



ANNUAL REPORT 2007

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BOARD OF DIRECTORS

Shlomo Zohar Chairman, the Bank; Mercantile Discount Bank Ltd.; Israel Credit Cards Ltd.; Israel Discount Capital Markets & Investments Ltd.; Vice Chairman of the Board, Israel Discount Bank of New York. Director, Discount Bancorp, Inc.; S. Zohar Consulting & Management Ltd.

Betzalel Eiger Chairman & CEO, Dorea Investments & Development Ltd. Chairman & CEO, Liberty Properties Ltd. Director, Comsec. Ltd.; Ortam Sahar Engineering Ltd.

Itshak Forer Chairman, K&G Properties Inc.; Shir Tal Holdings and Management Ltd.; F.H.Y Holdings Ltd.; Y.F.S.R. Management Services Ltd. Director, Conference on Jewish Material Claims Against Germany Inc.; Biomas Ltd. Member of the Advisory Committee, Tamir Fishman Investments Ltd.

Ittamar Givton Managing Director, Automotive Equipment Group. Director, Automotive Equipment Ltd.; Moto Parts Ltd.; Israel Automobile Corporation Ltd.; Automotive Equipment & Vehicles (2004) Ltd.; Metive Ltd.; Automotive Industries Ltd.; Advanced Vehicles C.R.M Ltd.; M.S.Y. Sport Cars Israel Ltd.; Metropolitan Public Transport Ltd.; Metrodan Beer Sheva Ltd. Member of Management Committee, Buxenbaum-Neta Fund (private fund). Member of Management, Sheba Fund (Endowment).

Ben-Zion Granit Management Consultant. Member of Management, Ilan — Israel Foundation for Handicapped Children.

Zipora Samet (Outside Director) Outside Director, Menora Mivtahim Pensions Ltd.; Menorah Mivtahim Gemel Ltd.; Sinai Insurance Holdings (1993) Ltd.; Ophir Optronics Ltd. Chair, Investment Committee, Avner-Motor Vehicle Accident Victims Insurance Ltd. President, Adif College for Insurance, Pension and Financial Studies. Director, Merav—Yaniv Financial Consultants Ltd.

Dr. Dafna Schwartz Business and Economics Consultant, Senior Lecturer, Department of Business Administration, Head, MBA Specialization (Magama) in Entrepreneurship and High-Tech Management, and Director, Bengis Center for Entrepreneurship and High-Tech Management, Ben Gurion University of the Negev. Outside Director, Oil Refineries Ltd.; Giron Development and Building Ltd. Director, Rotem Industries Ltd.

Tida Shamir Attorney at Law and Director, Tida Shamir & Co - Advocates. Outside Director, Gazit Globe Ltd; Elron Electronic Industry Ltd. Director, Dikla Insurance Company Ltd.; G.M.S.L. Ltd.

Dr. Yitzhak Sharir Private Investments. Outside Director, Zur Shamir Holdings Ltd.; Chairman, Revolutionare Ltd.

Prof. Eytan Sheshinski Professor of Public Finance, Hebrew University, Jerusalem. Director, Psagot Mutual Funds Ltd.

Joseph Singer (Outside Director) Director & Managing Partner, Giza Singer & Even Ltd. Independent Director, Poalim I.B.I. — Underwriting & Issuing Ltd. Director, Singer & Even Ltd.; Midroog Ltd.; Midroog Holdings Ltd.; Giza Singer & Even Finance Ltd.; Singer, Even & Kraizberg Holdings Ltd.; Giza Singer Even Real Estate Ltd.; Giza Singer Even Investments 2007 Ltd.

Zvi Streigold Attorney-at-Law and Director, Zvi Streigold — Law Company; Clal Finance Trusts 2007 Ltd.

Jorge Zafran Director & CEO, Power Phone Marketing Ltd.; Power Dialing Ltd.; Inter-American Marketing Services Ltd.; Cadillac Properties and Building Company Ltd.; Israel Learning Systems Ltd. Joint Managing Director, T.M. Intertrom Ltd.

Prof. Ben Zion Zilberfarb Professor of Economics, Bar-Ilan University. Edmond de Rothschild Chair for Global Asset Management, School of Banking and Capital Markets, Netanya Academic College. Outside Director Brimag Digital Age Ltd.; Direct Capital Investments Ltd.; The Delek Group Ltd.; Perrigo Company. Director, Prof. Ben-Zion Zilberfarb Economic and Management Consultant Ltd.

MANAGEMENT

Giora Offer President & Chief Executive Officer. **Joseph Beressi** Senior Executive Vice President Chief Accountant Comptroller Accounting Group. **Israel David** Senior Executive Vice President Retail Banking Division. **Noam Hanegbi** Senior Executive Vice President Operations & Information Systems Division. **Eli Hoter** Senior Executive Vice President Marketing & Strategic Planning Division. **Ehud Arnon** Executive Vice President Corporate Banking Division. **Dorit Bensimon** Executive Vice President Finance Division Risk Manager. **Esther Deutsch** Executive Vice President Legal Adviser Legal Advisory Group. **Amnon Gideon** Executive Vice President Human Resources Group.

Shlomo Pitchon Senior Executive Vice President Internal Auditor.

Ruth Moshkovitz Corporate Secretary.

2007

REPORT OF THE BOARD OF DIRECTORS TO THE GENERAL MEETING OF THE SHAREHOLDERS

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The Board of Directors, on March 31, 2008, approved and authorized for publication the consolidated financial statements of the Bank and its subsidiaries for the year ended December 31, 2007.

THE DISCOUNT GROUP - GENERAL OVERVIEW AND STRUCTURE OF THE GROUP

Israel Discount Bank Ltd. (hereinafter - "the Bank") was incorporated in Palestine in 1935, as a public company under the Companies Ordinance. The Bank was founded by the late Mr. Leon Recanati. The Bank is a banking corporation having a banking license under the provisions of the Banking Law (Licensing), 1981 (hereinafter: "the Banking Law (Licensing)").

During the seventy two years of its operation the Bank has developed a chain of branches and a wide variety of commercial banking activities in all banking spheres. The Discount Group is the third largest banking group in Israel

DOMESTIC OPERATIONS

The Bank is a universal bank, which grants its customers comprehensive banking services in all areas of financial activity, through 129 branches in Israel. The Bank also offers its customers a variety of direct banking, on-line banking and Internet services.

The Bank has two banking subsidiaries in Israel - Mercantile Discount Bank Ltd. - a commercial bank serving customers in all fields of financial activity through 70 branches, and Discount Mortgage Bank Ltd., serving as the main arm of the Group in the mortgage loan field. In addition, the Bank has an affiliated company, The First International Bank of Israel Ltd., also being one of the five major banking groups in Israel.

The activities in Israel include additional areas the main ones being:

- Credit cards - The Bank controls Israel Credit Cards Ltd. ("ICC") and Diners Club Israel Ltd. ("Diners"), which issue and market "VISA", "Diners" and "MasterCard" credit cards, both for domestic and overseas use.
- Securities portfolio management - The subsidiary, Tachlit Investment House Ltd., which manages securities investment portfolios for private customers, corporations, not-for-profit organizations and institutional bodies.
- Investments in private investment funds and venture capital funds and underwriting - The subsidiary, Israel Discount Capital Markets and Investments Ltd., engages in investment banking, as well as investing in private investment funds and venture capital funds and in securities issuance underwriting and management.
- Provident funds - The subsidiary, Discount Gemel Ltd. provides operating services to provident funds and mutual funds.

The Bank's activity in Israel underwent significant changes in the years 2006-2007 due to the implementation of the legislation passed in the wake of the Bachar Committee recommendations. These changes include the sale of shares of Ilanot Discount Ltd., the sale of the operations of the provident funds, decrease in the holdings in Harel Insurance Investments Ltd., the sale of holdings in the advanced training funds (Kahal) and the preparations for the entry into the pension consultancy field. For details see hereunder "Operations in the capital market" under "Further details as to activity in certain products", "Legislation and supervision" and Notes 6 E and 33 to the financial statements.



In the course of 2007, the Bank continued to strengthen its position in the retail banking market by several central processes:

- Success in winning the tender by the Accountant General for the provision of services to State employees, and completion of the preparations by the Bank for attracting and providing services to State employees through the establishment of specialized branches and the setting up of a supporting back-office layout as well as a targeted marketing layout;
- Success in winning the tender by the Accountant General for the provision of services to teaching personnel;
- A marketing campaign for the granting of mortgage loans jointly with the subsidiary Discount Mortgage Bank;
- Completing the preparations for obtaining a pension advisory services license.

At the same time, the Bank continued the opening of branches according to the retail service model unique to Discount Bank: Dozens of branches in a countrywide distribution are open to the public 10-12 hours each day and provide new norms of service in Israel.

The Bank completed in May 2007 the purchase of the shares of Discount Mortgage Bank held by the public. For details regarding "Discount Mortgage Bank" see under "Main investee companies" hereunder.

OVERSEAS EXTENSIONS OF THE BANK

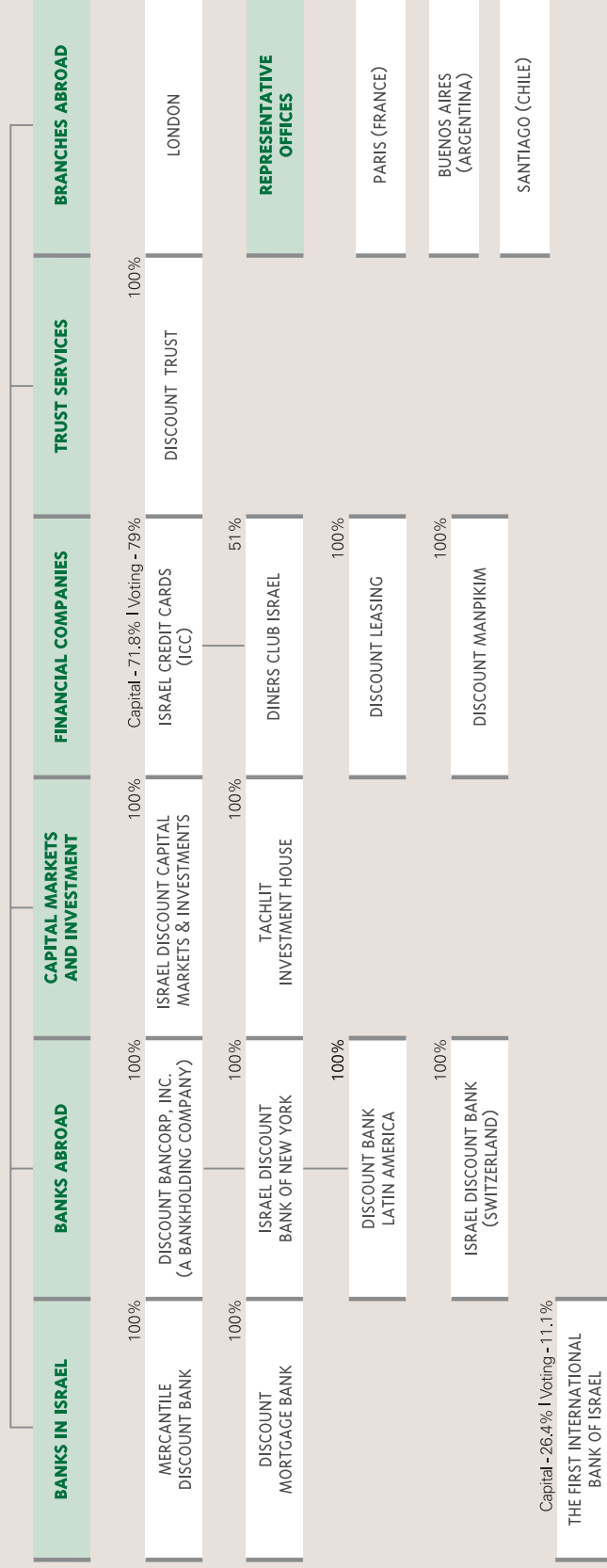
The major part of the Bank's operations abroad is conducted by Israel Discount Bank of New York, which is the largest of all Israeli banks operating abroad. The Bank also holds a commercial bank in Montevideo, Uruguay and a bank in Switzerland, located in Geneva, which focuses on private banking. The Bank operates a London branch, which provides commercial and private banking services. In addition, the Bank has representative offices in Paris, Berlin, Buenos Aires, Santiago and São Paulo.

MARKET SHARE

Based on data relating to the banking industry as of September 30, 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:

	September 30, 2007	December 31, 2006	December 31, 2005
	In %		
Total assets	17.6	17.8	18.1
Credit to the public	15.6	15.5	15.3
Deposits of the public	18.0	18.0	18.6
Earnings from financing operations	17.0	17.0	17.2
Provision for doubtful debts	28.1	18.9	17.5
Operating income	18.4	17.2	18.7
Operating expenses	20.6	21.0	22.3

DISCOUNT GROUP STRUCTURE



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.

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.

DISCOUNT GROUP SEGMENTS OF OPERATION - CONDENSED DESCRIPTION

The Bank reports its operations, in accordance with instructions of the Supervisor of Banks, under six operating segments, as follows:

- **Retail Banking - Household Segment:** This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as VIP customers (the definition excludes customers of the private banking centers). The segment also includes the customers of Mercantile Discount Bank in that bank's household segment - private customers of Mercantile Discount Bank, whose activities are typical of those of households, including credit of a volume not exceeding NIS 200 thousand and deposits of a volume not exceeding NIS 500 thousand.
- **Retail Banking - Small Business Segment:** This segment includes customers of the Bank's Retail Division and customers of Mercantile Discount Bank which are defined as small companies and small businesses with borrowings of up to NIS 10 million. Until December 31, 2006 the segment also included the customers of Mercantile Discount Bank in that bank's small business segment -

that bank's small business segment customers (individuals and corporations) whose granted volume of credit does not generally exceed NIS 1 million.

- **Corporate banking:** The segment includes primarily companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 50 million, which are customers of the Bank and of Mercantile Discount Bank.

Until December 31, 2006 the segment also included customers of the business segment of the Mercantile Discount Bank - corporations whose annual business turnover generally exceeds NIS 100 million and public companies handled by the corporate division of Mercantile Discount Bank and customers with a scope of transactions less than NIS 150 million and a scope of credit exceeding NIS 15 million.

- **Middle Market banking:** This segment includes mainly companies with annual turnovers exceeding NIS 30 million and/or total indebtedness of NIS 10-50 million, which are customers of the Bank and of Mercantile Discount Bank.

Until December 31, 2006 also included customers of the Middle Market banking of Mercantile Discount Bank - business 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.

- **Private banking:** This segment includes, as part of the Bank's domestic operations, customers of the Bank's Retail Division (individuals and corporations) who maintain their accounts at the private banking centers. These customers are generally Israeli customers having deposits of NIS 2 million and over, as well as foreign residents. The segment also includes customers of Mercantile Discount Bank of medium and high wealth, all the activity of the subsidiary in Geneva and the private banking customer activity at IDB New York.

- **Financial Management Segment:** 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 their own account operations of the Bank and Mercantile Discount Bank involving securities and other banks, as well as management of market and liquidity risks and dealing room operations, including those involving 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.

Starting with the year 2006, these segments include also the related part of the international operations of the Discount Group. This Report includes a chapter describing the international operations of the Discount Group.

These segments include also the related part of the operations of the product segments: credit cards, capital market activity, construction and real estate and mortgages.

- **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 in which the Bank

holds 71.8% in share capital and 79% in voting rights and by the issue as co-issuers 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.

- **Operations in the Capital Market:** The operations in the capital market includes securities activity (excluding activity for the Bank's own account), portfolio management, mutual funds. In accordance with the strategic plan, the investment consulting services layout is in the midst of an expansion and reinforcement process with the aim of providing a timely and professional response to the changing needs of customers. The operations include the activity of the Bank's securities department, as well as the operations of a specialized subsidiary - Tachlit Investment House and the operations in the capital market of Mercantile Discount Bank. Until June 30, 2007, the activities included those of Discount Management of Provident Fund, which was sold. Until June 30, 2006, the activities included those of the specialized subsidiary Ilanot Discount, that has been sold.
- **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.
- **Mortgage and Housing Loan Activity:** This segment includes the 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.

For additional details, see "Activities of the Group according to principal segments of operations", "Additional details regarding activities in certain products" and the "International activity" below. For details regarding the assumptions, assessments and reporting principles used in the preparations of the data, see Note 31 to the financial statements.

