts	2	1	1	4
Net income	9	1	1	11
Net income disregading certain components*	9	1	1	11

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

The principal data relating to the mortgage and housing loan operations (in NIS millions) (continued):

	Domestic operations			
	Households	Small Businesses	Middle Market Banking	Total
	For the six months ended June 30, 2007			
Income (loss) from financing activities before provision for doubtful debts				
- From externals	84	14	17	115
- Intersegmental	(25)	(3)	(11)	(39)
Total income from financial activity	59	11	6	76
Operating and other income	22	1	1	24
Total Income	81	12	7	100
Provision for doubtful debts	4	4	2	10
Net income	15	2	3	20
Net income disregading certain components*	15	2	3	20

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary and expenses in respect of early retirement incentive.

	Households	Small Businesses	Middle Market Banking	Total
	For the six months ended June 30, 2006			
Income from financing activities before provision for doubtful debts	67	12	5	84
Operating and other income	25	1	-	26
Total Income	92	13	5	110
Provision for doubtful debts	10	2	4	16
Net income	16	3	-	19
Net income disregading certain components*	17	3	-	20

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses and the profit from the sale of Ilanot Discount.

LEGISLATIVE RESTRICTIONS

Restriction on the credit concentration in a particular segment. Proper Banking Management Directives require an additional provision in respect of credit concentration as regards housing loans, in the event that the balance of housing loans in respect of which a provision, based on the extent of default, has been recorded, net of such a provision, exceeds 1.5% of the total balance of housing loans. As of June 30, 2007, the said rate at Discount Mortgage Bank amounted to 2.7%, and the provision required in this respect amounted to NIS 3 million.

MARKETING OF MORTGAGE PRODUCTS

Discount Mortgage Bank serves its customers through four branches (in Jerusalem, Haifa, the Diamond Exchange in Ramat Gan and Modi'in) and through 56 counters located inside branches of Israel Discount Bank Ltd, or in their vicinity.

In 2007, Discount Mortgage Bank intends to continue to increase the number of counters.

Discount Mortgage Bank engages in the marketing and advertising of its many and varied products, customizing them to the changing requirements of the public, to changing economic conditions and to market trends.

Discount Mortgage Bank operates a call center that enables customers to receive an approval in principle for the granting of loans. It is the intention of Discount Mortgage Bank to expand this service turning it into a gateway to the bank for all customer applications. This expansion began in 2006 and is continuing in 2007.

"Subsidized mortgage". In July 2007, the Bank launched a campaign for the marketing of mortgages at attractive interest rates for customers complying with predetermined conditions. The objective of this campaign is to attract new customers and maintain long-standing customers.

The benefit in the interest channels is granted to both new and existing customers transferring to their account at Discount Bank a monthly income of NIS 4,000 and over, or who hold high deposit amounts with the Bank.

The marketing campaign was successful and resulted in a material increase in the scope of mortgage underwriting of Discount Mortgage Bank.

For further details regarding the mortgage and housing loan activity, see the Annual Report for 2006 (pp. 136-139).

INTERNATIONAL OPERATIONS

GENERAL

Discount Group's overseas operations are carried out primarily by the Bank's subsidiaries in the United States, South America (including the Bank's representative offices) and Switzerland, and by means of the Bank's branch in the U.K. The international operations are characterized by commercial business activity and by private banking.

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in the first half of 2007 amounted to NIS 36 million, compared with a loss of NIS 33 million in the corresponding period last year.

Disregarding the effect of certain components (see hereunder), the segment's income would have amounted to NIS 50 million, compared with NIS 28 million in the corresponding period last year, an increase of 78.6%.

Provision for doubtful debts amounted to NIS 22 million in the first half of 2007, compared with NIS 2 million in the corresponding period last year.

Following are the principal data relating to the international operations (in NIS millions) :

	Households	Corporate Banking	Middle Market Banking	Private Banking	Financial Management	Total
	For the three months ended June 30, 2007					
Income (loss) from financing activities before provision for doubtful debts						
- From externals	2	195	259	(681)	368	143
- Intersegmental	-	(141)	(131)	735	(463)	-
Total income from financial activity	2	54	128	54	(95)	143
Operating and other income	-	9	13	18	(4)	36
Total Income	2	63	141	72	(99)	179
Provision for doubtful debts	-	2	6	3	3	14
Net income (loss)	1	19	47	19	(76)	10
Net income (loss) disregading certain components*	1	22	52	19	(74)	20

* The following components have been disregarded: Gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	Households	Corporate Banking	Middle Market Banking	Private Banking	Financial Management	Total
	For the three months ended June 30, 2006					
Income (loss) from financing activities before provision for doubtful debts	1	51	64	50	(2)	164
Operating and other income	-	8	(15)	48	(69)	(28)
Total Income	1	59	49	98	(71)	136
Provision for doubtful debts	-	(2)	(14)	4	(1)	(13)
Net income (loss)	1	36	(9)	27	(140)	(85)
Net income (loss) disregading certain components*	1	40	26	41	(134)	(26)

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount and the cost of implementing improvements and examinations in IDB New York.

The principal data relating to the international operations (in NIS millions) (continued):

	Households	Corporate Banking	Middle Market Banking	Private Banking	Financial Management	Total
	For the six months ended June 30, 2007					
Income (loss) from financing activities before provision for doubtful debts						
- From externals	3	210	310	(602)	446	367
- Intersegmental	-	(124)	(109)	701	(468)	-
Total income from financial activity	3	86	201	99	(22)	367
Operating and other income	-	11	25	31	2	69
Total Income	3	97	226	130	(20)	436
Provision for doubtful debts	-	5	9	4	4	22
Net income (loss)	1	26	43	15	(49)	36
Net income (loss) disregading certain components*	1	29	50	16	(46)	50

* The following components have been disregarded: Gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	Households	Corporate Banking	Middle Market Banking	Private Banking	Financial Management	Total
	For the six months ended June 30, 2006					
Income (loss) from financing activities before provision for doubtful debts	1	75	160	108	49	393
Operating and other income	-	12	1	70	(74)	9
Total Income	1	87	161	178	(25)	402
Provision for doubtful debts	-	2	-	-	-	2
Net income (loss)	1	39	4	41	(118)	(33)
Net income (loss) disregading certain components*	1	43	41	55	(112)	28

* The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, and the cost of implementing improvements and examinations in IDB New York.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS

The principal restrictions applicable to these operations are briefly described below:

Exposure restriction with regard to overseas offices. In accordance with the terms of a regulatory letter sent by the Supervisor of Banks, a restriction exists with respect to the extent of the exposure of the Bank in relation to the operations of its overseas offices.

In the past, the maximum exposure rate for overseas offices was 30%. In May 2001, the Supervisor of Banks increased the maximum exposure rate to 32%.

As of June 30, 2007, the calculated rate of exposure of the Bank with respect to overseas offices was 38.75%, as compared with 36.95% on December 31, 2006.

It should be noted that in the regulatory letter from the Bank of Israel, a sanction in the event of deviation from the imposed limitation was not determined. The Bank reviews developments in the calculated rate of exposure regarding its activity at the overseas extensions at monthly intervals.

For additional details regarding this limitation, see the Annual Report for 2006 (pp. 141-142).

For details regarding an investigation that was conducted in the United States with respect to matters related to the Prohibition of Money Laundering Regulations and its impact upon IDB New York, see under “Main Investee Companies” hereunder and Note 3 to the condensed financial statements.

TARGETS AND BUSINESS STRATEGY

Switzerland. The Bank initiated an expansion of its operations in Switzerland, either directly and/or through Discount Bank (Switzerland), by way of acquiring a local corporation engaged in the banking field.

The due diligence review of a local corporation, as abovesaid, has been completed. The Bank is conducting negotiations towards the signing of an agreement for the acquisition of the shares. The completion of the transaction is, among other things, subject to obtaining the necessary approvals and to the signing of an agreement.

London. The approval of the regulatory authorities in the U.K. has been received several months ago, according to which, the London branch would be permitted to expand its activity in the field of private banking, including investment advisory services for customers, investment portfolio management, etc.

IDB New York. In 2006, the Board of Directors of IDB New York approved, inter alia, the following:

- Change in organizational structure, in the framework of which IDB Capital (a wholly-owned subsidiary of IDB New York) will be transferred to Bancorp’s ownership; the said transaction was postponed at this stage.
- Reorganization of the Latin American representatives, through change in the nature of these ofices from client management activity for holders of accounts in the United States to selling and marketing activity for all Israel Discount Group companies under the authority of IDB New York.

For further details regarding the “International Operations”, see the Annual Report for 2006 (pp. 141-146).

MAIN INVESTEE COMPANIES

The total contribution of both domestic and overseas investee companies to the net results of the Bank amounted to NIS 366 million in the first half of 2007, compared with NIS 112 million in the corresponding period last year, and NIS 223 million in all of 2006.

Disregarding the effect of the hedge of the investment in overseas subsidiaries, net of tax effect, the contribution of both domestic and overseas investees to the net results of the Bank in the first half of 2007 would have been NIS 303 million, compared with NIS 163 million in the corresponding period last year, and NIS 346 million in all of 2006.

Sale of principal investee companies. In 2006, within the framework of the preparations for the capital market activity in the post Bachar Commission era, the Bank sold holdings in its two principal investee companies: Ilanot Discount and Harel. For further details see the Annual Report for 2006 (p. 148) and Notes 6 E and H to the financial statements as of December 31, 2006, respectively (pp. 305-306, and p. 308-309).

Following are the major developments in the Bank's main investee companies.

DISCOUNT BANCORP, INC.

Discount Bancorp, Inc. ("Bancorp") is fully owned by the Bank. Bancorp and controls Israel Discount Bank of New York (IDB New York).

Pursuant to Bancorp's Certificate of Incorporation and By-Laws, IDB New York may not be sold by Bancorp unless the Bank has given its prior written consent thereto. A legend to this effect appears on the share certificate of IDB New York.

Total assets at June 30, 2007 amounted to US$8,906 million, compared with US$8,822 million at the end of 2006, an increase of 1.0%.

The decrease in assets in IDB New York is derived from a decrease in IDB New York's investment activity in debentures, as a result of changes in the interest curve, which reduced the margin on this activity in excess of the cost of the deposits mobilized from financial institutions. Part of the deposits utilized to finance the investments was redeemed concurrently with the decrease in investments.

Total credit at June 30, 2007, was US$3,424 million, compared with US$3,120 million at the end of 2006, an increase of 10.0%.

Total deposits stood at US$6,674 million as at June 30, 2007, compared with US$6,937 million at the end of 2006, an increase of 3.8%.

Net income for the first half of 2007 totalled US$14 million, compared with US$9 million in the corresponding period last year, an increase of 55.6% and compared with US$28 million in all of 2006.

Shareholders' equity totalled US$596 million at June 30, 2007, compared with US$582 million at the end of 2006.

The ratio of capital to risk assets was 10.9% as at June 30, 2007, compared with 11.88% at December 31, 2006.

Return on equity reached an annualized rate of 5.21% in the first half of 2007, compared with 3.41% in the corresponding period last year and compared with a rate of 5.1% in all of 2006.

The contribution of the Bank's investment in Bancorp to the net results of the Bank was an income of NIS 82 million in the first half of 2007 (after deducting a provision for tax of NIS 9 million), compared with a loss of NIS 81 million (after deducting a provision for tax of NIS 8 million) in the corresponding period last year.

The said contribution is comprised of Bancorp's net income in the first half of 2007 (after deducting the provision for tax) of NIS 69 million with the addition of real term exchange rate differentials on the investment of NIS 13 million, compared with net income of NIS 10 million (after deducting a provision for tax) and deducting the addition of negative real term exchange rate differentials on the investment of NIS 91 million in the corresponding period last year.

Together with exchange rate differentials on the said investment, the Bank in Israel recorded financing expenses in the first half of 2007 in respect of the surplus foreign currency liabilities that the Bank created as hedge for the investment in Bancorp.

IDB New York continues to be the largest Israeli bank operating overseas.

Investigation regarding prohibition on money laundering. In 2005, the New York County District Attorney's Office conducted investigations in several banks and financial institutions regarding their compliance with requirements relating to money laundering legislation and transfer of funds from Brazil to the United States. In the framework of these investigations, IDB New York was also examined. To the best of the Bank's knowledge, the investigation findings ascertained that IDB New York did not act in accordance with regulations relating to the prohibition on money laundering, did not properly document customer details and decision regarding suspicious activity, did not report thereon as required and did not formulate an appropriate compliance program in connection with money laundering. Also, the audit findings ascertained that most of the deficiencies disclosed were ascertained in previous audits by the supervisory authorities. Concurrently, a regular examination was conducted in IDB New York in cooperation with the Banking Department of the State of New York and the FDIC (Federal Deposit Insurance Corporation), in which extensive deficiencies were ascertained regarding the effectiveness of the reporting and controls relating to the prohibition on money laundering (AML) and prevention of financing of terror activity.

Cease and Desist orders. As a result of the above-mentioned findings, the Banking Department of the State of New York and the FDIC (together – "the supervisory authorities") issued cease and desist orders according to which IDB New York was required to cease its activity according to existing defective procedures, to amend the defects and deficiencies, to expand the supervisory and control procedures, to formulate an enforcement program and to amend the procedures in this regard, all according to instructions and as of dates determined by the supervisory authorities ("the cease and desist orders").

The cease and desist orders include, inter alia, the following:

(1) The Board of Directors of IDB New York will appoint an outside entity that will examine the activity implemented by senior management to amend the defects and deficiencies ascertained in previous audits;

(2) A comprehensive program will be formulated, adopted and implemented that will ensure compliance with the provisions of the legislation and regulations regarding the prohibition on money laundering and prevention of financing terror; the program will take into consideration, inter alia, systems of controls, training programs, audit plan and appointment of an officer who will bear responsibility for compliance with the said legislation and regulations, including through the preparation of a report on examination of gaps and implementation of a "look-back" review as detailed below;

(3) A compliance committee will be appointed composed of directors in IDB New York, which will supervise implementation of the cease and desist orders;

(4) IDB New York will be subject to a payment that will not exceed US$ 16.5 million, payable to the Banking

Department of the State of New York, to the FDIC and to FinCen (Financial Crimes Enforcement Network). The total said amount was set aside in 2005.

On December 15, 2005, IDB New York confirmed its agreement to operate in accordance with the requirements of the cease and desist orders. The Bank, as the parent company of IDB New York, declared its awareness of the above-mentioned arrangements and committed to act insofar as possible to ensure fulfillment of the above-mentioned liabilities.

Concurrently and additionally, on December 15, 2005 I.D.B. New York reached a compromise arrangement with the District Attorney for the State of New York regarding cessation of his investigation. According to the arrangement, IDB New York committed to cooperate with the District Attorney. In addition, IDB New York confirmed its recognition of the facts regarding certain accounts and its awareness that certain internal controls, procedures and treatment regarding the prohibition on money laundering contributed to the findings of the District Attorney and the supervisory authorities. According to the conditions of the agreement, IDB New York committed to pay US$ 8.5 million and to report to the District Attorney within one year regarding all measures implemented to improve the bank's procedures and to amend the defects and deficiencies that were ascertained by the District Attorney and by the supervisory authorities as detailed in the cease and desist orders; such reporting was implemented as required. The total said amount was set aside in 2005. The District Attorney of the State of New York agreed to refrain from indicting IDB New York and its related parties regarding the investigation.

In consequence of this report, the Board of Directors of IDB New York decided to appoint a sub-committee to discuss the recommendation of the report concerning the performance of the Board of Directors. The committee of the Board of Directors has discussed the recommendations of the report in as far as they relate to the activities of the Board, and has prepared an analysis of the measures that had been and will be taken. The analysis was presented to the Board on its December 2006 meeting. Management of IDB New York was also required by the Board of Directors to present to the Board a detailed program for the implementation of the recommendations of the report.

Changes in composition of management and Board of Directors of IDB New York. On February 6, 2006 the Board of Directors of the Bank decided to recommend to the Board of Directors of IDB New York to appoint Mr. Reuven Spiegel as President and CEO of IDB New York, in place of Mr. Arie Sheer. On February 23, 2006, the Board of Directors of IDB New York decided to terminate the appointment of Mr. Arie Sheer and to appoint Mr. Reuven Spiegel as President and CEO of IDB New York (for details regarding a claim submitted by Mr. Sheer, see "Additional legal processes to which the Bank is a party" in the annual report for 2006, pp. 205-207). During 2006 all senior management and members of the Board of Directors of IDB New York were replaced.

Implementation of commitments stated in cease and desist orders. Management of IDB New York commenced immediately after issuance of the cease and desist orders to implement the commitments stated in the cease and desist orders and in the agreement for cooperation with the District Attorney, and such implementation continues in accordance with the timetable fixed. IDB New York is required to act on three levels: (a) preparation and formulation of a comprehensive program for enforcement and implementation of the cease and desist orders (for this purpose, KPMG was engaged to prepare for IDB New York a gap report); (b) examination of activity of senior management regarding implementation of previous audit findings. For this purpose, the services of Promontory (a company providing financial consulting services, one of its specialized areas is providing solutions to customers facing regulatory demands) were engaged; and (c) examination of all transactions in IDB New York between the years 2002 – 2005 (Look back) in order to ascertain any suspect activity that, as such, requires reporting.

Promontory report. On April 5, 2006, the Promontory report was transmitted to IDB New York, including a summary of the examination findings. The report details the circumstances, defects and deficiencies that resulted, according to the report's preparers, in issuance of the cease and desist orders and the District Attorney's examination. The report also includes recommendations for required improvements and changes in order to avoid similar defects and deficiencies in the future. According to the report, most of the recommendations have been implemented by IDB New York. Almost all of the defects and deficiencies included in the report constitute reporting and supervisory/control deficiencies derived, in part, from the defective internal communications and defective communications with the authorities, some of which derive from an organizational structure that requires change (such change has already been implemented) and some of which derive, as stated, from weak supervisory and control tools. IDB New York believes that addressing all the recommendations will be completed by the end of the third quarter of 2007.

The internal audit function of IDB New York is responsible for supervision of the activity implemented in order to improve the required procedures in accordance with the Promontory report. As of the date of publication of the financial statements, more than 94% of the recommendations included in the comprehensive enforcement program and in the Promontory report, were implemented.

KPMG report. The gap report examines IDB New York's compliance with regulations relating to the prohibition on money laundering and financing of terror, and recommends actions for IDB New York to implement in order to comply with these regulations.

The report was transmitted to the supervisory authorities in August 2006 and, according to IDB New York, all recommendations included in the report, including replacement of the computer system, will be implemented toward the end of 2007.

"Look Back" review. IDB New York identified 5.2 million transfers in the years 2002 – 2005, of which legal doubt exists regarding 12.5 thousand transfers. In order to determine the transfers regarding which retroactive reporting is required to the supervisory authorities, the bank engaged the services of a consulting and investigation company that prepared a methodology document in this regard, which was transmitted to the supervisory authorities in September 2006. In December 2006 the supervisory authorities informed IDB New York that the methodology document appears reasonable. Accordingly, implementation of the "look back" review commenced and as of the date of preparation of the financial statements the review continues; according to IDB New York completion of the review is expected in the third quarter of 2007.

Material weakness in internal controls in 2005 reports. According to information transmitted to the Bank, at the audit committee meeting at which the financial statements of IDB New York as of December 31, 2005 were approved, management of IDB New York reported that material weaknesses in internal controls were identified, which relate to compliance with the Bank Secrecy Act ("BSA") and the Anti-Money Laundering Act ("AML").

In order to implement appropriate supervision regarding controls relating to the BSA and AML, IDB New York appointed a compliance committee composed of three outside directors, and appointed a new BSA and AML officer. The committee reports monthly to the Board of Directors, and formulated rules for the committee's activity and defined responsibilities of the BSA and AML officer.

On February 7, 2006 the Board of Directors approved the compliance program relating to BSA/AML issues and distributed the program on February 23, 2006 to all IDB New York employees. The new BSA/AML officer commenced his responsibilities on January 16, 2006, and also serves on the compliance committee and reports to the Board of Directors, to the audit committee and to the General Manager.

Material weaknesses in internal controls on financial reporting for 2005. In the framework of IDB New York's reporting in accordance with Federal Deposits Insurance Corporation Improvement Act (FDICIA) regulations, the new management of IDB New York which was appointed after transfer of the control in the bank, reported that it identified material weaknesses in internal controls on financial reporting as of December 31, 2005, and that these weaknesses relate to the cease and desist orders issued by the supervisory authorities in the United States in December 2005.

IDB New York's auditors announced that the material weaknesses identified do not affect their unqualified opinion on the financial statements as of December 31, 2005, which was issued on March 20, 2006, and that the said weaknesses were taken into account in determining the required scope of the audit of the financial statements for 2005.

Lack of material weaknesses in internal controls on financial reporting for 2006. According to information transmitted to the Bank, at the audit committee meeting at which the financial statements of IDB New York as of December 31, 2006 were approved, management of IDB New York reported that no material weaknesses in internal controls were identified and that all material weaknesses identified in 2005 were amended.

Examination in Discount Bank Latin America ("DBLA"). As a result of the above-mentioned examinations by the authorities of IDB New York, in December 2005 an examination was implemented in DBLA by the Central Bank of Uruguay.

As a result of the examination, a penalty in the amount of US$ 41,000 was levied on DBLA and recommendations were transmitted for the arrangement of its activity: procedures for reporting on suspect transactions, installation of a computer system to locate and warn regarding suspect transactions, improvement of documentation and retention of customer data and closing DBLA representatives in Argentina, Brazil, Mexico and Peru. As a result of the examination, DBLA engaged the services of KPMG to formulate a program to improve preparations for implementation of regulations regarding the prohibition on money laundering. Most of the recommendations have already been implemented. The representative offices have been subordinated to IDB New York.

Costs. The financial statements as of December 31, 2005 include a provision in the amount of NIS 120 million in respect of penalties and consulting. The cost of implementation of the improvements and examinations amounted to US$16.1 million in 2006 and to an additional US$7 million in the first half of 2007. According to IDB New York, additional costs will be incurred during 2007 for implementation of improvements and examinations in an amount between US$3 million – US$5 million. These data constitute a forward-looking information, based on assumptions and estimates available to management of IDB New York as of the date of publication of the financial statements. The expected cost may change, inter alia, in accordance with the required scope of the "look back review" – the number of monetary transfers that may arouse doubt regarding their legality and on which reporting will be required to the supervisory authorities.

The Bank believes that the said investigation and the cease and desist orders described above had no significant effect on the business of IDB New York, over and above the increase in expenses and the reduction in earnings for 2006, resulting from the fines imposed on IDB New York and the expenses incurred in correcting the deficiencies. The Bank estimates, in view of the measures taken to correct the deficiencies, that the possible exposure with respect to the investigation and the cease and desist orders described above is low.

Developments in 2007. At the beginning of 2007, in the framework of the "look back review", it was ascertained that several accounts managed in IDB New York belonged to Iranian residents and that several transfers were implemented from accounts managed in IDB New York to Iranian residents. IDB New York informed the United

States Office of Terror Assets Control (OFAC) and engaged outside consultants to examine the issue. According to independent legal counsel engaged in this regard, the maximum penalty that may be levied on IDB New York in this regard may amount to US$1 million. The financial statements of IDB New York include a provision in accordance with the estimate of management of IDB New York.

In January 2007 IDB New York requested from an outside legal consultant that consults to the bank regarding regulatory issues ("the outside legal counsel") to prepare an examination regarding transactions implemented between IDB New York and Mr. Matthew Bronfman, a controlling shareholder in the bank and in related parties thereto. The examination was intended to ascertain that these transactions received all required approvals according to the law applying in the United States as transactions with a controlling shareholder and to provide recommendations regarding these transactions specifically, and regarding the issue in general. On February 23, 2007 the outside legal counsel prepared a draft report (hereinafter: "the draft report") that included consideration in respect of several transactions, including the transactions detailed in Note 22 I and J to the financial statements as of December 31, 2006 (p. 378).

The draft report was transmitted for comments to several entities, including the previous chairman of the Board of Directors of IDB New York, Mr. Leonard Grunstein. To the best of the bank's knowledge, Mr. Grunstein has certain criticisms regarding the draft report, including arguments regarding the unfair influence of IDB New York's management on the report's preparers. These arguments were passed on to an American legal firm for examination, as detailed above.

In February 2007 the outside legal counsel drew the attention of the members of the Board of Directors of IDB New York to their responsibility for supervision of the relationships between the shareholders and their representatives on the Board of Directors of IDB New York, in order to ensure that IDB New York does not impair the advancement of implementation of the cease and desist orders because of disputes between the shareholders.

On April 1, 2007, the Board of Directors of the Bank held a discussion regarding IDB New York. At the meeting, the following subjects were discussed:

(1) Recommendation to the controlling shareholders in the Bank or their representatives to refrain from serving as directors in IDB New York and in Bancorp.

The above-mentioned recommendation was accepted for the good of the Israel Discount Bank Group, including companies in which controlling shareholders or their representatives serve as directors. In the opinion of the Board of Directors of the Bank, participation of controlling shareholders and their representatives creates difficulties in the functioning of the Board of Directors and management of IDB New York.

(2) To set up an ad hoc committee authorized to request at its discretion and receive reports with respect to IDB New York and to Bancorp, including with respect to all transactions and agreements made by these companies not in the ordinary course of business, and to provide recommendations in this respect to the Board of Directors. Within this framework, the committee was authorized to examine the engagements entered into as mentioned in the draft examination report regarding Discount Bancorp and IDB New York, the arguments raised by Mr. Grunstein as part of his response to the draft report as well as other matters, among which is the engagement with the law office in which Mr. Grunstein is a partner, for providing legal services, and the engagement of IDB New York with Ms. Alexandra Lowenthal, who at that time served as a member of the board of directors of IDB New York, for her employment as president and CEO of IDB Capital Corp., a wholly owned subsidiary of IDB New York (hereinafter: "the investigated transactions").

(3) To instruct the Bank's internal auditor to conduct a special examination, not as part of the internal audit work plan in IDB New York, and to report his findings to the Board.

Following the said resolutions, the committee and the Bank's Board of Directors acted as follows:

(1) Upon receipt of the recommendation of the Board by the controlling shareholders and their representatives that they are not to act as Directors in IDB New York and in Bancrp, they informed Mr. Matthew Bronfman, who served as Chairman of Discount Bancorp and as a director in IDB New York, and Mr. Michael Rubinoff, who served as a director in IDB New York, that they will terminate their participation as directors in Israel Discount Bank Group companies.

Mr. Grunstein, who served at the same time as Chairman of IDB New York and as a director in Discount Bancorp, informed the Bank that he is not prepared to accept the said recommendation, and detailed reasons for his announcement. Also, for the good of the Discount Group, the Board of Directors decided at its meeting on April 13, 2007 to terminate Mr. Grunstein's service as a director in Discount Group companies.

(2) The committee held several meetings and among other things requested a legal opinion from an independent New York Counsel regarding the US law applying to the investigated transactions and provided guidelines to the independent Counsel engaged by the Bank to examine the arguments raised by Mr. Len Grunstein regarding the examination report (see above). Furthermore, the committee received reports from the internal auditor of the Bank regarding his audit findings in New York and among other things, has guided him to examine the activity of the Board of Directors of IDB New York and its committees.

(3) Among other things, the committee began discussing the manner in which the Bank, as the controlling shareholder of IDB New York and Bancorp, supervised the investigated transactions in particular, and the way in which transactions of this kind are approved generally, and the recommended manner in which such transactions are to be approved, supervised and controlled in the future. In this matter, the committee has requested an opinion from a leading legal Counsel, who among other things was engaged by the Bank to recommend an all inclusive company governance plan for the Group.

(4) On July 2, 2007, the report of the special examination performed by the Bank's Internal Auditor in Discount Bancorp and IDBNY was submitted to the Committee. The report's findings indicate, among other things, deficiencies at Bancorp and IDBNY concerning the procedures for approval of transactions with "related parties" and the lack of procedures in this respect.

(5) In July 2007 a report of the examination of a U.S. legal firm, which was engaged to examine the arguments of the former IDB Chairman, Mr. Len Grunstein, as raised in his response to the draft audit report, was submitted to the committee and the Board of Directors. The examination report ascertained that Mr. Grunstein's arguments have no basis.

(6) On August 2, 2007 a draft report of the examination of a U.S. legal firm, which was engaged to examine the transactions regarding which the committee was appointed, inter alia, from the standpoint of United States legislation. At this stage, the draft examination report does not include conclusions and recommendations. The committee has not yet completed its discussion of the draft findings.