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

MAJOR FIGURES FROM
THE CONSOLIDATED
FINANCIAL
STATEMENTS

PROFITABILITY

	For the year ended December 31			Rate of change in %	
	2007	2006	2005	2007	2006
				Compared with	
	In NIS millions			2006	2005
Income from financing activities					
before provision for doubtful debts	4,225	3,790	3,697	11.5	2.5
Provision for doubtful debts	447	570	691	(21.6)	(17.5)
Income from financing activities					
after provision for doubtful debts	3,778	3,220	3,006	17.3	7.1
Non-financing income	2,572	2,359	2,406	9.0	(2.0)
Non-financing expenses	5,066	5,020	4,729	0.9	6.2
Operating income before taxes	1,284	559	683	129.7	(18.2)
Operating income after taxes	718	209	359	243.5	(41.8)
Net income	1,265	836	458	51.3	82.5
Net income disregarding					
certain components*	924	672	693	37.5	(3.0)
Net earnings per share of					
NIS 0.1 par value	1.29	0.85	0.47		
The return on shareholders' equity	14.7	11.7	7.2		
The return on shareholders' equity					
disregarding certain components*	10.7	9.4	10.9		

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

BALANCE SHEET

	As at December 31		Rate of
	2007	2006	change
	In NIS millions		in %
Total assets	168,810	162,523	3.9
Credit granted to the public	101,899	90,097	13.1
Securities	37,278	38,977	(4.4)
Deposits from the public ⁽¹⁾	136,413	130,517	4.5
Shareholders' equity including minority interests	9,351	8,367	11.8
Shareholders' equity	9,204	7,965	15.6

(1) Including securities loaned or sold under buy-back arrangements. For details regarding the change in the mode of presentation of deposits from the public, see "Deposits from the public" under "Developments of assets and liabilities".

FINANCIAL RATIOS

	As at December 31	
	2007	2006
	In %	
Capital resources in relation to total assets	5.5	5.1
Ratio of capital to risk assets	10.9	10.5
Ratio of the provision for doubtful debts to credit to the public	0.41	0.59
Ratio of credit to the public to total assets	60.4	55.4
Ratio of credit to the public to deposits of the public ⁽¹⁾	74.7	69.0
Ratio of deposits of the public ⁽¹⁾ to total assets	80.8	80.3
Ratio of operating income to operating expenses	50.8	47.0
Operating expenses relative to total income	74.5	81.6

(1) Including securities loaned or sold under buy-back arrangements. For details regarding the change in the mode of presentation of deposits from the public, see "Deposits from the public" under "Developments of assets and liabilities".

THE PRICE OF THE DISCOUNT BANK SHARE IN COMPARISON TO THE TASE BANK INDEX



THE STRATEGIC PLAN

In March 2007, the bank adopted a multi-annual strategic plan intended to bring the Bank onto an accelerated growth route.

BACKGROUND - PREVIOUS STRATEGIC PLANS

The strategic plan for the years 2007-2011 constitutes a direct continuation of the two previous strategic plans:

A recovery plan (2001) that reached most of its targets and which reverted the bank to a route of profitability. During the period of this plan, 100 thousand new customers were attracted to the bank.

A differentiation and leadership plan (2004) that determined the vision of humane banking and the strategic backbone of the Bank, which guide the Bank's operations and forms the basis for its strategic plans:

- **The mission:** Humane banking;
- **The purpose:** Combining humaneness with professionalism;
- **The assignment:** Leading the personal and humane service experience;

- **Basic values:** The love of humanity, professionalism, integrity, initiative and commitment;
- **Market identity:** Discount Bank leading the personal and humane service experience, based on attentiveness and understanding of the customer's needs, creating innovative and clear solutions and rated by customer satisfaction;
- **The strategic pledge:** Taking you personally;
- **The strategic focus:** Satisfying every customer, whether an external or an internal one.

THE STRATEGIC PLAN FOR THE YEARS 2007-2011

The strategic plan for the years 2007-2011 - the accelerated growth plan - determines a strategic framework for increasing the value of the Bank and is based on growth engines in addition to the growth in current operations of the Bank. The strategic plan engulfs all areas of operation at the Bank and is measurable and controllable.

THE TARGETS OF THE STRATEGIC PLAN

- Double digit annual growth in net operating income;
- Return on equity of at least 13% as from 2010;
- Consistent improvement in operating indices.

It should be noted that the said minimum return assumes a distribution of dividend as from the year 2009, from the income of 2008, even though the Bank's Board of Directors has not yet adopted a dividend policy and has not decided on any dividend distribution.

HUMANE BANKING

The Bank is to continue operating in line with the humane banking vision as regards its customers and staff, with social responsibility and involvement.

THE RETAIL BANKING SEGMENT

The strategic plan determined that intensifying the activity with Bank customers is to be achieved by improving the ability to adapt to each customer the product package preferred by him. This concurrently with the improvement in the management information systems of the Bank, including the measurement of customer profitability.

THE CORPORATE AND MIDDLE MARKET BANKING SEGMENT

The merger of the corporate and middle market divisions was completed in 2007, according to the strategic plan. This merger will improve the preparation and focusing on the risk management field, the efficiency of the system and the decision making process, while reorganizing the business layout of the Bank.

FINANCIAL MANAGEMENT SEGMENT

In the coming years, the financial segment is to serve as a profit growth engine with the establishment of the global treasury layout (the group asset and liability management and dealing room), which is to act with a view of realizing the advantages of the international disposition of the Discount group. The dealing rooms, risk management and the asset and liability management will gradually be converted into group management.

The improvement in the Bank's capital adequacy brought about an increased ability to take on risks. In view of this, the bank intends to increase in a controlled manner the risk level of the Bank's own investments (Nostro investments) in order to achieve higher rates of return.

NON-FINANCIAL INVESTMENTS

According to the strategic plan, non-financial investments have been shifted and will be managed centrally by the subsidiary Israel Discount Capital Markets and Investments Ltd., which is to be reinforced and will become the non-financial investments arm of the Bank.

SALE OF FINANCIAL PRODUCTS AND PREPARATION FOR PENSION ADVISORY SERVICES

The investments consulting services layout is to be expanded and reinforced in order to provide a professional and timely response to the changing needs of customers. This expansion is to contribute to the improvement of professional service to customers and to the increase of the Bank's income from the sale of capital market products.

A pension advisory service layout is being established, which will enlarge the circle of customers seeking this service as well as the variety of services to customers, will strengthen relations with customers and will increase the Bank's income from the sale of pension products.

CORPORATE OUTLOOK

In the coming years, the Bank will act towards strengthening the corporate outlook and improving the synergy in the Group by way of intensifying the cooperation between Group companies.

EFFICIENCY AND IMPROVED EFFECTIVENESS

In 2008 the Bank intends to launch a program called "a lean organization" for improving the effectiveness of the branch layout. In addition, the Bank is to continue efforts made in the development of the information systems field, with the objective of increasing its productivity, side by side with the diversion of the center of activity from the "Ofek" Project to supporting the business units and implementing the strategy.

EXPANDING THE BANKING ACTIVITY ABROAD

According to the strategic plan, the Bank completed the first stage of the plan for the expansion of its banking operations abroad. In this framework, the transaction for the acquisition of a local bank in Switzerland has been completed.

Concurrently, the Bank plans the expansion of activities and increase in income of IDB New York and of the London Branch of the Bank.

CORPORATE GOVERNANCE

The Bank is to prepare the adoption of a corporate governance code intended to maintain at group level, a "best practice" policy regarding corporate governance. Among other things, the code is to be formed in the light of the rules and regulations applying to the Bank as a banking corporation and in the light of the Goshen Commission recommendations and of practices adopted in other countries around the world, while modifying it to the characteristics and the unique requirements of the Discount Group. The code is to include a risk management policy (including Basel II), a compliance policy and response to the requirements stemming from the application of SOX 404.

FORWARD-LOOKING INFORMATION

The essence of the strategic plan as discussed above, include evaluations that constitute forward-looking information, such as the estimate of return to equity, earnings, targets that had been set, etc. These evaluations are based on the up to date information and assessments in the hands of the Bank at date of issue of the Report.

The strategic plan is based on assumptions regarding the continued growth of the economy, the stability of the regulatory environment and the stability of the banking industry. Material changes in the state of the economy and in the position of customers, changes in regulation having a significant effect, or material changes in the structure of competition may affect the extent of achieving the targets of the strategic plan. An additional uncertainty factor derives from the limited ability to forecast precisely the implications of certain of the future processes and their impact on profitability.

INCOME AND PROFITABILITY

The Group's net income in 2007 totalled NIS 1,265 million, compared with NIS 836 million in the preceding year, an increase of 51.3%.

Net income disregarding certain components, as detailed hereunder, would have totalled NIS 924 million in 2007, compared with NIS 672 million in the preceding year, an increase of 37.5%.

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

		For the year ended on December 31,	
	Note	2007	2006
Reported net income		1,265	836
The bonus paid to the employees in respect of the sale of the controlling interest in the Bank	32	-	221
Expenses in respect of encouragement of early retirement		56	128
The cost of implementing improvements and examinations in IDB New York	6 D	30	20
Profit from the sale of Ilanot Discount shares	6 E	-	(256)
Gain on sale of Harel Insurance Investments shares	6 H		(104)
Reversal of the provision for impairment in value of the investment in the First International Bank recorded in 2003	6 F	-	(173)
Gain on the sale of the provident fund activity*	6 E	(483)	-
Gain on the sale of KAHAL	19 C 20	(74)	-
Provision for taxes in respect of the investment in the First International Bank	6 G	130	-
Net income disregarding certain components		924	672
The return on shareholders' equity disregarding certain components		10.7	9.4

* Includes gains in the amount of NIS 49 million on the sale of control (51%) of the provident funds operations of Mercantile Discount Bank, and includes the Bank's share in the gains of the First International Bank on the sale of the operations of its provident funds in the amount of NIS 41 million.

Return on shareholders' equity for 2007 was 14.7%, compared with 11.7% in the preceding year. (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").

Return on shareholders' equity, disregarding certain components, as detailed above, would have reached in 2007 a rate of 10.7% compared with 9.4% in 2006.

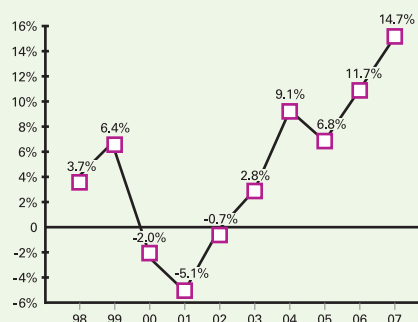
Net earnings per one share of NIS 0.1 par value amounted in 2007 to NIS 1.29, compared with NIS 0.85 in 2006.

Net earnings per one share of NIS 0.1 par value, disregarding certain components, as detailed above, would have reached in 2007 NIS 0.94 compared to NIS 0.69 in 2006.

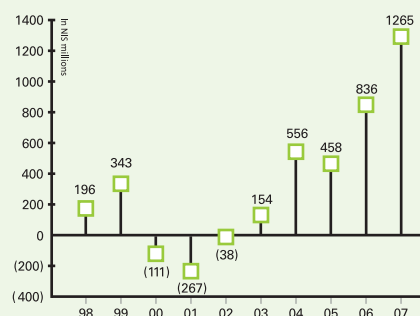
Following are the main factors that had an effect on the business results of the Group in 2007, compared with 2006:

- (a) An increase of 11.5% in income from financing activities before provision for doubtful debts.
- (b) A decrease of 21.6% in provisions for doubtful debts.
- (c) An increase in non-financing income at the rate of 9.0% that was affected by an increase in operating commissions at the rate of 16.0%, that were off set in part by a decrease of 22.2% in other income.
- (d) An increase in non-financing expenses at the rate of 0.9%, that was affected mainly from an increase in other expenses at the rate of 6.8%, and an increase of 20.6% in expenses in respect of maintenance and depreciation on buildings and equipment, which was partially off set from a decrease in salary and related expenses at the rate of 5.4% (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).
- (e) The Bank's share in earnings from ordinary operations of affiliates in 2007 totalled NIS 45 million, compared with NIS 188 million in 2006, a decrease of 76.1%, mainly as a result of a provision for taxes in the amount of NIS 130 million in respect of the investment in the First International Bank (see note 6 F) and as a result of the sale of the investment in Harel Insurance Investments Ltd.
- (f) Net gain on sale of the provident fund activity in the amount of NIS 483 million, net gain on the sale of KAHAL in the amount of NIS 74 million, (in 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, net gain in the amount of NIS 256 million from the sale of the Ilanot Discount shares and net gain of NIS 104 million on the sale of Harel Insurance Investments shares).

RETURN ON EQUITY- in %



NET INCOME (LOSS) - IN NIS MILLIONS



DEVELOPMENTS IN INCOME AND EXPENSES

Income from financing activities before provision for doubtful debts amounted to NIS 4,225 million in 2007, compared with NIS 3,790 million in the preceding year, an increase of 11.5%.

The principle factors affecting profits from financing operations before provision for doubtful debts in 2007, compared with 2006, were:

- a. An increase at the average rate of 17.2% in the income producing financial assets, from an amount of NIS 193,305 million to NIS 226,551 million, mostly due to the increased derivative financial instruments operations;
- b. A decrease of 0.1% in the overall interest margin, from a level of 1.81% to a level of 1.71%, mostly due to the increase in volume of operations in the non-linked Shekel segment, in derivative financial instruments with relatively low margins;
- c. Increased contribution of the active capital, in all linkage segments;
- d. An increase in other financing, net, of NIS 54 million;
- e. Hedging operations made by the Bank with a view to eliminate the fluctuations in the provision for income taxes deriving from changes in the investments in consolidated subsidiaries abroad due to devaluation or appreciation of foreign exchange, resulted in an increase of NIS 66 million in profits from financing operations in 2007. The effect of this hedging operation has been fully offset by the taxes on income item (hedging operations commenced following the full utilization of tax losses in respect of which no deferred tax assets had been recorded).

Income from financing activities before provision for doubtful debts amounted in the fourth quarter of 2007 to NIS 1,075 million, compared to NIS 1,004 million in the corresponding period last year, an increase of 7.1%

The principal factors which affected income from financing activities before provision for doubtful debts in the fourth quarter of 2007, compared to the corresponding period last year:

- a. An increase at the rate of 21.1% in the average balance of income generating financial assets, from NIS 202,380 million to NIS 245,130 million, mainly due to a growth in derivative financial instruments activity.
- b. A reduction in the total interest rate margin at the rate of 0.14% from a rate of 1.77% to 1.63%, mainly due to the increase in volume of operations in the non-linked Shekel segment in derivative financial instruments at relatively low margins.
- c. An increase in the contribution of the active capital, in all linkage segments.
- d. Hedging operations effected by the Bank in order to eliminate the volatility of the provision for taxes on income stemming from changes in the value of investments in foreign subsidiaries, arising from devaluation or appreciation of currencies, resulted in an increase of NIS 58 million in income from financing activity in the last quarter of 2007. The effect of this hedging operation was fully setoff against the taxes on income item. (The hedging activity began after the Bank had exhausted the brought-forward tax losses in respect of which deferred tax assets had not been recognized).

Financing income decreased by NIS 137 million compared to the third quarter of 2007. This decline stemmed mainly from a negative adjustment to fair value of derivative financial instruments in the

amount of NIS 85 million and from a decrease in the contribution of the active capital in the CPI linked segment amounting to NIS 64 million, this due to the stability of the CPI in the fourth quarter compared to a 2.5% rise in the CPI in the third quarter.

INCOME FROM FINANCING ACTIVITY BY LINKAGE SEGMENTS

Below is the composition of income from financing activity by linkage segments (including the effect of derivative financial instruments which may be allocated to segments of activity - ALM):

For the year ended December 31							
2007				2006			
	Contribution to profit			Contribution to profit			Changes in contribution
	Volume of activity* in %	in NIS millions	Change in %	Volume of activity* in %	in NIS millions	Change in %	in NIS millions
Unlinked shekels	39.7	1,995	47.2	32.7	1,692	44.6	303
CPI-linked shekels	9.8	362	8.6	11.1	347	9.2	15
Foreign Currency	50.5	1,519	35.9	56.2	1,456	38.4	63
	100.0	3,876	91.7	100.0	3,495	92.2	381
Options		(75)	(1.8)		108	2.9	(183)
Other derivative financial instruments (not including hedged derivatives and ALM)		89	2.1		(4)	(0.1)	93
Financing commissions		125	3.0		123	3.2	2
Other financing income, net		210	5.0		68	1.8	142
Total		4,225	100.0		3,790	100.0	435

* According to the average balance of the assets.

For further details of earnings from financing operations according to linkage terms, see "Financing income and expense ratios" in Schedule C in the Management Review hereunder.

INTEREST INCOME, NET, ACCORDING TO LINKAGE SEGMENTS (INCLUDING ALM)

In the non-linked shekel segment, net interest income totalled NIS 1,995 million in 2007, compared with NIS 1,692 million in 2006, an increase of 18.2%. Income from this segment constituted 47.2% of total net interest income in 2007, compared with 44.6% in 2006.

In 2007, assets exceeded liabilities in this segment by NIS 3,750 million, compared with 2006, where assets exceeded liabilities by NIS 1,890 million, contributing to the increase in earnings from financing operations in this segment.

The average balance of assets in this segment increased in 2007 by 42.0% compared with the preceding year.

The interest margin of the segment declined from a rate of 2.58% in 2006 to a rate of 2.10% in 2007. The increase in the segment's earnings resulted mainly from an increase in the volume of operations and from the increase in contribution of the active capital following the increase in the capital invested in the segment. The said increase was setoff by the decrease in the interest rate margin,

mainly due to the increase in the volume of operations in derivative financial instruments at relatively low margins and due to an expense of NIS 28 million in respect of fair value adjustments of derivative financial instruments in 2007 compared to an income of NIS 17 million in 2006.

In the CPI-linked shekel segment, net interest income totalled NIS 362 million in 2007, compared with NIS 347 million in 2006, a decrease of 4.3%. Its proportion of total net interest income in 2007 was 8.6%, compared with 9.2% in 2006.

The average asset balance in this segment in 2007, rose by 3.3% compared with the preceding year. The interest margin of the segment decreased from a rate of 1.32% in 2006 to a rate of 1.05% in 2007. The increase in the segment's earnings resulted mainly from an increase in contribution of the active capital, mostly as a result of an increase of 2.8% in the CPI in 2007, compared to a decrease of 0.3% in 2006. The said increase was setoff by the reduction in interest margins, among other things in respect of a net loss on derivative financial instruments operations.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net interest income amounted to NIS 1,519 million in 2007, compared with NIS 1,456 million in 2006, an increase of 4.3%. Its proportion of all net interest income was 35.9% in 2007, compared with 38.4% in 2006.

In 2007, the average balance of assets in this segment increased by 5.5% compared with the preceding year.

The interest margin of the segment decreased from a rate of 1.42% in 2006 to a rate of 1.31% in 2007. The increase in the segment's earnings resulted mainly from an increase in the volume of operations and from the increase in contribution of the active capital, mainly due to the decrease in capital and as a result of hedging operations effected by the Bank in order to eliminate the volatility of the provision for taxes on income stemming from changes in the value of investments in foreign subsidiaries, arising from devaluation or appreciation of currencies. The said increase was setoff by the decrease in the interest rate margins, mainly due to the increase in the volume of operations in derivative financial instruments at relatively low margins, which was moderated by a provision of NIS 47 million in respect to fair value adjustments of derivative financial instruments in 2007 compared to an income of NIS 27 million in 2006.

Other financing income, net, which include option transactions, net results of derivative financial instruments operations, which were not defined as hedging or ALM operations, net financing commissions and other financing income, increased by NIS 54 million, net, from an amount of NIS 295 million in 2006 to NIS 349 million in 2007, an increase of 18.3%.

Total interest margin in 2007 was 2.64%, compared with 2.33% in the preceding year (not including the effect of hedge transactions).

The interest margin, including the effect of other derivatives (in hedge transactions and ALM), reached a rate of 1.71% in 2007, compared with a rate of 1.81% in the preceding year.

The following is the composition of the income from financing activities, before provision for doubtful debts, by segments of operations:

	For the year ended 31 December		
	2007	2006	Rate of change
	In NIS Millions		in %
Retail - household segment	1,208	1,075	12.4
Retail - small business segment	735	536	37.1
Corporate market segment	928	899	3.2
Middle market segment	720	670	7.5
Private banking segment	314	302	4.0
Financial management	320	308	3.9
Total	4,225	3,790	11.5

Provision for doubtful debts totalled NIS 447 million in 2007, compared with a provision of NIS 570 million in the preceding year, a decrease of 21.6%. In 2007, the provision constituted 10.6% of the income from financing activities before provision for doubtful debts, compared with 15.0% of this income in the preceding year.

The annual provision for doubtful debts, as a ratio of credit to the public, not including off-balance sheet credit risk, was 0.41% in 2007 (0.24% - including off-balance sheet credit risk), compared with 0.59% (0.36% - including off-balance sheet credit risk) in 2006.

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 5,781 million in 2007 (NIS 5,975 million - including provision for off-balance sheet credit risk). The balance of this provision constitutes 5.37% of the credit to the public (3.19% - including off-balance sheet credit risk), compared with a balance of the provision in the amount of NIS 5,979 million, not including provision for off-balance sheet credit risk (NIS 6,114 million - including provision off-balance sheet credit risk), constituting 6.22% of the credit to the public (3.82% - including off-balance sheet credit risk) at the end of the preceding year.

The specific provision for doubtful debts amounted to NIS 459 million in 2007, compared with NIS 643 million in the preceding year, a decrease of 28.6%.

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 main part of the expense recorded by the Bank for the specific provision for doubtful debts in 2007 relates to the following industries: construction and real estate industries 11.4% in 2007, compared with 22.1% in 2006; hotel industry 10.8% in 2007, compared with 1.4% in 2006; communications and computer services 2.9% in 2007, compared with 2.2% in 2006; commercial

sector 14.1% in 2007, compared with 7.6% in 2006; various industrial sectors 24.5% in 2007, compared with 29.5% in 2006.

The Bank's specific provision for major sectors. The Bank's specific provision for the construction and real estate sector, as a ratio of credit to the public in this sector was 0.2% in 2007, compared with 0.5% in 2006.

The Bank's specific provision for the hotel sector, as a ratio of credit to the public in this sector, was 0.7% in 2007, compared with 0.2% in 2006.

The Bank's specific provision for the commercial sectors, was 0.5% in 2007, compared with 0.4% in 2006.

The Bank's specific provision for the various industrial sectors, was 0.5% in 2007, compared with 0.9% in 2006.

The Bank's specific provision for the communications and computer services, was 0.3% in 2007 similar to 2006.

The specific provision in the Bank, in respect of all other economic sectors, as a ratio of the credit granted to such sectors, was 0.3% in 2007, compared with 0.6% in 2006.

The supplemental provision for doubtful debts. An additional provision for doubtful debts in the amount of NIS 22.0 million, recorded by the Bank and by its banking subsidiaries in Israel, was reversed in 2007. compared with an expense of NIS 5.7 million in the previous year. The supplemental provision for doubtful debts is based on the quality of the credit portfolio in accordance with risk characteristics, as determined by proper banking management directives.

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

	2007				2006			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
Specific provision	94	110	162	93	217	158	130	138
Supplemental provision	(9)	(2)	(4)	3	(40)	(16)	(21)	4
Total	85	108	158	96	177	142	109	142
Rate of specific provision from credit granted to the public:								
Balance sheet*	0.34%	0.43%	0.65%	0.39%	0.91%	0.66%	0.55%	0.59%
Off balance sheet*	0.46%	0.58%	0.93%	0.56%	1.37%	1.07%	0.89%	0.01%

* Annualized.

Income from financing activities after provision for doubtful debts amounted to NIS 3,778 million in 2007, compared with NIS 3,220 million in the preceding year, an increase of 17.3%.

Non-financing income in 2007 amounted to NIS 2,572 million, compared with NIS 2,359 million in the preceding year, an increase of 9.0%.

Income from capital market activity in 2007 amounted to NIS 484 million, compared with NIS 541 million in 2006, a decrease of 10.5%.

The above includes: Income from provident fund management fees and reimbursement of expenses in 2007 amounted to NIS 119 million, compared to NIS 189 million in 2006, an decrease of 37.0% (for details as to the sale of the provident fund activity, see Note 6 E to the financial statements). Due to the sale of Ilanot Discount, income from mutual fund management totalled only NIS 6 million, this in comparison to NIS 100 million in 2006. The overall decrease in income from management fees and reimbursement of expenses by provident and mutual funds amounted therefore in 2007 to NIS 164 million. It should be emphasized that in view of the fact that the sale of the provident funds operations took place in the second half of 2007, an additional decrease in income from this source is expected in 2008.

Income from distribution fees earned from mutual fund managers amounted to NIS 52 million in 2007, compared with NIS 24 million in 2006.

Commissions totalled NIS 2,216 million in 2007, compared with NIS 1,911 million in the preceding year, an increase of 16.0%. The increase results mainly from an increase in income from credit cards, commissions from securities transactions, payment order system service, credit and contracts service and ledger fees (for details as to legislation in the matter of bank commissions and its implications see Note 36 to the financial statements).

The Group's income from credit card activity derives from both operating and financing activities. Income from credit card operating activities amounted to NIS 760 million in 2007, compared with NIS 640 million in 2006, an increase of 18.8%. Interest income on credit to customers via credit cards amounted to NIS 95 million in 2007, compared with NIS 82 million in 2006, an increase of 15.9%.

Gains on investment in shares, net, amounted to NIS 58 million in 2007, compared with NIS 65 million in 2006 (for details regarding a provision for impairment in value of a certain security in the amount of NIS 44 million, see "Financial management segment" below). The said earnings include, among other things, a dividend of NIS 70 million 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 39 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).

Other income in 2007 totalled NIS 298 million, compared with NIS 383 million in the preceding year, a decrease of 22.2%. This decrease derives mainly from a decrease in income from mutual funds and provident 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.

Following are the components comprising non-financing and other income:

	2007	2006	2005
	%	%	%
Revenue from management fees	9.8	9.6	11.2
Payment order system services	18.5	18.0	18.3
Revenue from credit cards	29.5	27.1	23.7
Revenue from capital market activities	21.1	25.5	23.9
Profits of the severance pay fund	3.5	2.1	6.7
Foreign trade activity	3.1	3.9	3.3
Other	14.5	13.8	12.9
Total	100.0	100.0	100.0

Non-financing expenses totalled NIS 5,066 million in 2007, compared with NIS 5,020 million in 2006, an increase of 0.9%.

Salaries and related expenses amounted to NIS 3,030 million in 2007, compared with NIS 3,202 in the preceding year, a decrease of 5.4%.

Salaries expenses in 2006 include a bonus paid to employees in respect of sale of the controlling interest of the Bank in the amount of NIS 232 million.

In 2007, the Bank continued encouraging early retirement of employees, while directing it towards employee populations with defined characteristics, where focused efforts are being made to encourage early retirement at beneficial terms. The financial statements for 2007, include an expense of NIS 91 million in respect of early retirement (2006: NIS 174 million). For additional details, including details on employees retired in 2005-2007, see "Human Resources" below.

Salaries and related expenses disregarding expenses in respect of encouragement of early retirement (2006 - disregarding expenses in respect of the sale of the controlling interest in the Bank and expenses in respect of encouragement of early retirement) amounted to NIS 2,939 million in 2007, compared with NIS 2,796 million in 2006, an increase of 5.1%, deriving mainly from the wage agreement for 2007.

Salaries expenses, excluding related expenses, amounted in 2007 to NIS 2,144 million, compared with NIS 2,209 million in 2006, a decrease of 2.9%.

Salaries expenses excluding related expenses disregarding the bonus in respect of the sale of the controlling interest in the Bank, amounted in 2007 to NIS 2,144 million, compared to NIS 1,977 million in 2006, an increase of 8.4%.

Depreciation and maintenance of building and equipment totalled NIS 819 million in 2007, compared with NIS 679 million in the previous year, an increase of 20.6%. The majority of the increase is due to the growth in the Bank's depreciation expenses, following the amortization of software costs for which in house development has been completed.

Other expenses totalled NIS 1,217 million in 2007, compared with NIS 1,139 million in the preceding year, an increase of 6.8%. This results mainly from an increase in advertising costs, amortization of goodwill and other expenses, partly setoff by the decrease in computer expenses and commissions.

The **cover rate** of non-financing income to non-financing expenses reached 50.8% in 2007, compared with 47.0% in the preceding year.

The **cover rate** of non-financing expenses by non-financing income, disregarding the expenses detailed above, would have reached 52.2% in 2007, compared with 51.5% in 2006.

Total operating expenses in relation to total income dropped from a rate of 81.6% in 2006 to 74.5% in 2007.

Total operating expenses in relation to total income, disregarding the expenses mentioned above, dropped from a rate of 74.5 % in 2006 to 72.4 % in 2007.

Operating income before taxes totalled NIS 1,284 million in 2007, compared with NIS 559 million in the preceding year, an increase of 129.7%.

Provision for taxes on operating income totalled NIS 566 million in 2007, compared with NIS 350 million in the preceding year.

In 2006, the Bank did not record a current tax expense in respect of taxable current income of NIS 191 million due to the utilization of carry forward tax losses in respect of which no deferred tax assets had been recorded in the past. 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 718 million in 2007, compared with NIS 209 million in the preceding year, an increase of 243.5%.

The Bank's share in operating income of affiliated companies after taxes totalled in NIS 45 million in 2007, compared with NIS 188 million in the preceding year, a decrease of 76.1%, particularly as a result of recording a provision for tax in the amount of NIS 130 million, in respect of the Bank's share in earnings of the First International Bank (see Note 6 G to the financial statements) and as a result of the sale of holdings in Harel Insurance Investments Ltd.

Operating income totalled NIS 707 million in 2007, compared with NIS 315 million in the preceding year, an increase of 124.4%.

The ratio of operating income before taxes to shareholders' equity, including minority interest, was 16.4% in 2007, compared with a ratio of 9.4% in the preceding year.

The ratio of operating income after taxes to shareholders' equity, including minority interest, was 9.6% in 2007, compared with a ratio of 3.5% in the preceding year.

Net earnings from extraordinary operations, after taxes, amounted, in 2007, to NIS 558 million, due to a net gain of NIS 483 million, from the sale of the provident fund activity (see Note 6 E to the financial statements), a net gain in the amount of NIS 74 million from the sale of KAHAL (see Note 19 C 20 to the financial statements). This compared with earnings of NIS 521 million in 2006, resulting from an amount of NIS 173 million being the reversal of a provision for impairment in value of the Bank's investment in FIBI, which was recorded in 2003 in accordance with the instructions of the Supervisor of Banks (see Note 6F to the financial statements), net earnings of NIS 256 million from the sale of Ilanot Discount (see Note 6 E to the financial statements) and net earnings of NIS 104 million from the sale of shares in Harel Insurance Investments (see note 6H to the financial statements).

Net income in 2007 amounted to NIS 1,265 million, compared with of NIS 836 million in the preceding year, an increase of 51.3%.

Net income, disregarding certain components as detailed above, would have amounted to NIS 924 million in 2007, compared with NIS 672 million in 2006, an increase of 37.5%.

Return on shareholders' equity reached a rate of 14.7% in 2007, compared with a rate of 11.7% in the preceding year.

The return on shareholders' equity, disregarding certain components as detailed above, would have reached in 2007 a rate of 10.7% compared with 9.4% in 2006.

Net earnings per one share of NIS 0.1 par value amounted in 2007 to NIS 1.29 compared with NIS 0.85 in the preceding year.

Net earnings per one share of NIS 0.1 par value, disregarding certain components, as detailed above, would have reached in 2007 NIS 0.94, compared with NIS 0.69 in 2006.

Net income in the fourth quarter of 2007 amounted to NIS 41 million, compared with NIS 392 million in the third quarter of 2007 compared to NIS 148 million in the corresponding quarter last year.

Net income in the fourth quarter of 2007 disregarding certain components amounted to NIS 126 million, compared with NIS 306 million in the third quarter of 2007 compared to NIS 123 million in the corresponding quarter last year.