(7) On August 2, 2007 the committee recommended to the Board of Directors to adopt the principles and procedures stated in the legal opinion submitted by a well-known legal expert, according to which approval procedures required by Israeli legislation regarding transactions between interested parties in the bank and the Bank would be applied to transactions between an interested party in the Bank and between Bancorp and

I.D.B. New York. The said recommendations are subject to the possibility of their application under the US laws applying to Bancorp and IDB New York.

It should be noted that the said legal opinion is part of Discount Bank Group's overall program of "company governance" currently being prepared (see "Company Governance Code" under "Miscellaneous" hereunder).

MERCANTILE DISCOUNT BANK LTD.

Mercantile Discount Bank Ltd. ("Mercantile Discount") is a wholly-owned subsidiary of the Bank.

Total assets at June 30, 2007 amounted to NIS 18,360 million, compared with NIS 17,280 million at the end of 2006, an increase of 6.3%.

Total credit granted to the public at June 30, 2007 was NIS 12,957 million, compared with NIS 12,646 million at the end of 2006, an increase of 2.5%.

Total deposits from the public at June 30, 2007 amounted to NIS 15,585 million, compared with NIS 14,484 million at the end of 2006, an increase of 7.6%.

Shareholders' equity at June 30, 2007 amounted to NIS 1,260 million, compared with NIS 1,160 million at the end of 2006, an increase of 8.6%.

The ratio of capital to risk assets was 12.7% as at June 30, 2007, similar to December 31, 2006.

Net income was NIS 88 million in the first half of 2007, compared with NIS 22 million in the corresponding period last year, and increase of 300%.

The results reported in the first half of 2006 resulted from the bonus granted by Mercantile Discount Bank to its employees and from the accounting treatment of the related part of the bonus paid by the State to employees of Mercantile Discount Bank (see – "The accounting treatment of the Employee Agreement", in Note 32 D to the financial statements as of December 31, 2006, p. 406-407) (hereinafter, together – "the privatization bonus"). Disregarding the effect of the privatization bonus, net earnings for the first half of 2006 would have reached NIS 55 million.

The improvement in the business results of Mercantile Discount Bank stems also from an increase in the income from operating income before provision for doubtful debts (an increase of NIS 18 million compared with the corresponding period last year, a decrease in the provision for doubtful debts (a decrease of NIS 16 million compared with the corresponding period last year) and an increase in operating and other income (an increase of NIS 25 million compared with the corresponding period last year).

Net earnings for the second quarter of 2007 amounted to NIS 44 million, compared with an amount of NIS 46 million in the corresponding period last year, a decrease of 4.3%.

Return on shareholders' equity in the first half of 2007 reached an annualized rate of 15.2%, compared with a rate of 4.2% in the corresponding period last year, and 5.6% in all of 2006. Disregarding the effect of the privatization bonus, the return on equity in the first half of 2006 would have reached an annualized rate of 10.6%.

Concerning a request to approve an action against Mercantile Discount Bank as a class action suit for unlawfully hiking up the price of securities, see Note 5.1 to the condensed financial statements and Note 19 C articles 14.2 and 15.1 to the financial statements as of December 31, 2006 (p. 349 and pp. 350-351)

For details regarding the third party notice submitted by Arab bank, see Note 5.8 to the condensed financial statements.

Investigation of suspected violations of the Prohibition of Money Laundering Law. For details regarding

Investigation of suspected violations of the Prohibition of Money Laundering Law, see pp. 153-154 to the financial statements as of December 31, 2006. To best of the Bank's and Mercantile Discount Bank's knowledge, the Public Prosecution, up to this point, has decided to file an indictment against only one of the former employees of the branch (who was already suspended from office during the course of the investigation).

DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank is a subsidiary of the Bank. As of June 30, 2007, the Bank held 100.0% of its equity and of its voting rights, this following a full purchase offer for the shares of Discount Mortgage Bank (see hereunder and in Note 9 to the condensed interim financial statements).

Total assets at June 30, 2007 amounted to NIS 10,111.1 million, compared with NIS 10,464.2 million at the end of 2006, a decrease of 3.4%.

Total credit granted to the public amounted at June 30, 2007 to NIS 9,786.9 million, compared with NIS 9,854.1 million at the end of 2006, a decline of 0.7%.

Shareholders' equity amounted to NIS 862.3 million at June 30, 2007, compared with NIS 844.5 million at the end of 2006, a rise of 2.1%.

The ratio of capital to risk assets was 12.3% as at June 30, 2007, compared with 12.2% as at December 2006.

Net income totalled NIS 17.8 million in the first half of 2007, compared with NIS 28.2 million in the corresponding period last year, and NIS 35.3 million in all of 2006.

Return on shareholders' equity in the first half of 2007 reached an annualized rate of 4.2%, compared with 7.0% in the corresponding period last year, and a 4.3% in all of 2006.

The Bank's share in the net income of Discount Mortgage Bank in the first half of 2007 totalled NIS 14.6 million, compared with NIS 18.2 million in the corresponding period last year, and NIS 23 million in all of 2006.

Full purchase offer for the shares of Discount Mortgage Bank. On March 14, 2007, the Bank published a full purchase offer for the shares of Discount Mortgage Bank held by the public, namely, 460,735 ordinary shares of NIS 1 par value each, comprising 34.93% of the issued and fully paid up share capital and of the voting rights in this Discount Mortgage Bank. According to the purchase offer, holders of the shares were invited to sell their shares to the Bank at a price of NIS 575 per share, under terms detailed in the purchase offer published by the Bank, this until April 30, 2007 (hereinafter: "last date of acceptance"). The total consideration in respect of these shares at the above stated price amounted to NIS 256 million.

The Bank's obligation to purchase the shares in terms of the purchase offer was conditional upon obtaining the following approvals: (a) A permit by the Governor of Bank of Israel under Section 34 of the Banking Law (Licensing), according to which the Bank is entitled to obtain complete control over Discount Mortgage Bank; (b) Approval by the Commissioner of Restrictive Trade Practices, to the extent that such an approval is indeed required.

The Bank has obtained all the approvals required for the purchase of the shares in accordance with the purchase offer. The obligation of the Bank was conditional upon the receipt of acceptance notices for at least 394,777 shares (hereinafter – "the minimum acceptance rate").

On April 29, 2007, the Bank amended the said purchase offer, increasing the price per share in the purchase offer from NIS 575 to NIS 665 per share, and deferred the last date of acceptance to May 3, 2007. Accordingly, the total consideration in respect of the shares was increased to NIS 306 million.

Acceptance notices for 415,532 shares were received by May 3, 2007, comprising 31.5% of the equity and of voting rights in Discount Mortgage Bank. Accordingly, the forced purchase provision in the purchase offer under section 337(a) of the Companies Law 1999 came into effect. Such forced purchase was made on May 7, 2007, thereby the Bank reached 100% holdings in the equity and voting of Discount Mortgage Bank.
On May 9, 2007 the shares of Discount Mortgage Bank Ltd. were removed from trade on the Tel Aviv Stock Exchange.
For details of the contingencies relating to the Discount Mortgage Bank Ltd. see Note 19 C 15.9 to the financial statements as of December 31, 2006 (p. 350 and p. 353) and Note 5.6 to the condensed financial statements in the matter of charging commissions in respect of life insurance and property insurance of borrowers and in the matter of insuring property for amounts exceeding its reinstatement value, and Note 5.9 to the condensed financial statements in the matter of an alleged damage caused by the realization of guarantees.

FIRST INTERNATIONAL BANK OF ISRAEL LTD.

The First International Bank of Israel Ltd. ("FIBI") is an affiliated company of the Bank. As of June 30, 2007, the Bank held 26.4% of its share capital and 11.1% of its voting rights.
The Bank's share in the net income of FIBI Bank in the first half of 2007 totalled NIS 78 million, compared with NIS 75 million in the corresponding period last year.
Return on shareholders' equity in the first half of 2007 reached an annualized rate of 12.5%, compared with a rate of 13.7% in the corresponding period last year, and a rate of 11.5% in all of 2006.
The ratio of capital to risk assets was 11.1% as at June 30, 2007, compared with a rate of 10.1% at the end of 2006.
Rights issue by FIBI. In an immediate report dated March 13, 2007, FIBI informed of the decision of its Board of Directors to take action towards the increase of the share capital of the bank by means of a rights issue for shares and/or issue of rights for other securities intended to improve its capital structure. These rights are to be offered to all the shareholders of the bank, and are to include a possible benefit component in relation to the price of the shares on the market.
It should be noted that in view of the capital structure of the bank, and in view of the provisions of the Securities Law, FIBI is entitled to issue and list for trading on the Stock Exchange only shares and/or rights for shares of NIS 0.01 par value each, which are the class of shares having preferred voting rights. The recommendation of management of FIBI is to prepare for a capital raising of between NIS 500 and NIS 700 million.
FIBI noted that there is no certainty that the issuance and/or issuances would in fact be carried out, and if so, their structure and/or the amount that would be raised thereby, may change.
In an immediate report dated March 28, 2007, FIBI reported the filing of a draft Prospectus for the offering of rights to shares of the bank of NIS 0.01 par value each to all the shareholders of the bank.
Prior to the above notice, the controlling shareholder of FIBI informed the President and CEO of the Bank that it is the intention of FIBI publish a rights issue Prospectus, despite the fact that the Bank might be adversely affected as a result thereof.
Following the said notice, the Bank, through its representative, submitted to FIBI a demand that no action should be taken which might be detrimental to the Bank and the only purpose of which is to benefit the controlling shareholder of FIBI.
Concurrently, the Bank has reached an agreement with the Bank of Israel, the details of which are as follows:

The Bank will acquire (subject to approval of its authorized organs) the full amount of the shares offered to it according to the Prospectus as a shareholder of FIBI; the Bank shall deposit with a trustee, the identity of whom and instructions given to him are to be agreed upon with the Supervisor of Banks, that part of the shares to be acquired by it under the Prospectus, which would result in a higher rate of holdings in the equity of FIBI than the rate of holdings immediately prior to the publication of the Prospectus (hereinafter: "the excess holdings") and for a period not to exceed 18 months; the Bank shall refrain from exercising the voting rights attached to the excess holdings at general meetings of shareholders of FIBI; the rights of the Bank regarding the appointment of Directors of the First International bank will not be changed; after exercising the rights as detailed above, the Bank intends to negotiate with FIBI and its controlling shareholders in order to examine various suggestions and scenarios, among which are suggestions regarding the capital structure of FIBI and the Bank's holdings therein; in the event that the said move is not successful and if at the end of one year from date of exercise of the rights by the bank a scenario acceptable to Bank of Israel is not found, whether regarding the excess holdings or regarding the holdings of FIBI, then, after the Bank has been given a fair opportunity to bring its arguments before the Bank of Israel, the Bank shall dispose of all the excess holdings, all this subject to maintaining the Bank's right in FIBI, to the extent relevant to its ability to represent the investment in FIBI by the equity method in the Bank's financial statements, including everything relating thereto, and in accordance with the instructions to be included in the trust letter.

On May 3, 2007, the bank informed FIBI of the arrangement reached with the Bank of Israel, stating that the arrangement is not final, being subject to certain conditions. The Bank's representative requested that FIBI should clarify that it would not hinder the Bank from exercising the rights in the manner acceptable to the Bank of Israel. In his response, the representative for FIBI requested the Bank on May 9, 2007, to provide him with the details of the arrangement. On May 15, 2007, the Bank's representative repeated the request that FIBI inform of its acceptance of the position of the Bank of Israel and should clarify that it has no intention of preventing the exercise of the Bank's right to acquire shares in FIBI, in a manner acceptable to the Bank of Israel. The Bank's representative added that the absence of a response constitutes evasion.

On May 22, 2007, details of the said arrangement with the Bank of Israel were submitted orally to representatives of FIBI. On May 24, 2007, at about 18:00 a letter was sent to FIBI stating the details of the abovesaid arrangement. The Bank's representative emphasized in this letter that withholding the response to the Bank's demand constitutes the absence of good faith on FIBI's part and the violation of the duties towards the Bank as a shareholder.

On May 24, 2007 FIBI published a shelf prospectus for issuance of shares of NIS 0.01 par value, and options, through allocation of rights or through a public issuance. Concurrently, FIBI published an immediate report stating that no certainty exists that the said issuances will actually be implemented.

On July 5, 2005, the Bank of Israel confirmed that the said arrangement will also apply to several rights offerings according to the shelf Prospectus published by FIBI, subject to certain conditions. The wording of the trust agreement and the identity of the trustee were also confirmed.

Under the circumstances, the Bank is considering the possibility of instituting legal proceedings against FIBI claiming, inter-alia, that the only purpose of such action is to benefit the controlling shareholder, being discrimination against the rights of the Bank as a minority shareholder and abuse of the power of the controlling shareholder of FIBI, and as such requires the necessary approvals.

Concurrently, deliberations are conducted between the parties, the results of which, at this stage, are uncertain regarding the possibility of reaching any agreement.
For additional details see Note 10 to the condensed financial statements.
For details regarding certain legal actions filed against FIBI in the matter of life insurance and property insurance commissions and regarding requests to approve them as class actions, see Note 19 C 16 to the financial statements as of December 31, 2006 (pp. 356) and Note 6 to the condensed financial statements.

ISRAEL CREDIT CARDS LTD. (ICC)

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of June 30, 2007, the Bank owned 71.8% of the equity and 79.0% of the voting rights in ICC, the remainder of the shares held by the First International Bank of Israel (for details as to the acquisition of additional means of control in ICC, see Note 34 A to the financial statements as of December 31, 2006 (pp. 415-416) and Note 13 to the condensed financial statements). ICC issues and operates "VISA", "Diners" and "MasterCard" credit cards.
Total assets at June 30, 2007 amounted to NIS 6,168 million, compared with NIS 6,148 million at the end of 2006, an increase of 0.3%.
Total shareholders' equity at June 30, 2007 amounted to NIS 425 million, compared with NIS 335 million at the end of 2006, an increase of 26.9%.
The ratio of equity to risk assets at June 30, 2007, was 13.5%, compared with 11.3% at the end of 2006.
Total revenues amounted in the first half of 2007 to NIS 455 million, compared with NIS 386 million in the corresponding period last year, an increase of 17.9%.
Net income amounted, in the first half of 2007, to NIS 90 million, compared with NIS 61 million in the corresponding period last year, an increase of 47.5%.
Return on equity reached an annualized rate of 54.1% in the first half of 2007, compared with 40.5% in the corresponding period last year and a rate of 38.5% in all of 2006.
The Bank's share in the net earnings of ICC in the first half of 2007 amounted to NIS 42 million, compared with NIS 26 million in the corresponding period last year.
Acquisition of ICC shares held by Harel. On March 1, 2007 the Bank and FIBI entered into a transaction to acquire the shares of ICC held by Harel (5%) according to their proportionate share in ICC. The price of the transaction was the same as the price determined in the transaction for the sale to the Bank and to FIBI of the ICC shares held by Fishman. The basic consideration with respect to the shares to be purchased by the bank was fixed at NIS 48.7 million. The additional consideration based on the results of ICC for 2006, was fixed at NIS 4.4 million. The basic consideration and the additional consideration have been deposited in a trust account in the name of Harel. On May 1, 2007, the said transaction was completed.
Following the completion of the acquisition of the Harel shares in ICC, the Bank holds 71.8% in the equity and 79.0% in the voting rights in ICC, while FIBI holds 28.2% in the equity and 21.0% in the voting rights in ICC.
As for details regarding changes in arrangements concerning the credit card field in Israel, see Note 34 C to the financial statements as of December 31, 2006 (p. 417-420).

ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

Israel Discount Capital Market and Investments Ltd. ("DCMI"), a wholly owned and controlled consolidated subsidiary of the Bank, is engaged in the underwriting and management of public offerings of securities (through a subsidiary), in investment banking and in investment in venture capital funds, together with foreign institutional entities.

Total assets as at June 30, 2007 amounted to NIS 355 million, compared with NIS 240 million at the end of 2006, an increase of 47.9%.

Net income in the first half of 2007 amounted to NIS 19 million, compared of NIS 7 million in the first half of 2006, an increase of 171.4%.

Return on equity in the first half of 2007 reached an annualized rate of 25.3%, compared with a rate of 11.5% in the corresponding period last year.

Contribution of the Bank's investment in Israel Discount Capital Markets and Investments to the Bank's results amounted in the first half of 2007 to NIS 2.7 million, compared to NIS 6.6 million in the corresponding period of the previous year (difference between net income of Israel Discount Capital Markets and Investments Ltd and between its contribution to the Bank's results is derived from differences in implementation of generally accepted accounting principles).

In July and August 2007, two funds in which DCMI invests realized two portfolio companies. The proceeds in respect of these realizations are expected to amount to US$5.5 million and the gain is expected to amount to US$1.7 million, which will be recorded in the third quarter of 2007.

In the first half of 2007 DCMI participated through a subsidiary in 12 public offering, totaling NIS 4.3 billion and in 2 private offerings totaling NIS 0.7 billion.

This is in contrast to 12 public offerings totaling NIS 1.5 million and 4 private offerings toalling NIS 0.4 billion in the same period last year.

As to an indictment filed against DCMI and two of its former employees, and the decision of the Court to acquit them of the charges. For details regarding a request for disclosure of documents submitted by Arab Bank against IDB New York, against Mercantile Discount Bank and against the Bank, see Note 5.10 to the condensed financial statements see Note 19 C 15.10 to the financial statements as of December 31, 2006 (p. 355).

COMPLETION OF THE SALE OF A CONTROLLING INTEREST IN THE BANK

On January 31, 2006, the transaction signed on February 1, 2005 and entered into by M.I. Holdings Ltd. and the Government of Israel (hereinafter – "the Government") on the one hand, and a corporation controlled by the Bronfman Family and others and a corporation controlled by Mr. Rubin Schron (hereinafter together – "the Purchasers") on the other hand, for the sale of a controlling interest in the Bank was completed, whereby:

- The Purchasers are to acquire shares in the Bank comprising 26% of its issued share capital;
- The Purchasers were granted an option for a period of three years from date of the transaction, to acquire further shares comprising an additional 25% of the issued share capital of the Bank;
- Arrangements have been made between the Government and the Purchasers as to the coordination of their voting and of their exercise of control of the Bank.

Following the closing of the transaction, as above, control of the Bank has passed to the Bronfman-Schron Group.

For additional details see under “Control of the Bank” in 2006 Annual Report (pp. 170-189), including: “Entities in possession of Bank shares” (pp. 170-172); “Sale of a controlling interest in the Bank” (pp. 172-173); “The Governor of the Bank of Israel permit for the control and holding of means of control in the Bank (pp. 173-176); “Arrangements with regard to cooperation between the buyers and the Government, in respect of holding shares of the Bank and excercising the control in the Bank” (pp. 177-179); “Arrangements between the members of the Bronfman-Schron Group” (pp. 180-182); “Credit Agreement” (pp. 182-183).

GOVERNMENT DECISIONS REGARDING THE BANKING SYSTEM AND CHANGES IN THE CAPITAL MARKET STRUCTURE

For details regarding Government decisions regarding the banking system and changes in the capital market structure, see Note 2 to the condensed financial statements and Note 33 to the financial statements as of December 31, 2006 (pp. 407-415).

LABOR RELATIONS

The Bank’s Management is conducting separate negotiations, with the clerks and managers committees, at their request, regarding the wage agreements for 2007, while raising demands relevant to each such group.

LEGISLATION AND SUPERVISION

GENERAL

The Bank operates within the framework of Laws, Regulations and Directives, certain of which are exclusive to the banking industry, and others, though even not exclusive as above, do have an effect on certain sections of its operations.

The Banking Ordinance, various banking laws and the proper banking management directives issued from time to time by the Supervisor of Banks, constitute the central legal basis for the operations of the Bank Group.

These, among other things, define the limits of the operations of the Bank, the permitted operations of subsidiaries and companies related to the bank and the terms for owning and controlling them, the relations between the Bank and its customers, the use made of assets of the Bank, and the mode of reporting to the Supervisor of Banks and the public as to the Bank’s said operations.

Alongside these, the Bank is subject to a wide legislation that regulates its capital market operations both on behalf of customers an on its own behalf (for example: investment and customer portfolio management consulting, mutual investments funds, the overall activities of provident funds, securities laws and restrictions on insurance business activity).

Additional legislation as regards special subjects imposes on banks, including the Bank, specific duties and rules. Thus for instance, the legislation relating to the prohibition of money laundering and the prohibition of financing of terror activities, the credit data law, legislating relating to housing loans, guarantees, etc.

In addition legislation exists, which because of its connection to the operations of the Bank, has a considerable implication on the way the Bank is being managed. In this respect it should be mentioned, among other things, the debt execution laws, liquidation and receivership laws, laws relating to specific economic sectors (local authorities, mortgagees, the agricultural sector) and various tax laws.

Following is a summary of legislation changes and relevant legislation initiatives during the reported period, which affect or might have a significant effect on the operations of the Bank.
For further details regarding legislative initiatives, see "Legislation and supervision" in the Annual Report of 2006 (pp. 190-199).

REFORM IN THE STRUCTURE OF THE ISRAELI CAPITAL MARKET AND IN THE ACTIVITY OF THE BANKS AND OTHER PLAYERS IN THE CAPITAL MARKET FIELD

Towards the end of 2004, the Government adopted the recommendations of the inter-office committee, headed by the Director General of the Ministry of Finance (the Bachar Committee) and in the course of 2005, the legislation designated to carry out the Government's decisions in these areas was formed and approved. This concluded in fact the legislation work intended to formulate arrangements in various areas relating to the activity of the banking industry, as to which decisions were taken by the Government as early as 1993.
In August 2005, three comprehensive laws were published relating to the activity of the banks and other players in the capital market. Regulations and various principles designated at complementing the arrangements by way of secondary legislation were published later on in 2005 and during 2006 and 2007.
The new legislation is designed to bring about a change in structure of the capital market and in the role of the banking industry therein. Banks are required, within a transition period as determined in the legislation, to discontinue their present form activity in the field of provident and mutual funds, and to transfer the management and ownership thereof to other capital market players, thereby turning into consultants in the capital market and pension fields, who do not have a direct interest in the products that are being sold to their customers. Within the framework of the new legislation, the provident fund industry has been regularized for the first time by primary legislation, and a new law was passed regarding the pension industry, dealing with pension consultancy and marketing.
For a condensed review of the principle changes in legislation and their implications, see Note 33 to the financial statements as of December 31, 2006 (pp. 407-415) and Note 2 to the condensed financial statements.

LEGISLATION AND ARRANGEMENTS REGARDING BANKING COMMISSIONS

In recent years various matters pertaining to commissions charged by banks appeared on the public agenda, including their rates, types, the disclosure given to customers with regards thereof and supervision thereof. In this respect, a large number of private bills have been tabled before the Knesset, concerning limiting the ability to increase commission rates, limiting the total income from commissions, prohibiting charging commissions in respect of certain services and more, a bill proposing the establishment of a Fair Trade Authority which will be responsible for various matters, including the regulation of bank-customer relations, as well as a proposal presented by various entities for the imposition of controls and more. The matter was also examined by various professional teams who have submitted their recommendations thereon.
Parliamentary inquiry commission. During 2006, the matter of banking commissions was discussed from time to time, and a parliamentary inquiry commission was appointed at the beginning of 2007 to examine all aspects thereof. The inquiry commission finalized its discussions on June 12, 2007, and submitted a draft report.
The commission recommended the reduction in the number of bank charges and the transfer of the supervisory authority over prices of bank services to the Bank of Israel, which would be authorized to establish a uniform tariff

for all banks with respect to a limited number of bank charges applying to household and small business bank transactions. Alternatively, it was recommended to establish a voluntary arrangement between the Union of Banks and the Supervisor of Banks with a view to make the authority to be granted to the Supervisor of Banks to fix bank charges redundant. In addition, the commission recommended increasing the awareness of bank customers to the option of transferring their accounts from one bank to another, with a view of encouraging competition.

The draft report also includes recommendations for the adoption of a policy for increasing in the banking market by way of development of an off-banking capital market, instituting structural reforms in the banking market intended to reduce the market power of banks, mainly in the retail segment, and the lowering of regulatory entry barriers for new banks, both local and foreign.

In addition, the report includes recommendations regarding the regulatory reform of banks, within the framework of which it is recommended to examine a reform of the supervision over financial brokerage in Israel, including the establishment of one financial authority that would be entrusted with all regulatory and enforcement powers applying to the capital and banking markets.

Most of the commission's recommendations were in fact incorporated within the context of Amendment No.12 to the Banking Law (Customer Service), as detailed below. Notwithstanding, it is not clear at this stage if the recommendations of the inquiry commission will have further implications.

Amendment of the Banking Law (Customer Service). The Amendment of the Banking Law (Customer Service) in the matter of bank charges was issued at the beginning of July 2007. This Amendment grants the Governor of the Bank of Israel and the Supervisor of Banks extensive supervisory authority regarding the prices of bank services as well as the authority to determine a list of bank services in respect of which banks would be entitled to collect charges and the manner of their computation ("Tariffs").

The supervisory authority as regards prices of banking services in this respect replaces the supervisory authority of the Controller of Prices at the Ministry of Industry and Trade. The supervisory authority applies to all bank customers and not only to a particular sector.

The Governor is entitled to declare certain services as subject to price control if one of the causes determined in the Law applies (such as a service that is obtainable only at the banking corporation at which the account is maintained, an essential service that public interest requires its control, the charges in respect of the service might reduce competition between banks). It should be mentioned that the list of causes is not final and under certain circumstances, the Governor may add additional control causes.

The manner of supervising the price of a service already declared as "under supervision", is by determining the charge in its respect, determining the amount or the maximum rate of the charge or by forbidding a charge in its respect.

An increase in the price of a service already declared as "under supervision" requires the submission of a reasoned application to the Supervisor of Banks for the approval thereof. An increase in the price of a service which is not "under supervision" requires a prior notice to the Supervisor of Banks.

The authority to determine the Tariffs, which is mainly intended to reduce the number of bank charges and to make them better understood and comparable, applies to private customers as well as to business corporations (as determined by the Governor in Regulations to be issued, considering their business turnover).

Following consultation with the Consulting Commission, the Governor will issue the "Full Tariff List" to include a list of services in respect of which a bank may collect charges, as well as the manner of their computation (whether a rate of charge or a fixed amount). The Governor may instruct that "Narrow Tariff List" be derived from the “Full Tariff List”, in accordance with the type of service. In the Regulations to be issued, the Governor will also state the manner in which customers should be informed of the tariffs.

A banking corporation shall not be entitled to collect a charge from its customers unless it is in respect of a service appearing in the tariffs. A banking corporation may apply to the Supervisor to add a service to the tariff list (the Supervisor has the discretion whether to consent to the application, whether to subject it to certain condition or to refuse it).

As part of the Rules fixing the tariffs, the Governor is to ensure that the charges would be fairly and clearly presented to customers in a manner that would make them comparable.

The Governor may determine types of services to which the tariffs would not apply (such as securities operations etc.).

The quarterly reports issued until now by banking corporations to their customers regarding the amounts of charges collected from them with respect to principal services, will now apply to all charges, though now it will be issued semi-annually instead of quarterly.

The Law regarding price control is effective immediately from date of publication thereof in the Official Gazette (namely, July 5, 2007).

The semi-annual reporting of all charges is to begin on January 1, 2008.

The Bank of Israel was given a period of three months in which to set the tariffs, which period may be extended by three additional months (by application to the Knesset Economics Committee). Banking corporations were granted a preparatory period of three months from the date the tariffs are determined. This period may also be extended by three additional months by application to the Supervisor of Banks and with the approval of the Knesset Economics Committee.

On July 9, 2007, the Supervisor distributed to the banks an initial draft of the tariffs as part of determining the banking service directives. The draft includes less than one hundred types of services in respect of which charges may be collected as well as a proposal for discerning types of banking operations justifying the collection of charges. Negotiations are presently conducted between the banks and the Supervisor with respect to the tariffs draft.

The Bank believes that this process will adversely affect the income of the Bank from operating commissions, though at this stage it is not possible to assess the loss or quantify its effects.

AMENDMENT OF THE EXECUTION LAW.

On April 1, 2007, the amendment to the Execution Law came into effect, which enables the submission of claims in a determined amount of less than NIS 50 thousand, directly to the Bailiff’s Office, without having to file a claim with the Court and obtain judgment, which subsequently is submitted for execution to the Bailiff’s Office. The Bank believes that this amendment will make the handling of small claims against debtors more efficient, will expedite debt collection and will reduce the cost of handling such claims.

To the Bank’s best knowledge, the Bailiff Offices are not yet equipped with the required computerized systems to handle the said claims, but the proposal of the Ministry of Justice to postpone the effective date of this amendment for an additional period was not acceptable to the Knesset Legislation Committee.

For further details see “Retails sector – Household segment”, in the section “Activities of the Group according to principal segments of operation”.