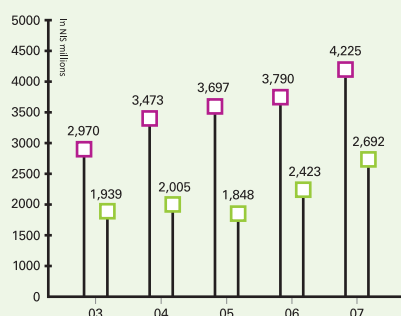
Return on shareholders' equity in the fourth quarter of 2007 reached an annualized rate of 1.8%, compared with a rate of 18.9% in the third quarter of 2007, and compared with a rate of 8.1% in the corresponding quarter last year.

Return on shareholders' equity in the fourth quarter of 2007 disregarding certain components, reached an annualized rate of 5.5%, compared with a rate of 14.6% in the third quarter of 2007, and compared with 6.5% in the corresponding quarter last year.

An estimate of the effect of the Bank's wage agreements and the sale bonus on the business results for the first quarter of 2008. The wage agreement signed for the year 2008 will increase the wage base for computing the provisions for severance pay, vacation pay and long service award by a rate of 5%. Accordingly, the Bank will include in its financial statements for the first quarter of 2008, the full increase in the provisions for wage related liabilities, in the estimated amount of NIS 117 million.

**INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION
FOR DOUBTFUL DEBTS - THE BANK/CONSOLIDATED**

■ Consolidated
■ The bank



**DEVELOPMENT OF THE COVER RATE OF NON FINANCING
INCOME TO NON FINANCING EXPENSES - CONSOLIDATED**



DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2007 amounted to NIS 168,810 million, compared with NIS 162,523 million at the end of the preceding year, an increase of 3.9%.

Following are the developments in the principal balance sheet items:

	December 31		Rate of
	2007	2006	change
	In NIS millions		in %
Assets			
Cash and deposits with banks	19,850	25,100	(20.9)
Securities	37,278	38,977	(4.4)
Credit granted to the public	101,899	90,097	13.1
Liabilities			
Deposits from the public	136,413	130,517	4.5
Deposits from banks	5,072	8,099	(37.4)
Debentures and subordinated capital notes	7,437	6,302	18.0
Shareholders' equity	9,204	7,965	15.6

CREDIT GRANTED TO THE PUBLIC

General. Credit to the public as at December 31, 2007, totalled NIS 101,899 million, compared with NIS 90,097 million on December 31, 2006, an increase of 13.1%. The ratio of credit granted to the public to total assets reached 60.4% at the end of 2007, compared with 55.4% at the end of 2006.

The Bank's credit policy. The Bank's policy regarding the granting of credit to the public is intended, among other things, to improve the quality of the credit portfolio and to spread the risks inherent therein.

A discussion of the credit policy is held once a year determining the credit policy for the following year. The policy is approved by the Bank's Management and Board of Directors. The credit policy addresses the Bank's strategy with respect to the increase/decrease in the credit portfolio, directions of activity, improvement of the credit portfolio management and quality and the pricing of credit.

The Bank has a detailed credit policy with respect to economic sectors, borrower groups, linkage segments and operational segments. The policy for spreading the risk between economic sectors is based on an assessment of expected developments in the various economic sectors with a view of assessing the risk level and the business potential existing in the activity with the various economic sectors. Within the framework of setting credit policy the Bank has set an internal limitation as to the exposure to economic sectors.

The credit policy concerning large borrowers/groups of borrowers includes internal limitations set by the Bank as well as a format for periodic discussion of each borrower group.

In addition, a detailed credit policy is determined with respect to additional areas, such as the acquisition of means of control and the diamond and real-estate industries.

The Bank's business goals are determined according to the general outlines determined by the credit policy.

When a credit risk is discovered in a certain industry/group of borrowers, steps are taken to reduce the risk in the industry/group by way of formulating a policy for the reduction of exposure to that industry/group, for monitoring the activity in the industry/group and for determining limitations on the activity.

In addition, computer software has been developed with a view of improving the decision making process and making it more efficient as well as the maintenance of proper control.

The Bank provides credit to its customers collateralized by various means, including: liquid assets, fixed assets, pledges and guarantees of all kinds. The margins taken in respect of reliance on the collateral are based on procedures and are approved by the Board of Directors as part of the credit policy.

Composition of credit granted to the public by linkage segments

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

	December 31, 2007		December 31, 2006		
	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of changes in %
Non-linked shekels	48,074	47.2	40,457	44.9	18.8
CPI-linked shekels	18,642	18.3	17,778	19.7	4.8
Foreign currency and foreign currency-linked shekels	35,183	34.5	31,862	35.4	10.4
Total	101,899	100.0	90,097	100.0	13.1

Credit to the public denominated in foreign currency and in Israeli currency linked thereto increased by 10.4%. In US Dollar terms, credit to the public increased by US\$1,607 million as compared to December 31, 2006, an increase of 21.3%.

Developments in the provisions for doubtful debts and in credit to problematic borrowers in the group. The annual proportion of the provision for doubtful debts to credit to the public (excluding off-balance sheet credit risk) reached 5.37 % in 2007 compared to 6.22 % in 2006, which indicates improvement in the quality of the credit portfolio of the Bank.

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

	December 31	
	2007	2006
Non-performing debts	2,230	2,529
Reorganized debts ⁽²⁾	278	*290
Debts due for reorganization ⁽³⁾	33	143
Debts temporarily in arrears	387	327
Debts under special supervision ⁽⁴⁾	3,520	*3,767
Total balance sheet credit to borrowers	6,448	7,056
Off-balance sheet credit risk regarding problematic borrowers ⁽⁵⁾	978	928
Debentures of problematic borrowers	1	1
Other assets in respect of derivative instruments of problematic borrowers	22	10
Total overall credit risk concerning problematic borrowers	7,449	7,995

* Reclassified

Notes:

(1) Not including problem debts for 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, which per Management decision is to be reorganized, but which reorganization has not yet been implemented.

(4) Of which: debts of NIS 925 million, presented net of specific provision made thereof, and housing loans of NIS 188 million, in respect of which a provision according to the period of default exists (December 31, 2006: NIS 893 million and NIS 209 million, respectively).

(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.

The major part of the credit risk is in the construction and real-estate, communications, computer services, industry and the hotel sectors.

Creditors arrangement regarding the “Tevel” group. The merger transaction of the cable companies was consummated on December 31, 2006, as part of the creditors arrangement regarding the “Tevel group”. Upon consummation of the merger, HOT Cable Communication Systems Ltd. (Formerly named Matav; hereinafter - “HOT”) allotted 45,649,567 shares to the shareholders of the cable companies, which operations and assets had been transferred to HOT. As part of this allotment of shares, the banks (as shareholders of Tevel) received 28.1% of the shares in HOT (of which the share of the Bank is approximately 2.7%). The shares are being held separately by each bank. The merger transaction represents a gross value of NIS 6,277.5 per subscriber.

It should be noted that the HOT shares are listed for trade on the Stock Exchange. The merger agreement includes provisions limiting the maximum volume of shares that may be disposed of on the market. The agreement provides also for the right of first refusal upon sale of shares.

Concurrently with the consummation of the merger agreement, a loan agreement came into effect between HOT and a consortium of banks (including the Bank and Mercantile Discount Bank).

The shares received are presented in “available for sale securities” (for additional details see Note 3 D to the financial statements).

Directive regarding a certain loan. The Bank and Mercantile Discount Bank have granted a loan as part of a consortium of banks. As the borrower did not abide by the terms of the loan and did not settle the periodic interest payments, the court, at the request of the consortium, appointed a receiver to realize shares of "Bezeq" pledged as collateral for the loan.

The Supervisor of Banks issued, on July 15, 2003, a directive stating that the balance of the said loan as of June 30, 2003, should be treated as an "investment in shares" classified as "available-for-sale securities", based on the market value of the proportionate share of the Bank and Mercantile Discount Bank in the said collateral. The Bank and Mercantile Discount Bank have made the classification according to the directive and as of June 30, 2003 changes in market value are taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value.

For details regarding dividends received in respect of the said shares see above "Gains on investment in shares". For further details see Note 3 to the financial statements.

A directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses". On December 31, 2007, the Supervisor of Banks issued a Directive in the matter of "Measurement and disclosure of delinquent debts, credit risk and the provision for credit losses (hereinafter: "the Directive"). The Directive aligns the reporting principles applying to banking corporations in Israel with those applying to banks in the United States, and among other things, it is based on US accounting principles and on the directives of the bank regulatory authorities in the US as well as on the SEC. The principles on which the 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.

For additional details regarding the directive and the principal changes included therein as compared with prevailing instructions, see Note 1 Y to the financial statements.

The instruction is to be applied in financial statements of banking corporations and of credit card companies starting with the statements as of January 1, 2010 onwards. Upon the initial implementation of the Directive, banking corporations will be required to write off accounting wise, the balance of problematic debts that qualify the criteria specified in the Directive for an accounting write-off and to reverse all interest income accrued until January 1, 2010, if not actually collected by this date, in respect of defective debts as defined in the Directive.

The instruction is not to be applied retroactively in financial statements for prior periods. Adjustments of the balance of the provision for loan losses in respect of credit to the public and in respect of off-balance sheet credit instruments as of January 1, 2010, according to the requirements of the instruction, will be reflected directly in the retained earnings item of shareholders' equity.

The application of the instructions requires preparation and material changes to the existing information systems, which, at this stage, are not compatible with reporting according to the new regulations. Further more, the new rules require each bank to formulate a methodology regarding various matters, including for example, the evaluation of the effect on the outstanding loan balance in the case of the "class provision" that cannot be performed without identification and determination of the models and parameters leading to the formation of homogenous classes

having similar risk characteristics and the gathering of adequate information for the purpose of assessing the rate of past losses for each class of loans.

In view of the above, it is not possible at this stage to quantify the anticipated effect of the implementation of the Directive on the financial statements for 2010 and thereafter, on the results of operations of the Bank, including the effect of the initial implementation of the Directive of the Bank's equity as at January 1, 2010. Notwithstanding, it is expected that the implementation of the Directive will have an adverse effect on the results of operations of the Bank and on its financial position.

The Banks management is preparing for the implementation of the Directive within the framework of a project to be conducted by the Bank's Corporate Division. The team involved in the project, includes, inter-alia, representatives of cesomertain of the subsidiaries.

Within the framework of the project, the activity of the teams formed at the time in a number of areas are to be renewed (methodology from the group provision aspect, methodology from the individual provision aspect, financial reporting, operation, procedures and training), while coordinating and interfacing with work being done in partly overlapping areas, which is already being conducted at the Bank as regards Basel II and credit rating.

The tasks required for the implementation of the Directive include, in summary, characterization of various relevant work procedures, characterization of the changes required in the various information systems of the Bank, the definition of data required for the establishment of a data base for the computation of group and individual provisions, the development of a statistical model for the computation of a group provision, the development of a system, data bases and user interface for the purpose of feeding cash flow and discount rate forecasts, the development of decision supporting reporting systems as regards the individual provisions, implementing changes in organizational work procedures on the basis of a requirement characterization document, current project management, and so forth. In carrying out the project, the Bank is considering taking on the assistance of outside consultants. At this stage , it is not possible to assess the cost of the preparation for the implementation of the Directive and its absorption at the Bank and in the Group companies.

Risk characterization of the credit to the public portfolio. The improvement in the quality of the portfolio is also reflected in the decline in the balance sheet rate of problematic debts out of the total credit to the public of the Group, from 7.8% at the end of 2006 to 6.3 % at the end of 2007. A continuous improvement took place in the volume of operations and in the repayment ability of borrowers in most of the economic sectors as from the second half of 2003.

The provision for doubtful debts in the Group totaled NIS 447 million in 2007, compared to a provision of NIS 570 million in 2006.

The specific provision for doubtful debts in the Group amounted in 2007 to NIS 459 million as compared to a provision of NIS 643 million in 2006.

Following the improvement, a material drop in the proportion of the specific provision to total credit to the public with respect to most of the sectors of the Group took place.

The improvement in the quality of the credit portfolio stems from a decrease in loans intended for reorganization, as a result of the improvement in the operating earnings margins, in cash flows and in the repayment ability of borrowers in all economic sectors.

The decrease in the non income generating debts stemmed from intensifies collection arrangements and/or arrangements for the repayment of loans made with customers who had recorded an improvement in their financial position or an increase in the value of the collateral securing their debt to the Bank.

The improvement in the financial position of borrowers in the various economic sectors derived from the following developments:

The commercial sector - an improvement has been recorded in revenues and in operating earning rates resulting from the growth in private consumption and in the domestic demand levels.

The construction and real estate sector - Growth has been recorded in occupancy rates and in rental fees of income generating properties (commercial and office buildings in demand areas), as well as in income from construction of residential properties as a result of price increases and the increase in the number of units sold.

The industrial sector - Performance of corporations has improved as a result of the growth in domestic and foreign demand on background of the expansion in world trade.

The communications sector - Improvement has taken place in efficiency and in earning margins following a process of mergers and acquisitions.

Following are the rates of the specific provision for doubtful debts in certain sectors in relation to balance sheet credit to the public in the Group in these sectors for the years 2006 and 2007:

Industry	2007	2006
Construction and real-estate	0.5%	0.9%
Hotel	1.0%	0.2%
Commerce	0.3%	0.7%
Industry	0.5%	1.2%
Communications	0.3%	0.4%

The improvement in the situation of borrowers in the Group also contributed to the decrease in their weight of the total specific provision for particular borrower sectors in the Group, characterized by a relatively high sensitivity to the effects of economic slowdown in local and world markets, as detailed below:

Industry	Proportion of provision	
	2007	2006
Construction and real-estate	20.9%	23.8%
Hotel	6.1%	0.9%
Commerce	8.9%	13.1%
Industry	19.2%	28.0%
Communications	1.7%	1.4%

The data shown above indicates a decline in the proportion of the provision for doubtful debts in relation to the credit to the public granted by the Bank to the principal economic sectors, including a decline in their weight in the total provision. This decline reflects a significant improvement in the overall risk profile of the bank.

This assessment is also supported by the improvement in the debt rating of specific borrowers at the Bank: the proportion of credit rated at low risk levels (solid, good and reasonable) was 56.0% of the total debt as of December 31, 2007, compared to 53.4% at the end of 2006; the proportion of the debt rated as moderate was 9.6% of the total debt, compared to 10.2% at the end of the previous year, and the proportion of the problematic debt was 28.6 % of the total debt, as compared to 36.4% at the end of the previous year.

(it should be noted that the rates shown above have been measured in relation to the balance of debt before provision for doubtful debts. It is further noted that about 4% of the credit balance is not rated).

Development of credit to the public by economic sectors. Balance sheet credit risk for the construction and real estate sector totalled NIS 19.4 billion as at December 31, 2007, compared with NIS 16.1 billion on December 31, 2006, an increase of 20.5%, which constituted about 18.3% of the total balance sheet credit risk to the public, compared with 17.2% on December 31, 2006. Off-balance sheet credit risk for the construction and real estate sector (mostly sales guarantees and non-utilized credit lines) amounted to NIS 13.4 billion as at December 31, 2007, compared with NIS 11.9 billion on December 31, 2006, and it constituted 16.9% of the off-balance sheet credit risk, compared with 18.8% as at December 31, 2006.

Total credit risk for the construction and real estate sector constituted 17.7% of the total credit risk to the public as at December 31, 2007, compared with 17.8% on December 31, 2006.

Total credit risk for the industrial sectors totalled NIS 33.0 billion as at December 31, 2007, compared with NIS 29.0 billion at December 31, 2006, an increase of 13.8%, and it constituted 17.9% of the total credit risk to the public under the Group's responsibility, compared with 18.4% as at December 31, 2006. Credit to industry is extended to a large number of customers in various industrial sectors. Included within the framework of credit to industry is credit to the diamond industry with a small spread. The Bank's total credit risk to the diamond industry as at December 31, 2007 totalled NIS 3.6 billion, compared with NIS 3.9 billion at December 31, 2006.

Total credit risk for the commercial sector amounted to NIS 22.8 billion as at December 31, 2007, compared with NIS 21.1 billion as at December 31, 2006, an increase of 8.1%, and it constituted 12.3% of the total credit risk to the public, compared with 13.4% the preceding year.

Total credit risk to individuals was NIS 37.2 billion as at December 31, 2007, compared with NIS 34.7 billion as at December 31, 2006, an increase of 7.2%, and it constituted 20.0% of the total credit risk to the public, as compared with 22.0% as at December 31, 2006.