AMENDMENT TO THE PROHIBITION OF MONEY LAUNDERING LAW

In July 2007, a Bill for the amendment of the Prohibition of Money Laundering Law was published and passed its first reading by the Knesset. Various amendments are included in the Bill, among which, expansion of the list of original offences, changes in the existing arrangement regarding immunity of the identity of the reporting entity (in a manner that might disclose the identity of a bank employee who submitted the report on the transaction), the addition of various segments as reporting entities and the broadening of the authority of the Prohibition of Money Laundering Authority.

"PRINCIPLES OF CONDUCT" DOCUMENT

Continued holding and joint activity of Automatic Bank Services Ltd. ("ABS"). On June 19, 2002 the Commissioner of Restrictive Trade Practices informed the banks that he authorizes them to operate within the framework of ABS subject to the provisions determined by him. The above mentioned exemption was due to expire in June 2007. On June 21, 2007, the Commissioner extended the term of the exemption for an additional period of three months, during which all the changes that had taken place in the relevant fields for the exemption application are to be reviewed.

The continued holding and joint activity of the Bank Clearing Center ("BCC"). On June 19, 2002, the Commissioner of Restrictive Trade Practices informed the shareholders of BCC (five banks including the Bank) of his approval of their joint holding of BCC, subject to the provisions determined by him.

The above mentioned exemption was due to expire in June 2007. On June 21, 2007, the Commissioner extended the term of the exemption for an additional period of three months, during which all the changes that had taken place in the relevant fields for the exemption application are to be reviewed.

For additional details see the Annual Report for 2006 (pp. 196-198).

CRITICAL ACCOUNTING POLICIES

The financial statements of the Bank are prepared according to generally accepted accounting principles (summarized in Note 1 to the financial statements as of December 31, 2006 and Note 1 to the condensed financial statements) and according to instructions and guidelines of the Supervisor of Banks.

The level of regulation regarding the financial reporting of banking corporations is among the highest in the financial reporting field in Israel. The instructions and guidelines of the Supervisor of Banks are comprehensive, detailed and at times even dictate the wording to be used by banking corporations. Nonetheless, there are areas where application of the accounting policy involves a high level of evaluation and assessment performed by management of the banking corporation in the course of preparing of the financial statements.

Application by management of the accounting principles and the instructions and guidelines of the Supervisor of Banks, sometimes requires various assumptions, evaluations and assessments that affect the reported amounts of assets and liabilities, including contingent liabilities, as well as the financial results reported by the Bank. It is possible that when the evaluations and assessments materialize in the future, their results may be different than those anticipated at the time the financial statements were prepared.

Certain of the evaluations and assessments applied involve uncertainty or sensitivity to various variables to a large extent. Such evaluations and assessments, changes in which might have a considerable effect on the reported financial results, are considered evaluations and assessments of "critical" matters.

Management believes that the evaluations and assessments used in the preparation of the financial statements are fair and were made in accordance with the best of its knowledge and professional judgment.

A summary review of evaluations and assessments made regarding "critical" matters is included in the Annual Report for 2006 (pp. 199-205).

THE INTERNAL AUDIT IN THE GROUP

Details regarding the internal audit in the Group, including the professional standards according to which the internal audit operates, the annual work programs and the considerations at its basis were included in the 2006 Annual Report (pp. 215-217).

The annual report for 2006 was submitted on March 11, 2007 and discussed by the audit committee of the board on April 26, 2007. During the second quarter of 2007 the following reports were submitted and discussed: The report for the first quarter of 2007 was submitted on May 2, 2007, and discussed by the audit committee of the board on June 26, 2007. The report for the second quarter of 2007 was submitted on August 8, 2007, and has not yet been brought up for discussion.

LEGAL PROCEEDINGS

As for details regarding "Outstanding claims against the Bank", "Debt collection procedures", and "Additional legal proceedings to which the Bank is a party" see the Annual Report of 2006 (pp. 205-207).

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN THE SECOND QUARTER OF 2007

On November 1, 2004, an action was filed with the Court in Los Angeles against the Bank and others for the payment of damages in the sum of US$350 million as well as a plea for punitive damages against the Bank as the Court will determine.

The plaintiff alleged that the Bank has breached explicit undertakings towards it for the granting of a credit line in the amount of US$3 million. The plaintiff alleged that due to the said breach of undertakings, the Bank brought about its demise and caused it heavy losses estimated at amount in excess of US$350 million.

On February 18, 2005, the Bank submitted to the Court in Los Angeles, a petition requesting that the claim be dismissed on the grounds, inter alia, that the Court in Los Angeles has no jurisdiction in this matter, due to the fact that the agreement between the plaintiff and the Bank contains a clause stipulating that exclusive jurisdiction in any legal proceedings is given to a Court in Israel and applying the Israeli law to the agreements, and that the appropriate forum for hearing this matter is a Court in Israel. The plaintiff also submitted an objection to this petition.

On April 8, 2005, the Federal Court in Los Angeles dismissed the action on the grounds that the appropriate forum for dealing with this action is the Court in Israel. The Court did not refer to the other arguments of the Bank including the argument regarding the jurisdiction.

On May 6, 2005, the plaintiff appealed the said decision. On April 19 2007 the Court rejected the appeal of the Federal Court's verdict brought by the plaintiff.

It should be noted that the plaintiff is entitled to submit a request to appeal the claim to the Supreme Court. To date, such request was not yet submitted. Dismissal of the appeal does not preclude the filing of a claim in Israel. Nonetheless, the Management of the Bank, based on counsel's opinion, is unable to determine whether the plaintiff would submit a similar claim in Israel, and if so under what causes of claim and for which amount.

For further details see Note 4.1 to the condensed financial statements.

See Note 4.2 to the condensed financial statements for details of a material legal proceeding which came to an end at the beginning of the third quarter of 2007.

PROCEEDINGS REGARDING AUTHORITIES

1. For details of the investigation regarding matters relating to the prohibition of money laundering, conducted at IDB New York, see "Discount Bancorp, Inc." under "Main investee companies" above and Note 3 to the condensed financial statements.
2. Further to the audits conducted in the Bank in August and September 2006, as detailed in paragraph 10 of "Proceedings regarding authorities", in the Annual Report for 2006 (p. 209), in April 2007, the head of recording and enforcing labor laws in the Ministry of Industry, Trade and Labor, levied on the Bank two administrative penalties in the amount of NIS 15,000 each.
3. On June 13, 2007, the Bank was served with a copy of an indictment filed with the Tel Aviv Court for Local

Affairs against the Bank, as owner (per registration) and others, with respect to construction work carried out at the Discount Tower (Floors 30-33), constituting, as alleged by the licensing authorities, a deviation from the building permit. The original date of reading of the indictment, which was fixed for June 24, 2007, was deferred by consent to November 4, 2007. The parties are conducting negotiations out of Court to settle the dispute between them regarding the alleged deviation from the terms of the permit.

4. **Audit report in the matter of the implementation of the provisions of the Money Laundering Prohibition** Law. As stated in the Annual Report for 2006 (p. 195), the Audit Department of the Bank of Israel conducted during the second half of 2005 and in the first months of 2006 a crosswise audit at the Bank in the matter of compliance with the prohibition of money laundering provisions. The audit report in the matter was submitted to the Bank in July 2007. The Bank is studying the audit report and is preparing its response. It should be mentioned that the audit report states that a notice regarding the submission of a motion for imposing a monetary sanction shall be submitted to the Bank separately.
5. For details regarding investigation of suspected violations of the Prohibition of Money Laundering Law, see pp. 153-154 to the financial statements as of December 31, 2006 and under "Mercantile Discount Bank" in "Main investee companies" above.

For further details regarding proceedings regarding authorities see 2006 Annual Report (pp. 208-209).

INVOLVEMENT WITH AND CONTRIBUTION TO THE COMMUNITY

Since its formation, Israel Discount Bank has been active in community affairs, having an overall management philosophy, according to which activities beneficial to the community form part of a business, social and cultural obligation. The social work and involvement in the community was carried out by the Bank through donations; sponsorships; "Tzalash" Project; Discount Culture and Art Activities Fund and "Lema'an" Project.

"LEMA'AN" PROJECT – DISCOUNT EMPLOYEES FOR THE COMMUNITY

The varied activity continued in the second quarter of 2007, while focusing on voluntary activities in the framework of various associations acting in aid of youth at risk and in distress and in assisting various associations supporting the needy.

The following projects and activities conducted in the second quarter of 2007 deserve special mention:

Saluting the Volunteers. On June 17, 2007, the Bank's management organized an event in honor of the many hundreds of Discount Bank employee volunteers participating in the "Le'maan" project. Many volunteers and guests from other projects which the Bank supports and is involved in were present in the event.

"Our Children's horizon" Project. During the summer months the Bank employs visually impaired youths. Most of these youths reach the Bank with the help of the Our Children's Horizon Association – a national organization of parents of blind or visually impaired children. The Bank decided this year to extend this activity and assist in training provided to such youth even before they commence work, as preparation for work at the bank. Two sessions were held at the Discount College attended by the youths accompanied by supervisors of the Association. At the College, these young persons received instruction on banking and "direct banking" subjects and were given a guided tour at the TeleBank. In addition, they received guidance on matters of qualification and proficiency at work.

Renovation at the Wolfson Hospital. The waiting room at the Children Neurological Department at the Wolfson

Hospital in Holon has been renovated. The renovation was effected by the Bank's employees from the Organization and Methods Department in cooperation with additional departments of the Bank.

ARTS AND CULTURE

"Artist Wall" – A project for encouraging Israeli art and creativity. "Artist Wall" is an additional layer in the wide range of activities carried out by the Bank for the benefit of the community, which combines support of the arts with community activity.

In this project the Bank offers its branch facilities all over the country to serve as a platform where artists are able to exhibit their works to the public. The Bank is committed to purchasing one work from each exhibition, and, concurrently, the exhibiting artist must also donate one work. At the conclusion of the project, an exhibition will be held in which all the works purchased by the Bank and donated by the artists will be offered for sale. All the proceeds from the sale will be used for financing projects in aid of children and youth.

The following exhibitions were held in the second quarter of 2007: The exhibition "Painting and Sculpture" of the artists Nurit Levav, Anita Arba Bokovza, Limor Peleg and Matti Orlov, was held at the Nataniya Branch.

DIS-COVER. In the second quarter of 2007 the project focused on the design of games under the heading "conducting ourselves". Young persons residents of the Ayanot, Ort Marine Ashdod and Johanna Jabotinski youth villages created games suitable for their living space at the villages, using various recycled materials.

The project was guided by lecturers and students of the Holon Technical Institute with the participation of the Ministry of Education.

SPONSORSHIPS

Sponsorships were granted during the second quarter of 2007 to activities in various fields. Especially noted are the following sponsorships:

Theatronetto. Sponsorship was granted in the course of April 2007 to the other theatre festival "Theatronetto" held at Acco.

The Arab-Jewish Youth Orchestra. Sponsorship was granted to the Arab-Jewish Youth Orchestra performing in concerts all over the country and promoting peace and friendship values between the nations through music.

The Caesarea Harbor Jazz Festival. In June 2007, this jazz festival was held for the third consecutive time at the Caesarea Harbor, with the participation of international jazz artists. The Bank granted its sponsorship to the festival, benefits to customers being granted as part thereof.

Habima National Theatre. The Bank granted its sponsorship to the Habima National Theatre, benefits to customers being granted as part thereof.

MISCELLANEOUS

DECLARATIONS AS TO DISCLOSURE IN FINANCIAL STATEMENTS

Following the accounting scandals exposed in recent years in the United States, the Sarbanes-Oxley Act of 2002 was passed with the intension of improving the accuracy, reliability and transparency of reporting by corporations, in order to restore public trust in them.

In the spirit of Section 302 of the said Act and the instructions published in accordance therewith by the SEC in the United States, the Supervisor of Banks issued a directive regarding a declaration as to disclosure in quarterly and annual reports of banking corporations. This directive was applied for the first time in the financial statements for the second quarter of 2005.

The Bank and its banking subsidiaries in Israel have engaged an independent firm of Certified Public Accountants, to provide consultation, support and guidance to assist them in their preparations towards the signing of the required declaration.

In order to establish these declarations, the Bank, engaging outside assistance as stated, has examined the principal processes of production and delivery of information related to the financial statements by the various units of the Bank, as well as the controls applying to these processes. As part of this review, the processes of data communication have been mapped and documented in detail, including the controls implemented in these processes. Additional new controls have been formed, the absorption of which in the work processes is being implemented.

Based on the findings of the said detailed examination, the Bank’s President and CEO and its Chief Accounting Officer have evaluated, on the basis of the said evaluation in conjunction with the Bank’s Management, the efficiency of the controls and procedures relating to disclosure at the Bank. Based on this evaluation, the President and CEO and Chief Accounting Officer have reached the conclusion that as of the end of the reporting period, the controls and procedures relating to disclosure at the Bank operate efficiently in order to record, process, summarize and report the information that the Bank is required to disclose in its quarterly report, in accordance with the directives of the Supervisor of Banks in the matter of reporting to the public and at such date indicated therein.

During the quarter ended June 30, 2007, no change occurred in the internal control over the financial reporting at the Bank, which had a material effect or which is reasonably expected to have a material effect on financial reporting.

It should be stressed that, at this stage, the declaration regarding disclosure in the financial statements is not supposed to cover the extensive aspects of evaluating the effectiveness of the internal control over the financial reporting determined in section 404 (see hereunder). Included in this, the Bank has not as yet used the internal control model for examining its effectiveness, as required by the said Section 404.

CIRCULAR REGARDING “MANAGEMENT’S RESPONSIBILITY AS TO THE INTERNAL CONTROL OVER FINANCIAL REPORTING – SOX ACT 404”

The Supervisor of Banks issued in December 2005 a draft circular in the above matter, according to which banking corporations are to prepare for the inclusion in their financial statements, starting with the financial statements as of December 31, 2008, a certification with regards the management’s responsibility for the establishment and maintenance of a proper system and procedures for the internal control over financial reporting as well as an assessment as of the end of the fiscal year of the effectiveness of the internal control system and procedures regarding financial reporting. At the same time, the independent auditors of banking corporations would be required to render an opinion in the preparation of which they will be required to implement the relevant standards to be adopted or published by the Public Company According Oversight Board (PCAOB). Everything in accordance with the provisions of Section 404 of the US Sarbanes Oxley Act and the directives issued by the SEC under it.

The circular requires the banking corporations to complete, until the date of issue of the report for the first quarter of 2006, the preliminary preparations for the implementation of the project – planning of the project (at the Bank and at the subsidiaries) – the appointment of a steering committee, the appointment of a project team, definition of the internal control and the scope of the work, its targets, interim products, the determination of a methodology, the identification of hardware and software to be used, establishment of work plans, budgets, employee training schemes, means of communication between the various factors, etc. The banking corporations must complete the overall project in the first half of 2008, so that the audit work of the independent auditors would begin in June 2008 at the latest and should be completed until the reporting date (December 31, 2008).

The circular states that the internal control model "COSO", to which the regulatory authorities in the United States refer, may be used by the banking corporations in Israel, within the framework of implementing the provisions of section 404, for the purpose of assessing the internal control. The COSO model defines the internal control, and provides methodologies and criteria according to which the effectiveness of the internal control system is to be examined.

The implementation of the Supervisor of Banks' requirements would require the upgrading and/or establishment of infrastructure systems of internal controls at the Bank, a matter that in the opinion of the Bank would require the allocation of large both financial and executive resources in the coming years.

The Bank and its banking subsidiaries in Israel have chosen an independent firm of Certified Public Accountants to assist, advise, guide and accompany them in their preparations for the implementation of the project.

A MEMORANDUM OF UNDERSTANDING BETWEEN THE REGULATORY AUTHORITIES FOR COOPERATION AND THE SHARING OF INFORMATION REGARDING THE SUPERVISION OF THE FINANCIAL MARKETS IN ISRAEL

On June 24, 2007, the Supervisor of Banks, the Chairman of the Israeli Securities Authority and the Commissioner of the Capital Market, Insurance and Savings signed a memorandum of understanding for the cooperation and sharing of information among the regulatory authorities with respect to the supervision of financial markets in Israel. This memorandum establishes the informal cooperation existing for some time between the said entities, and it does not replace or derogate from any legislation and/or other regulation and/or authority bestowed and the responsibility imposed by law on each of the regulatory bodies.

Within the framework of the memorandum of understanding, it has been agreed to establish a coordinating committee, the members of which will be the three Regulators. This committee is to meet at least once a month to discuss, among other things, relevant trends and changes in the supervised sectors. The committee may form sub-committees to deal with particular matters and may summon other parties to its meetings.

It was also agreed that any significant regulation within the authority of any one of the Regulators, would be brought to the attention of the other two Regulators and they would voice their opinion regarding the said regulation. In addition, full and timely cooperation has been agreed between the three entities including mutual assistance of the Regulators in everything related to the implementation of coordinated and integrated supervision over the financial markets, including: the assembly, processing and analysis of information, compliance and enforcement activity, etc.

INTEGRATED SYSTEM INCLUDING ACCOUNTING AND MANAGEMENT DATA

At the beginning of 2007 the Bank implemented a new accounts system integrated in the liquidity reporting system, in the management data system of profit centers by customers and in the system for management of problematic debts.

The new system was implemented during more than one year concurrently with the previous system, in order to compare the two systems currently including a complex process of comparison and analysis of differences.

The new system is long-term, multi-currency, and manages value balances as well as recorded amount balances. The system enables exact detailed analysis of balances according to account characteristics and balances at the customer level.

The system ensures uniform exact, reconciled accounting and management reporting, according to all required cut offs, of accounting systems and costing management systems.

AMENDMENT TO THE PUBLIC REPORTING INSTRUCTIONS REGARDING “THE RETURN OF NET EARNINGS ON SHAREHOLDERS’ EQUITY “

On May 2, 2007, the Supervisor of Banks published an amendment to the public reporting instructions regarding the “return on equity of net earnings”. According to this amendment, the computation of the return on equity is to be based upon the “average equity” during the reported period (which includes also current earnings accumulated in the reported period), instead of upon the equity as of the beginning of the reported period, as was customary up to now. The amendment applies to financial statements for periods beginning January 1, 2007 and thereafter.

The comparative figures for the return on equity have been restated according to the said amendment.

Following is a calculation of the return on equity as reported in the past and as recalculated in accordance with the new requirement:

	2006					
	First half	Quarter I	Quarter II	Quarter III	Quarter IV	Annual
	In %					
As reported in the past	13.6	1.6	26.8	14.4	8.1	12.2
As recalculated	13.5	1.6	26.6	14.2	7.9	11.7

REFORM OF BANK PAYMENT AND CLEARING SYSTEM

In July 2004, Bank of Israel informed of its intension to reform the bank payment and clearing systems by establishing a system for “real-time gross settlement” (RTGS). The new system is intended to replace the present system for settlement of accounts with international settlement arrangements of the Bank for International Settlements (BIS) in accordance with accepted standards of other central banks in the world.

According to the model proposed by Bank of Israel, an RTGS system would be established, replacing the present system, enabling inter-bank settlements only when sufficient liquidity for such settlements exists. Settlement would be effected in real-time and would be final.

On July 30, 2007, the Bank of Israel successfully launched the first stage of the system, which includes the multilateral clearing (central banking clearing, check clearing and the Stock Exchange clearing), inter-bank liquidity trading transactions and the liquidity centers of the Bank of Israel. The full operation of the system, which is to include money transfers between customers and between dealing rooms, is expected at the beginning of September 2007, and the Bank is preparing accordingly.

The Bank's entry into the new clearing arrangements, as stated, is based on agreements signed in July 2007 between the Bank, the Bank of Israel and the Stock Exchange Clearing House. These agreements include arrangements intended to secure the conclusiveness of the settlement. Within the framework of these agreements, the banks being party thereto agreed to implement a mechanism that will be automatically activated in case of "settlement default", and will oblige the banks to bear the costs caused by any "settlement default", in proportion to the relative share of each bank.

The new clearing arrangements expose the banking corporations to large money movements in "real time", and they may from time to time require credit from the Bank of Israel for short periods of time. In order to secure the payment in full of amounts due to the Bank of Israel in respect of the said credit, the Bank and Mercantile Discount Bank registered pledges in favor of the Bank of Israel, as detailed in Note 18 to the condensed financial statements.

"COMPANY GOVERNANCE CODE" FOR THE DISCOUNT BANK GROUP

As part of the Bank's strategic plans for the years 2007-2011, the Bank has decided on adopting a "Company Governance Code" for the Discount Bank Group. The Code is to address, among other things, setting up a decision making mechanism, approval of operations and transactions, and control mechanisms regarding the following matters: operations and transactions with related parties; reorganization and structural changes; material investments; risk management policy; policy regarding the prohibition of money laundering and the finance of terror activities, and more.

In the course of the second quater of 2007, the Bank has engaged the services of a renowned legal expert for the purpose of drafting a proposal for an overall company governance plan for the Group and would submit an opinion on matters relating to this issue.

On August 13, 2007, the Board of Directors adopted a legal opinion prepared by the said expert according to which transactions between Bank subsidiaries and the Bank's related parties would be approved according to procedures stated in the Israeli law regarding approval of transactions with the Bank itself.

AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD

Remuneration plan for the Chairman of the Board of Directors and for the President and CEO. On January 30, 2007, the Bank's Audit Committee approved a comprehensive remuneration plan for the Chairman of the Board of Directors and for the President and CEO. The plan was formulated by the Human Resources Committee of the Board that, inter alia, reviewed remuneration plans of large companies in Israel and abroad, formed (with the assistance of experts engaged for this purpose) several models of remuneration, and performed sensitivity analyses in this regard, taking into account also data for prior years.

Representatives of the Committee also conducted negotiations with the Chairman of the Board of Directors and the President and CEO, taking into considerations extensive appreciation for the activities of the Chairman of the Board of Directors and the President and CEO and the great importance that the Bank attributes to their continued activity in the Bank.

The remuneration plan approved by the Audit Committee is not similar, (in its conditions or in the amounts derived therefrom), to the remuneration plan approved in March 2006, and was examined independently from the previous plan. The remuneration plan was formulated for a period of five years (as from February 2006) and includes short-term remuneration (salaries and annual bonuses) and long-term remuneration (stock option plan). The entitlement to annual bonuses and to the option plan are dependent on Discount Group's results and performance (that are measured in accordance with several parameters, mainly rates of change) and on the yield from the Bank's shares, both per se and in comparison to the other large banking groups. Entitlement to annual bonuses is limited to monetary ceilings.

In general (except regarding certain parameters relating to bonuses payable to the President and CEO upon retirement), linkage was maintained in the remuneration proposals to the Chairman of the Board of Directors and the President and CEO.

In February 2007 the Bank requested the reaction of its principal shareholders (the controlling shareholders, on one hand, and the Accountant General in the Ministry of Finance and M.I. Holdings Ltd., on the other hand) regarding the said issues. On July 1, 2007, the Accountant General at the Ministry of Finance and the President of M.I. Holdings Ltd. informed the Bank of their consent to the remuneration plan for the Chairman of the Board of Directors, including a proposed share option plan, to a share option plan for the President and CEO and to a proposal for the increase of the registered share capital of the Bank. It should be noted that the Chairman of the Board of Directors has been employed by the Bank for over a year and a half but has not yet received any remuneration for his work (the Bank has recorded full provisions for salary and bonuses in accordance with the plan approved by the Audit Committee. No provisions were recorded in respect of the options component).

For additional details, see the Annual Report as of December 31, 2006, (pp. 229-231) and Notes 13 and 22 to the financial statements as of December 31, 2006 (pp.314-320, and pp. 376-378).

On July 18, 2007 the Bank's Board of Directors approved the conditions of the Bank's agreement with the Chairman of the Board of Directors, the conditions of the Bank's agreement with the Bank's President and CEO, the option plan intended for these officers, convocation of a General Meeting regarding these decisions for purposes of approving the said agreements and convocation of a general meeting for purposes of approving an increase in authorized share capital.

On August 26, 2007 a special General Meeting of the Bank approved the conditions of employment of the Chairman of the Board of Directors of the Bank (for the period from February 6, 2006 to February 5, 2011) and the allocation of options to the Chairman of the Board of Directors, in the framework of an option plan for the Bank's Chairman of the Board of Directors and for the President and CEO. The General Meeting also approved an increase in the Bank's authorized share capital by NIS 3,000,000 par value (intended to enable the allocation of option warrants within the framework of the said plan) and an amendment to the Bank's articles of association and memorandum of association, accordingly.

For further details, see Note 7 to the condensed financial statements.

Issue of Options to New Members of Management. On January 29, 2007 the Board of Directors determined, in principle, that Mr. Ehud Arnon, who was appointed as Executive Vice President and Head of the Corporate Banking Division, will be entitled to options equivalent to the options issued to the previous Head of the Corporate Banking Division who retired, and whose options expired (1,176,767).

On May 14, 2007 the Board of Directors determined, in principle, the Bank's Legal Advisor, who was appointed as Executive Vice President, will be entitled to 980,639 options. It was also determined, for both Mr. Arnon and Ms. Deutsch, that the option plan will be similar, insofar as possible, to the option plan approved for Executive Vice Presidents in March 2006 and that was approved in July 2006, subject to required changes.

The Board of Directors' decision regarding the above mentioned options constitutes, as stated, a determination in principle and requires approval of the Bank's authorized entities and by the interested parties, in accordance with an existing cooperation agreement. To the best of the Bank's knowledge, the interested parties have not yet approved the option plan for the Head of the Corporate Banking Division and the Bank's Legal Advisor. Accordingly, a discussion has not yet been held in this regard.

It should be noted that following the retirement of a member of management, the options issued to her (1,176,767) expired.

REVIEW BY THE INDEPENDENT AUDITORS

In their review report of the interim consolidated condensed unaudited financial statements for the three and six month periods ended on June 30, 2007 the independent auditors drew attention to the contents of the following Notes:

- Note 1 B - regarding the adjustment by way of a restatement of the comparative figures for previous periods, following the initial implementation of the Directive of the Supervisor of Banks concerning the inclusion in the item "Credit to the public" of outstanding debts deriving from credit card transactions.
- Note 3 – Regarding the investigation that was conducted in the United States with respect to matters related to the Prohibition of Money Laundering Regulations and its impact upon IDB New York (a consolidated subsidiary).
- Note 5 items 5.1, 5.3 and 5.4 – Regarding pleas for the approval of certain actions as class actions suits and to Note 5.8 regarding a third party notice served against the Bank and consolidated subsidiaries of the Bank.

The said Notes present details regarding the above matters.

CHANGES IN MANAGEMENT

On July 12, 2007 Ms. Linda Benshoshan, Senior Executive Vice President, retired from office at the Bank. The Board of Directors of the Bank and the President and CEO wish to thank Ms. Benshoshan for her contribution to the Bank during her term of office.

MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

In the first half of 2007, the Board of Directors held 18 meetings. In addition, 39 meetings of committees of the Board of Directors were held.

Shlomo Zohar	Giora Offer	
Chairman of the	President & Chief	
Board of Directors	Executive Officer	August 29, 2007

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1]

REPORTED AMOUNTS

	For the three months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Non-Linked Israeli Currency:								
Assets[4][5]	59,054	880	6.10		**52,295	875	6.86	
Effect of derivatives:[3]								
Hedging derivatives	52	-			-	-		
Embedded derivatives and ALM	20,960	199			9,094	123		
Total assets	80,066	1,079		5.50	61,389	998		6.66
Liabilities[5]	(57,740)	(405)	(2.84)		**(52,095)	(480)	(3.74)	
Effect of derivatives:[3]								
Hedging derivatives	(52)	-			-	-		
Embedded derivatives and ALM	(20,051)	(194)			(7,540)	(98)		
Total liabilities	(77,843)	(599)		(3.11)	(59,635)	(578)		(3.93)
Interest margin			3.26	2.39			3.12	2.73
Israeli Currency Linked to the CPI :								
Assets[4][5]	21,299	397	7.67		21,496	535	10.33	
Effect of derivatives:[3]								
Embedded derivatives and ALM	690	13			14	-		
Total assets	21,989	410		7.67	21,510	535		10.33
Liabilities[5]	(18,423)	(313)	(6.97)		(18,973)	(415)	(9.04)	
Effect of derivatives:[3]								
Embedded derivatives and ALM	(1,365)	(44)			(1,090)	(6)		
Total liabilities	(19,788)	(357)		(7.41)	(20,063)	(421)		(8.66)
Interest margin			0.70	0.26			1.29	1.67

** Restated – see note 1b.

For footnotes see page 112.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	For the three months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Foreign Currency:[6]								
Assets[4][5]	72,262	2,893	17.00		*76,337	*(2,087)	(10.50)	
Effect of derivatives:[3]								
Hedging derivatives	785	(120)			4,169	(146)		
Embedded derivatives and ALM	38,904	1,268			23,950	(419)		
Total assets	111,951	4,041		15.24	104,456	(2,652)		(9.78)
Liabilities[5]	(71,659)	(2,585)	(15.23)		*(76,205)	*2,520	12.59	
Effect of derivatives:[3]								
Hedging derivatives	(785)	153			(4,198)	180		
Embedded derivatives and ALM	(38,878)	(1,290)			(24,286)	348		
Total liabilities	(111,322)	(3,722)		(14.06)	(104,689)	3,048		11.15
Interest margin			1.77	1.18			2.09	1.37

* Reclassified.