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

	December 31, 2007		December 31, 2006		
	In NIS Millions	% of total credit to public	In NIS Millions	% of total credit to public	Rate of change in %
Retail - household segment	25,113	24.6	21,759	24.2	15.4
Retail - small business segment	12,245	12.0	9,680	10.7	26.5
Corporate market segment	39,925	39.2	35,785	39.7	11.6
Middle market segment	22,360	22.0	20,748	23.0	7.8
Private banking segment	2,256	2.2	2,125	2.4	6.2
Total	101,899	100.0	90,097	100.0	13.1

Developments in credit to the public, including off-balance sheet credit risk by borrower size.

Approximately 99% of borrowers were granted credit of less than NIS 1.2 million. Credit to this group constituted 24.2% of total credit to the public as at December 31, 2007, compared with 26.8% as at December 31, 2006.

The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 51.8% of all credit as at December 31, 2007, compared with 55.2% as at December 31, 2006.

The 94 largest borrowers, in the credit brackets between NIS 200 million and NIS 2,800 million, were granted credit constituting 22.8% of total credit as at December 31, 2007, compared with 71 borrowers that were granted credit constituting 16.6% of the total credit as at December 31, 2006.

Credit granted to the Governments totalled NIS 374 million as at December 31, 2007, compared with 324 million as at end of 2006, an increase at a rate of 15.4%.

The balance as at December 31, 2007 includes funds deposited with the Accountant General's deposit as part of the Bank's success in the State employees tender (For additional details see "Retail banking sector - Household segment" under "Activities of the Group according to principal segments of operations" hereunder).

At the beginning of 2008, the Bank deposited with the Accountant General at the Ministry of Finance an additional amount of NIS 1,036 million, in respect of the tender for provision of banking services to State employees won by the Bank.

Securities totalled NIS 37,278 million as at December 31, 2007, compared with NIS 38,977 million at the end of 2006, a decrease of 4.4%.

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

	December 31		Rate of
	2007	2006	change
	(in NIS millions)		in %
Non-linked shekels	13,580	13,732	(1.1)
CPI-linked shekels	2,685	1,946	38.0
Foreign currency and foreign currency-linked shekels	19,240	22,092	(12.9)
Shares - non-monetary items	1,773	1,207	46.9
Total	37,278	38,977	(4.4)

For details as to the policy applying to the composition of investments in the “nostro” securities portfolio, see hereunder “Financial management segment” under “Activities of the Group according to principal operating segments”.

For details as to the Bank’s investments in asset backed securities, see above: “Financial management segment” and Note 3 to the financial statements

In accordance with directives of the Supervisor of Banks, securities have been classified into three categories: held-to-maturity bonds portfolio, available-for-sale securities portfolio, and trading securities portfolio.

Following is the composition of investments in securities according to the above categories:

	December 31, 2007			December 31, 2006		
	Net adjusted cost	Fair value	Book value	Net adjusted cost	Fair value	Book value
	In NIS millions					
Bonds						
Held-to-maturity	3,345	3,354	3,345	4,824	4,790	4,824
Available-for-sale	29,222	29,134	29,134	29,872	29,895	29,895
Trading	3,021	3,026	3,026	2,917	3,051	3,051
Shares						
Available-for-sale	1,476	1,760	1,760	941	1,193	1,193
Trading	13	13	13	13	14	14
Total Securities	37,077	37,287	37,278	38,567	38,943	38,977

For additional details see Note 3 to the financial statements.

Deposits from the public as at December 31, 2007, totalled NIS 130,518 million, compared with NIS 130,517 million at the end of the preceding year.

Change in the mode of presentation of deposits from the public. In accordance with public reporting directives, in effect as from January 1, 2007, securities lent or sold under buy-back

agreements are presented as a separate item. Until December 31, 2006, such securities had been presented as part of deposits from the public. The relevant directive states that the comparative data for prior periods shall not be reclassified. As a result of the above, comparison of the deposits data for 2007 with that of the previous year has been hampered. In order to allow comparability, the deposits data has been presented on the basis of the "old" mode of presentation in several places in the Directors' Report.

Deposits from the public, including securities lent or sold as part of buy-back agreements, amounted as of December 31, 2007 to NIS 136,413 million, compared to NIS 130,517 million at the end of the previous year, an increase of 4.5%.

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

	December 31, 2007		December 31, 2006		
	In NIS millions	% of total deposits from public	In NIS millions	% of total deposits from public	Rate of change in %
Non-linked shekels	55,066	42.2	49,722	38.1	10.7
CPI-linked shekels	11,578	8.9	12,095	9.3	(4.3)
Foreign currency and foreign currency-linked shekels	63,874	48.9	68,700	52.6	(7.0)
Total	⁽¹⁾ 130,518	100.0	130,517	100.0	-

(1) In 2007 securities lent or sold under buy-back agreements, are not presented within deposits from the public.
For details regarding the change in the mode of presentation of deposits from the public, see above in this chapter.

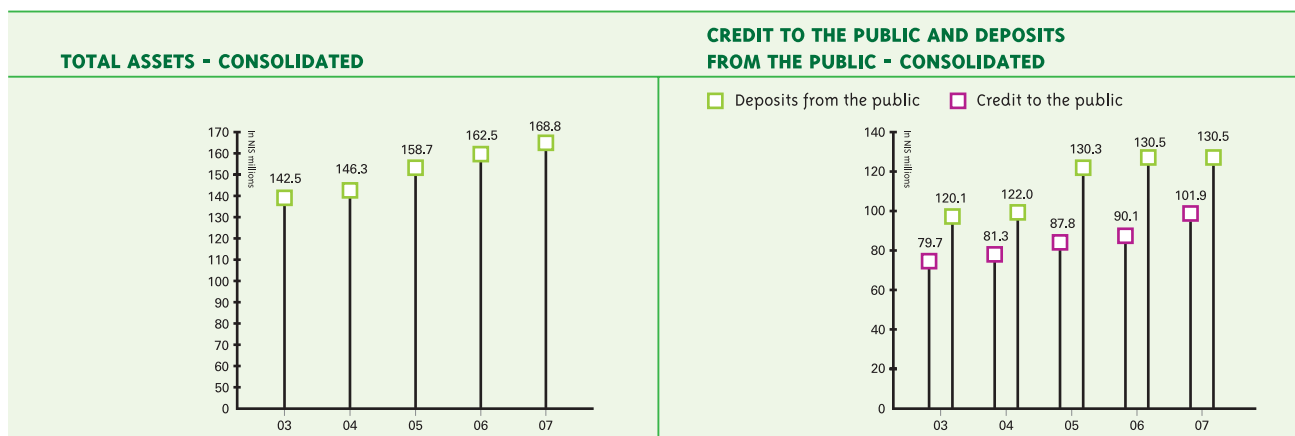
Deposits from the public denominated in foreign currency and in Israeli currency linked thereto decreased by 7.0%. In US Dollar terms, deposits from the public increased by US\$348 million as compared to December 31, 2006, an increase of 2.1%.

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

	December 31, 2007		December 31, 2006		
	In NIS Millions	% of Deposits from the public	In NIS Millions	% of Deposits from the public	Rate of change in %
Retail - household segment	53,151	39.0	52,738	40.4	0.8
Retail - small business segment	10,511	7.7	8,057	6.2	30.5
Corporate market segment	16,342	12.0	13,414	10.3	21.8
Middle market segment	12,572	9.2	12,627	9.6	(0.4)
Private banking segment	37,942	27.8	41,607	31.9	(8.8)
Securities loaned or sold under buy-back arrangements	⁽¹⁾ 5,895	4.3	2,074	1.6	184.2
Total	136,413	100.0	130,517	100.0	4.5

(1) For details regarding the change in the mode of presentation of deposits from the public, see above in this chapter.

The ratio of total credit to the public to deposits from the public was 78.1% at the end of 2007, compared with 69.0% at the end of the previous year.



FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2007, the investment in buildings and equipment amounted to NIS 2,780 million, compared with NIS 2,614 million at the end of 2006, an increase of 6.4%.

Most of the premises on which the business of the Bank is conducted in Israel are owned directly by the Bank or by its auxiliary corporations.

The total office space at the Bank's disposal at December 31, 2007, was 164 thousand square meters, compared with 163 thousand square meters at the end of 2006. Of this area, 100 thousand square meters were freehold property and 64 thousand square meters leasehold property (2006: 104 thousand square meters were freehold property and 59 thousand square meters leasehold property). At the end of 2007, some 74 thousand square meters served the Bank's branches and the balance served the head office, compared with 72 thousand square meters in 2006.

For details as to the Bank's investments in buildings and equipment, see Note 7 to the financial statements.

INFORMATION AND COMPUTER SYSTEMS

GENERAL

The information and control systems stand at the core of the operations of the Bank and comprise the backbone on which the Bank's operations are based. The Bank's data processing system is a central computerized system composed of main frame computers located at the Bank's computer center and work stations at the branches and at the head office units. The central system is currently based on IBM computers integrated with Unisys computers.

Some 6,000 work stations (PC's) and 400 servers are installed at the branches and at head office units, providing service to both internal and external customers.

Direct banking services are provided by the Bank through a variety of channels: Internet, information stations, automatic teller machines, computerized vocal response and more. These services are interfaced with the central computer in order to receive and update data, by way of designated services using advanced data security technology.

Over 400 information stations are available to customers providing also self service operations and a wide variety of services - "Discount Information Station".

Most of the various computer systems serve both the Bank and Mercantile Discount Bank.

Over the years the Bank has developed efficient, stable and effective computer solutions with respect to all business areas in which the Bank operates. The solutions developed are among the most advanced existing in banks in Israel. These systems are capable of serving the Bank for many years to come, subject to maintenance services being provided at an appropriate level.

For details as to the cost of in-house development of computer programs, see Note 7 E to the financial statements.

"OFEK" PROJECT

Background. At the beginning of the 1970's, the Bank decided to base its business operations on Unisys computers. With the development of technology and business in Israel and around the world, additional systems and sub-systems were added over the years to the basic systems, comprising the "core system", which are connected to the central system and to one another through data communication. In addition, over the years, IBM established itself as the principal provider in the world of mega computers that support large organizations. Because of the Bank's estimate that it would remain the sole customer of Unisys central computer systems in Israel, a matter comprising a risk in itself, and in order to avoid dependence on a system provided by a supplier who has ceased to focus on central systems intended for large organizations, the Bank's Board of Directors decided, as early as 1998, to convert the computer systems to IBM.

"Ofek" Project. The main objective of the "Ofek" Project is the renewal of the Bank's central computer infrastructure while replacing the Unisys operating systems with IBM operating systems, converting data and computer software from Unisys computers to IBM computers as well as replacing most of the software used by the Bank to IBM compatible systems.

After examining several alternatives, the Bank decided to base the change to an IBM environment on the AltaMira product, which was operational at that time in some 80 banks around the world,

while relying on Accenture, a consulting company specializing in projects of this nature, to carry out the Project itself. In 2001, the Bank entered into agreements with two companies of the Global Accenture Group, Accenture Ltd. and Alnova, Technologies Corporations S.L. for the purchase of core banking software systems, for adapting the said systems to the requirements of the Bank and for their integration at the Bank. Due to the complexity and scope of the project, it was initially divided into several stages of execution called roll out. At each such stage, several systems have been released for operational use. Due to the gradual release of the systems, the project includes a material component of co-existence between the old and the new systems. It should be noted that, to the best knowledge of the Bank, such a large and complex software project has never been undertaken in Israel.

Except for Accenture, which led the project together with the Bank, several leading Israeli software houses took part in the project.

The first roll out was launched in the second half of 2003. In the course of 2006 the Bank successfully launched the third roll out.

The principal modules of the system operating at the Bank after completing the third roll out are: IBM infrastructures, customers, current accounts, deposits, clearing, taxation, the main ledger, system schedules including the central commissions schedule, product system, central mailing, branch management, cash inventory management and more.

COMPLETION OF THE OFEK PROJECT

With the completion and integration of the third roll out systems, the principal assignments of integrating the core banking system purchased from Accenture and operating as the central system of the Bank, have been successfully achieved. These systems, developed as part of the Ofek Project, constitute, as stated, the center of the core banking operations. Such systems are of the most advanced in Israel, and are based upon state of the art technology. With the completion of the third roll out, the Bank has exhausted most of the potential embedded in the core systems purchased from Accenture, while completing about 70% of the project for renewal of the computer infrastructure. In view of this, the Ofek Project has been to de-facto completed. Completion of the conversion of systems from the Unisys to the IBM environment, and completion of development of systems that had begun within the framework of the Ofek Project, would now be carried out within the framework of the current development work of the Bank, as part of the regular development budget, while considering their preference within the general development assignments of the Bank.

Development costs for the core systems ("Ofek Project") are amortized over a period of seven years. The Bank is considering the amortization period of the core systems in relation to the economic benefits anticipated from systems of this sort, and it may extend the period of amortization in the future.

The completion of the Project enables the Bank Group the long-term use of an advanced computer system, providing an infrastructure for the implementation of modern, integrated, customer directed banking that provides business and operating flexibility.

**LOCATIONS OF THE
OPERATION**

The mainframe systems of the Bank are located at two different locals, the primary system in Tel-Aviv and the secondary system in Rishon LeTzayon. The fact that the two systems are located at a distance from one another adds to the survivability of the information systems of the Bank.

The two computer sites of the Bank, in Tel-Aviv and in Rishon LeTzayon, are connected by optical fibers in two different routes.

These sites also house the disc systems of EMC Company, cassette robots, central printers and additional peripheral equipment required for the operation of the Bank. Needless to say that this equipment is also backed-up at the two sites.

The branches and the head office units are connected to the computer center by two communication lines. Both lines are active at the same time and provide a band width of 3MB. In the event of failure, one line provides back-up for the active applications on the other line, and vice versa.

**BACK-UP AND
DISASTER RECOVERY**

The Bank operates by the "hot backup" method. This means that the computers in both locations are updated concurrently as to the transactions conducted at the branches of the Bank, so that in case of failure at the central computer in Tel-Aviv, the secondary location at Rishon LeTzayon begins operations without losing any entry.

**INFORMATION
SECURITY**

The information technology layout of the Bank constitutes a central component of the current and proper operation and management of the Bank, and as such dominates all areas of the Bank's operation. The importance of this layout increases in view of the technological developments in recent years and its consequences on the Bank. Therefore, the Bank views the protection of information and its security as a primary interest and invests vast resources in order to protect the data on hand.

The principal risks involving data protection are: improper use of the information by system users and unauthorized changes in the data maintained therein; harming the system environment, the operation of the system and its impact upon the business of the Bank; sensitivity of the information and violation of privacy and confidentiality of the data and its owners (Bank customers).

The protection of data at the Bank is conducted mostly in accordance with provisions of the Law including the Computer Law, the Protection of Privacy Law, and the Supervisor of Bank's Proper Banking Management Directives. The principal procedure as regards the management of information systems at banking corporations is Proper Banking Management Directive No. 357, and the Bank's activity with respect to data protection is conducted in compliance with the guidelines of this Instruction.

As regards the links of the Bank to the Internet, in view of the importance of the information and in order to minimize risks, the system providing information to customers via the Internet is managed separately from the central banking system providing information to Bank employees, who conducts banking business on an ongoing basis. Thus, the exposure to the risk of changing the real data at the Bank is minimized.

The Bank operates a data protection center the purpose of which is to identify risks and breaches in the data protection system.

Furthermore, as part of the internal audit operates a unit which specializes in the field of information systems, which conduct a current audit of this matters.



MAIN FUTURE PROJECTS

1. The principal systems that are still in operation on the Unisys computer are: the credit system and the securities system. In order to complete the conversion of the principal systems to the IBM computers the Bank began the conversion of the software and data in these fields to the IBM computers.
2. In view of the regulatory provisions regarding credit and risk management (Basel II) matters and in the matters of securities and the capital market the Bank expects to be required to enter into additional projects relating to computer systems in the coming years.

The Bank has begun the Basel II preparation project. The timetable determined for the completion of this project is within the time limits outlined by Bank of Israel.

The Bank's budget for 2008 in respect of projects for the development of information systems amounts to NIS 350 million. In view of existing and expected regulatory demands, business demands and the Bank's plans for the future, the Bank believes that its total computer expenditure is not expected to decrease significantly in the coming years.