For footnotes see page 112.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	For the three months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated financing income [4][5]	152,615	4,170	11.39		150,128	(677)	(1.79)	
Effect of derivatives:[3]								
Hedging derivatives	837	(120)			4,169	(146)		
Embedded derivatives and ALM	60,554	1,480			33,058	(296)		
Total assets	214,006	5,530		10.74	187,355	(1,119)		(2.37)
Monetary liabilities which generated financing expenses[5]	(147,822)	(3,303)	(9.24)		(147,273)	1,625	4.34	
Effect of derivatives:[3]								
Hedging derivatives	(837)	153			(4,198)	180		
Embedded derivatives and ALM	(60,294)	(1,528)			(32,916)	244		
Total liabilities	(208,953)	(4,678)		(9.26)	(184,387)	2,049		4.37
Interest margin			2.15	1.48			2.55	2.00
In respect of options		(73)				28		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives)[3]		(20)				2		
Commissions on financing operations and other financing income[7]		142				36		
Other financing expenses		15				(63)		
Income from financing activities before provision for doubtful debts		916				933		
Provision for doubtful debts (including general and supplemental provisions)		(158)				(109)		
Income from financing activities after provision for doubtful debts		758				824		

For footnotes see next page.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	For the three months ended	June 30,
	2007	2006
	Average Balance[2]	Average Balance[2]
	in NIS millions	
Total:		
Monetary assets which generated financing income [4][5]	152,615	150,128
Assets related to derivative instruments[8]	1,331	-
Other monetary assets[5]	3,061	*3,249
General and supplemental provisions for doubtful debts	(607)	(731)
Total monetary assets	156,400	152,646
Total:		
Monetary liabilities which generated financing expenses [5]	(147,822)	(147,273)
Liabilities related to derivative instruments[8]	(1,438)	*(285)
Other monetary liabilities[5]	(3,874)	*(2,590)
Total monetary liabilities	(153,134)	(150,148)
Surplus of monetary assets over monetary liabilities	3,266	2,498
Non-monetary assets	4,984	4,931
Non-monetary liabilities	(153)	(62)
Total capital resources	8,097	7,367

* Reclassified.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities, included in shareholders equity under other cumulative comprehensive income, in the item "Adjustments for the presentation of available-for-sale securities at fair value" (including in respect of bonds transferred from the available-for-sale portfolio to the bonds held to maturity portfolio), 2007 – NIS (290) million in the non-linked segment, NIS (12) million in the CPI linked segment and NIS (75) million in the foreign currency segment; 2006 – NIS (39) million in the non-linked segment, NIS (1) million in the CPI linked segment and NIS 173 million in the foreign currency segment.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

(7) Including gains/losses on sale of investments in bonds and adjustment to fair value of trading bonds.

(8) Average balances of derivative instruments (excluding average off-balance sheet balances of derivative instruments).

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES(1) (CONTINUED)

	For the three months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance(2)	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives(3)	Average Balance(2)	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives(3)
	in NIS millions		%		in NIS millions		%	
Foreign Currency – Nominal in US$(6)*								
Assets(4)(5)	17,766	262	6.03		16,643	222	5.44	
Effect of derivatives:(3)								
Hedging derivatives	188	(34)			918	10		
Embedded derivatives and ALM	9,843	55			5,275	56		
Total Assets	27,797	283		4.13	22,836	288		5.14
Liabilities(5)	(14,741)	(200)	(5.54)		(16,641)	(149)	(3.63)	
Effect of derivatives:(3)								
Hedging derivatives	(187)	42			(922)	(6)		
Embedded derivatives and ALM	(9,879)	(47)			(5,345)	(51)		
Total liabilities	(24,807)	(205)		(3.35)	(22,908)	(206)		(3.65)
Interest margin		78	0.49	0.78		82	1.81	1.49

* Nominal Israeli Shekel amounts translated to US$ Dollars at the representative rate of exchange.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are computed based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities (including bonds transferred from the available-for-sale to the held-to-maturity portfolios) 2007 - in amount of US$ (18) million. 2006 - in amount of US$ 53 millions.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	For the six months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Non-Linked Israeli Currency:								
Assets[4][5]	58,283	1,752	6.10		**52,224	1,697	6.60	
Effect of derivatives:[3]								
Hedging derivatives	31	-			-	-		
Embedded derivatives and ALM	18,295	389			7,893	182		
Total assets	76,609	2,141		5.67	60,117	1,879		6.35
Liabilities[5]	(57,113)	(854)	(3.01)		**(51,928)	(915)	(3.56)	
Effect of derivatives:[3]								
Hedging derivatives	(31)	(1)			-	-		
Embedded derivatives and ALM	(17,192)	(371)			(6,327)	(130)		
Total liabilities	(74,336)	(1,226)		(3.33)	(58,255)	(1,045)		(3.62)
Interest margin			3.09	2.34			3.04	2.73
Israeli Currency Linked to the CPI :								
Assets[4][5]	21,198	628	6.01		21,440	837	7.96	
Effect of derivatives:[3]								
Embedded derivatives and ALM	537	2			102	3		
Total assets	21,735	630		5.88	21,542	840		7.95
Liabilities[5]	(18,646)	(439)	(4.76)		(18,926)	(629)	(6.76)	
Effect of derivatives:[3]								
Embedded derivatives and ALM	(1,236)	(52)			(1,047)	(23)		
Total liabilities	(19,882)	(491)		(5.00)	(19,973)	(652)		(6.64)
Interest margin			1.25	0.88			1.20	1.31
Foreign Currency:[6]								
Assets[4][5]	73,238	2,830	7.88		*76,846	*167	0.44	
Effect of derivatives:[3]								
Hedging derivatives	733	(118)			4,474	(55)		
Embedded derivatives and ALM	37,663	1,110			23,981	(130)		
Total assets	111,634	3,822		6.96	105,301	(18)		(0.03)
Liabilities[5]	(72,444)	(2,208)	(6.19)		*(76,344)	*648	1.69	
Effect of derivatives:[3]								
Hedging derivatives	(733)	150			(4,427)	102		
Embedded derivatives and ALM	(37,966)	(1,106)			(24,580)	(5)		
Total liabilities	(111,143)	(3,164)		(5.77)	(105,351)	745		1.41
Interest margin			1.69	1.19			2.13	1.38

* Reclassified.
** Restated – see note 1b.
For footnotes see page 116.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	For the six months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average Balance[2]	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated financing income [4][5]	152,719	5,210	6.94		150,510	2,701	3.62	
Effect of derivatives:[3]								
Hedging derivatives	764	(118)			4,474	(55)		
Embedded derivatives and ALM	56,495	1,501			31,976	55		
Total assets	209,978	6,593		6.38	186,960	2,701		2.91
Monetary liabilities which generated financing expenses[5]	(148,203)	(3,501)	(4.78)		(147,198)	(896)	(1.22)	
Effect of derivatives:[3]								
Hedging derivatives	(764)	149			(4,427)	102		
Embedded derivatives and ALM	(56,394)	(1,529)			(31,954)	(158)		
Total liabilities	(205,361)	(4,881)		(4.81)	(183,579)	(952)		(1.04)
Interest margin			2.16	1.57			2.40	1.87
In respect of options		(33)				65		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives)[3]		(9)				8		
Commissions on financing operations and other financing income[7]		271				93		
Other financing expenses		(3)				(90)		
Income from financing activities before provision for doubtful debts		1,938				1,825		
Provision for doubtful debts (including general and supplemental provisions)		(254)				(251)		
Income from financing activities after provision for doubtful debts		1,684				1,574		

For footnotes see next page.

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[(1)] (CONTINUED)

REPORTED AMOUNTS

	For the six months ended June 30,	
	2007	2006
	Average Balance[(2)]	Average Balance[(2)]
	in NIS millions	
Total:		
Monetary assets which generated financing income [(4)(5)]	152,719	150,510
Assets related to derivative instruments[(8)]	1,160	-
Other monetary assets[(5)]	3,531	*3,082
General and supplemental provisions for doubtful debts	(607)	(733)
Total monetary assets	156,803	152,859
Total:		
Monetary liabilities which generated financing expenses [(5)]	(148,203)	(147,198)
Liabilities related to derivative instruments[(8)]	(1,247)	*(184)
Other monetary liabilities[(5)]	(4,092)	*(2,968)
Total monetary liabilities	(153,542)	(150,350)
Surplus of monetary assets over monetary liabilities	3,261	2,509
Non-monetary assets	5,199	4,807
Non-monetary liabilities	(190)	(63)
Total capital resources	8,270	7,253

* Reclassified.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities, included in shareholders equity under other cumulative comprehensive income, in the item "Adjustments for the presentation of available-for-sale securities at fair value" (including in respect of bonds transferred from the available-for-sale portfolio to the bonds held to maturity portfolio), 2007 – NIS (238) million in the non-linked segment, NIS (11) million in the CPI linked segment and NIS (107) million in the foreign currency segment; 2006 – NIS (59) million in the non-linked segment, NIS (1) million in the CPI linked segment and NIS 145 million in the foreign currency segment.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

(7) Including gains/losses on sale of investments in bonds and adjustment to fair value of trading bonds.

(8) Average balances of derivative instruments (excluding average off-balance sheet balances of derivative instruments).

INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES(1) (CONTINUED)

	For the six months ended June 30,							
	2007				2006			
			Ratio of Income (Expense)				Ratio of Income (Expense)	
	Average Balance(2)	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives(3)	Average Balance(2)	Financing Income (Expense)	Excluding the effect of derivatives	Including the effect of derivatives(3)
	in US$ millions*		%		in US$ millions*		%	
Foreign Currency – Nominal in US$(6)*								
Assets(4)(5)	17,693	512	5.87		16,497	429	5.27	
Effect of derivatives:(3)								
Hedging derivatives	182	(31)			972	18		
Embedded derivatives and ALM	9,285	132			5,210	93		
Total Assets	27,160	613		4.56	22,679	540		4.82
Liabilities(5)	(16,046)	(367)	(4.63)		(16,494)	(283)	(3.46)	
Effect of derivatives:(3)								
Hedging derivatives	(182)	39			(961)	(13)		
Embedded derivatives and ALM	(9,359)	(120)			(5,337)	(87)		
Total liabilities	(25,587)	(448)		(3.53)	(22,792)	(383)		(3.39)
Interest margin		165	1.24	1.03		157	1.81	1.43

* Nominal Israeli Shekel amounts translated to US$ Dollars at the representative rate of exchange.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are computed based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities (including bonds transferred from the available-for-sale to the held-to-maturity portfolios) 2007 - in amount of US$ (25) million. 2006 - in the amount of US$ 31 millions.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

CERTIFICATION

I, Giora Offer, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of June 30, 2007 (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 quarterly financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in this report;
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining controls and procedures for the disclosure required in the Report of the Bank and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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) 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
   (c) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. The other officers of the Bank providing this certification and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors to the audit committee of the Board of Directors, and to the finance committee of the Board of Directors:
   (a) All significant deficiencies and material weaknesses in the design 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.

Giora Offer,
President & Chief Executive Officer

August 29, 2007

CERTIFICATION

I, Joseph Beressi, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of June 30, 2007 (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 quarterly financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in this report;-
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining controls and procedures for the disclosure required in the Report of the Bank and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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) 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
   (c) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. The other officers of the Bank providing this certification and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors to the audit committee of the Board of Directors, and to the finance committee of the Board of Directors:
   (a) All significant deficiencies and material weaknesses in the design 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.

Joseph Beressi,
Senior Executive Vice-President
Chief Accountant

August 29, 2007

Somekh Chaikin

ZIV HAFT

TO: THE BOARD OF DIRECTORS OF ISRAEL DISCOUNT BANK LTD.

RE: REVIEW OF UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS FOR THE SIX MONTH AND THREE MONTH PERIODS ENDED JUNE 30, 2007

At your request we have reviewed the following condensed consolidated interim financial statements of Israel Discount Bank Ltd. and its subsidiaries: balance sheet as at June 30, 2007, statements of profit and loss and statements of changes in shareholders' equity for the six month and three month periods then ended.

Our review was performed in accordance with procedures prescribed by the Institute of Certified Public Accountants in Israel, and included, inter alia, reading of the aforementioned interim financial statements, reading the minutes of shareholders' meetings and meetings of the Board of Directors and its Committees, as well as making inquiries of officers of the Bank responsible for financial and accounting matters.

We were furnished with reports of other auditors on their review of the condensed interim financial statements of certain affiliated companies, the investments in which amounts to NIS 63 million as at June 30, 2007 and the Bank's equity in their net income amounted to an income of NIS 11 million and NIS 2 million in the periods of six and three months then ended, respectively.

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

In the course of our review, including the reading of the review reports of the other auditors referred to above, nothing came to our attention which would indicate the necessity of making material changes in the condensed consolidated interim financial statements as at June 30, 2007 and for the six month and three month periods then ended, in order for them to be in conformity with generally accepted accounting principles and in accordance with the reporting instructions and directives of the Supervisor of Banks.

We draw attention to the following notes to the condensed consolidated interim financial statements:

(a) Note 1 B regarding the adjustment by way of a restatement of the comparative data as of June 30, 2006, following the initial implementation of the Directive by the Supervisor of Banks concerning the inclusion in the item "Credit to the public" of outstanding debts deriving from credit card transactions.

(b) Note 3 as regards the investigation that was conducted in the United States with respect to matters related to the Prohibition of Money Laundering Regulations and its impact upon IDB New York (a consolidated subsidiary).

(c) Note 5 items 5.1, 5.3 and 5.4 regarding action suits and pleas for the approval of certain actions as class action suits and item 5.8 regarding a third party notice served against the Bank and consolidated subsidiaries of the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)

Ziv Haft
Certified Public Accountants (Isr.)

Tel-Aviv, August 29, 2007

Somekh Chaikin, a partnership registered under the Israeli Partnership Ordinance, is the Israeli member firm of KPMG International. a Swiss cooperative.

ZIV HAFT is a member of BDO.

CONDENSED CONSOLIDATED BALANCE SHEET

REPORTED AMOUNTS

	Unaudited		Audited
	30.06.07	30.06.06	31.12.06
	in NIS millions		
Assets			
Cash and deposits with banks	26,135	22,084	25,406
Securities	39,794	40,648	38,914
Borrowed securities	464	-	-
Credit granted to the public	94,667	** 88,450	90,175
Credit granted to Governments	49	81	18
Investments in affiliated companies	1,450	* 1,732	* 1,367
Buildings and equipment	2,678	2,412	2,614
Other assets	4,421	* 4,170	* 4,044
Total assets	169,658	159,577	162,538
Liabilities and Shareholders` Equity			
Deposits from the public	135,574	129,435	130,517
Deposits from banks	8,157	7,732	8,099
Deposits from the Government	123	* 120	119
Debentures and subordinated capital notes	6,614	5,561	6,302
Other liabilities	10,202	** 9,118	9,134
Total liabilities	160,670	151,966	154,171
Minority interest	120	463	402
Shareholders` equity	8,868	7,148	7,965
Total Liabilities and Shareholders` Equity	169,658	159,577	162,538

* Reclassified.
** Restated - see Note 1 B.

The notes to the condensed financial statements form an integral part thereof.

Shlomo Zohar	Giora Offer	Joseph Beressi
Chairman of the Board of Directors	President & Chief Executive Officer	Senior Executive Vice President Chief Accountant

Date of approval of the financial statements:

August 29, 2007

CONDENSED CONSOLIDATED STATEMENT OF INCOME

REPORTED AMOUNTS

	Unaudited				Audited
	For the three months ended June 30,		For the six months ended June 30,		For the year ended December 31,
	2007	2006	2007	2006	2006
	in NIS millions				
Financing Income					
Income from financing activities before provision for doubtful debts	916	933	1,938	1,825	3,790
Provision for doubtful debts	158	109	254	251	570
Income from financing activities after provision for doubtful debts	758	824	1,684	1,574	3,220
Non-Financing Income					
Operating commissions	540	*465	1,071	*938	1,911
Net income on investment in shares	4	42	54	50	65
Other income	131	95	199	204	383
Total non-financing income	675	602	1,324	1,192	2,359
Non-Financing Expenses					
Salaries and related expenses	641	*749	1,428	*1,745	3,201
Maintenance and depreciation of buildings and equipment	194	159	384	*325	679
Other expenses	328	*289	581	*560	1,140
Total non-financing expenses	1,163	1,197	2,393	2,630	5,020
Operating income before taxes	270	229	615	136	559
Provision for taxes on operating income	69	90	236	168	350
Operating income (loss) after taxes	201	139	379	(32)	209
Bank's share in operating income of affiliated companies, net of tax effect	47	49	88	98	188
Net operating income before minority interest	248	188	467	66	397
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(13)	(25)	(30)	(48)	(82)
Net operating income	235	163	437	18	315
Cancellation of provision for impairment in value of investment in affiliated company	-	-	-	173	173
Net income from extraordinary items, net of taxes	392	254	395	253	348
Net income	627	417	832	444	836

*Reclassified.

CONDENSED CONSOLIDATED STATEMENT OF INCOME (CONTINUED)

REPORTED AMOUNTS

	Unaudited				Audited
	For the three months ended June 30,		For the six months ended June 30,		For the year ended December 31,
	2007	2006	2007	2006	2006
	in NIS millions				
Earnings per share of NIS 0.1 (in NIS)					
Net operating income	0.24	0.17	0.45	0.02	0.32
Net income from extraordinary items, net of taxes(1)	0.40	0.26	0.40	0.43	0.53
Net income	0.64	0.43	0.85	0.45	0.85
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639	980,639

Footnote:

(1) The statements for June 30, 2006 and December 31, 2006 include cancellation of provision for impairment in value of investment in an affiliated company.

The notes to the condensed financial statements form an integral part thereof.

CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

REPORTED AMOUNTS

	Total capital and capital reserves	Retained Earnings(1)(2)	Total Shareholders' equity	Total capital and capital reserves	Retained Earnings(1)(2)*	Total Shareholders' equity
	Unaudited					
	For the three months ended June 30,					
	2007			2006		
	in NIS millions					
Balance at beginning of period	3,820	4,418	8,238	3,809	3,014	6,823
Income for the period	-	627	627	-	417	417
Benefit in respect of stock options granted to officers	**-	-	**-	3	-	3
Net adjustment for the presentation of available-for-sale securities at fair value	-	7	7	-	(125)	(125)
Related tax effect	-	(4)	(4)	-	31	31
Financial statement translation adjustments	-	-	-	-	(1)	(1)
Balance at end of period	3,820	5,048	8,868	3,812	3,336	7,148

** An amount below NIS 1 million.

See footnotes next page

CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (CONTINUED)

REPORTED AMOUNTS

	Total capital and capital reserves	Retained Earnings(1)(2)	Total Shareholders' equity	Total capital and capital reserves	Retained Earnings(1)(2)*	Total Shareholders' equity
	Unaudited					
	For the six months ended June 30,					
	2007			2006		
	in NIS millions					
Balance at beginning of period (audited)	3,817	4,148	7,965	3,634	3,084	6,718
Initial application of an accounting standard by an affiliated company	-	-	-	-	1	1
Income for the period	-	832	832	-	444	444
The State's bonus to the employees of the Bank (privatization)	-	-	-	175	-	175
Benefit in respect of stock options granted to officers	3	-	3	3	-	3
Net adjustment for the presentation of available-for-sale securities at fair value	-	100	100	-	(267)	(267)
Related tax effect	-	(32)	(32)	-	75	75
Financial statement translation adjustments	-	-	-	-	(1)	(1)
Balance at end of period	3,820	5,048	8,868	3,812	3,336	7,148

* Reclassified.

Footnotes:

(1) Including an amount of NIS 2,704 million that is not available for distribution.

(2) Retained earnings include:

- Translation adjustments on investments in autonomous units and translation adjustments on the source of finance for such investments and the related tax effect:
  as of June 30, 2007 – NIS (233) million.
  as of June 30, 2006 – NIS (230) million.
- Adjustments for the presentation of available-for-sale securities at fair value, net:
  as of June 30, 2007 – NIS 317 million.
  as of June 30, 2006 – NIS (174) million.
- Net loss on hedging of cash flows:
  as of June 30, 2006 – NIS (1) million.

The notes to the condensed financial statements form an integral part thereof

CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (CONTINUED)

REPORTED AMOUNTS

	Total capital and capital reserves	Retained Earnings[(1)(2)]	Total Shareholders' equity
		Audited	
		For the year ended December 31, 2006	
		in NIS millions	
Balance at January 1, 2006	3,634	3,084	6,718
Initial application of an accounting standard by an affiliated company	-	1	1
Income for the year	-	836	836
The State's bonus to the employees (privatization)	175	-	175
Benefit in respect of stock options granted to officers	8	-	8
Net adjustments for the presentation of available-for-sale securities at fair value	-	426	426
Related tax effect	-	(195)	(195)
Financial statement translation adjustment	-	(4)	(4)
Balance at December 31, 2006	3,817	4,148	7,965

Footnotes:
(1) Including an amount of NIS 2,704 million that is not available for distribution.
(2) Retained earnings include:
- Translation adjustments on investments in autonomous units and translation adjustments on the source of finance for such investments and the related tax effect:
  as of December 31, 2006 – NIS (233) million.
- Adjustments in respect of the presentation of available-for-sale securities at fair value, net:
  as of December 31, 2006 – NIS 249 million.
- Net loss on hedging of cash flows:
  as of December 31, 2006 – NIS (1) million.

The notes to the condensed financial statements form an integral part thereof

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES:

A. General. The condensed financial statements have been prepared in accordance with accounting principles applied in the preparation of interim financial statements.

The financial statements have been prepared on the basis of the same accounting principles used for the preparation of the audited financial statements as of December 31, 2006 (except as detailed in item (c) hereunder).

These financial statements should be read in conjunction with the annual financial statements as of December 31, 2006 and the notes thereto.

B. Credit card transactions – (data as of March 31, 2006) restatement. On February 21, 2007, the Supervisor of Banks published an amendment to the public reporting directives, following the publication of the reporting format for credit card companies. The directive amends the definition of "credit to the public" to include also "debit balances of the public resulting from credit card transactions".

According to a legal opinion obtained by the Bank, outstanding debts resulting from credit card transactions made by customers of the Bank using credit cards issued to these customers by the Bank in conjunction with the credit card company, are deemed "credit" extended by the Bank to the customer.

In the past, such outstanding balances were presented as an "off-balance sheet item". In accordance with the said amendment, these balances are reclassified as of the financial statements as of December 31, 2006, and presented as a component of "credit to the public".

Comparative amounts as of June 30, 2006 were restated accordingly. As a result of the restatement, credit to the public as of December 31, 2006 increased by NIS 4,107 million against an increase in the same amount in other commitments.

C. Implementation for the first time of amendment to public reporting requirements regarding transfers and services relating to financial assets and settlement of liabilities. In May 2006 the Supervisor of Banks published a memorandum amending the public reporting requirements regarding "transfers and services relating to financial assets and settlement of liabilities". The requirements stated in the memorandum adopt the measurement and disclosure principles stated in FAS 140, accounting principles for transfer and services relating to financial assets and settlement of liabilities, for differentiation between transfers of financial assets recorded as sale and between other transfers. Accordingly, the principle was adopted according to which a transferred financial asset will be included in the balance sheet of the controlling party, whether the transferor or the recipient of the asset. In this regard, the provisions detail determinations for control relating to reacquisition transactions, securities' lending, issuance of debentures against proceeds from future cash flow, sale and participation in loans.

The Bank implements the amendments to the public reporting requirements regarding securities' lending transactions, reacquisition of securities, issuance of debentures in respect of financial assets, other transfers of financial assets, provision of services for financial assets and settlement of liabilities, implemented after December 31, 2006.

Implementation for the first time of the amendments to the public reporting requirements as stated above did not have a material effect on the Bank's operating results and financial position.

D. Disclosure of the Effect of New Accounting Standards on the Period Prior to Their Application. Details regarding the effect of new Accounting Standards follow hereunder.

Accounting Standard No. 29. The Israel Accounting Standards Board published in July 2006 Accounting Standard No. 29 "Adoption of International Financial Reporting Standards (IFRS)" (hereinafter: "the Standard"), this following the

1. ACCOUNTING POLICIES (CONTINUED)

resolution of November 2005 of the Professional Committee of the Israel Accounting Standards Board.

In accordance with the provisions of the Standard, corporations to which the Securities Law, 1968 applies and which are obligated to report in accordance with the rules enacted under this Law, will prepare their financial statements in accordance with the international financial reporting standards, starting with the financial statements for the period beginning January 1, 2008 and thereafter.

The above is not applicable to corporations, whose financial statements are prepared according to the directives and guidelines of the Supervisor of Banks, in accordance with the Securities Regulations.

The IFRS standards initial adoption will be through IFRS 1, which deals with initial adoption of the IFRS standards.

The Supervisor of Banks informed banking corporation as follows regarding the method of implementation of the Standard:

- The Supervisor will issue on-going directives for implementation of Israel accounting standards published by the Israel Accounting Standards Board, based on the IFRS standards, and which do not relate to the core banking activity.
- In the second half of 2009, the Supervisor will determine the implementation date of IFRS standards that relate to core banking activity, taking into consideration the results of the adoption process of these standards in Israel on the one hand, and the progress in the convergence process between international reporting standards (IFRS) and United States standards, on the other hand.
- Regarding core banking activity, financial statements prepared according to the directives and guidelines of the Supervisor of Banks will continue to be prepared according to United States standards fixed in public reporting directives.

Accounting Standard No. 27. In September 2006, the Israel Accounting Standard Board published Accounting Standard No. 27 – "Fixed Assets". This Standard deals with the recognition of assets, the recording of depreciation in their respect, the treatment of compensation in respect of impairment in value of an asset, the disposal of assets and the treatment of obligations in respect of the cost of dismantling and removal of an item and of the restoration of the site on which it is located.

The principal change in the new Standard is the addition of a remeasurement model as a possible model for the recognition of an asset. In accordance with the remeasurement model, a fixed asset item, whose fair value can be determined reliably, shall be recognized at the remeasured amount less accumulated depreciation and less impairment losses accumulated thereafter. Reassessments are to be made on a current basis in respect of each group of assets to which the remeasured item belongs.

The Standard applies to Financial Statements for periods beginning on January 1, 2007 and thereafter. The Standard is to be initially applied retroactively, except for two exceptions detailed in the Standard.

On August 5, 2007, the Supervisor of Banks issued guidelines regarding the implementation of the Standard in which it was determined that a banking corporation is to prepare its financial statements for periods beginning on January 1, 2007 and thereafter, as provided in the Standard, however, notwithstanding that said in Section 29 of the Standard, a banking corporation shall implement the cost model only. The Supervisor also determined that sections of the Standard that include terms defined in the instructions of the Supervisor of Banks shall not apply, that sections referring to Standards which have not as yet been adopted by the Supervisor of Banks shall not be adopted, and that sections which instituted changes from the International Standard as detailed in Annex "B" to the Standard, shall not apply.

Management of the Bank is examining possible implications, if any, of implementation of the Standard for the first time.

1. ACCOUNTING POLICIES (CONTINUED)

Accounting Standard No. 23. In December 2006, the Israel Accounting Standards Board published Accounting Standard No. 23 – "The accounting treatment of transactions between an entity and the controlling shareholder therein".

The Standard replaces the Securities Regulations (Presentation in the financial statements of transactions between an entity and the controlling shareholder therein), 1996. The Standard states that the basis of valuation in transactions between a corporation and the controlling shareholder therein should be determined according to the fair value of the transaction. Differences between the consideration determined in transactions between a corporation and the controlling shareholder therein and the fair value of such transactions should be reflected in equity. The Standard presents details regarding accounting treatment with respect to prevalent kinds of transactions.

The Standard applies to transactions between an entity and the controlling shareholder therein subsequent to January 1, 2007, and is also applicable as from the said date to a loan extended to the controlling shareholder or received from the controlling shareholder prior to the said date.

As of date of publication of the financial statements, the Supervisor of Banks has not yet issued directives regarding the manner in which the Standard should be adopted by banking corporations, if at all.