The contents of the above section constitutes a forward-looking information based on past experience in everything related to system development and technological abilities, the investment required for the development of new systems and adaptation of existing systems in order for them to comply with regulatory demands and the Bank's business requirements. The above is also based on regulatory provisions existing at date of publication of the Annual Report (even though they have not as yet become effective) and provisions expected by the Bank to apply, based, inter alia, on drafts published by the various Regulators. The above is also based on development programs of the Bank existing at date of publication of the Annual Report, and on business intentions, the realization of which would require the development of supportive computer systems.

Legislative and regulatory changes unknown at the above date, including changes in the details of existing initiatives and drafts, technological developments and/or activities of competitors bringing about changes in customer demands and expectations, as well as macro developments in Israel and in the world, may bring about changes in the assessments or in the ability to carryout the Bank's plans at date of the Annual Report.

MAJOR SUPPLIERS

The Bank has a large number of major suppliers in the field of information systems and their development. The Bank has no significant dependence on any supplier, with the exception of IBM and Unisys. IBM is engaged to the Bank through IBM (Israel) Ltd., while Unisys is engaged to the Bank through Malam Company.

The Bank has a letter of undertaking by Unisys U.K., being an annex to the agreement with Malam, whereby Unisys England is committed to providing maintenance services for the said systems in the event that Malam would not honor its obligations.

INTANGIBLE ASSETS

The Bank has exclusive intellectual property rights in the following trademarks that are duly registered with the Registrar of Trademarks, and in the logo accompanying each of them: "Israel Discount Bank Ltd.", "Discount Bank", and "Discount". In addition, the Bank registers from time to time, for the purpose

of its business and marketing operations, names of services and products such as: "Drive, you have the drive to live" and slogans such as "In Discount we take you personally", "banking from the heart", etc. The Bank also has intellectual property rights in designated software systems and various modules used in its business, which the Bank develops in the course of its ongoing operations for its own use and/or the use of subsidiaries and affiliates. The development is conducted either by the staff of the Bank or by software houses hired by the Bank for this purpose.

TAXATION

GENERAL

The provisions of the Income Tax Law (Adjustments for inflation), 1985, apply to the Bank and its subsidiaries in Israel, up to and including the tax year 2007 (for details regarding the cancellation of the Adjustments Law, under "Legislation and supervision" hereunder and note 29 I to the financial statements). The Bank and most of its subsidiaries in Israel are considered a financial institution under the Value Added Tax Law, 1975, and as such are chargeable to payroll tax and to profit tax at the rate of 15.5% of the payroll expense and of the profit, respectively (until June 30, 2006 - a rate of 17%). During the last years the Bank did not record current tax expenses in respect of current earnings for tax purposes and net timing differences, due to the utilization of tax losses, carry forward losses and deductions for tax purposes and the net timing differences (including in respect of earnings or losses, as the case may be respectively, that were taken to a capital reserve in respect of available-for-sale securities), in respect of which no deferred tax assets have been recorded. During 2006 the Bank exhausted the said tax losses, carry forward losses and deductions for tax purposes and net timing differences, in respect of which no deferred tax assets have been recorded. Final tax assessments have been issued to the Bank for the years up to and including the tax year 2002.

REDUCTION IN COMPANY TAX RATES

In August 2005 the Income Tax Ordinance Amendment Law (No.147) - 2005 (hereinafter - "the Amendment") was published. The Amendment provides for an additional gradual reduction in the rate of company tax, as follows: a rate of 31% for 2006, a rate of 29% for 2007, a rate of 27% for 2008, a rate of 26% in 2009 and a rate of 25% for 2010 and thereafter.

REDUCTION IN THE RATE OF "PAYROLL TAX" AND "PROFIT TAX"

On June 29, 2006, the Minister of Finance signed a Value Added Tax Order (The tax rate applying to not for profit organizations and financial institutions) (Amendment), 2006, whereby the "Profit tax" and "Payroll tax" rates applying to banking corporations were reduced as from July 1, 2006, from 17% to a rate of 15.5%. Following this amendment, the statutory tax rate applying to banking corporations was reduced to 40.65% in 2006. and 38.53% in 2007; The statutory tax rate will be stand at 36.80% in 2008; 35.93% in 2009 and 35.06% as from 2010 onwards.

For details regarding the tax assessment received in respect of the 2003 tax year and the objection filed against it, see Note 29 D to the financial statements.

For additional details regarding the Bank's provision for taxes, final assessments and reconciliation of the Bank's applicable statutory tax rate to the effective tax rate, see Note 29 to the financial statements. For details as to the cancellation of the "Adjustments Law", see under "Legislation and supervision" below and Note 29 I.

MAIN TRENDS IN THE ISRAELI ECONOMY IN 2007

GENERAL

The Israeli economy continued to grow in 2007 at an accelerated rate of 5.3%, similarly to the growth rates in the years 2004-2006. The business sector product has also recorded a fair increase of 6.1%, even though lower than that of the years 2004-2006 (between 6.5% and 7.2%). The accelerated growth rate typified all applications, excluding residential construction, this side by side with the significant acceleration in imports (12.3% in 2007 compared to 3.3% in 2006). A particularly sharp acceleration was recorded in investments in fixed assets in all principal industries (18% in 2007 compared to 11.6% in 2006), where the export of goods and services also grew rapidly (8.4%) as well as private consumption (6.0%).

Towards the end of the year, the international rating agency, Standard & Poor's raised the long-term foreign currency debt rating of the State of Israel from "A-" to "A", and left the "positive" forecast unchanged. The rating agency also raised the long-term local currency debt from "A+" to "AA-" and raised the rating forecast in this channel to "stable". The main factors for the raised rating were the economic growth, the fiscal stability and the accumulation of assets abroad during the past four years. The rapid growth for the fourth consecutive year, left its mark on the labor market with the rate of unemployment dropping and stabilizing at a level of 6.7% in the fourth quarter of 2007.

The State of the Economy Index registered in 2007 a fair increase of 7.1%, following an increase of 7.8% in 2006. This increase indicates the continued accelerated expansion in economic activity in 2007. Industrial production grew in 2007 at the rate of 4.4%, a slowed down growth rate compared to 2006 (9.8%). A sharp growth was recorded in the mixed high technology industries and a moderate growth was recorded in the traditional technology industry.

A record number of 20.5 million person/nights (of Israelis and tourists) was recorded in 2007, an increase of 6% compared to 2006.

The increase in 2007 should be examined on the background of the damage to the tourist industry in 2006 (mainly in the months of July to October), due to the war in the North of Israel, which caused a sharp decrease in incoming tourists. It should be noted, that while tourist person/nights marked a sharp increase in 2007 (22.6%), person/nights of Israelis dropped by 3%.

Investments in Israel by foreign residents amounted in 2007 to US\$13.6 billion. This level is indeed lower by about 50% than the record level of 2006, but is higher than in years prior to that. The direct investments maintained a high level of US\$10.3 billion, of which real-estate investments amounted to US\$1.6 billion. Contrary to the direct investments, portfolio investments of foreign residents were adversely affected by the financial instability during the year, and amounted to some US\$300 million, compared to US\$8.5 billion in 2006. The turnabout in financial investments began in the third quarter of the year with the occurrence of the "Subprime" financial crisis. Investments abroad by Israeli residents recorded a drop of 50% in 2007 amounting to US\$16.2 billion, a level even slightly lower than that of 2005. Notwithstanding, unlike the investments of foreigners in Israel, direct investments by Israelis abroad dropped sharply (by about 50%) amounting to US\$7.1 billion.

DEVELOPMENTS IN GLOBAL ECONOMY

A credit crisis arose in July 2007, when the extent of the losses expected on the "subprime" market became clear bringing about a collapse of several hedge funds which in turn caused apprehension

as to the profits and stability of many large financial institutes. As a result, banks refused to grant inter-bank credit and caused a shortage in liquidity in the world financial system. This phenomenon was accompanied by a flight to safety of funds, primarily US Government bonds. As a result, the yield on US Government bonds decreased and the yield spread between these bonds and corporation and emerging markets bonds increased with equity prices falling sharply. With the intensification of the crisis in the US housing market and the growing concern over the future of economic growth, the US Federal Reserve decreased the interest rate in the months of September to December 2007 by a sharp cumulative rate of 1%, from a level of 5.25% to a level of 4.25%. In the first eight months of 2007 the Federal Reserve's interest rate remained unchanged at a level of 5.25%. In contrast, the Euro European Central Bank (ECB) left its rate unchanged. The crisis had its effect on the non-financial economy towards the end of the year, a fact translated in the US into a low growth rate of 0.6% in the last quarter of 2007. According to IMF assessments, looking at the year as a whole, world economy grew in 2007 by 4.9%, in continuation to a similar growth in 2006, this to a large extent, due to the continued growth of emerging markets. A growth of 2.2% was recorded in the US in 2007, and according to the IMF the Euro block recorded an economic growth of 2.6% while in Japan growth stood at 1.9%.

DEVELOPMENTS IN FOREIGN EXCHANGE RATES AND INFLATION RATES

The New Israeli Shekel (NIS) appreciated against the US dollar in 2007 by 9%, in continuation to an appreciation at the rate of 8.2% in 2006. As against the Euro the NIS devalued by 1.7% in continuation to a devaluation of 2.2% in 2006. The appreciation as against the dollar occurred on the background of the weakness of the dollar as against the major world currencies. The narrowing of the negative interest rate spread between the Bank of Israel's and the Fed's in the second half of the year as a result of an increase in the Bank of Israel's interest rate and a decrease in the Fed's interest rate as well as the continued improvement in the indicators relating to the Israeli economy. Among these may be noted the continued economic growth, Israel's large surplus on the current account and continued foreign investments in the Israeli economy.

The Consumer Price Index (CPI) increased during 2007 at a rate of 3.4% (compared with a decline of 0.1% in 2006). This rate is 0.4% higher than the upper boundary of the inflation rate targeted by the government, which is 1% to 3% per annum.

The increase in the CPI in 2007 was affected primarily by the sharp increase in prices of energy and commodities in the world.

The wholesale price index of industrial output for the domestic market increased in 2007 at a sharp rate of 11.4%, compared to an increase of 2.1% in 2006.

Price increases encompassed all principal consumption items, excluding the apparel and footwear item which decreased by 0.7%. Marked increases were recorded in the foodstuffs (6.3%), fruit and vegetables (7%), housing maintenance (6.1%) and transportation and communications (4.2%) items. The housing item increased in 2007 at a relatively moderate rate (1.9%), this despite the marked weakness of the US dollar as against the NIS during the year.

FISCAL AND MONETARY POLICY

Fiscal policy. Actual performance data of the State's budget in 2007 indicate a very low deficit of NIS 126 million (excluding the granting of credit), in comparison to a deficit of NIS 5.5 billion in 2006 (comprising 0.9% of the GDP). The low deficit in 2007 originates from revenues, which were 7% higher than those of 2006. This, as a result of the growth in non-financial activity. The actual deficit in 2007 was significantly lower than the targeted deficit (2.9% of the GDP). The Government debt decreased in 2007 to 80% of the GDP, this in continuation to the downwards trend of recent years.

Monetary policy During the first half of the year, the Bank of Israel lowered the interest rate by a cumulative rate of 1%, from a level of 4.5% to a level of 3.5%, this in order to increase the prospects of reverting the inflation rate to the targeted range. As from the month of August, in view of the continued accelerated economic growth rate and the decline in the product gap, the expectancy for increased global inflation rate and the positive interest rates gap between world countries and Israel, the Bank of Israel resumed the trend of increasing interest rates, thus in the period from August to December 2007 the interest rate increased at a cumulative rate of 0.5% to a level of 4%.

THE CAPITAL MARKET

Following moderate increases in 2006, securities market prices increased sharply in 2007 and the general share index increased by 22.9%. The average daily trading volume amounted to NIS 2.08 billion, compared to an average daily volume of NIS 1.45 billion in 2006. Share price increases in 2007 covered all sectors, excluding the insurance sector which dropped by 1.7%. Sharp increases were recorded in industrial shares (33.9%) holding companies (31.5%) and in trade and services (20.6%). In 2007, the "TA 25" Index increased by 31.4%, the "TA 100" Index increased by 25.3%, while the "Tel Tech" Index fell by 3.5%.

Total market value of shares and convertibles amounted at the end of 2007 to NIS 904.7 billion, compared to NIS 681.9 billion at the end of 2006. During 2007, mutual funds raised deposits of NIS 5.06 billion compared to large withdrawals of NIS 18.37 billion in 2006. The deposits in 2007 relate to mutual funds specializing in bonds which raised NIS 12.29 billion, whereas in all other types of funds: mutual funds specializing in shares, Shekel securities and securities specializing in foreign investments, withdrawals were recorded.

Dynamic activity continued in 2007 in the trading in options on the "TA 25" Index, and the daily average trading volume amounted to 385 thousand contracts, compared to 305 thousand contracts in 2006.

The general bond index covering all classes of bonds increased during 2007 by 4%, compared to an increase of 4.6% in 2006. Price increases were recorded in the non-linked and the CPI linked bonds whereas the prices of foreign currency linked bonds fell.

The CPI linked Government bonds index increased in 2007 by 6.7%, and the non-linked Government bonds index increased by 3.1%.

The daily bond trading volume on the Tel Aviv Stock Exchange grew from NIS 1.7 billion in 2006 to NIS 3.3 billion in 2007. In continuation of the trend in 2006, a marked increase was recorded in the market volume of trading in non-linked Government bonds.

**PRINCIPAL
ECONOMIC
DEVELOPMENTS IN
JANUARY-MARCH
2008**

Due to apprehension as to the future of economic growth the US Federal Reserve twice reduced the interest rate in January, so that on a cumulative basis the interest rate fell by 1.25% to a level of 3%. Despite these reductions in interest rates, the US economy took a turn for the worse in January-February, reflected in a weakness in the labor market and the continued slowdown in the real estate market. Furthermore, the credit crisis in the financial markets intensified, which in March was reflected, among other things, in the loss of liquidity at one of the leading investments banks in the US. The fear of this crisis spreading and affecting additional banks brought about the intervention of the Federal Reserve providing liquidity to that bank, a fact that enabled its acquisition by another bank. Moreover, the weakness of the US economy and the anticipation for the continued reduction in interest rates brought about the continued weakness of the US dollar as against most of the principal currencies in the world. In March 2008, the Federal Reserve interest rate was reduced by 0.75% to a level of 2.25%. In Israel the Consumer Price Index remained unchanged in January, and in February it dropped by 0.2%. The Bank of Israel interest rate for January was increased by 0.25% to 4.25% and in March was reduced by 0.5% to 3.75%.

As a result of the irregular behavior of the exchange rate of the Shekel, reflected in the weakness of the US dollar in relation to the Shekel exceeding its weakness in relation to principal world currencies (since the beginning of 2008 until the middle of March the Shekel appreciated by 11.4% as against the Dollar, this in comparison to an appreciation of 6.4% in the Euro as against the dollar), the Bank of Israel purchased foreign currency in the course of business in the middle of March.

The international rating agency Fitch increased Israel's debt rating from "A-" to "A" in February 2007. In the first months of the year, the cumulative surplus in the State's budget amounted to NIS 3.6 billion (excluding the granting of credit).

Since the beginning of 2008 the local capital market was characterized by a trend of sharp decrease in securities prices alongside a similar trend in world markets. The TA 25 Index dropped since the beginning of the year by a cumulative rate of 18%.

The Government bond market recorded in contrast an upward trend in prices.