Accounting Standard No. 30. In March 2007, the Israel Accounting Standard Board issued Accounting Standard No. 30 – "Intangible assets". This standard determines the accounting treatment of intangible assets not dealt with by other Standards, and it cancels certain provisions of Accounting Standard No. 20. The Standard applies to financial statements for periods beginning January 1, 2007.

On August 5, 2007, the Supervisor of Banks issued guidelines regarding the implementation of the Standard in which it was determined that a banking corporation is to prepare its financial statements for periods beginning on January 1, 2007 and thereafter, as provided in the Standard, subject to the following:

- Despite that stated in Section 72 of the Standard, a banking corporation shall implement the cost model only;
- Until the adoption in Israel of International Financial Reporting Standard No.3, "Business combinations", Sections 33-43 regarding the recognition of intangible assets acquired in business combinations, shall not apply to banking corporations. However, a banking corporation that with the approval of the Supervisor would adopt an early implementation in full of the US Accounting Standard No.141 (FAS 141) shall also implement the provisions of Sections 33-43 of the Standard.
- The balance of excess cost not attributed to balance sheet items, shall be deducted from equity for the purpose of calculating the equity to risk assets ratio. A banking corporation that would adopt an early implementation in full of FAS No.141 should refer to the Supervisor for specific guidelines in this matter.
- The cost of software recognized as an intangible asset is to be reflected in the item "Property and equipment".

The Supervisor also determined that sections of the Standard that include terms defined in the instructions of the Supervisor of Banks shall not apply, and that sections referring to Standards which have not as yet been adopted by the Supervisor of Banks shall not be adopted, and that sections which instituted changes from the International Standard as detailed in Annex "B" to the Standard, shall not apply.

Management of the Bank is examining possible implications, if any, of implementation of the Standard for the first time.

Accounting Standard No. 16. In February 2007 the Israel Accounting Standards Board issued Accounting Standard No. 16 – "Real estate investment". The Standard determines the accounting treatment of real estate for investment and it applies to financial statements for periods beginning January 1, 2007 or thereafter.

1. ACCOUNTING POLICIES (CONTINUED)

On August 5, 2007, the Supervisor of Banks issued guidelines regarding the application of this Standard in which it is provided that a banking corporation is to prepare its financial statements for periods beginning January 1, 2007 and thereafter, as determined in the Standard, however, notwithstanding the provisions of Section 30 of the Standard, a banking corporation is to apply the cost model only. The Supervisor also determined that sections of the Standard that include terms defined in the instructions of the Supervisor of Banks shall not apply, that sections referring to Standards which have not as yet been adopted by the Supervisor of Banks shall not be adopted, and that sections which instituted changes from the International Standard as detailed in Annex "B" to the Standard, shall not apply.

Management of the Bank is examining possible implications, if any, of implementation of the Standard for the first time.

2. GOVERNMENT DECISIONS REGARDING THE BANKING SYSTEM AND CHANGES IN THE STRUCTURE OF THE CAPITAL MARKET

On November 14, 2004, the Government accepted the recommendations of the "Bachar Committee" which were aimed at establishing a competitive structure in the capital market, reducing its centrality, and minimizing conflicts of interest.

Following the recommendations of the "Bachar Committee", three comprehensive laws were passed on August 10, 2005, relating to the capital market and to the activities of the banks therein. A summary review of the main amendments to the legislation was brought in Note 33 to the financial statements as of December 31, 2006.

Two new legislation initiatives commenced at the beginning of 2007, which if passed as law, are expected to impact the activity of the Bank in the field of pension consulting services: one, the Ministers' Legislation Committee adopted a private Bill, the essence of which is to prefer banking corporations having a shareholders' equity not in excess of NIS 10 billion (among which is the Bank) at the date of entry into the pension consulting field (by applying stiffer terms to the larger banks wishing to obtain a pension consulting license and extending the period until such license may be obtained) and advancing the date on which these banking corporations would be entitled to engage also in insurance products consulting. This proposed Bill grants the Bank as well as other banks an advantage over the two largest banks with respect to the date of entry into the pension consulting field.

On July 20, 2007, the Commissioner of Capital Market, Insurance and Savings in the Ministry of Finance informed that an agreement with Bank Hapoalim was reached, according to which Bank Hapoalim will be authorized to provide pension consulting to salaried employees in another three years, i.e. as from August 1, 2010. Until the said date, and following, Bank Hapoalim's preparations, including finalization of sale of its provident funds, Bank Hapoalim will be authorized to provide pension consulting to self-employed customers (that are not salaried employees), to customers up to the age of 18 (minors that saved in provident funds) and to customers age 55 years or more that are not salaried employees, and as long that they are not salaried employees (mainly early retirees who do not work).

In the framework of the said agreement, the Supervisor announced that the Treasury department will initiate, during 2007, proposed government legislation that will enable banks to provide consulting regarding life assurance products (as defined in the Pension Consulting Law), and to collect in respect of such products distribution commissions equivalent to distribution commissions in respect of mutual fund and pension products. It has been announced accordingly, that the Ministry of Finance intends to include, within the framework of the Economic Arrangements Law for 2008, an amendment of this nature to the Law and Regulations.

In contrast, a private Bill was tabled by several members of the Knesset, whereby the authority of the Commissioner

2. GOVERNMENT DECISIONS REGARDING THE BANKING SYSTEM AND CHANGES IN THE STRUCTURE OF THE CAPITAL MARKET (CONTINUED)

is to be limited as would be the discretion granted to him, thereby enabling a delay in the entry of the large banks into the pension consulting market.

The second initiative is the adoption of a law for "compulsory pension" for each working individual. According to the proposed law which was passed in the first reading in March 2007, as from 2010, the tax regulations applying to capital provident funds are to be equalized with those applying to pension provident funds, so that a working person may save under any fund while enjoying the tax benefits granted at present to the pension instrument. The decision as to the nature of the retirement savings would be deferred until retirement date, on which the worker would be entitled to convert the savings into a monthly pension or to capitalize part of the savings into a one-time payment in accordance with rules to be determined. The worker would also have the possibility of dividing the retirement savings components and acquire these from various entities and not from one entity. Each of these entities would on its part be entitled to offer the savers all the required coverage, with no subordination as to tax benefits.

This initiative, if adopted, may significantly increase the potential population requiring pension consulting services. Notwithstanding, the matter might harm the demand for pension consultation, in view of the deferment of the date on which the customer is required to decide of the savings option, particularly to the extent that they are not allowed to provide insurance consulting services. In addition, the initiative requires a reexamination of the framework of the banks' remuneration as consultants through distribution commissions, and as operating service providers to management companies through operating fees.

The New Federation of Labor and the Industrialists Association signed an agreement for a compulsory pension for every employee in July 2007. At this stage it is unclear whether it is the Government's intention to continue the legislation process regarding compulsory pension or to apply the said agreement to additional sectors in the economy by way of an Extension Order.

At this stage, it is not possible to assesses whether any single one, if any of the above mentioned proposals will be enacted into Law, and what will be the arrangements that will be enacted according to them.

Concurrently with the legislation process following the Bachar Committee recommendations, and even more intensely following the completion of this process, the Bank commenced the examination of the reform in the capital market, the risks faced by the Bank, and the opportunities that it presents. In the last two years, the Bank has been acting towards the implementation of several steps intended at enhancing its preparations for capital market activities in the post Bachar Committee era. In this context the Bank completed the sale of the shares in Ilanot Discount Ltd. and the sale of its activities in the field of provident funds management, later completed the sale of Ilanot Discount Ltd. shares and signed an agreement for the sale of its provident fund management activities, as detailed in Note 6 E to the financial statements as of December 31, 2006 and Note 11 hereunder. The Bank has also signed an agreement for the sale of the operations in the field of further training funds, the implementation of which was completed subsequent to balance sheet date, as detailed in Note 19 C 21 to the financial statements as of December 31, 2006 and Note 12 hereunder. Hence, the anticipated damage to the Bank as a result of the detachment of the provident funds and mutual funds stems mostly from the loss of income. In addition, the Bank is expected to sustain damages in view of the inevitable decrease in its holdings in insurance-related corporations, in order to enable the Bank to engage in pension consulting, mainly as a result of loss of income (for details regarding the sale of holdings in Harel, see Note 14 below).

Damage to the Bank may result from the Regulations regarding the distribution commissions that a bank would be

2. GOVERNMENT DECISIONS REGARDING THE BANKING SYSTEM AND CHANGES IN THE STRUCTURE OF THE CAPITAL MARKET (CONTINUED)

entitled to collect from provident fund and mutual fund management companies, their rates, the basis of their calculation and circumstances of collection. The Regulations pertaining to these matters came into effect on April 1, 2006. The arrangement determined in the Regulations, in particular with regards to provident funds, might adversely effect the income of the Bank. This in view of the fact that the earning of a distribution fee in respect of provident fund savings of customers is conditional upon the customers signing a pension consulting agreement (an act that may begin only after the pension consulting license is obtained). In September 2006, the Capital Market Commissioner issued a circular regarding agreements for the providing of operational services to institutional bodies. Among other things, the circular regularizes the matter of the payment that banks would be entitled to collect from the managing companies in respect of the "existing inventory" of members' assets in the provident funds being sold. A transitional period until the end of 2007 has been determined, during which the banks, under certain terms, would be entitled to an annual payment of 0.25% of the value of assets of provident fund members who have not as yet signed a consultation agreement with the bank and continue to hold their assets with the provident fund that had been sold. The circular letter also regularized the maximum amount of operating fees that may be charged to the management company for management services provided to it, fixing it at 0.1% of the assets of the members in respect of which the services are provided At this stage it is not yet possible, to assess what implications these Regulations, the Commissioner's circular and other arrangements to be determined by the market and by the authorities, might have on the Bank's income and on the volume of its activity in distributing the said products. The Bank estimates a material decrease in income from provident funds and mutual funds in the coming years.

The limitations imposed on the additional activities that would be permitted to banks, on the one hand, and the uncertainty regarding arrangements to be established by legislation, in view of the new legislation initiatives in the pension field, on the other hand, make it difficult to assess, at this stage, the income that the Bank would derive from the implementation of the new legislation, including the income to be earned from new areas of operations on the one hand, and the loss of income from provident funds and mutual funds and from the investment in Harel on the other hand.

The Bank believes that even after entering the sale agreements as aforementioned, the implementation of the new legislation may have an adverse effect on the Bank's business and on its results of operations. However, in view of everything stated above, the future implications of the implementation of the capital market reform and new legislation initiatives in this field on the position and the Bank's results of operations cannot yet be evaluated or quantified.

The income from management fees and the reimbursement of expenses by provident funds in the first half of 2007, amounted to NIS 97 million, compared to NIS 93 million in the corresponding period last year, and NIS 189 million in 2006.

As a result of the sale of Ilanot Discount, the Bank did not receive income from mutual fund management, as compared to NIS 98 million in the first half of 2006.

Earnings from distribution fees charged to managers of mutual funds amounted, in the first half of 2007 to NIS 29 million.

The contribution of Harel to the net earnings of the Bank in the first half of 2006 totalled NIS 22 million.

3. IDB NEW YORK – AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS AND OTHER MATTERS

Investigation regarding prohibition on money laundering. In 2005, the New York County District Attorney's Office conducted investigations in several banks and financial institutions regarding their compliance with requirements relating to money laundering legislation and transfer of funds from Brazil to the United States. In the framework of these investigations, IDB New York was also examined. To the best of the Bank's knowledge, the investigation findings ascertained that IDB New York did not act in accordance with regulations relating to the prohibition on money laundering, did not properly document customer details and decision regarding suspicious activity, did not report thereon as required and did not formulate an appropriate compliance program in connection with money laundering. Also, the audit findings ascertained that most of the deficiencies disclosed were ascertained in previous audits by the supervisory authorities. Concurrently, a regular examination was conducted in IDB New York in cooperation with the Banking Department of the State of New York and the FDIC (Federal Deposit Insurance Corporation), in which extensive deficiencies were ascertained regarding the effectiveness of the reporting and controls relating to the prohibition on money laundering (AML) and prevention of financing of terror activity.

Cease and Desist orders. As a result of the above-mentioned findings, the Banking Department of the State of New York and the FDIC (together – "the supervisory authorities") issued cease and desist orders according to which IDB New York was required to cease its activity according to existing defective procedures, to amend the defects and deficiencies, to expand the supervisory and control procedures, to formulate an enforcement program and to amend the procedures in this regard, all according to instructions and as of dates determined by the supervisory authorities ("the compulsory procedures").

The cease and desist orders include, inter alia, the following:

(1) The Board of Directors of IDB New York will appoint an outside entity that will examine the activity implemented by senior management to amend the defects and deficiencies ascertained in previous audits;

(2) A comprehensive program will be formulated, adopted and implemented that will ensure compliance with the provisions of the legislation and regulations regarding the prohibition on money laundering and prevention of financing terror; the program will take into consideration, inter alia, systems of controls, training programs, audit plan and appointment of an officer who will bear responsibility for compliance with the said legislation and regulations, including through the preparation of a report on examination of gaps and implementation of a "Look Back" review as detailed below;

(3) A compliance committee will be appointed composed of directors in IDB New York, which will supervise implementation of the compulsory procedures;

(4) IDB New York will be subject to a payment that will not exceed US$ 16.5 million, payable to the Banking Department of the State of New York, to the FDIC and to FinCen (Financial Crimes Enforcement Network). The total said amount was set aside in 2005.

On December 15, 2005, IDB New York confirmed its agreement to operate in accordance with the requirements of the compulsory procedures. The Bank, as the parent company of IDB New York, declared its awareness of the above-mentioned arrangements and committed to act insofar as possible to ensure fulfillment of the above-mentioned liabilities.

Concurrently and additionally, on December 15, 2005 IDB New York reached a compromise arrangement with the District Attorney for the State of New York regarding cessation of his investigation. According to the arrangement, IDB

3. IDB NEW YORK – AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS AND OTHER MATTERS (CONTINUED)

New York committed to cooperate with the District Attorney. Also, IDB New York confirmed its recognition of the facts regarding certain accounts and its awareness that certain internal controls, procedures and treatment regarding the prohibition on money laundering contributed to the findings of the District Attorney and the supervisory authorities. According to the conditions of the agreement, IDB New York committed to pay US$ 8.5 million and to report to the District Attorney within one year regarding all measures implemented to improve the bank's procedures and to amend the defects and deficiencies that were ascertained by the District Attorney and by the supervisory authorities as detailed in the compulsory procedures; such reporting was implemented as required. The total said amount was set aside in 2005. The District Attorney of the State of New York agreed to refrain from indicting IDB New York and its related parties regarding the investigation.

Changes in composition of management and Board of Directors of IDB New York. On February 6, 2006 the Board of Directors of the Bank decided to recommend to the Board of Directors of IDB New York to appoint Mr. Reuven Spiegel as President and CEO of IDB New York, in place of Mr. Arie Sheer. On February 23, 2006, the Board of Directors of IDB New York decided to terminate the appointment of Mr. Arie Sheer and to appoint Mr. Reuven Spiegel as President and CEO of IDB New York. During 2006 all senior management and members of the Board of Directors of IDB New York were replaced.

Implementation of commitments stated in the cease and desist orders. Management of IDB New York commenced immediately after issuance of the cease and desist orders to implement the commitments stated in the cease and desist orders and in the agreement for cooperation with the District Attorney, and such implementation continues in accordance with the timetable fixed. IDB New York is required to act on three levels: (a) preparation and formulation of a comprehensive program for enforcement and implementation of the cease and desist orders (for this purpose, KPMG was engaged to prepare for IDB New York a gap report); (b) examination of activity of senior management regarding implementation of previous audit findings. For this purpose, the services of Promontory (a company providing financial consulting services, one of its specialized areas is providing solutions to customers facing regulatory demands) were engaged; and (c) examination of all transactions in IDB New York between the years 2002 – 2005 ("Look Back") in order to ascertain any suspect activity that, as such, requires reporting.

Promontory report. On April 5, 2006, the Promontory report was transmitted to IDB New York, including a summary of the examination findings. The report details the circumstances, defects and deficiencies that resulted, according to the report's preparers, in issuance of the cease and desist orders and the District Attorney's examination. The report also includes recommendations for required improvements and changes in order to avoid similar defects and deficiencies in the future. According to the report, most of the recommendations have been implemented by IDB New York. Almost all of the defects and deficiencies included in the report constitute reporting and supervisory/control deficiencies derived, in part, from the defective internal communications and defective communications with the authorities, some of which derive from an organizational structure that requires change (such change has already been implemented) and some of which derive, as stated, from weak supervisory and control tools. IDB New York believes that addressing all the recommendations will be completed by the end of the third quarter of 2007.

The internal audit function of IDB New York is responsible for supervision of the activity implemented in order to improve the required procedures in accordance with the Promontory report. As of the date of publication of the financial statements, around 94% of the recommendations included in the comprehensive enforcement program and in the

3. IDB NEW YORK – AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS AND OTHER MATTERS (CONTINUED)

Promontory report, were implemented.

KPMG report. The gap report examines IDB New York's compliance with regulations relating to the prohibition on money laundering and financing of terror, and recommends actions for IDB New York to implement in order to comply with these regulations.

The report was transmitted to the supervisory authorities in August 2006 and, according to IDB New York, all recommendations included in the report, including replacement of the computer system, will be implemented toward the end of 2007.

"Look Back" review. IDB New York authorized transfers in the amount of US$ 5.2 million in the years 2002 – 2005, of which legal doubt exists regarding US$ 12.5 thousand of this amount. In order to determine the amounts regarding which retroactive reporting is required to the supervisory authorities, the bank engaged the services of a consulting and investigation company that prepared a methodology document in this regard, which was transmitted to the supervisory authorities in September 2006. In December 2006 the supervisory authorities informed IDB New York that the methodology document appears reasonable. Accordingly, implementation of the "Look Back" review commenced and as of the date of preparation of the financial statements the review continues; according to IDB New York completion of the review is expected in the third quarter of 2007.

Material weakness in internal controls in 2005 reports. According to information transmitted to the Bank, at the audit committee meeting at which the financial statements of IDB New York as of December 31, 2005 were approved, management of IDB New York reported that material weaknesses in internal controls were identified, which relate to compliance with the Bank Secrecy Act ("BSA") and the Anti-Money Laundering Act ("AML").

In order to implement appropriate supervision regarding controls relating to the BSA and AML, IDB New York appointed a compliance committee composed of three outside directors, and appointed a new BSA and AML officer. The committee reports monthly to the Board of Directors, and formulated rules for the committee's activity and defined responsibilities of the BSA and AML officer.

On February 7, 2006 the Board of Directors approved the compliance program relating to BSA/AML issues and distributed the program on February 23, 2006 to all IDB New York employees. The new BSA/AML officer commenced his responsibilities on January 16, 2006, and also serves on the compliance committee and reports to the Board of Directors, to the audit committee and to the General Manager.

Material weaknesses in internal controls on financial reporting for 2005. In the framework of IDB New York's reporting in accordance with Federal Deposits Insurance Corporation Improvement Act (FDICIA) regulations, the new management of IDB New York which was appointed after transfer of the control in the bank, reported that it identified material weaknesses in internal controls on financial reporting as of December 31, 2005, and that these weaknesses relate to the cease and desist orders issued by the supervisory authorities in the United States in December 2005.

IDB New York's auditors announced that the material weaknesses identified do not affect their unqualified opinion on the financial statements as of December 31, 2005, which was issued on March 20, 2006, and that the said weaknesses were taken into account in determining the required scope of the audit of the financial statements for 2005.

Lack of Material weaknesses in internal controls on financial reporting for 2006. According to information transmitted to the Bank, at the audit committee meeting at which the financial statements of IDB New York as of December 31, 2006 were approved, management of IDB New York reported that no material weaknesses in internal

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controls were identified and that all material weaknesses identified in 2005 were amended.

Examination in Discount Bank Latin America ("DBLA"). As a result of the above-mentioned examinations by the authorities of IDB New York, in December 2005 an examination was implemented in DBLA by the Central Bank of Uruguay.

As a result of the examination, a penalty in the amount of US$41,000 was levied on DBLA and recommendations were transmitted for the arrangement of its activity: procedures for reporting on suspect transactions, installation of a computer system to locate and warn regarding suspect transactions, improvement of documentation and retention of customer data and closing DBLA representatives in Argentina, Brazil, Mexico and Peru. As a result of the examination, DBLA engaged the services of KPMG to formulate a program to improve preparations for implementation of regulations regarding the prohibition on money laundering. Most of the recommendations have already been implemented. The representative offices have been subordinated to IDB New York.

Costs. The financial statements as of December 31, 2005 include a provision in the amount of NIS 120 million in respect of penalties and consulting. The cost of implementation of the improvements and examinations amounted to US$16.1 million in 2006 and to an additional US$7 million in the first half of 2007. According to IDB New York, additional costs will be incurred during 2007 for implementation of improvements and examinations in an amount between US$3 million – US$5 million.

The Bank believes that the said investigation and the cease and desist orders described above had no significant effect on the business of IDB New York, over and above the increase in expenses and the reduction in earnings for 2006, resulting from the fines imposed on IDB New York and the expenses incurred in correcting the deficiencies.

The Bank estimates, in view of the measures taken to correct the deficiencies, that the possible exposure with respect to the investigation and the cease and desist orders described above is low.

Developments in 2007. At the beginning of 2007, in the framework of the "Look Back" review, it was ascertained that several accounts managed in IDB New York belonged to Iranian residents and that several transfers were implemented from accounts managed in IDB New York to Iranian residents. IDB New York informed the United States Office of Terror Assets Control (OFAC) and engaged outside consultants to examine the issue. According to independent legal counsel engaged in this regard, the maximum penalty that may be levied on IDB New York in this regard may amount to US$ 1 million. The financial statements of IDB New York include a provision in accordance with the estimate of management of IDB New York.

In January 2007 IDB New York requested from an outside legal consultant that consults to the bank regarding regulatory issues ("the outside legal counsel") to prepare an examination regarding transactions implemented between IDB New York and Mr. Matthew Bronfman, a controlling shareholder in the bank and in related parties thereto. The examination was intended to ascertain that these transactions received all required approvals according to the law applying in the United States as transactions with a controlling shareholder and to provide recommendations regarding these transactions specifically, and regarding the issue in general. On February 23, 2007 the outside legal counsel prepared a draft report (hereinafter: "the draft report") that included consideration in respect of several transactions, including the transactions detailed in Note 22 I and J to the financial statements as of December 31, 2006.

In February 2007 the outside legal counsel drew the attention of the members of the Board of Directors of IDB New York to their responsibility for supervision of the relationships between the shareholders and their representatives on

3. IDB NEW YORK – AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS AND OTHER MATTERS (CONTINUED)

the Board of Directors of IDB New York, in order to ensure that IDB New York does not impair the advancement of implementation of the cease and desist orders because of disputes between the shareholders.

The draft report was transmitted for comments to several entities, including the previous chairman of the Board of Directors of IDB New York, Mr. Leonard Grunstein. To the best of the bank's knowledge, Mr. Grunstein has certain criticisms regarding the draft report, including arguments regarding the unfair influence of IDB New York's management on the report's preparers. These arguments were transmitted for to an outside American legal examination, as detailed hereunder.

On April 1, 2007, the Board of Directors of the Bank held a discussion regarding IDB New York. At the meeting, the following subjects were discussed:

(1) Recommendation to the controlling shareholders in the Bank or their representatives to refrain from serving as directors in IDB New York and in Bancorp.

The above-mentioned recommendation was accepted for the good of the Israel Discount Bank Group, including companies in which controlling shareholders or their representatives serve as directors. In the opinion of the Board of Directors of the Bank, participation of controlling shareholders and their representatives creates difficulties in the functioning of the Board of Directors and management of IDB New York.

(2) To set up an ad hoc committee authorized to request at its discretion and receive reports with respect to IDB New York and to Bancorp, including with respect to all transactions and agreements made by these companies not in the ordinary course of business, and to provide recommendations in this respect to the Board of Directors. Within this framework, the committee was authorized to examine the engagements entered into as mentioned in the draft examination report regarding Discount Bancorp and IDB New York, the arguments raised by Mr. Grunstein as part of his response to the draft report as well as other matters, among which is the engagement with the law office in which Mr. Grunstein is a partner, for providing legal services, and the engagement of IDB New York with Ms. Alexandra Lowenthal, who at that time served as a member of the board of directors of IDB New York, for her employment as president and CEO of IDB Capital Corp., a wholly owned subsidiary of IDB New York (hereinafter: "the investigated transactions").

(3) To instruct the Bank's internal auditor to conduct a special examination, not as part of the internal audit work plan in IDB New York, and to report his findings to the Board.

Following the said resolutions, the committee and the Bank's Board of Directors acted as follows:

(1) Upon receipt of the recommendation of the Board by the controlling shareholders and their representatives that they are not to act as Directors in IDB New York and in Bancrp, they informed Mr. Matthew Bronfman, who served as Chairman of Discount Bancorp and as a director in IDB New York, and Mr. Michael Rubinoff, who served as a director in IDB New York, that they will terminate their participation as directors in Israel Discount Bank Group companies.

Mr. Grunstein, who served at the same time as Chairman of IDB New York and as a director in Discount Bancorp, informed the Bank that he is not prepared to accept the said recommendation, and detailed reasons for his announcement. Also, for the good of the Discount Group, the Board of Directors decided at its meeting on April 13, 2007 to terminate Mr. Grunstein's service as a director in Discount Group companies.

(2) The committee held several meetings and among other things requested a legal opinion from an independent

3. IDB NEW YORK – AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS AND OTHER MATTERS (CONTINUED)

New York Counsel regarding the US law applying to the investigated transactions and provided guidelines to the independent Counsel engaged by the Bank to examine the arguments raised by Mr. Len Grunstein regarding the examination report (see above). Furthermore, the committee received reports from the internal auditor of the Bank regarding his audit findings in New York and among other things, has guided him to examine the activity of the Board of Directors of IDB New York and its committees.

(3) Among other things, the committee began discussing the manner in which the Bank, as the controlling shareholder of IDB New York and Bancorp, supervised the investigated transactions in particular, and the way in which transactions of this kind are approved generally, and the recommended manner in which such transactions are to be approved, supervised and controlled in the future. In this matter, the committee has requested an opinion from a leading legal Counsel, who among other things was engaged by the Bank to recommend an all inclusive company governance plan for the Group.

(4) On July 2, 2007, the report of the special examination performed by the Bank's Internal Auditor in Discount Bancorp and IDBNY was submitted to the Committee. The report's findings indicate, among other things, deficiencies at Bancorp and IDBNY concerning the procedures for approval of transactions with "related parties" and the lack of procedures in this respect.

(5) In July 2007 a report of the examination of a U.S. legal firm, which was engaged to examine the arguments of the former IDB Chairman, Mr. Len Grunstein, as raised in his response to the draft audit report, was submitted to the committee and the Board of Directors. The examination report ascertained that Mr. Grunstein's arguments have no basis.

(6) On August 2, 2007 a draft report of the examination of a U.S. legal firm, which was engaged to examine the transactions regarding which the committee was appointed, inter alia, from the standpoint of United States legislation. At this stage, the draft examination report does not include conclusions and recommendations. The committee has not yet completed its discussion of the draft findings.

(7) On August 2, 2007 the committee recommended to the Board of Directors to adopt the principles and procedures stated in the legal opinion submitted by a well-known legal expert, according to which approval procedures required by Israeli legislation regarding transactions between interested parties in the bank and the Bank would be applied to transactions between an interested party in the Bank and between Bancorp and I.D.B. New York. The said recommendations are subject to the possibility of their application under the US laws applying to Bancorp and IDB New York.

It should be noted that the said legal opinion is part of Discount Bank Group's overall program of "company governance" currently being prepared.

4. VARIOUS ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

As detailed in Note 19 C 14 to the financial statements as of December 31, 2006, various actions are pending against the Bank and its consolidated subsidiaries, including class action suits and requests to approve actions as class action suits.

In the opinion of the Management of the Bank, which is based, inter alia, on legal opinions and/or on the opinion of managements of its consolidated subsidiaries, which are based upon the opinion of their legal counsels, respectively, as the - case may be, adequate provisions have been included in the financial statements, where required.

The total exposure with respect to claims filed against the Bank and its consolidated subsidiaries, whose prospects of materializing, in whole or in part, has been assessed as reasonably possible, amount on June 30, 2007 to approximately NIS 108 million.

A description of material legal proceedings being conducted against the Bank and Group companies was brought in Note 19 C sections 14 through 16 to the financial statements as of December 31, 2006. The criteria under which a legal proceeding will usually be defined by the Bank as material is brought in Note 1 Q to the financial statements as of December 31, 2006.

Following is a summary of significant updates regarding material legal actions against the Bank and its subsidiaries:

4.1 Note 19 C 14.1.2 to the financial statements as of December 31, 2006, described an action filed on November 1, 2004, with the Court in Los Angeles against the Bank and others for the payment of damages in the sum of US$350 million as well as a plea for punitive damages against the Bank as the Court will determine.

The plaintiff alleged that the Bank has breached explicit undertakings towards it for the granting of a credit line in the amount of US$3 million. The plaintiff based the action upon several causes, amongst which are: the non-disclosure of material facts, making promises with no intension of honoring them, deceit through the non-disclosure of material facts, misrepresentations, negligence, breach of a written agreement, cover up and violation of non-competition laws.

The plaintiff alleged that due to the said breach of undertakings, the Bank brought about its demise and caused it heavy losses estimated at amount in excess of US$350 million.

It should be noted that according to the agreements signed between the plaintiff and the Bank, the applicable jurisdiction is that of the Courts in Israel and the applicable law is the Israeli law.

On December 17, 2004, the Bank submitted to the Court in Los Angeles a petition, requesting that the hearing of the claim be transferred from the Court of the State of California to the Federal Court. On January 25, 2005, the plaintiff submitted an objection to this request.

On February 18, 2005, the Bank again submitted to the Court in Los Angeles, a petition requesting that the claim be dismissed on the grounds, inter alia, that the Court in Los Angeles has no jurisdiction in this matter, due to the fact that the agreement between the plaintiff and the Bank contains a clause stipulating that exclusive jurisdiction in any legal proceedings is given to a Court in Israel and applying the Israeli law to the agreements, and that the appropriate forum for hearing this matter is a Court in Israel. The plaintiff also submitted an objection to this petition.

On April 8, 2005, the Federal Court in Los Angeles dismissed the action on the grounds that the appropriate forum for dealing with this action is the Court in Israel. The Court did not refer to the other arguments of the Bank including the argument regarding the jurisdiction.

On May 6, 2005, the plaintiff appealed the said decision.

On April 19 2007 the Court rejected the appeal of the Federal Court's verdict brought by the plaintiff.

The date for submission of request for permission to appeal to the Supreme Court has passed, and to the Bank's best

4. VARIOUS ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

knowledge no such request has been submitted.

Dismissal of the appeal does not preclude the filing of a claim in Israel. Nonetheless, the Management of the Bank, based on counsel's opinion, is unable to determine whether the plaintiff would submit a similar claim in Israel, and if so under what causes of claim and for which amount.

4.2 Note 19 C 15.3 to the financial statements as of December 31, 2006, described a lawsuit in the amount of US$300 million filed by a former customer of the Bank (hereinafter: 'The plaintiff") on December 8, 2005 in the Court of the State of California, USA, being a counterclaim following proceedings instituted by the Bank in the United States, for the enforcement of Court rulings given in Israel against the Plaintiff, in an amount of US$13 million. It should be noted that on January 15, 2007, the Israeli Supreme Court dismissed the plaintiff's appeal of the verdicts against him, the enforcement of which is the subject of the claim filed by the Bank in the United States.

The counterclaim is based on the argument that the Bank had violated its obligation to provide credit to the plaintiff and to a company of which he was one of the owners (hereinafter: "the company"), for the purpose of purchasing another company. It is also alleged that false and negligent representation had been provided to the plaintiff.

The direct damage was set at an amount of at least US$100 million in respect of loss of earnings as a result of the failure of the transaction to purchase that other company, and at least US$200 million in respect of loss of earnings as a result of the collapse of the company. Punitive damages are also claimed in an amount not estimated by the plaintiff. It should be noted that a similar action filed by the plaintiff and others in Israel was dismissed, and that the proceedings instituted in the USA by the plaintiff several years ago with respect to the issue which is the subject of the claim, had been dismissed by the Court in New York, following the admittance of the Bank's argument regarding improper forum. On June 26, 2007, the lawsuit was dismissed in limine on grounds of inappropriate forum. The Plaintiff is entitled to appeal this ruling. As of date of issue of the financial statements the Bank has not received notice of such appeal.

4.3 Note 19 C 15.6 to the financial statements as of December 31, 2006 described an action filed on June 19, 2006, together with a motion for its approval as a class action against the State of Israel and 31 other defendants, including the Bank, Mercantile Discount Bank, Discount Gemel (Formerly: Discount Management of Provident Fund Ltd.) and the provident funds of Mercantile Discount Bank.

The claimants allege that the defendants have unlawfully received payments in respect of foreclosures imposed by those who were granted execution through the magnetic media. The principal claim is that the defendants do not provide the service required by law, in that they do not provide full and detailed information in their reply to the Bailiff Office, and accordingly are not entitled to the payment determined in the regulations.

The amount of the claim against all defendants totals NIS 233 million. The claim does not specify the amount claimed from each of the defendants. The Bank estimates that the maximum exposure of the companies of the Discount Group involved in this case would not exceed NIS 10 million.

On October 18, 2006, the Bank motioned the Court for the dismissal of the claim in limine concurrently with a plea for extension of the date for submission of a response brief to the motion for approval of the claim as a class action. As claimed by the Bank, the claim is to be dismissed being based on a cause existing between the Bank and its customer, while the Claimants are not considered customers of the Bank and the service being the subject of the claim does not constitute a banking service. A decision with respect to this motion has not as yet been given. The hearing of the case was postponed to October 2007.

5. REQUESTS TO APPROVE CERTAIN ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES AS CLASS ACTION SUITS AND OTHER ACTIONS FOR WHICH IT IS NOT POSSIBLE AT THIS STAGE TO EVALUATE THEIR PROSPECTS OF SUCCESS

Class action suits and requests to approve certain actions as class action suits as well as other actions are pending against the Bank and its consolidated subsidiaries, which in the opinion of the Management of the Bank, which is based on legal opinions and/or on the opinion of managements of its consolidated subsidiaries, which is based on the opinions of their legal counsels, respectively, as the case may be, it is not possible at this stage to evaluate their prospects of success, and therefore no provision have been included in respect therewith.

5.1 A requests to approve a certain action against the Bank as a class action suit:

Note 19 C 15.1 to the financial statements as of December 31, 2006, described a lawsuit that was filed in December 2002 against the Bank and against Mercantile Discount Bank together with a plea to have it approved as a class action suit. The plaintiff raises claims against the Bank, according to which the Bank allowed the opening of fictitious accounts at the time of the securities issue by a corporation which was one of the Bank's clients and granted credit to hundreds of "Straw Customers" without obtaining collateral, and that at a later stage, the Bank enabled the manipulation in the price of the shares. The plaintiff estimates that the damage caused to him amounts to NIS 5.7 million. The total amount of the damage stated in the petition for a class action against the Bank and Mercantile Discount Bank together is NIS 500 million.

The court has extended the date by which the reaction to the request for approval may be submitted until such time as the preliminary requests submitted by the Bank and Mercantile Discount Bank, are decided, so that in effect, at this stage, the proceeding is in practice delayed until the decision on the preliminary requests.

For details of the action filed against Mercantile Discount Bank based on other grounds see note 19 C section 14.2 to the financial statements as of December 31, 2006 .

5.2 Note 19 C 15.2 to the financial statements as of December 31, 2006, described an application for exemption from the Court fee submitted on September 1, 2004, to the Tel Aviv District Court in connection with a suit in a sum of NIS 500 million brought by the liquidators of a company against forty defendants, one of which was the Bank. The court accepted partially the request for exemption and determined the fee at NIS 320 thousand.

The suit against the Bank turns on three causes only, which relate to alleged injury valued at US $4 million in respect of a transaction undertaken between the company in liquidation and a third party involving the sale of an asset mortgaged to the Bank, which, according to the liquidators' assertions, was sold for less than its true value, the release of the shareholders of one of the companies in the group from their guarantees in relation to the debts of the company to the Bank totaling NIS 3 million; and the return of deferred payment orders to the company in liquidation without the items passing through the company's bank account, thus causing injury valued at NIS 9 million.

It should be noted that the liquidators claim that the behavior of the Bank as described above led to the final liquidation of the company without any specific claims having been made by the liquidators as to the injury attributable to the Bank in relation to this cause of action.

The Bank submitted its defense brief on October 3, 2006. A date for a hearing on the case has not yet been fixed.

5.3 Note 19 C 15.5 to the financial statements as of December 31, 2006 described a lawsuit that was filed on September 12, 2006, against the Bank, Bank Leumi Le'Israel. and Bank Hapoalim, together with a motion for approval of the lawsuit as a class action suit. The claimant assesses the amount of the claim at NIS 7 billion in respect of all the defendants, while reserving the right of amending the amount according to developments in the case.

5. REQUESTS TO APPROVE CERTAIN ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES AS CLASS ACTION SUITS AND OTHER ACTIONS FOR WHICH IT IS NOT POSSIBLE AT THIS STAGE TO EVALUATE THEIR PROSPECTS OF SUCCESS (CONTINUED)

The claimant argues that the defendant banks provide most of the credit to the public (about 80%) and that they exploit their central position in the credit market in order to regulate between them the interest rate, credit allocation commission and ledger fees in everything relating to non-linked Shekel credit accounts in general, and to current loan accounts particularly.

As argued by the claimant, the complete similarity between the three banks resulted in enormous profits on the one hand, and in an enormous loss to the public and to the economy on the other hand. The claim is based on the findings of the "Bachar Committee" and on data provided by the Bank of Israel as well as on the financial reports of the defendant banks for the years 1998-2005.

The claimant argues that it has a cause of action both under the Restrictive Trade Practices Law, the case constituting a prohibited Binding Arrangement, and under the Banking Law (Customer Service), as according to their claim the banks took advantage of the customers' distress, ignorance and lack of experience to provide them with banking services under unreasonable terms.

The claimant submits the claim in respect of the personal loss caused to it by conducting its account at the Bank, as well as requesting permission to sue on behalf of all the customers of the Banks who received non-linked Shekel credit based on the prime rate interest, as well as on behalf of business customers who received non-linked Shekel credit in current loan accounts.

The relief claimed is a retroactive reduction in the prime rate of interest and in the interest on current loan accounts, cancellation of the credit allocation commission and a reduction in ledger fees, all relating to interest and commission fees charged in the last decade.

The Bank has responded to the motion for approval of a Class Action Suit.

The parties accepted the Court's suggestion to submit their summing-up briefs in writing based on the material submitted to the Court, without having to hold hearings of evidence.

5.4 Note 19 C 15.7 to the financial statements as of December 31, 2006 described a lawsuit filed on November 23, 2006, at the Jerusalem District Court together with a motion for its approval as a class action suit against the Bank, Bank Hapoalim BM and Bank Leumi Le Israel BM. The claimants assess the amount of the claim at between NIS 5.2 and NIS 5.6 billion for all the defendants, while they reserve the right to amend the claim brief. In the claim brief the claimants argue that the defendant banks charge the private household sector interest at an exorbitant rate, which is much higher than the interest rate charged to the commercial and business sectors, this without any economic and commercial justification. According to the claimants, they have a cause of action under the Restrictive Trade Practices Law, due to the defendant banks constituting, as alleged by them, a monopoly, which according to them misuses its monopolistic power, and because, as they claim, there exists prima facie a binding contract between the defendant banks, and also under the Banking Law (Customer service) and under the Consumer Protection Law in respect of - according to their claim – the misleading of customers while utilizing their distress and ignorance for engaging them in transactions at unreasonable terms and/or for the purpose of receiving consideration that exceeds the accepted consideration.

The claimant apply for relief by way of the refund of interest at an average yearly rate of 2.2% in respect of the credit taken in the past seven years by each member of the class, which the claimant assess at about 950 thousand account holders, holding some 2 million bank accounts. The personal claim of each member is assessed by the claimants at

5. REQUESTS TO APPROVE CERTAIN ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES AS CLASS ACTION SUITS AND OTHER ACTIONS FOR WHICH IT IS NOT POSSIBLE AT THIS STAGE TO EVALUATE THEIR PROSPECTS OF SUCCESS (CONTINUED)

between a few Shekels and NIS 10,000, while the amount of the average claim is estimated by them to be NIS 2,630 per class member. The personal claim of one of the claimants who owns a bank account amounts to NIS 430.

The bank responded to the motion to approve the claim as a class action suit. A date for the hearing has not yet been fixed.

5.5 Note 19 C 15.8 to the financial statements as of December 31, 2006 described a lawsuit filed on January 31, 2007, by members of provident funds and of further education funds at the Tel-Aviv District Court together with a motion to approve the lawsuit as a class action suit, against the Bank and two other banks.

The plaintiffs allege that the banks collected excessive commissions with respect to securities operations of provident funds and further education funds managed by them, while exploiting their control over these funds. Among other things, the plaintiffs base their claim upon the Report by the State Comptroller and Ombudsman for 2003.

The plaintiffs allege that the banks violated various provisions of the Banking Law, the Banking Regulations and the Rules for approval of provident funds, relating, among other things, to the duty of fair disclosure, investment consultancy and customer service.

The plaintiffs' petition for the reimbursement of all commissions collected from the provident and further education funds in respect of securities operations, and alternatively, determining lower rates for such commissions and the repayment of the difference.

The plaintiffs assess the claim against all the Defendants at NIS 200 million, without allocating the amount among the Defendants. According to an annex attached to the claim brief, the share of the Bank amounts to NIS 50 million.

The Bank has not yet responded to the motion for approval of the class action.

5.6 Request to approve a certain action against Discount Mortgage Bank ("DMB") as class action suit:

Note 19 C 15.9 to the financial statements as of December 31, 2006, described a petition for approval of an action as a class action suit filed with the District Court On June 19, 2000, by two borrowers of DMB against DMB and against the Israel Phoenix Insurance Co. Ltd., where the properties of the borrowers are insured. The action is for an amount of NIS 105 million. The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

The hearing of the pre trial in this action has been set for June 28, 2007. and was deferred until July 2, 2007. At the preliminary meeting convened on July 2, 2007, it was decided to defer the hearing until January 7, 2008.

5.7 A lawsuit was filed on April 1, 2007 with the Tel Aviv District Court against the Bank, Bank Hapoalim, First International Bank and Harel Investment House Ltd., Clal Finance Batuchah Investment Management Ltd. and the Central Company for Stock exchange services (Securities) Ltd., together with a motion for approval of the lawsuit as a class action.

The Plaintiffs argue that that as from 2004, the Bank collected from Ilanot Mutual Funds Ltd., which was under its control, commissions in respect of trading in securities and in foreign currency at rates that were in excess of the rates collected from other customers. The Plaintiffs further claim that even after the sale of Ilanot, the Bank continued to collect commissions at higher rates than permitted, this as part of the sale of Ilanot.

The argued causes of action are infringement of the Mutual Investment Trust Law, 1994, infringement of Sections 3 and 4 of the Banking Law (Customer Service), 1981, and actions contrary to proper banking management regarding capital market activity of the banking industry.

The Plaintiffs claim from all the Defendants an amount of NIS 386 million, and attribute to the Bank damage in a total

5. REQUESTS TO APPROVE CERTAIN ACTIONS AGAINST THE BANK AND ITS CONSOLIDATED SUBSIDIARIES AS CLASS ACTION SUITS AND OTHER ACTIONS FOR WHICH IT IS NOT POSSIBLE AT THIS STAGE TO EVALUATE THEIR PROSPECTS OF SUCCESS (CONTINUED)

amount of approximately NIS 62 million.

The response of the Bank has not as yet been filed.

5.8 On April 6, 2007, the Arab bank served third party notices with respect to five actions filed against it in 2005 by thousands of Israeli victims of terror activities, their heirs or the executors of their estate. These actions were filed with a New York Court of Law, for the payment of damages in respect of the alleged involvement of the Arab bank in terror financing activities, assistance to genocide activities and assistance to the commitment of crimes against humanity. The actions are based on the US law, are not quantified, and inter-alia, they refer to laws determining fixed compensation to each injured party without proof of damage.

The Arab bank served third party notices against the Bank, Bank Hapoalim, IDB New York, and Mercantile Discount Bank Ltd. The said notices do not state an amount, do not apportion the liability between the third parties, are drafted in general terms and argue that to the extent that the Arab bank would be found guilty, the said third parties have the duty to indemnify it with the full amount charged. The Arab bank focuses on the fact that the third parties are Israeli banks and does present any supporting evidence tying the Bank to the activities forming the basis of the actions brought against it. At this stage a defense brief has not yet been submitted, and the Bank intends to file a motion for the dismissal in limine of the third party notice.

It should be noted that prior to the serving of the third party notices, the Arab bank requested a general disclosure of documents as part of the proceedings between that bank and the Plaintiffs. The Bank objected to this request, both on grounds of judicial authority and on other grounds. This request is still pending and has not yet been decided.

5.9 On April 18, 2007, debtors of Discount Mortgage Bank and the guarantors of their debts filed a monetary claim in the amount of NIS 50 million against the Bank and against Discount Mortgage Bank and against five present and former Bank employees. According to the petitioners, damage was incurred to them, inter alia, as a result of legal processes for realization of collateral implemented by Discount Mortgage Bank for repayment of their debts, in the amount of NIS millions. The plaintiffs also claim that the Bank is responsible for the alleged damage as the parent company of Discount Mortgage Bank. The plaintiffs did not provide details in writing regarding computation of the claimed amount, nor did they present evidence supporting the damage in the claimed scope. According to the indictment, in the future the petitioners will append professional opinions prepared by an appraiser and accountant.

No fees were paid in respect of the petition and therefore approval of the claim or its amount is subject to court approval, which has not yet been issued. The Bank and Discount Mortgage Bank, as well as the State of Israel, submitted opposition to granting the requested exemption.

6. REQUESTS FOR APPROVAL OF CERTAIN ACTIONS AGAINST THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. AS CLASS ACTION SUITS

The financial statements of the First International Bank of Israel Ltd. in describing details of requests for approval of class actions that are pending against this bank and against its subsidiaries, and with respect to which management of the First International Bank, after consulting with legal advisors, is unable to estimate, at this stage, the prospects of these claims and therefore no provision has been made therein, make mention, inter alia, of the following procedure:

In 1997, claims were brought in the Tel Aviv District Court against two subsidiaries of FIBI – the First international Mortgage Bank Ltd. and Atzma'ut Mortgage and Development Bank Ltd. (hereinafter: "the mortgage banks in the First

6. REQUESTS FOR APPROVAL OF CERTAIN ACTIONS AGAINST THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. AS CLASS ACTION SUITS (CONTINUED)

International Group"), which in the meantime have been merged into FIBI, and against other mortgage banks, in which it was claimed that the said banks unlawfully charged borrowers with a commission relating to life insurance and property insurance policies, and that the borrowers are entitled to the refund of such amounts. These claims total approximately NIS 1.5 billion (in nominal values). A petition to approve these actions as a class action suits was also filed. The said claims and petition did not include the manner of calculation of the said amount; neither did they include details as to what part of the amount is attributed to the mortgage banks in FIBI Group.

In November 1997, the Court ruled as to the action filed in July 1997, according to which it dismissed the claim in the form of a class action according to the Banking Law (Customer service), 1981, and the Restrictive Practices Law, 1988. Nevertheless, the Court ruled that it was possible to hear a claim for a declarative relief under Section 29 of the Civil Code Regulations, with respect to causes of action created prior to May 10, 1996 (date of publication of the amendments to these Laws regarding class actions).

In December 1997, the said banks applied to the Supreme Court for permission to appeal against the said judgment, as well as petitioned the court to stay execution of the proceedings until judgment is passed in this appeal. The request for permission to appeal and for the stay of execution has been admitted by the Supreme Court.

In a hearing held by the Supreme Court in the above appeal on November 25, 2001, the parties accepted the suggestion of the Court to stay the hearing of the appeals until a judgment is given in another appeal case pending at the Supreme Court, in which the matter of the status, applicability and terms of Section 29 of the Civil code Regulations are at hand. On April 2, 2003, a judgment was given in that other appeal detracting from the status and applicability of Section 29 for the purpose of submitting a class action. Therefore, on April 10, 2003, the Supreme Court decided that the parties submit their arguments in writing as to the continuation of the appeal proceedings. All the parties have already submitted their briefs as stated. The decision of the Supreme Court in the matter has not yet been given.

On September 1, 2005, a decision was given in the further hearing in the matter of the status and application of Regulation 29, which left the ruling as is. This ended, for the time being, the use of Regulation 29 as an instrument for serving class action suits.

Pursuant to the Class Action Suits Law, 2006, published on March 12, 2006, new statutory arrangements have been established, essentially different from the laws in existence prior to the enactment of the above law, as regards to the filing of class action suits. According to the law, the Court is empowered to also apply the provisions of the new law to actions that had been pending prior to its enactment, under terms specified in the law. No requests were actually submitted.

Gross earnings recorded by FIBI Group's mortgage activity, from management fees and services in respect of life insurance and property insurance of borrowers provided as collateral within the mortgage activity, amounted in the first half of 2007 to NIS 8.6 million, compared with NIS 10.5 million in the corresponding period last year and NIS 20.2 million in 2006.

If the said motions will be granted, the earnings of FIBI Group would be significantly reduced.

7. AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD

On January 30, 2007, the Bank's Audit Committee approved a comprehensive remuneration plan for the Chairman of the Board of Directors and for the President and CEO. The plan was formulated by the Human Resources Committee of the Board that, inter alia, reviewed remuneration plans of large companies in Israel and abroad, formed (with the assistance of experts engaged for this purpose) several models of remuneration, and performed sensitivity analyses in this regard, taking into account also data for prior years.

Representatives of the Committee also conducted negotiations with the Chairman of the Board of Directors and the President and CEO, taking into considerations extensive appreciation for the activities of the Chairman of the Board of Directors and the President and CEO, and the great importance that the Bank attributes to their continued activity in the Bank.

The remuneration plan approved by the Audit Committee is not similar, (in its conditions or in the amounts derived therefrom), to the remuneration plan approved in March 2006, and was examined independently from the previous plan. The remuneration plan was formulated for a period of five years (as from February 2006) and includes short-term remuneration (salaries and annual bonuses) and long-term remuneration (stock option plan). The entitlement to annual bonuses and to the option plan are dependent on Discount Group's results and performance (that are measured in accordance with several parameters, mainly rates of change) and on the yield from the Bank's shares, both per se and in comparison to the other large banking groups. Entitlement to annual bonuses is limited to monetary ceilings.

In general (except regarding certain parameters relating to bonuses payable to the President and CEO upon retirement), linkage was maintained in the remuneration proposals to the Chairman of the Board of Directors and the President and CEO.

In February 2007 the Bank requested the reaction of its principal shareholders (the controlling shareholders, on one hand, and the Accountant General in the Ministry of Finance and M.I. Holdings Ltd., on the other hand) regarding the said issues. On July 1, 2007, the Accountant General at the Ministry of Finance and the President of M.I. Holdings Ltd. informed the Bank of their consent to the remuneration plan for the Chairman of the Board of Directors, including a proposed share option plan, to a share option plan for the President and CEO and to a proposal for the increase of the registered share capital of the Bank. It should be noted that the Chairman of the Board of Directors has been employed by the Bank for about a year and a half but has not yet received any remuneration for his work (the Bank has recorded full provisions for salary and bonuses in accordance with the plan approved by the Audit Committee. No provisions were recorded in respect of the options component).

Additional details were brought in Notes 13 and 22 to the financial statements as of December 31, 2006.

On July 18, 2007 the Bank's Board of Directors approved the conditions of the Bank's agreement with the Chairman of the Board of Directors, the conditions of the Bank's agreement with the Bank's President and CEO, the option plan intended for these officers, convocation of a General Meeting regarding these decisions for purposes of approving the said agreements and convocation of a general meeting for purposes of approving an increase in authorized share capital.

On August 26, 2007 a special General Meeting of the Bank approved the conditions of employment of the Chairman of the Board of Directors of the Bank (for the period from February 6, 2005 to February 5, 2011) and the allocation of options to the Chairman of the Board of Directors, in the framework of an option plan for the Bank's Chairman of the Board of Directors and for the President and CEO. The General Meeting also approved an increase in the Bank's authorized share capital by NIS 3,000,000 par value (intended to enable the allocation of option warrants within the framework of the said plan) and an amendment to the Bank's articles of association and memorandum of association, accordingly.

7. AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD (CONTINUED)

Employment agreement with the Chairman of the Board of Directors of the Bank. On July 18, 2007 the Board of Directors of the Bank decided, after receiving the Bank's Audit Committee, approval, to approve the personal employment agreement between the Bank and the Chairman of the Bank's Board of Directors.

The duration of the employment agreement was supposed to have been for a period of five years, as from February 6, 2006 (date of commencement of position as Chairman of the Board of Directors) until February 5, 2011 (hereinafter: "the defined period of the agreement"), and thereafter renewed automatically for periods of one year at a time, until cancelled by either party according to an advance notice of three months. The special General Meeting decided that the employment agreement will be for the period as from February 6, 2006 until February 5, 2011, and will not be automatically renewed for additional periods.

The agreement stipulates indemnification to which the Chairman of the Board of Directors will be entitled in the event that the Bank would terminate his service prior to the end of the defined period of the agreement or in the event of material impairment of his authority, in an amount equivalent to payment of his full salary, including benefits and provisions, as detailed in the employment agreement, for the balance of the period until the determining date. In addition, the Chairman of the Board of Directors will be entitled to a proportionate share of the annual bonus for the year in which the employment agreement was terminated.

The agreement also states that the Chairman of the Board of Directors will be entitled to a bonus in the event of termination of his service, at his initiative or at the Bank's initiative, as long as such termination did not involve circumstances of breach of trust toward the Bank. The bonus will be equivalent to 12 months' salary, including benefits and provisions as detailed in the employment agreement.

The Chairman of the Board of Directors will be employed in a full time position, and will not be entitled to engage in additional salaried work, except with the approval of the Board of Directors of the Bank.

The monthly salary of the Chairman of the Board of Directors will be NIS 178,700, gross, and will be updated every three months according to the rate of increase in the consumer price index, relative to the index published on January 15, 2006.

The employment agreement determines that the Bank will grant the Chairman of the Board of Directors, annually from 2006 until 2010, a special bonus as detailed hereunder.

The agreement further stipulates that the Chairman of the Board of Directors will be entitled to vacation days, sick leave, recreation pay, appropriate vehicle, entertainment expenses, social benefits (severance pay, retirement benefits, loss of ability to work and payments to continuing education fund) and additional benefits.

The agreement also includes provisions regarding responsibilities levied on the Chairman of the Board of Directors, being among others: provisions regarding a cooling off period of three months and maintenance of confidentiality.

New employment agreement with the President and CEO of the Bank. On July 18, 2007 the Bank's Board of Directors of the Bank decided, after the Audit Committee's approval, to approve a new personal employment agreement with the President and CEO of the Bank (replacing the previous employment agreement with him), which is similar in principle to the personal employment agreement of the Bank's Chairman of the Board of Directors, except as detailed below.

The agreement is for a period of five years starting February 1, 2006, and thereafter renewed automatically for periods of one year at a time.

The President and CEO will be entitled, subject to fulfillment of certain conditions as determined in the agreement, to

7. AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD (CONTINUED)

an additional retirement bonus in an amount equivalent to 24 months' salary, including benefits and provisions as detailed in the employment agreement. The President and CEO will also be entitled to a special assiduity bonus for his period of work in the Bank (taking into account his previous years of work), subject to completion of five continuous years of service in the position as from February 1, 2006 until the determining date. The bonus will be equivalent to 12 months' salary (without social benefits or other supplementary benefits therein).

Bonus plan for the Chairman of Board of Directors and President and CEO of the Bank. The employment agreement of the Chairman of the Board of Directors and the President and CEO of the Bank stipulates that the Bank will grant each of them, annually as from 2006 until 2010, a special bonus that will not exceed twice their annual salary (hereinafter: "the maximum annual bonus"). The annual bonus will only be granted in respect of a year in which the Bank's financial statements record a net income.

The annual bonus will be calculated according to five indices as detailed in the agreement, wherein the maximum annual bonus for each index will constitute 25% of the maximum annual bonus. The annual bonus for each of the indices will be determined according to the operating results in the relevant period, in such a way that a minimum goal, target goal and maximum goal will be fixed regarding each index. Fulfillment of the minimum goal will entitle the officer to 20% of the maximum annual bonus for the relevant index, fulfillment of the target goal will entitle the officer to 50% of the maximum annual bonus for the relevant index and fulfillment of the maximum goal will entitle the officer to the maximum annual bonus for the relevant index.