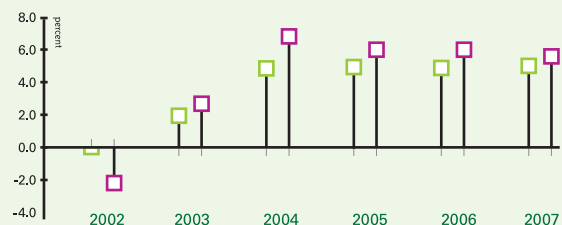
ISRAEL DISCOUNT BANK LIMITED AND ITS SUBSIDIARIES

TRENDS IN THE LABOR MARKET

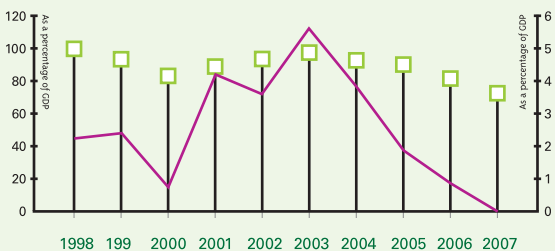
□ Unemployment rate (left Axis) — Labor force participation rate (right Axis)

**ECONOMIC GROWTH IN ISRAEL**

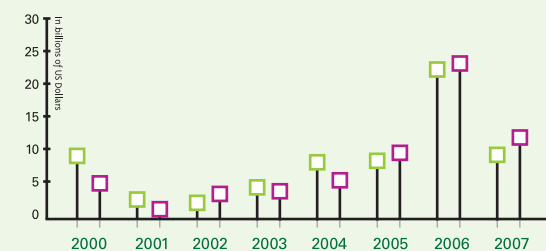
□ Gross domestic product
□ Business sector GDP

**GOVERNMENT BUDGET DEFICIT AND PUBLIC DEBT**

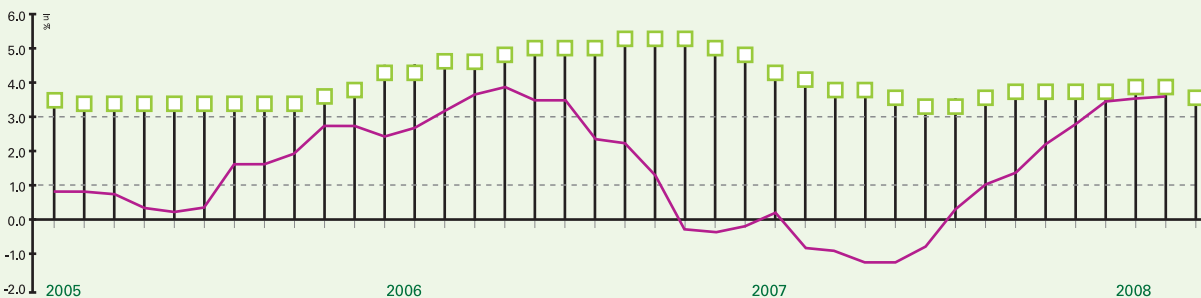
□ Public debt (left Axis)
— Government deficit (right Axis)

**DIRECT AND PORTFOLIO INVESTMENT**

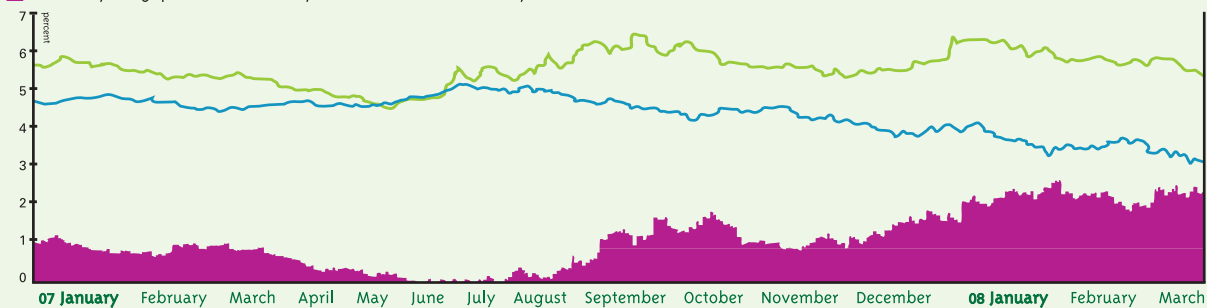
□ Investments in Israel by foreigners
□ Investments abroad by Israelis

**MONETARY DEVELOPMENTS**

□ Bank of Israel Interest rate — Inflation rate in the last 12 months — The official inflation target bound

**LONG-TERM (10 YEAR) NOMINAL INTEREST RATES IN THE US AND ISRAEL, AND THE GAP BETWEEN THEM**

□ Nominal yield gap — Nominal yield in US — Nominal yield in Israel



CAPITAL RESOURCES

COMPONENTS OF CAPITAL

The Bank's capital resources as at December 31, 2007, including minority interest, totalled NIS 9,351 million, compared with NIS 8,367 million at the end of the preceding year, an increase of 11.8%.

Shareholders' equity as at December 31, 2007, totalled NIS 9,204 million, compared with NIS 7,965 million at the end of the preceding year, an increase of 15.6%.

The increase in shareholders' equity in 2007, resulted, inter-alia, from the current income.

The ratio of shareholders' equity, including minority interest, to total assets as at December 31, 2007, stood at 5.5%, compared with 5.1% at the end of the preceding year.

Ratio of tier I capital to risk assets as of December 31, 2007, reached a rate of 8.15%, 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 7.29% as of December 31, 2007, compared to 7.22 % at 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 subordinate capital notes, 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 stood at 10.9% on December 31, 2007, compared with 10.5% at the end of 2006.

Hybrid tier I capital constitutes capital notes recognized as part of tier I capital (see Note 14 to the financial statements). The Bank's hybrid tier I capital as of December 31, 2007 amounted to NIS 1,044 million, compared with NIS 750 million at the end of 2006. The amount of the 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 December 31, 2007, the compound primary capital amounted to 10.49% 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 528 million as of December 31, 2007. The Bank is presently considering an additional issue of Hybrid Tier I Capital. 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. According to Bank of Israel directives, Tier II Capital serves as a component of total capital for the purpose of calculating the ratio of capital to risk assets. Tier II Capital is composed of, inter alia, subordinated capital notes and the general provision for doubtful debts. The Bank's Tier II capital totalled NIS 4,819 million as at December 31, 2007, including NIS 4,562 million of subordinated capital notes and NIS 257 million of general provision for doubtful debts. The extent of subordinated capital notes is limited to 50% of the tier I capital.

As of December 31, 2007, the said ratio was 45.84%. The balance of the subordinated capital notes, which the Bank may issue until reaching the limit amounted to approximately NIS 414 million as of December 31, 2007. For details regarding an offering in the amount of NIS 1,021 million carried out in March 2008, see below.

The policy regarding the ratio of capital to risk assets. On March 24, 2008, the Board of Directors resolved as a policy matter that the Bank should aim at reaching a ratio of capital to risk assets of not less than 12% by the end of 2009. Within the framework of the said policy an interim target has been determined whereby the Bank would work towards achieving a ratio of capital to risk assets of between 11.25% - 11.50% by the end of 2008.

The said policy, according to which the Bank will take action to broaden the safety margin of the capital adequacy ratio over and above the minimum capital ratio prescribed at present by regulation, has been determined as part of the general preparations for the implementation of the Basel II principles, taking into consideration the sensitivity of the Bank's capital to changes in exchange rates.

Following are details regarding the components of the upper tier capital

	December 31 2007	December 31 2006
	in NIS millions	
Share capital	3,597	3,597
Hybrid tier I capital	1,044	750
Capital reserves	12	(14)
Retained earnings	5,398	4,133
Minority interest	147	402
Excess of cost of investments in investee companies not attributed to tangible assets	(246)	(231)
Total tier I capital	9,952	8,637
Investments deducted from capital:		
First International Bank of Israel Ltd.	1,451	1,254
Automatic Bank Services Ltd.	9	9
Bank Clearing Center Ltd.	6	6
Others	-	2
Total investments deducted from capital	1,466	1,271

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

Capital allocation required in respect of credit risks at the Bank as at December 31, 2007 is as follows:

	Balances	Weighted credit risk in NIS millions	Capital requirements
Credit risk assets			
Cash and deposits with banks	19,850	3,493	314
Securities	37,278	7,692	692
Securities borrowed or purchased under resale agreements	346	-	-
Credit granted to the public	102,188	86,132	7,752
Credit granted to the government	374	2	-
Investment in affiliated companies	1,930	457	41
Buildings and equipment	2,780	2,780	250
Other assets	4,275	2,957	266
Total assets	169,021	103,513	9,315
Off-Balance Sheet Instruments			
Transactions whose balance represents credit risk	13,922	12,599	1,134
Derivative financial instruments	10,959	3,844	346
Other	56	56	5
Total off-balance sheet instruments	24,937	16,499	1,485
Total credit risk assets	193,958	120,012	10,800
Total assets as above	169,021	-	-
General provision	(211)	-	-
Total assets according to the financial statements	168,810		

Below is the distribution of credit risk assets of the Bank as of December 31, 2007, in accordance with the various levels of risk determined in the directive

	0%	20%	50%	100%	Total
in NIS millions					
Cash and deposits with banks	3,197	16,449	-	204	19,850
Securities	16,987	15,748	-	4,543	37,278
Securities borrowed or purchased under buy-back agreements	346	-	-	-	346
Credit granted to the public	11,447	2,800	4,738	83,203	102,188
Credit granted to the government	372	-	-	2	374
Investment in affiliated companies	*1,473	-	-	457	1,930
Buildings and equipment	-	-	-	2,780	2,780
Other assets	500	1,024	-	2,751	4,275
Transactions whose balance represents credit risk	496	741	469	12,216	13,922
Derivative financial instruments	145	8,657	89	2,068	10,959
Other	-	-	-	56	56
Total credit risk assets	33,963	45,419	5,296	108,280	193,958
Deduction factors included in the above credit risk rates:					
Securities:					
Bonds and deposits	59				
Guarantees received	310	241			
Credit granted to the public:					
Bonds and deposits	11,132				
Guarantees received	315	2,535			
Transactions whose balance represents credit risk:					
Bonds and deposits	496				
Guarantees received	-	741			
Derivative financial instruments:					
Bonds and deposits	145				

* Investments in affiliated companies classified as such were offset from the equity.

ISSUE OF SUBORDINATED CAPITAL NOTES

Issuance of subordinated capital notes in 2007. During 2007 the Bank issued subordinated capital notes in the amount of of NIS 1,196 million, of which NIS 1,148 million were raised by the issue of marketable capital notes. This compared with NIS 672 million in 2006, of which NIS 624 million by the issue of marketable capital notes. On October 29, 2007, the Bank issued NIS 800 million of subordinated capital notes (see hereunder).

The publication of a shelf prospectus (2006). On September 28 2006, the subsidiary Discount Manpikim published a shelf prospectus for the issuance of up to NIS 4 billion par value, subordinated capital notes (series "C" - "F"), and for the listing for trade of NIS 300 million par value, capital notes (series "B").

At the beginning of March 2007 Discount Manpikim issued NIS 350 million par value subordinate capital notes (series "E") in accordance with a shelf offer report dated March 5, 2007.

According to a shelf offering report of October 24, 2007, Discount Manpikim Ltd. issued on October 29, 2007, subordinated capital notes (Series "D") of a par value of NIS 400 million as well as subordinated capital notes (Series "E"), of a par value of NIS 400 million.

On February 27, 2008, Discount Manpikim informed, further to the publication of a shelf Prospectus of that date (see hereunder), that according to a resolution of Discount Manpikim's Board of Directors, upon the publication of the above mentioned shelf Prospectus, it will no longer issue subordinate capital notes according to the shelf Prospectus of September 28, 2006.

The publication of a shelf Prospectus (2008). On February 27, 2008, Discount Manpikim published a shelf Prospectus for the issue of up to NIS 2 billion par value, of subordinate capital notes (for each series from G to R) and an issue by way of extension of up to NIS 2 billion par value, of the subordinate capital notes (for each series B, D and E).

At the beginning of March 2008, Discount Manpikim issued NIS 665 million par value, of subordinate debt notes (series G) and NIS 356 million par value, of subordinate capital notes (series H), in accordance with a shelf offer report dated March 5, 2008.

Issuance of Capital Notes in 2008. An amount of NIS 520 million of capital notes issued in the past will be deducted in the course of 2008 from the secondary capital of the Bank, used in calculating the ratio of capital to risk assets. As stated above, the Bank raised in March 2008 an amount of NIS 1,021 millions in debt notes.

RATING THE BANK'S LIABILITIES

Standard & Poor's, Ma'alot (formerly: "Ma'alot - the Israeli Securities Rating Company Ltd."; hereinafter: "Ma'alot") determined, in September 2003, a rating of "AA-" with respect to deposits with the Bank and subordinated capital notes issued by the Bank, directly and through Discount Manpikim Ltd. In December 2007, Ma'alot raised the rating to "AA" in view of its assessment that the risk level inherent to the Bank's operations had been reduced (the paper presenting the principal considerations for raising the Bank's rating is shown on the website of the Tel Aviv Stock Exchange and on the website of Ma'alot.

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.

The international rating agency S&P rated the Bank in the past, based on public information, with a "BBpi" long term local currency rating. In February 2008, S&P determined the following rating for the Bank: "A-2" for the short-term and "BBB" for the long-term. S&P further determined a "Stable" forecast for the Bank. The said rating was set following a rating process conducted by S&P at the Bank.

The international rating agency Moody's rated the Bank, based on public information, with an "A2" rating with respect to long-term deposits, and with a "P1-" rating with respect to short-term deposits. Moody's also rated the Bank with a "C-" rating for the financial stability parameter.

Ma'alot ranked as "A" 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.

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), which the Bank distributes regularly. On November 11, 2007, the Board of Directors resolved to pay on December 27, 2007, an interim dividend of 6% to the holders of 40,000 Cumulative 6% Preference Shares of NIS 0.00504 par value each, and to recommend to the Annual General Meeting of the Bank to be convened in 2008, to declare this dividend a final dividend.

The main limitation affecting the ability of the Bank to distribute a dividend in the recent 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 the Section “Agreement with the employees” under “Control of the Bank” hereunder. 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” hereunder and Note 32 B to the financial statements.

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.

Distribution of dividend. Following the strategic plan and on background of the satisfactory progress that had been made in reaching its goals, including as regards the Bank’s profitability and its capital adequacy, the Bank’s Management decided as follows:

- a. To recommend to the Board of Directors a dividend distribution in 2008 in an amount comprising a dividend yield of approximately 3.0%. The recommendation would take its form proximate to its presentation to the Board during 2008, when the suggested dividend rate would be determined, among other things, taking into account the maintenance of capital adequacy at a suitable level and the Bank’s ability to continue the accelerated development of its business, and prior to that, it would be brought to the attention of the Supervisor of Banks, as required.
- b. To bring before the Board, in the first quarter of 2009, a recommendation for a dividend policy for the following years.

The above is considered a forward-looking information, which is based on the Bank’s assumptions as of the date of the financial statements. The information may not materialize in the event that

the level of economic activity is reduced as a result of decline in the defense situation, or due to crisis in the international markets, or as a result of developments which might adversely affect the Bank's capital adequacy and profitability.

LIQUIDITY AND THE RAISING OF SOURCES IN THE BANK GENERAL

During 2007, the Bank of Israel provided the banking industry with liquidity by way of relatively large volumes of monetary loans bids and by way of cancellation of the monetary deposit bids. Most of the funds were provided in the first half of the year, concurrently with lowering the interest rate from a level of 4.5% in January to 3.5% in June of the same year. Together with the increase in the rate of inflation in the second half of 2007, the Bank of Israel increased the interest rate to a level of 4.0%, reduced the volume of the monetary loans and reverted to deposit bids, even though at a reduced volume as compared to prior years.

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 requires 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).

As part of the expansion and upgrade of the liquidity market in Israel, the Bank of Israel commenced implementing in October 2007 resale transactions - the purchase and resale of Government bonds and short term loans (MAKAM) ("RIPO") - made with institutional bodies and banking corporations.

ASSET PORTFOLIO HELD BY THE PUBLIC

The composition of the asset portfolio held by the public in 2007 reflects the impressive strength of Israel's financial markets, despite the instability at political and security levels. Following are the main influencing factors:

1. High volatility of the exchange rate of the Shekel against the US dollar: the exchange rate of the dollar, which at the beginning of 2007 stood at a level of NIS 4.20 fell at the end of May 2007 to a level of NIS 3.97, rose in August to a level of NIS 4.32 and fell again at the end of the year to a level of NIS 3.89, the Shekel thus completing an appreciation of 7.5%
2. The Bank of Israel interest rate: the Bank of Israel interest rate fell from a level of 4.50% at the beginning of 2007 to a level of 3.50% in the months of June and July, rose to a level of 4.0% in September and remained at that level until the end of the year. The short-term interest rate gap between the United States and Israel, which overturned at the end of 2006, maintained its negative level during most of the year and reached a record of 1.75% in June 2007.
3. Volume of fund raising: A decrease in the volume of funds raised by the Government on the domestic bond market, and in contrast an increase in the issuance of bonds by corporations.
4. The Israeli equity market: Despite high volatility, the principal share indices of the Tel Aviv Stock Exchange reached an all time record during 2007. The "Ma'of" Index recorded a rise of about 31% during the year.