Following are the indices for purposes of determining the annual bonus:

(1) Increase in the Bank's market share. Measured as increase (in percentiles) of the Bank's share relative to the entire banking system, according to the weighted average of three sectors (sub indices): credit to the public, deposits of the public and operating and other income (according to the relative part of each of the sub indices as stated in the agreement). Non-decrease in the market share relative to the previous period will be deemed fulfillment of the minimum goal for purposes of this index. An increase of 0.1% will be deemed fulfillment of the target goal and an increase of 0.2% will be deemed fulfillment of the maximum goal. It should be noted that calculation of this index will be implemented with regard to a period of 12 months ending on September 30 of the year of the bonus, compared to the previous 12 months, wherein the data will be derived from the Bank of Israel's publications regarding the said period.

(2) Increase in the Bank's scope of activity. Measured as an increase in credit to the public (as defined in the agreement), and in deposits by the public according to the Bank's consolidated balance sheet as of December 31 of the year of the bonus, compared to corresponding data in the Bank's balance sheet as of December 31 of the previous year. The minimum goal, the target goal and the maximum goal fixed for this index will be deemed an increase of 1%, 1.75% and 2.5%, respectively.

(3) Increase relative to coverage of expenses. Measured according to increase (in percentiles) regarding coverage of expenses (as defined in the agreement), calculated according to the Bank's financial statements for the year of the bonus, compared to the rate of coverage of expenses calculated for the previous year. The minimum goal, the target goal and the maximum goal fixed for this index will be deemed an increase of 1%, 2% and 3%, respectively.

(4) Decrease in margin in respect of return on equity of the Bank compared to average return on equity of other banks. Measured according to the difference between the return on equity of the Bank, compared to the average

7. AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD (CONTINUED)

return on equity of the four largest banks (as defined in the agreement) (hereinafter: "the yield margin"), wherein a decrease of 0.5% in the yield margin compared to the yield margin in the previous measurement period will be deemed fulfillment of the minimum goal, a decrease of 0.75% will be deemed fulfillment of the target goal and a decrease of 1% will be deemed fulfillment of the maximum goal, for this index.

However, in the event that in a certain bonus year the result exceeds the maximum goal for this index, or in the event that in a certain bonus year the result is lower than the minimum goal for this index, the difference between the result and the maximum goal or the minimum goal will be added or deducted respectively, as relevant, in the following bonus year, from the "yield margin in the previous measurement period", for purposes of calculating the decrease in the yield margin in that same following bonus year.It should be noted that the calculation regarding this index will be implemented for the period of 12 months ending on September 30 of the bonus year, compared to the previous 12 months.

(5) Attaining return on equity goals. Measured according to data taken from the Bank's financial statements in such a way that return on equity at a rate of 8.5% will be deemed fulfillment of the minimum goal for this index, return on equity at a rate of 10% (11% for years 2009 and 2010) will be deemed fulfillment of the target goal for this index and return on equity at a rate of 12% (13% for years 2009 and 2010) will be deemed fulfillment of the maximum goal, for this index.

Allocation of stock options to the Chairman of the Board of Directors and the President and CEO. On July 18, 2007 the Board of Directors of the Bank decided, after receiving the approval of the Bank's Audit Committee, to approve, within the framework of a stock option plan, allocation of options to the President and CEO and to the Chairman of the Bank's Board of Directors.

Within the framework of the option plan, 8,909,275 option warrants will be allotted to a trustee on behalf of the President and CEO, and an equal number of options to a trustee on behalf of the Chairman of the Board of Directors; each option exercisable into one ordinary share.

The exercise price of the options will be determined according to the closing rate of the Bank's shares on the stock exchange on the day prior to the date of approval by the general meeting.

Assuming, theoretically, exercise in full of all the options granted to the President and CEO and to the Chairman of the Board of Directors according to the option plan (and assuming that all other options issued by the Bank are not exercised), the President and CEO and the Chairman will acquire 1.64% of the equity and voting rights in the Bank (assuming full dilution - 1.6% of the equity and voting rights). It is emphasized that this assumption is purely theoretical, as the exercise of the options is based on "net exercise".

The option warrants will be allocated in five equal annual installments in each of the years 2006 through 2010.

Entitlement to options will be subject, inter alia, to the yield on the Bank's shares (total shareholders' return) in a specific calendar year, in a manner that ensures it will reach a least 85% of the average return on shares of other banks in the same period.

The option plan determines, inter alia, various provisions regarding exercise of the options, shortening of the exercise period in the event of termination of service, method of adjustment of options should certain events occur and taxation tracks in accordance with this plan.

The economic value of the option warrants, for purposes of recording in the Bank's financial statements, will be

7. AN AWARD PLAN AND A STOCK OPTION PLAN FOR OFFICERS OF THE BANK AND THE ENGAGEMENT CONDITIONS OF THE CHAIRMAN OF THE BOARD (CONTINUED)

calculated according to the Monte Carlo method, i.e. accepted statistical quantitative method for purposes of pricing financial instruments, including options for employees.

The economic value of the option warrants allocated to the trustee on behalf of the Chairman of the Board of Directors and the President and CEO according to the option plan, and which will be recorded in the Bank's financial statements, on the date of approval by the general meeting, according to the closing rate of the Bank's shares on the stock exchange on the preceding day, is NIS 31.26 million.

The Bank estimates that in the second half of 2007 an expense in the amount of half the said economic value will be recorded, most of which in the third quarter of the year.

Issue of Options to New Members of Management. On January 29, 2007 the Board of Directors determined, in principle, that a management member, who was appointed as Executive Vice President and Head of the Corporate Banking Division, will be entitled to options equivalent to the options issued to the previous Head of the Corporate Banking Division who retired, and whose options expired (1,176,767).

On May 14, 2007 the Board of Directors determined, in principle, that the Bank's Legal Advisor, who was appointed as Executive Vice President, will be entitled to 980,639 options. Also, it was determined, for both Mr. Arnon and Ms. Deutsch, that the option plan will be similar, insofar as possible, to the option plan approved for Executive Vice Presidents in March 2006 and that was approved in July 2006, subject to required changes.

The Board of Directors' decision regarding the above mentioned options constitutes, as stated, a determination in principle and requires approval of the Bank's authorized entities and by the interested parties, in accordance with an existing cooperation agreement. The Bank initiated contact with the relevant government entities regarding allocation of options to the Head of the Corporate Banking Division. To the best of the Bank's knowledge, the interested parties have not yet approved the option plan for Head of the Corporate Banking Division. Accordingly, a discussion has not yet been held in this regard. Request for approval to allocate options to the Bank's Legal Advisor has not yet been submitted to the interested parties in the Bank

It should be noted that following the retirement of a member of management, the options issued to her (1,176,767) expired.

8. TENDER FOR PROVISION OF SERVICES TO GOVERNMENT EMPLOYEES

On April 1, 2007, the Bank was informed of its success in a tender issued by the Accountant General at the Ministry of Finance, for the granting of loans, credit facilities and other banking services to State employees (these services are being provided at present by Bank Yahav for State Employees Ltd.). The period of this engagement is for seven years beginning on January 1, 2008.

On May 10, 2007 the Bank signed an agreement in this regard. Within the framework of this tender, the Bank will establish a special deposit for seven years in the amount of NIS 1,036 billion, for the purpose of granting loans and credit facilities to State employees. At the end of the period the principal amount of the deposit will be repaid to the Bank together with CPI linkage increments. (The Accountant General is entitled to interest in respect of the loans and credit facilities granted out of the deposit funds, as well as interest on the balance of the deposit).

Loans to State employees entitled to subsidized loans shall be granted under subsidized terms (the interest rate determined is the lower between two thirds of the prime rate and two thirds of the cumulative amount of the nominal inflation rate, with the addition of 2%) out of funds of the deposit. The Bank is also obligated to provide credit facilities of up to an amount of NIS 7,000 (out of the deposit funds) under the same terms, to each State employee who opens

8. TENDER FOR PROVISION OF SERVICES TO GOVERNMENT EMPLOYEES (CONTINUED)

a current account with the Bank and has his monthly salary credited to this account. The Bank is entitled to provide credit in amounts exceeding NIS 7,000 out of Bank funds, at an interest rate not exceeding the prime rate + 1.4%.

Under the terms of the tender, the charges that the bank is entitled to collect are restricted to the amounts stated in an annex to the tender; a large part of the retail banking services must be provided free of charge. As to other services not stated in the agreement, the Bank may collect a maximum of 70% of the amount of the charge stated in the tariff of the Bank.

According to the terms of the tender, the Bank is to provide services to State employees at at least 50 branches located at places determined in the tender terms. The Bank is also required to provide banking services, within four months from the date of the government's providing the location for the Bank's use, in four branches located in government buildings on in government centers, as detailed in the agreement, and in three branches located in hospitals. In these locations, Bank Yahav branches are presently located. The agreement does not include the government's commitment to vacate these branches.

The Bank estimates that following the success in winning its tender, a competition may develop between the Bank and "Yahav" Bank regarding the provision of services to State employees.

Commencement of operations under the terms of the tender is to begin on January 1, 2008, and until such date the Bank must make the necessary preparations in order to be able to provide the prescribed services to State employees, in the scope, terms and quality defined in the terms of the tender.

The Bank has begun preparations which involves for the most part the modification of the computer systems of the Bank to the operations required by the tender, and to a lesser extent the establishment of the branches. The Bank believes that it will abide by the time schedules determined.

The Bank estimates the cost of the preparations for providing the said services at approximately NIS 22.5 million, inter-alia, in order to comply with the terms of the tender, the Bank will be required to open six additional branches until the beginning of 2008.

This cost may change depending on the scope of the investment in construction or in the recruitment of employees and their training.

The said terms also entitle the Accountant General, at his own discretion, to transfer to the Bank the existing portfolio of loans to State employees, in whole or in part. No notice has as yet been given to the Bank in this respect.

On July 25, 2007, Yahav Bank filed a motion with the High Court of Justice against the Minister of Finance, the Accountant General at the Ministry of Finance, the Supervisor of Banks and Israel Discount Bank requesting the Court for an order nisi as follows:

a. An order directed at the Minister of Finance and the Accountant General at the Ministry of Finance for the withdrawal of the demand issued to Yahav Bank to vacate its branch offices located at Government offices.

b. An order directed at the Minister of Finance, the Accountant General at the Ministry of Finance and the Supervisor of Banks – requesting them to instruct Israel Discount Bank to refrain from providing banking services by teams operating outside the branches of the Bank, namely at places of work of State employees.

   Alternatively, Yahav Bank motions for an order giving Yahav Bank a fair and equal opportunity to operate teams similar to those Israel Discount Bank is permitted to operate.

8. TENDER FOR PROVISION OF SERVICES TO GOVERNMENT EMPLOYEES (CONTINUED)

c. An order against the instruction of the Ministry of Finance for the termination of the arrangement whereby Yahav Bank was entitled to recover loans and deposit sums in savings accounts by way of withholding such amounts from salaries of State employees.

Yahav Bank also motioned for an urgent interim order that would prevent the issue of an authorization to Israel Discount Bank to operate teams providing banking services outside Discount Bank branches until a final ruling is given in the motion, unless Yahav Bank will also be authorized to operate teams according to the same format. The main argument of Yahav Bank is that the Accountant General grants Discount Bank preferential rights that are not obligatory under the terms of the tender.

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On August 15, 2007 the court determined that the petition will be heard before a panel, during September 2007. Furthermore, the court determined that, in light of government clarifications and the "convenience balance", an interim order as requested will not be issued at this stage.

9. A FULL PURCHASE OFFER FOR THE SHARES OF DISCOUNT MORTGAGE BANK

On March 14, 2007, the Bank published a full purchase offer for the shares of Discount Mortgage Bank held by the public, namely, 460,735 ordinary shares of NIS 1 par value each, comprising 34.93% of the issued and fully paid up share capital and of the voting rights in this Discount Mortgage bank. According to the purchase offer, holders of the shares were invited to sell their shares to the Bank at a price of NIS 575 per share, under terms detailed in the purchase offer published by the Bank, this until April 30, 2007 (hereinafter- "last date of acceptance"). The total consideration in respect of these shares at the above stated price amounted to NIS 256 million.

The Bank's obligation to purchase the shares in terms of the purchase offer was conditional upon obtaining the following approvals: (a) A permit by the Governor of Bank of Israel under Section 34 of the banking Law (Licensing), according to which the Bank is entitled to obtain complete control over Discount Mortgage Bank; (b) Approval by the Commissioner of Restrictive trade Practices, to the extent that such an approval is indeed required.

The Bank has obtained all the approvals required for the purchase of the shares in accordance with the purchase offer. The obligation of the bank was conditional upon the receipt of acceptance notices for at least 394,777 shares (hereinafter – "the minimum acceptance rate").

On April 29, 2007, the Bank amended the said purchase offer, increasing the price per share in the purchase offer from NIS 575 to NIS 665 per share, and deferred the last date of acceptance to May 3, 2007. Accordingly, the total consideration in respect of the shares was increased to NIS 306 million.

Acceptance notices for 415,532 shares were received by May 3, 2007, comprising 31.5% of the equity and of voting rights in Discount Mortgage Bank. Accordingly, the forced purchase provision in the purchase offer under section 337(a) of the Companies Law 1999 came into effect. Such forced purchase was made on May 7, 2007, thereby the Bank reached 100% holdings in the equity and voting of Discount Mortgage Bank.

On May 9, 2007 the shares of Discount Mortgage Bank Ltd. were removed from trade on the Tel Aviv Stock Exchange.

10. RIGHTS ISSUE BY THE FIRST INTERNATIONAL BANK ("FIBI")

In an immediate report dated March 13, 2007, FIBI informed of the decision of its Board of Directors to take action towards the increase of the share capital of the bank by means of a rights issue for shares and/or issue of rights for other securities intended to improve its capital structure. These rights are to be offered to all the shareholders of the bank, and are to include a possible benefit component in relation to the price of the shares on the market.

It should be noted that in view of the capital structure of the said bank, and in view of the provisions of the Securities Law, FIBI is entitled to issue and list for trading on the Stock Exchange only shares and/or rights for shares of NIS 0.01 par value each, which are the class of shares having preferred voting rights. The recommendation of management of FIBI is to prepare for a capital raising of between NIS 500 and NIS 700 million.

FIBI noted that there is no certainty that the said issuance and/or issuances would in fact be carried out, and if so, their structure and/or the amount that would be raised thereby, may change.

In an immediate report dated March 28, 2007, FIBI reported the filing of a draft Prospectus for the offering of rights to shares of the bank of NIS 0.01 par value each to all the shareholders of the bank.

Prior to the above notice, the controlling shareholder of FIBI informed the President and CEO of the Bank that it is the intention of FIBI publish a rights issue Prospectus, despite the fact that the Bank might be adversely affected as a result thereof.

Following the said notice, the Bank, through its representative, submitted to t FIBI a demand that no action, which might be detrimental to the Bank and the only purpose of which is to benefit the controlling shareholder of FIBI, should be taken.

Concurrently, the Bank has reached an agreement with the Bank of Israel, the details of which are as follows:

The Bank will acquire (subject to approval of its authorized organs) the full amount of the shares offered to it according to the Prospectus as a shareholder of the First International Bank; the Bank shall deposit with a trustee, the identity of whom and instructions given to him are to be agreed upon with the Supervisor of Banks, that part of the shares to be acquired by it under the Prospectus, which would result in a higher rate of holdings in the equity of FIBI than that immediately prior to the publication of the Prospectus (hereinafter: "the excess holdings") and for a period not to exceed 18 months; the Bank shall refrain from exercising the voting rights attached to the excess holdings at general meetings of shareholders of FIBI; the rights of the Bank regarding the appointment of Directors of FIBI will not be changed; after exercising the rights as detailed above, the Bank intends to negotiate with FIBI and its controlling shareholders in order to examine various suggestions and scenarios, among which are suggestions regarding the capital structure of FIBI and the Bank's holdings therein; in the event that the said move is not successful and if at the end of one year from date of exercise of the rights by the Bank a scenario acceptable to the Bank of Israel is not found, whether regarding the excess holdings or regarding the holdings of the Bank in FIBI, then, after the Bank has been given a fair opportunity to bring its arguments before the Bank of Israel, the Bank shall dispose of all the excess holdings, all this subject to maintaining the Bank's right in FIBI, to the extent relevant to its ability to represent the investment in FIBI by the equity method in the Bank's financial statements, including everything relating thereto, and in accordance with the instructions to be included in the trust letter.

On May 3, 2007, the Bank informed FIBI of the arrangement reached with the Bank of Israel, stating that the arrangement is not final, being subject to certain conditions. The Bank's representative requested that FIBI clarify that it would not hinder the Bank from exercising the rights in the manner acceptable to the Bank of Israel. In his response, the representative for FIBI requested the Bank on May 9, 2007, to provide him with the details of the arrangement. On

10. RIGHTS ISSUE BY THE FIRST INTERNATIONAL BANK ("FIBI") (CONTINUED)

May 15, 2007, the Bank's representative repeated the request that FIBI inform of its acceptance of the position of the Bank of Israel and should clarify that it has no intention of preventing the exercise of the Bank's right to acquire shares in FIBI, in a manner acceptable to the Bank of Israel. The Bank's representative added that the absence of a response constitutes evasion.

On May 22, 2007, details of the said arrangement with the Bank of Israel were submitted orally to representatives of FIBI. On May 24, 2007, at about 18:00 a letter was sent to FIBI stating the details of the above said arrangement. The Bank's representative emphasized in this letter that withholding a response to the Bank's demand of the Bank constitutes the absence of good faith on behalf of FIBI and the violation of the duties of FIBI towards the Bank as a shareholder.

On May 24, 2007 FIBI published a shelf prospectus for issuance of shares of NIS 0.01 par value, and options, through allocation of rights or through a public issuance. Concurrently, FIBI published an immediate report stating that no certainty exists that the said issuances will actually be implemented.

On July 5, 2005, the Bank of Israel confirmed that the said arrangement will also apply to several rights offerings according to the shelf Prospectus published by FIBI, subject to certain conditions. The wording of the trust agreement and the identity of the trustee were also confirmed.

Under the circumstances, the Bank is considering the possibility of instituting legal proceedings against FIBI claiming, inter-alia, that the only purpose of such action is to benefit the controlling shareholder, being discrimination against the rights of the Bank as a minority shareholder and abuse of the power of the controlling shareholder of the First International Bank, and as such requires the necessary approvals.

Concurrently, deliberations are conducted between the parties, the results of which, at this stage, are uncertain regarding the possibility of reaching any agreement.

11. THE SALE OF PROVIDENT FUND OPERATIONS

A. SALE OF THE BANK'S PROVIDENT FUND OPERATIONS

As described in Note 6 E to the financial statements as of December 31, 2006, the Bank and its subsidiary Discount Gemel Ltd. (Formerly: Discount Management of Provident Fund Ltd.; hereinafter: "Discount Gemel") signed an agreement with Clal Insurance Company Ltd. (hereinafter: "Clal Insurance") on January 29, 2007, according to which Clal Insurance would acquire from the Bank and from Discount Gemel their provident fund management activity (hereinafter: "the sold provident funds") including, inter alia, the goodwill acquired in respect of provident fund management, the rights to ownership of the trade names of the sold provident funds, as well as the information, data base, lists of members and actual portfolios; rights and liabilities with respect to the management of all the sold provident funds as well as the assets of the sold provident funds, including the right to receive management fees and other income related to the management of the sold provident funds and all remaining rights and liabilities of the management company with respect to the sold provident funds (hereinafter together: "the assigned rights and liabilities").

The consideration for the assigned rights and liabilities was fixed at NIS 621 million.

On June 19, 2007, the transaction was consummated following the fulfillment of qualifying conditions in accordance with the sale agreement.

Concurrently with the consummation of the transaction, agreements were signed between the Bank and subsidiaries

11. THE SALE OF PROVIDENT FUND OPERATIONS (CONTINUED)

of Clal Insurance for the distribution, operation and services to members.

Pursuant to these agreements, the Bank will distribute the sold provident funds for a period of ten years, and will also distribute other provident funds managed by subsidiaries of Clal Insurance, and will provide Clal Insurance with operating services with respect to the sold provident funds for a period of five years. In consideration for the distribution services, the Bank will receive a distribution commission according to the maximum tariff stated in relevant legislation. The annual consideration for operating services will be calculated at the rate of 0.1% of the assets of the sold provident funds. As part of the member services agreement, the Bank will provide services to members of the sold provident funds in the period following the Bank's receipt of a license to engage in pension consulting until the date of signing consulting agreements with the members, but not later than December 31, 2007 (hereinafter: "the transition period"), all as stated in the memorandum issued by the Commissioner of Capital Markets. The member services agreement includes adjustment mechanisms in the event of changes in the provisions of the legislative arrangement with respect to the transition period.

The agreement includes provisions with respect to the transfer the owenrship of the data base of the sold provident funds and with respect to limited utilization rights of the said data base for the Bank and for Discount Gemel.

The agreement also included indemnification arrangements whereby indemnification would be granted in respect of any claim or request submitted until the end of the seven years following the closure date, against Clal Insurance, Clal Gemel or any officers thereof, though not against the sold provident funds, the cause of which would be acts of commission or omission by the Bank, Discount Gemel Ltd. or officers thereof committed prior to the closure date. Full indemnification would be given with respect to matters relating to claims by employees. In respect of other matters, the indemnification would amount to 50% and would be limited to a cumulative amount exceeding US$1 million. In any event, the cumulative amount of the indemnification shall not exceed the total consideration for the transaction, with the addition of interest and linkage increments.

As from the date of closing of the transaction, the Bank was released from its obligation and guarantee regarding certain payments to members of the sold provident funds relating to their deposit component in nominal terms (hereinafter: "the Bank's guarantee") and Clal Insurance took on an alternative obligation towards the members.

The sold provident funds are: Tamar, Gefen, General Severance Pay Fund, Shikma, Eshkolot, Toar, Hadas Central Severance Pay Fund and Edmond de Rothschild Discount Overseas.

The consideration paid with respect to the assigned rights and liabilities, net after adjustments as agreed between the parties, amounted to NIS 607 million.

The net gain from the sale of the provident fund activity amounted to NIS 394 million and was recognized under "Net income from extraordinary items, net of taxes" in the financial statements as of June 30, 2007.

B. SALE OF MERCANTILE DISCOUNT BANK'S PROVIDENT FUNDS ACTIVITY

On July 30, 2007, Mercantile Discount Bank (hereinafter – "Mercantile") entered into an agreement whereby Mercantile together with its subsidiary will sell the control (51%) in the provident fund activitiy of Mercantile to a group of investors, in consideration for NIS 79 million, subject to adjustments.

The remaining share in this activity (49%) will be sold by Mercantile to the purchasers in August 2011, at the latest (hereinafter – "the final realization date"), at a price to be derived mainly from a rate of 4.25% of the volume of the assets of the provident funds and from the average rate of management fees in effect at the above date.

Within the framework of the agreement, the purchasers granted Mercantile two option, as follows:

11. THE SALE OF PROVIDENT FUND OPERATIONS (CONTINUED)

- An option for an early realization of the remainder of the activity at a price to be derived from the price determined for the final realization date, subject to adjustments. Notwithstanding, the realization price will be reduced at rates of between 15% and 20% if Mercantile decides to exercise this option during the first two years following the consummation of the transaction.
- An option to continue holding up to 10% of the activities even after the final realization date, which comprises the maximum rate of holdings permitted by Law to a pension consultant. In the event that Mercantile would decide to exercise this option, the price payable at the final realization date will be reduced accordingly.

Consummation of the transaction is subject to certain regulatory approvals, including approvals by the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance as well as the Commissioner of Restrictive Trade Practices.

The expected net gain (after tax) from the first stage of the transaction amounts to approximately NIS 50 million, subject to adjustments. The gain will be recognized in the quarter in which the transaction is consummated. Additional gains are expected to be recognized upon the exercise of the option.

12. THE SALE OF KAHAL

On May 26, 2006, the Bank, Bank Leumi Le'Israel B.M., KAHAL – Employee Training Fund Ltd. (hereinafter – "KAHAL") and KAHAL Training Fund Management (1996) Ltd. (hereinafter – "KAHAL Management"), entered into an agreement with Migdal Capital Markets Ltd. on behalf of a company controlled by it and Migdal Insurance Holding and Finance Ltd. (1995) on behalf of a company controlled by it (hereinafter – "the Purchaser") for the sale of goodwill, management rights, additional rights and the means of control of the banks in KAHAL, and for the sale of goodwill, operations, assets and liabilities connected to the training funds managed by KAHAL Management, all in consideration of NIS 264 million, subject to adjustments.

The Bank's share of the consideration amounts to approximately NIS 114 million.

The transaction was consummated on July 15, 2007, after all conditions for its execution had been fulfilled, in accordance with the terms of the sale agreement.

At consummation date, agreements were signed between the Bank, KAHAL and Migdal, whereby the Bank will distribute the training funds sold as well as other provident funds under their control, in consideration for a distribution fee as stated in the Regulations. The Bank will also provide services to members of the sold training funds.

The Bank estimates that the net profit to be derived from this transaction may reach approximately NIS 73 million, and it would be recorded in the third quarter of 2007.

13. CREDIT CARD ACTIVITY

As to acquisition of means of control in Israel Credit Cards Ltd. (hereinafter: "ICC") and as to changes in the arrangements in the credit card field, see Note 34 to the financial statements as of December 31, 2006.

Acquisition of ICC shares held by Harel. On March 1, 2007 the Bank and FIBI entered into a transaction to acquire the shares of ICC held by Harel (5%) according to their proportionate share in ICC. The price of the transaction was the same as the price determined in the transaction for the sale to the Bank and to FIBI of the ICC shares held by Fishman. The basic consideration with respect to the shares to be purchased by the bank was fixed at NIS 48.7 million. The additional consideration based on the results of ICC for 2006, was fixed at NIS 4.4 million. The basic consideration and the additional consideration have been deposited in a trust account in the name of Harel.

13. CREDIT CARD ACTIVITY (CONTINUED)

On May 1, 2007, the said transaction was completed.

Following the completion of the acquisition of the Harel shares in ICC, the Bank holds 71.8% in the equity and 79.0% in the voting rights in ICC, while FIBI holds 28.2% in the equity and 21.0% in the voting rights in ICC.

14. THE SALE OF THE HOLDINGS IN HAREL INSURANCE INVESTMENTS LTD. (HEREINAFTER - "HAREL")

As detailed in Note 6 H to the financial statements as of December 31, 2006 the transaction for the sale of 10.1% of the share capital of Harel to Samporena Capital Pte Ltd. (hereinafter: "Samporena Group"), in consideration for an amount of NIS 414 million was completed on November 1, 2006.

Following the sale, the Bank holds 5.79% of the share capital of Harel. (which are stated in the item "Available-for-sale securities"). Samporena Group and G.I.N. Economic Consulting and Management Ltd. (a company fully controlled by the Hamburger Group) have granted the Bank an option to sell to them on May 28, 2007, all of the remaining shares (5.79% of Harel's share capital) the Bank holds in Harel. The Bank has decided not to exercise the said option for the sale of 5.79% of the equity in Harel that it holds (included in securities available for sale).

15. RESPONSIBILITY INSURANCE OF OFFICERS

On June 26, 2007 a special General Meeting approved the Bank's acquisition of a responsibility insurance policy for officers, as follows: the insurance policy will be issued by Clal Insurance Company Ltd, and will constitute a joint policy for the Bank and for its subsidiaries in which the Bank holds, directly or indirectly, 50% or more of the equity or voting rights. The policy also includes position holders appointed by the Bank to serve in a company in which the Bank holds less than 50% of the equity or voting rights. The policy is in effect for the period April 1, 2007 through March 31, 2008, with maximum coverage in the amount of US$ 100 million for an event and for the period. The insurance premium for the policy is US$ 550 thousand and the Bank's part (not including the subsidiaries) in the premium will not exceed US$ 330 thousand. The coverage for claims regarding breach of money laundering legislation is US$ 5 million only, for supervisory responsibility only. In the event of claims against any position holder, the position holder shall not bear any deductible. The Bank will bear participation (deductible) in the amount of US$ 75 thousand per event.

The insurance policy is applicable, with the same conditions, for present position holders and for position holders in the Bank prior to the period of the insurance policy, including two former position holders who served as directors in subsidiaries and who are also controlling shareholders in the Bank.

16. ADVANCE EXEMPTION AND INDEMNIFICATION OF DIRECTORS AND OTHER POSITION HOLDERS

On June 26, 2007 a special General Meeting approved advance exemption from responsibility of directors and other position holders in the Bank and of former directors and position holders in the Bank (according to a list of individual names), for damage caused to the Bank as a result of breach of the requirement for caution toward the Bank, except as a result of breach of the requirement for caution in respect of distribution, all subject to qualifications detailed in the decision, derived from the Bank's articles regarding exemption from responsibility.

The abovementioned special General Meeting also approved a commitment for indemnification of directors and other position holders in the Bank and of former directors and position holders in the Bank (according to a list of individual names), in respect of monetary liabilities levied on them and in respect of reasonable legal expenses, subject to a limit on the total amount of the indemnification payable to position holders in the Bank and to position holders in subsidiaries of 10% of the Bank's shareholders' equity, as reflected in the most recent financial statements published prior to the actual date of the indemnification, and subject to the indemnification amount not impairing the minimum capital

16. ADVANCE EXEMPTION AND INDEMNIFICATION OF DIRECTORS AND OTHER POSITION HOLDERS (CONTINUED)

adequacy ratio in accordance with Regulation 311 of the Appropriate Banking Management Regulations. The indemnification will be provided in respect of any action implemented in connection with the subjects detailed in the indemnification letter in effect for directors and position holders in the Bank, subject also to fulfillment of additional accepted conditions in such indemnification letters.

The above-mentioned indemnification will be provided only in the event that the monetary liability and/or expenses are not covered by a third party, including an insurance company.

Concurrently with the passing of the above resolutions, the special meeting of shareholders resolved to approve the amendment of certain bye-laws of the Bank, regarding the granting of exemption and indemnification to Directors and other Officers of the Bank.

The abovementioned special General Meeting also approved a commitment for indemnification of other directors and position holders in the Bank as of the date of the decision (as detailed in the list appended to the announcement of the General Meeting), in respect of monetary liabilities levied on them and in respect of reasonable legal expenses, all in connection with mobilization of primary (tier I) capital implemented in the Bank in December 2006 and May 2007. The commitment for indemnification is limited to the amount of the mobilization (NIS 1 billion), subject, that in each event:

(1) Realization of the indemnification will not impair the minimum capital adequacy ratio in accordance with the Appropriate Banking Management Regulations;

(2) Realization of the indemnification will not impair the required original primary (tier I) capital ratio (without hybrid tier one capital) of at least 6.5% at any time.

17. PUBLICATION OF PROSPECTUS – LISTING FOR TRADING OF DEFERRED CAPITAL NOTES (SERIES A)

According to a decision of the Board of Directors of the Bank of December 10, 2006, on December 31, 2006 deferred capital notes were allocated in the amount of NIS 750 million in a private offering, and on May 13, 2007 an additional NIS 250 million was allocated to investors in a private offering.

The Governor of the Bank of Israel approved that the abovementioned deferred capital notes will be deemed complex capital instruments and will be recognized as part of the Bank's primary capital (tier I).

In accordance with the conditions of the note, the Bank will pay an additional 1.25% over the annual interest rate payable in respect of the capital notes, for the period until the date of listing of the capital notes for trading on the stock exchange.

On May 31, 2007, the Bank published a Prospectus for the listing for trade of subordinate capital notes (Series "A").

Further to the Bank's application for the recognition of the subordinate capital notes issued in May 2007 as hybrid tier I capital, the Bank informed the Supervisor of Banks on May 30, 2007, that in the event that the matter of a dividend distribution in the period to December 31, 2009, would be tabled for discussion by the Bank's Board of Directors at least 30 days notice would be given to the Supervisor prior to passing a resolution in the matter.

18. PLEDGES

In July 2007, the Bank of Israel launched a system for the real-time settlement of large amounts (RTGS), enabling the swift and final transfer of funds between banks connected to the system, provided that the liquidity balance at these banks shall not fall below the volume required for effecting such money transfers.

In view of the new settlement arrangements, the Bank may require from time to time credit from the Bank of Israel for short periods of time. In order to secure the repayment in full of amounts due to the Bank of Israel with respect to such credit, as part of joining the security management system operated in this respect by the Stock Exchange Clearing House, the Bank registered on July 26, 2007, in favor of the Bank of Israel a first degree floating pledge on its holdings in Israel Government bonds.

At the end of July 2007, the Bank deposited with the said account bonds, valued at NIS 5.2 billion near the publication of the financial statements.

Mercantile Discount Bank has also registered a similar pledge in favor of the Bank of Israel and has deposited with the Bank of Israel account at the Stock Exchange Clearing House bonds in the amount of NIS 540 million.

19. AMENDMENT OF THE BANKING LAW (CUSTOMER SERVICE)

The Amendment of the Banking Law (Customer Service) in the matter of bank charges was issued at the beginning of July 2007. This Amendment grants the Governor of Bank of Israel and the Supervisor of Banks extensive supervisory authority regarding the prices of bank services as well as the authority to determine a list of bank services in respect of which banks would be entitled to collect charges and the manner of their computation ("Tariffs").

The supervisory authority as regards prices of banking services in this respect replaces the supervisory authority of the Controller of Prices at the Ministry of Industry and Trade. The supervisory authority applies to all bank customers and not only to a particular sector.

The Governor is entitled to declare certain services as subject to price control if one of the causes determined in the Law applies (such as a service that is obtainable only at the bank at which the account is maintained, an essential service that public interest requires its control, the charges in respect of the service might reduce competition between banks). It should be mentioned that the list of causes is not final and under certain circumstances, the Governor may add additional control causes.

The manner of controlling the price of a service declared as "under control", is by determining the charge in respect of which, by determining the amount or the maximum rate of the charge or by forbidding a charge in respect of which.

An increase in the price of a service declared as "under control" requires the submission of a reasoned application to the Supervisor of Banks for the approval thereof. An increase in the price of a service which is not "under control" requires a prior notice to the Supervisor of Banks.

The authority to determine the tariffs, which is mainly intended to reduce the number of bank charges and to make them better understood and comparable, applies to private customers as well as to business corporations (as determined by the Governor in Regulations to be issued, considering their business turnover).

Following consultation with the Consulting Commission, the Governor will issue the "full tariff" to include a list of services in respect of which a bank may collect charges, as well as the manner of their computation (whether a rate of charge or a certain amount). The Governor may instruct that "summarized tariffs" be derived from the "full tariff", in accordance with the type of service. In the Regulations to be issued, the Governor will also state the manner in which customers should be informed of the tariffs.

19. AMENDMENT OF THE BANKING LAW (CUSTOMER SERVICE) (CONTINUED)

A banking corporation shall not be entitled to collect a charge from its customers unless it is in respect of a service appearing in the tariffs. A banking corporation may apply to the Supervisor to add a service to the tariff. The Supervisor has the discretion whether to consent to the application, whether to subject it to certain condition or to refuse it.

As part of the Rules fixing the tariffs, the Governor is to ensure that the charges would be fairly and clearly presented to customers in a manner that would make them comparable.

The Governor may determine types of services to which the tariffs would not apply (such as securities operations etc.).

The quarterly reports issued until now by banks to their customers regarding the amounts of charges collected from them with respect to principal services, will now apply to all charges, though now it will be issued semi-annually instead of quarterly.

The Law regarding price control is effective immediately from date of publication thereof in the Official Gazette (namely, July 5, 2007).

The semi-annual reporting of all charges is to begin on January 1, 2008.

The Bank of Israel was given a period of three months in which to determine the tariffs, which period may be extended by three additional months (by application to the Knesset Economics Committee). Banking corporations were granted a preparatory period of three months from the date the tariffs are determined. This period may also be extended by three additional months by application to the Supervisor of Banks and with the approval of the Knesset Economics Committee.

On July 9, 2007, the Supervisor delivered to the banks a first draft of the tariffs as part of determining the banking service rules. The draft includes less than one hundred types of services in respect of which charges may be collected as well as a proposal for discerning types of banking operations justifying the collection of charges.

Negotiations are presently conducted between the banks and the Supervisor with respect to the tariffs draft.

The Bank expects that this process will adversely affect the income of the Bank from operating commissions, though at this stage it is not possible to assess the loss or quantify its effects.

APPENDIX "A"

CONSOLIDATED INCOME FROM FINANCING OPERATIONS BEFORE PROVISION FOR DOUBTFUL DEBTS

Reported Amounts

	Unaudited			
	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
	in NIS millions			
A. On Assets*				
Credit granted to the Public	2,465	359	3,430	2,276
Credit granted to the Governments	-	(3)	-	(1)
Deposits with the Bank of Israel and cash	14	(28)	5	(11)
Deposits with Banks	806	(1)(253)	774	(1)325
Borrowed securities	3	-	4	-
Bonds	915	(737)	1,028	131
Total	4,203	(662)	5,241	2,720
B. On Liabilities*				
Deposits from the Public	(2,929)	(1)1,675	(3,040)	(627)
Deposits from the Government	(3)	2	(3)	(1)
Deposits from the Bank of Israel and cash	(19)	(5)	(36)	(12)
Deposits from banks	(222)	(1)106	(226)	(1)(12)
Debentures and subordinated capital notes	(130)	(1)(134)	(196)	(216)
Total	(3,303)	1,644	(3,501)	(868)
C. In respect of derivative financial instruments and hedging activities				
Expenses net in respect of ALM derivative instruments**	(48)	(50)	(28)	(102)
Income (expenses) net in respect of other derivative instruments	(93)	28	(42)	72
Total	(141)	(22)	(70)	(30)
D. Other				
Commissions on financing activities	30	35	60	63
Net gains (losses) on sale of available-for-sale bonds	29	(12)	48	(9)
Net realized and unrealized gains (losses) from adjustment of trading bonds to fair value	(25)	4	(20)	(18)
Other financing income	95	(1)(22)	111	(1)16
Interest income on problem debts	13	(1)31	70	(1)41
Gain from sale of loans	-	-	2	-
Other financing expenses	15	(63)	(3)	(90)
Total	157	(27)	268	3
Total income from financing activities before provision for doubtful debts	916	933	1,938	1,825
Of which: Net exchange differences	28	(1)(41)	(24)	(1)(31)
E. Details of the net effect of derivative instruments hedging earnings from financing operations				
Financing income in respect of assets (item A)*	33	34	31	47

Footnote:
(1) Reclassified.
* Including the effective component of hedging relations.
** Derivative instruments comprising a part of the asset and liability management system of the Bank, which were not designed for hedging relations.

APPENDIX "B"

1. PROVISION FOR DOUBTFUL DEBTS - CONSOLIDATED

Reported Amounts

	Specific provision[1]				Specific provision[1]			
	According to extent of delinquency	Other	Supplemental provision[2]	Total	According to extent of delinquency	Other	Supplemental provision[2][3]	Total
	Unaudited							
	For the three months ended June 30,							
	2007				2006			
	in NIS millions							
Balance of provision at beginning of period	162	5,006	678	5,846	154	5,071	752	5,977
Provision for the period	14	204	3	221	14	150	9	173
Reduction of provision	(14)	(40)	(7)	(61)	(13)	(20)	(30)	(63)
Collection of debts written-off in previous years	-	(2)	-	(2)	-	(1)	-	(1)
Provision charged to statement of Income	-	162	(4)	158	1	129	(21)	109
Write-offs	-	(68)	-	(68)	-	(87)	-	(87)
Balance of provision at end of period	162	5,100	674	5,936	155	5,113	731	5,999
Includes – Balance of provision that was not deducted from "credit granted to the public"	–	131	81	212	–	44	69	113

For footnotes see next page.

APPENDIX "B"

1. PROVISION FOR DOUBTFUL DEBTS - CONSOLIDATED

Reported Amounts

	Specific provision(1)				Specific provision(1)			
	According to extent of delinquency	Other	Supplemental provision(2)	Total	According to extent of delinquency	Other	Supplemental provision(2)(3)	Total
	Unaudited							
	For the six months ended June 30,							
	2007				2006			
	in NIS millions							
Balance of provision at beginning of period (Audited)	161	5,278	675	6,114	150	5,006	748	5,904
Provision for the period	30	348	17	395	33	317	24	374
Reduction of provision	(28)	(90)	(18)	(136)	(26)	(53)	(41)	(120)
Collection of debts written-off in previous years	-	(5)	-	(5)	-	(3)	-	(3)
Provision charged to statement of Income	2	253	(1)	254	7	261	(17)	251
Write-offs	(1)	(431)	-	(432)	(2)	(154)	-	(156)
Balance of provision at end of period	162	5,100	674	5,936	155	5,113	731	5,999
Includes – Balance of provision that was not deducted from "credit granted to the public"	–	131	81	212	–	44	69	113

Footnotes:

(1) For loans for which a provision was made according to the extent of the delinquency - does not include a provision for interest on such debt in arrears.
For other loans - does not include provision for interest on doubtful debts after such debts were deemed doubtful.

(2) Includes balance of a general provision for doubtful debts.

(3) Including a special provision for doubtful debts of NIS 5 million.

APPENDIX "B" (CONTINUED)

2. DETAILS AS TO THE MANNER OF COMPUTING THE SPECIFIC PROVISION FOR HOUSING LOANS – CONSOLIDATED

eported Amounts

	Unaudited					
	June 30, 2007					
				Specific provision		
	Balance of credit	Balance of debt[4]	Balance in arrears[5]	According to extent of delinquency	Other	Total
	in NIS millions					
Housing loans[1]	6,403	284	91	141	-	141
"Large loans"[2]	1,405	69	30	5	26	31
"Other loans"[3]	841	86	22	16	20	36
Total	8,649	439	143	162	46	208
	June 30, 2006					
				Specific provision		
	Balance of credit	Balance of debt[4]	Balance in arrears[5]	According to extent of delinquency	Other	Total
	in NIS millions					
Housing loans[1]	6,584	312	82	135	-	135
"Large loans"[2]	1,209	71	27	5	26	31
"Other loans"[3]	880	96	26	15	18	33
Total	8,673	479	135	155	44	199

Footnotes:
(1) Loans, which according to the Directive of The Bank of Israel, the provision in respect thereof is to be computed based on the period in arrears.
(2) Housing loans, the outstanding balance of each exceeds NIS 785 thousand (June 30, 2006: NIS 788 thousand).
(3) Loans against mortgage of a residential apartment – in accordance with Bank of Israel memorandum of January 1, 2006, according to which housing loans for purposes of financial reporting should include loans granted for any purpose against mortgage of a residential apartment.
(4) Problematic credit balances (in arrears exceeding three months) and after deduction of the balance of the provision
(5) Including overdue interest and without deduction of balances of provisions

APPENDIX "C"

CONDENSED CONSOLIDATED REPORT OF ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS

Reported amounts

	Unaudited						
	June 30, 2007						
	Israeli currency		Foreign currency[1]			Non	
	Non-linked	Linked to the CPI	In US$	In Euro	In other currencies	monetary Items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	3,603	798	14,599	5,310	1,825	-	26,135
Securities	14,514	2,241	19,867	1,215	245	1,712	39,794
Borrowed securities	464	-	-	-	-	-	464
Credit granted to the public	42,141	17,749	27,238	3,482	4,057	-	94,667
Credit granted to the Government	32	1	3	-	13	-	49
Investments in affiliated companies	4	7	3	-	-	1,436	1,450
Buildings and equipment	-	-	-	-	-	2,678	2,678
Other assets	1,489	24	1,874	161	234	639	4,421
Total assets	62,247	20,820	63,584	10,168	6,374	6,465	169,658
Liabilities							
Deposits from the public	53,260	11,220	59,326	8,868	2,900	-	135,574
Deposits from banks	2,445	644	4,871	163	34	-	8,157
Deposits from the Government	48	6	69	-	-	-	123
Subordinated capital notes	481	6,133	-	-	-	-	6,614
Other liabilities	7,533	142	1,730	229	253	315	10,202
Total liabilities	63,767	18,145	65,996	9,260	3,187	315	160,670
Difference	(1,520)	2,675	(2,412)	908	3,187	6,150	8,988
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	3,604	(601)	1,129	(981)	(3,151)	-	-
Options in the money, net (in terms of base asset)	418	-	(459)	42	(2)	1	-
Options out of the money, net (in terms of base asset)	(13)	44	(65)	35	(1)	-	-
Total	2,489	2,118	(1,807)	4	33	6,151	8,988
Options in the money, net (discounted nominal value)	1,856	-	(1,878)	20	1	1	-
Options out of the money, net (discounted nominal value)	2,475	412	(2,567)	(323)	2	1	-

Footnote:
(1) Includes those linked to foreign currency.

APPENDIX "C" (CONTINUED)

CONDENSED CONSOLIDATED REPORT OF ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)

Reported amounts

	Unaudited						
	June 30, 2006						
	Israeli currency		Foreign currency[1]			Non	
	Non-linked	Linked to the CPI	In US$	In Euro	In other currencies	monetary Items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	2,068	1,354	11,829	5,185	1,648	-	22,084
Securities	13,179	1,486	23,828	1,138	291	726	40,648
Credit granted to the public	**37,217	18,734	26,500	2,657	3,342	-	88,450
Credit granted to the Government	8	2	71	-	-	-	81
Investments in affiliated companies	5	7	1	-	-	*1,719	1,732
Buildings and equipment	-	-	-	-	-	2,412	2,412
Other assets	1,497	11	2,156	25	113	*368	4,170
Total assets	53,974	21,594	64,385	9,005	5,394	5,225	159,577
Liabilities							
Deposits from the public	46,479	12,623	59,274	8,300	2,759	-	129,435
Deposits from banks	2,250	761	4,342	329	50	-	7,732
Deposits from the Government	*46	10	64	-	-	-	120
Debentures and subordinated capital notes	153	5,408	-	-	-	-	5,561
Other liabilities	**6,582	108	1,919	31	149	329	9,118
Total liabilities	55,510	18,910	65,599	8,660	2,958	329	151,966
Difference	(1,536)	2,684	(1,214)	345	2,436	4,896	7,611
Effect of hedging derivative instruments:							
Derivative instruments (except for options)	-	-	94	(30)	(64)	-	-
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	2,693	(1,116)	894	(311)	(2,160)	-	-
Options in the money, net (in terms of base asset)	(192)	6	158	27	1	-	-
Options out of the money, net (in terms of base asset)	412	4	(384)	(29)	(3)	-	-
Total	1,377	1,578	(452)	2	210	4,896	7,611
Options in the money, net (discounted nominal value)	420	10	(462)	31	1	-	-
Options out of the money, net (discounted nominal value)	1,663	207	(1,667)	(200)	(4)	1	-

* Reclassified.
** Restated.
Footnote:
(1) Includes those linked to foreign currency.

APPENDIX "C" (CONTINUED)

CONDENSED CONSOLIDATED REPORT OF ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)

Reported amounts

	Audited						
	December 31, 2006						
	Israeli currency		Foreign currency[1]			Non	
	Non-linked	Linked to the CPI	In US$	In Euro	In other currencies	monetary Items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	3,003	1,250	14,525	4,712	1,916	-	25,406
Securities	13,669	1,946	20,368	1,308	416	1,207	38,914
Credit granted to the public	40,520	17,793	25,273	2,907	3,682	-	90,175
Credit granted to the Government	8	3	7	-	-	-	18
Investments in affiliated companies	6	7	1	-	-	*1,353	1,367
Buildings and equipment	-	-	-	-	-	2,614	2,614
Other assets	1,735	19	1,672	37	76	*505	4,044
Total assets	58,941	21,018	61,846	8,964	6,090	5,679	162,538
Liabilities							
Deposits from the public	49,722	12,095	57,465	8,437	2,798	-	130,517
Deposits from banks	2,785	681	4,341	264	28	-	8,099
Debentures and subordinated capital notes	49	6	64	-	-	-	119
Subordinated capital notes	128	6,174	-	-	-	-	6,302
Other liabilities	7,285	126	1,288	53	118	264	9,134
Total liabilities	59,969	19,082	63,158	8,754	2,944	264	154,171
Difference	(1,028)	1,936	(1,312)	210	3,146	5,415	8,367
Effect of hedging derivative instruments:							
Derivative instruments (except for options)	-	-	157	38	(195)	-	-
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	2,549	(797)	1,320	(381)	(2,691)	-	-
Options in the money, net (in terms of base asset)	28	-	(90)	66	(5)	1	-
Options out of the money, net (in terms of base asset)	475	59	(536)	-	1	1	-
Total	2,024	1,198	(461)	(67)	256	5,417	8,367
Options in the money, net (discounted nominal value)	1,253	-	(1,151)	66	(169)	1	-
Options out of the money, net (discounted nominal value)	1,031	206	(1,285)	46	1	1	-

* Reclassified.

Footnote:

(1) Includes those linked to foreign currency.

APPENDIX “D”

BUSINESS SEGMENTS IN DISCOUNT GROUP

Reported Amounts

	Unaudited							
	For the three months ended June 30, 2007							
						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	(563)	113	851	220	(1,168)	(4)	1,467	916
- Intersegmental	862	58	(573)	(1)	1,248	(7)	(1,587)	-
Total Income from financing activities	299	171	278	219	80	(11)	(120)	916
Non-financing and other income	414	98	36	58	39	5	25	675
Total Income	713	269	314	277	119	(6)	(95)	1,591
Provision for doubtful debts	31	46	56	19	3	-	3	158
Net income (loss)	447	89	96	99	27	(2)	(129)	627
Net income (loss) disregading certain components*	97	61	93	80	29	(2)	(129)	229
avarage assets	20,759	8,192	31,287	21,067	4,927	915	65,147	152,294
avarage liabilities	54,647	8,360	17,194	11,272	35,697	26	25,635	152,831

* The following components have been disregarded: gain on the sale of provident fund activity, one quarter of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

	For the three months ended June 30, 2006*							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	317	187	296	235	(119)	(5)	22	933
- Intersegmental	(61)	(46)	(40)	(90)	189	(2)	50	-
Total Income from financing activities	256	141	256	145	70	(7)	72	933
Non-financing and other income	362	71	59	74	66	7	(37)	602
Total Income	618	212	315	219	136	-	35	1,535
Provision for doubtful debts	24	32	29	24	-	-	-	109
Net income (loss)	262	56	109	16	37	8	(71)	417
Net income (loss) disregading certaincomponents**	30	28	106	23	44	8	(69)	170

* Reclassified

** The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one quarter of the effect of the provision in respect of provisions for salary related expenses, the profit from the sale of Ilanot Discount, the cost of implementing improvements and examinations in IDB New York and the effect of the reversal of the provision for impairment in value of the investment in the First International Bank.

APPENDIX "D" (CONTINUED)

BUSINESS SEGMENTS IN DISCOUNT GROUP (CONTINUED)

Reported Amounts

Unaudited

For the six months ended June 30, 2007

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial: Non Financial Companies	Financial: Financial Management	Total Consolidated
Income (loss) from financing activities before provision for doubtful debts								
- From externals	(507)	311	1,123	457	(1,101)	(4)	1,659	1,938
- Intersegmental	1,089	8	(623)	(76)	1,249	(8)	(1,639)	-
Total Income from financing activities	582	319	500	381	148	(12)	20	1,938
Non-financing and other income	807	177	124	113	72	5	26	1,324
Total Income	1,389	496	624	494	220	(7)	46	3,262
Provision for doubtful debts	60	73	65	48	4	-	4	254
Net income (loss)	497	114	199	95	27	4	(104)	832
Net income (loss) disregading certain components*	170	94	204	84	32	4	(96)	492
avarage assets	20,546	9,207	35,319	21,340	4,031	713	65,674	156,830
avarage liabilities	56,122	8,281	16,167	13,788	35,598	26	23,545	153,527

* The following components have been disregarded: gain on the sale of provident fund activity, one half of the effect of the provision in respect of the wage agreement for 2007 on the increase in liabilities in respect of provisions for salary related expenses at the Bank and at a consolidated subsidiary, expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

For the six months ended June 30, 2006*

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial: Non Financial Companies	Financial: Financial Management	Total Consolidated
Income (loss) from financing activities before provision for doubtful debts								
- From externals	(291)	356	638	458	(157)	(1)	822	1,825
- Intersegmental	819	(80)	(185)	(132)	306	(13)	(715)	-
Total Income from financing activities	528	276	453	326	149	(14)	107	1,825
Non-financing and other income	712	155	94	126	105	11	(11)	1,192
Total Income	1,240	431	547	452	254	(3)	96	3,017
Provision for doubtful debts	53	67	62	68	-	-	1	251
Net income (loss)	198	33	129	(8)	45	20	27	444
Net income (loss) disregading certain components**	89	55	163	39	69	20	(102)	333

* Reclassified

** The following components have been disregarded: the privatization bonus, expenses in respect of early retirement incentive, one half of the effect of the provision in respect of provisions for salary related expenses, expenses in respect of early retirement incentive and examinations in IDB New York and the effect of the reversal of the provision for impairment in value of the investment in the First International Bank.

APPENDIX "D" (CONTINUED)

BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

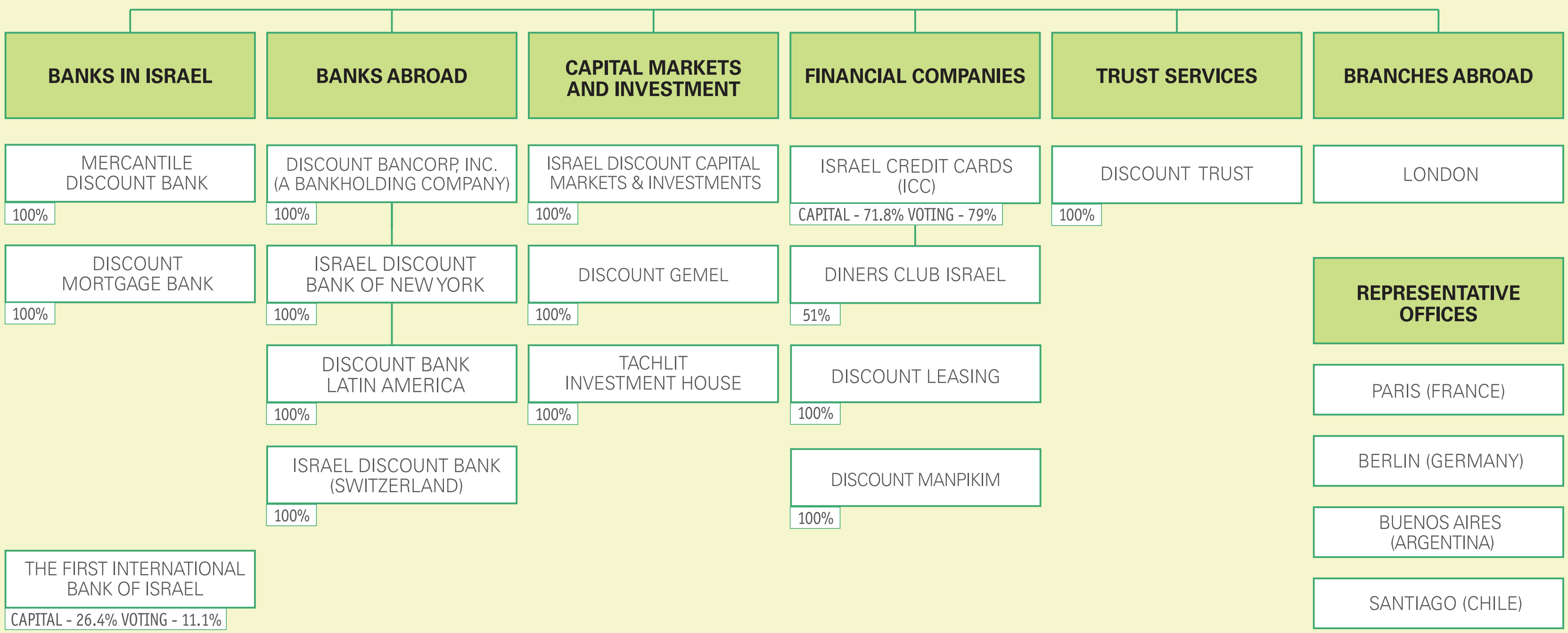
Activity Sectors in Discount Bank Business Segments (continued)

Reported Amounts

	Audited							
	For the year ended December 31, 2006							
						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	487	747	1,283	1,175	814	(3)	(713)	3,790
- Intersegmental	568	(200)	(402)	(478)	(512)	(15)	1,039	-
Total Income (loss) from financing activities	1,055	547	881	697	302	(18)	326	3,790
Non-financing and other income	1,440	331	165	191	130	13	89	2,359
Total Income	2,495	878	1,046	888	432	(5)	415	6,149
Provision for doubtful debts	109	183	154	122	2	-	-	570
Net income	251	52	207	3	31	155	137	836
Net income disregading certain components*	149	78	250	66	56	51	16	666
Avarage Assets	17,669	12,007	35,968	23,540	3,533	307	61,310	154,334
Avarage Liabilities	53,946	7,562	14,246	12,579	37,478	24	20,897	146,732

* The following components have been disregarded: privatization bonus, expenses in respect of early retirement incentive, payments to the US regulatory authorities and the cost of improvements and examinations at IDB New York, the reversal of the provision for impairment in value of the investment in the First International Bank, profit from the sale of Harel shares and profit from the sale of Ilanot Discount.

DISCOUNT GROUP STRUCTURE



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