Following are the changes recorded in the securities portfolio during the first eleven months of 2007:

1. An increase in the weight of equity securities from 25.6% at the end of 2006 to 28.0% at the end of 2007. The increase stems from the Israeli shares component.

2. A decrease in the weight of non-linked assets from 29.3% at the end of 2006 to 27.5% at the end of 2007.
3. A slight decrease in the weight of CPI linked assets from 29.9% at the end of 2006 to 29.8% at the end of 2007.
4. A slight decrease in the weight of foreign currency linked assets from 15.1% at the end of 2006 to 14.7% at the end of 2007.

THE BANK

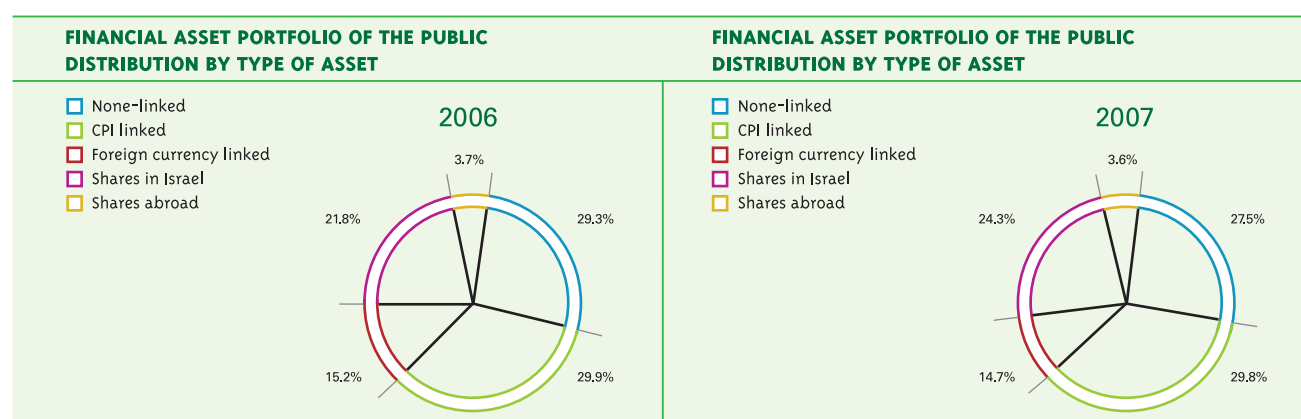
During the entire year, the Bank maintained liquid assets in a volume higher than its liquid liabilities. Following are the changes in the composition of deposits of the Bank in 2007:

The non-linked segment. The volume of non-linked deposits of the public with the Bank reached at the end of 2007 an amount of NIS 45.3 billion, compared with NIS 40.5 billion at the end of 2006, an increase of 11.9%.

The CPI linked segment. The total of CPI linked financial resources amounted to NIS 9.8 billion at the end of 2007, compared with NIS 9.7 billion at the end of 2006, an increase of 1.0%.

The foreign currency and foreign currency linked segment. The volume of non-linked deposits of the public with the Bank reached US\$9.7 billion at the end of 2007, compared to US\$8.2 billion at the end of 2006, an increase of 18.3%.

Raising of capital. For details regarding the issuance of secondary capital and hybrid tier I capital in 2007 see "Capital resources" above.



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.

In order to address all risks, the Bank adopted a risk management policy that defines the kind of risk exposure to the Bank, the units responsible for the risk exposure or for hedging against exposure, and their authorization. Also, tools and mechanisms were defined for the management, measurement and reporting of risk exposure. This policy addresses, inter alia, Proper Banking

Management Directive No. 339 - "Risk Management", issued by the Supervisor of Banks, regarding management and control of financial risks.

This policy is based on various forecasts and assessments as to the development of various economic and capital and money markets indices.

The Bank has a committee of risk managers headed by the risk manager of the Bank. The committee's members are:

Ms. Dorit Ben-Simon, Executive Vice President -	Risk Manager of the Bank, Market and Liquidity Risk Manager and Chairperson of the Committee
Mr. Ehud Arnon, Executive Vice President -	Credit risk manager of the Bank;
Ms. Esther Deutsch, Executive Vice President -	Legal risk manager.
Mr. Noam Hanegbi, Senior Executive Vice President -	Head of Operations and Information Division;
Mr. Amir Rozin -	Manager of the Risk Management Department.

Each risk manager is responsible for risk management in his own sphere of activity.

The committee is engaged in forming the risk management policy of the Bank in the various areas, in identifying new risk areas and risk centers and in initiating changes required in the risk management policy. The committee also serves as the Bank's supreme steering committee in the matter of the preparations of the Bank for the implementation of the "Basel II" directives.

The risk management department at the finance division (see hereunder), which is subject to the Risk Manager of the Bank, is responsible for the overall risk management at the Bank and the Group.

THE ESTABLISHMENT OF A RISK MANAGEMENT DEPARTMENT

As part of the Bank's preparations to address the overall risks at the Bank and the Group, including preparations for the implementation of Basel II guidelines, and in view of the strategic importance that the Bank attributes to the issue of risk management and corporate governance (ERM), the Bank has established a risk management department within the framework of the finance division. The new department acts to incorporate risk management norms, to form a policy and a methodology and to implement advanced risk management procedures at the Bank and in the Group. The department engages in managing market risks, credit risks and operational risks (excluding legal risks, regulation and compliance risks, which are handled by the Legal Advisory Group and financial reporting risks dealt with the Accounting), and also coordinates the activities required for the implementation of the Basel II guidelines and the requirements of the Supervisor of Banks in the matter.

Concurrently, the Bank is in the midst of a process of establishing organizational functional entities for risk management at the various divisions, which are to support the divisional risk management within the framework of their business activity. These entities will receive professional and methodological support from the risk management department as well as tools for implementing the methodology.



DESCRIPTION OF EXPOSURE TO AND MANAGEMENT OF MARKET RISKS

General. In accordance with Proper Banking Management Directive No. 339, the Bank is required to manage the market risk on a Group basis while, at this stage, market risks are managed on the basis of the Bank alone. The appetite for risk, including actual market risks, of the banking subsidiaries is reviewed frequently and on a quarterly basis at the very least. The Boards of Directors of the banking subsidiaries have also determined policies regarding the maximum exposure to market risks, with each subsidiary managing its own market risks according to these policies. Risk exposures of the principal subsidiaries are reported to the Bank's Board of Directors once in each quarter. The Bank is adopting the necessary measures to assess and measure the Group's overall exposure to market risks. In recent months, the Bank has intensified its efforts in this respect and in December 2007, the Board of Directors determined the market risk appetite of the group as a whole, in terms of VaR and in terms of exposure to interest rate risk. This review presents market and liquidity risks applicable to the Bank only.

The Bank distinguishes between exposure incurred during the Bank's asset and liability management process and exposure incurred by trading. The trading exposure results from the Bank's activity as a market maker and from "nostro" investments in financial assets for trade.

The Board of Directors determined different limitations for trading and non-trading activity.

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 thereto segment.

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The following is a summary of the net linkage balances of the Bank (in NIS millions)⁽¹⁾:

	Non-linked shekels	CPI linked shekels	Foreign ⁽²⁾ currency	Non-monetary asset	Total
As at December 31, 2007					
Assets	53,661	16,801	33,632	10,662	114,716
Liabilities	51,542	13,822	40,061	87	105,512
Balance sheet difference	2,119	2,979	(6,429)	10,535	9,204
Derivatives	230	(2,713)	2,483	-	-
Options	379	2	(381)	-	-
Total Difference	2,728	268	(4,327)	10,535	9,204
As at December 31, 2006					
Assets	45,955	14,604	37,013	9,383	106,955
Liabilities	47,947	13,681	37,184	178	98,990
Balance sheet difference	(1,992)	923	(171)	9,205	7,965
Futures contracts, net	2,374	(407)	(1,967)	-	-
Options	586	60	(646)	-	-
Total Difference	968	576	(2,784)	9,205	7,965

Footnotes:

(1) The above presented data reflect the accounting positions, which differ from the economic positions in the various linkage segments, on the basis of which the daily exposure management is actually performed (see hereunder).

(2) The base exposure is computed in accordance with generally accepted accounting principles, as stated in Note 17 to the financial statements. For current management purposes, certain changes have been implemented, which take into account the Bank's economic approach to base exposure. Exposure to foreign currencies is permitted within the limitations approved by the Board of Directors of the Bank.

The exposure to base risk is measured as a percentage of the Bank's available capital, defined as the Bank's equity, net of investments in investee companies, and with the addition of investments in foreign subsidiaries that are financed from foreign currency deposits and with the addition of adjustments required for the economic presentation of exposure to base risks. Available capital is defined by the Bank as a non-linked shekel resource.

The mix of investments of the available capital in the various linkage segments is determined on a current basis within the framework of the limitations presented below and on the basis of forecasts regarding the relevant market variables.

Following is the actual distribution of investment of the Bank's available capital on a standalone basis (not consolidated), compared to the limitations determined by the Board of Directors (the data is presented in relation to the available capital):

Segment of operations	Limitations	2007				2006			
		Year end	Average	Maximum	Minimum	Year End	Average	Maximum	Minimum
Non-linked Shekel	140%-(30%)	123%	88%	123%	44%	106%	113%	159%	61%
CPI linked Shekel	120%-(40%)	(23%)	10%	33%	0%	(6%)	(13%)	(59%)	0%
Foreign currency	50%-(50%)	0%	2%	45%	0%	0%	0%	4%	0%

No deviation from the limitations were recorded in 2007.

The Boards of Directors of the banking subsidiaries have each determined their policies with respect to the subsidiaries' maximum exposure to base risks.

Capital sensitivity of the Bank to changes in exchange rate. The Bank's capital sensitivity 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 December 31, 2007 (in NIS million):

The capital sensitivity of the Bank ⁽¹⁾ to changes in exchange rates (in NIS millions):				
Segment ⁽²⁾	10%	5%	-5%	-10%
USD	(24)	(1)	(24)	(54)
EUR	23	9	9	1
GBP	11	6	(6)	(11)
CHF	14	7	(7)	(14)
JPY	3	2	(2)	(3)

Notes:

(1) The theoretical change in the economic value of the Bank as a result of the scenario (including commercial activities).

(2) Investigation of maximum daily changes during last ten years: Yen - increase of 14% in October 1998. This scenario would have impacted on the Banks equity by NIS 1 million.

This impact was calculated on the basis of the expected change in the Bank's economic positions in respect of various currencies, in accordance with scenarios determined by the Supervisor of Banks. The calculation is based on the Bank's economic position that is based, in turn, on the difference between assets and liabilities, with the addition of off-balance sheet items and economic adjustments.

(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.

Interest risk exposure data take into account early repayments and withdrawals from savings

schemes as of “exit dates”, and the assumed spread of a certain rate of current account balances. For details see “Behavioral assumptions applied in the assessment of market and liquidity risks” below. The limitation determined by the Board for interest risk exposure in the various linkage segments relates to the maximum damage to economic capital resulting from concurrent movements in the yield curve of 1% in each segment.

Measurement of the risk is performed in weekly intervals. The results of the measurements are reported to the financial forum on a weekly basis and to the asset and liability management committee on a monthly basis.

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

Limitations determined by the Board of Directors (not including trading activities), in US\$ million:									
Segment of		2007					2006		
operations	Limitations	Year end	Average	Maximum	Minimum	Year End	Average	Maximum	Minimum
Non-linked Shekel	180	125	87	126	63	96	102	121	79
CPI linked Shekel	180	17	32	101	4	58	20	58	3
Foreign currency	100	6	5	16	-	4	3	7	-
Total segments	320	148	127	207	71	158	121	158	93

During 2007, the Bank complied with the limitations on exposure to interest risk determined by the Board of Directors.

The analysis of exposure of the Bank (non-consolidated) to economic interest rates, presents the following findings:

In the CPI linked segment - A temporary increase in the exposure level took place during the year as a result of a mortgage marketing campaign - within the framework of “Discount layout” (see “Mortgage and housing loans” under “Further details as to activity in certain products” below. The exposure was reduced towards the end of the year.

The non-linked segment - During 2007 the exposure to interest rate risk increased in this segment.

In determining the interest rate exposure, the Bank’s policy is to consider a part of current account deposit balances in Israeli currency as a liability for a longer period in accordance with a model used by the bank (see hereunder). In contrast, Schedule “D” hereunder reflects the current account balances in accordance with directives of the Bank of Israel, under “demand deposits and up to one month”.

In the foreign currency segment (including foreign currency linked) - Most of the activity is on the basis of variable interest rates and the availability of varied financial instruments in international markets enables the reduction of exposure. The Bank decided to maintain low interest risk exposure in this segment.

The following is a summary of the Bank's and its consolidated subsidiaries' exposure to fluctuations in interest rates, including the internal rate of return (IRR) and the average maturity, as per the various linkage segments (in NIS millions) Including assumptions regarding early repayments⁽¹⁾:

	As at December 31, 2007			As at December 31, 2006		
	Non-linked shekels	CPI linked shekels	Foreign currency and foreign currency linked shekels	Non-linked shekels	CPI linked shekels	Foreign currency and foreign currency linked shekels
Total Assets	64,690	22,853	70,053	54,712	21,018	76,900
Total Liabilities	61,454	18,882	74,618	55,740	19,082	74,856
Average maturity (years):						
Assets	0.71	4.61	1.35	0.62	4.16	1.26
Liabilities	0.41	4.11	0.23	0.30	4.03	0.51
Average maturity gap	0.30	0.50	1.12	0.32	0.13	0.75
IRR gap	2.99	0.78	1.74	2.97	0.93	0.99

(1) For details see "Behavioral assumption applied in the assessment of market and liquidity risks".

The data in the Bank's and its consolidated subsidiaries' report on their exposure to fluctuations in interest rates indicates that:

- In the non-linked shekel segment, a gap existed as at December 31, 2007, between the average maturity of liabilities and the average maturity of assets, amounting to 0.30 years, compared with an average maturity gap on December 31, 2006 of 0.32 years.
- In the CPI-linked shekel segment, the average maturity gap between assets and liabilities as at December 31, 2007, was 0.5 years (about 6 months), compared with 0.13 years (about 2 months) on December 31, 2006. Calculation of the average maturity gap includes the effect of early redemption and withdrawals at exit points of savings deposits, based on a model which serves the Bank (see hereunder).
- In the foreign currency segment, including activity in shekels linked to foreign currency, the gap between the average maturity of liabilities and average maturity of assets as at December 31, 2007, was 1.12 years, compared with a gap of 0.75 years on December 31, 2006. The exposure to interest rates in this segment is affected also by the manner in which the Bank finances its investments abroad from the foreign currency sources of the Bank.

Sensitivity of the Bank's capital to changes in interest rate. The sensitivity of the Bank's capital to changes in interest rates is presented in the following Table, which details the effect of changes in interest rates on the capital of the Bank as of December 31, 2007. This impact was calculated on the basis of the expected change in the economic value of the Bank, given interest rate scenarios determined by the Supervisor of Banks.

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Profit and loss ⁽¹⁾ as a result of changes in the interest rate curve (in NIS millions):						
Segment ⁽²⁾	Maximum increase in market factors ⁽³⁾	10%	5%	-5%	-10%	Maximum decrease in market factors ⁽³⁾
Non linked Shekel	*(190)	(99)	(50)	52	106	244
CPI linked Shekel ⁽⁴⁾	(7)	(5)	(2)	2	5	7
USD	(4)	(4)	(2)	2	4	6

Notes:

(1) In the economic value of the Bank

(2) The theoretical computation performed with respect to the Euro, Pound Sterling, Swiss Frank and the Japanese Yen currencies indicates negligible changes in the economic value, and therefore these currencies are not presented in the table.

(3) In the maximum daily change scenarios during the past ten years.

(4) During the reported year, a higher exposure was recorded in the CPI linked segment than that recorded at the end of the year, and its sensitivity to changes in interest rates was assessed at NIS 33 million (in a 10% increase scenario).

Following are details regarding the maximum daily change scenarios during the past ten years:

Segment	Maximum increase in market factors			Maximum decrease in market factors		
	Date	Change in %	Effect in NIS millions	Date	Change in %	Effect in NIS millions
Non linked Shekel	June 2002	20%	(190)	Dec. 2001	(22%)	244
CPI linked Shekel	Feb. 2002	15%	(7)	Dec. 2001	(15%)	7
USD	June 2003	12%	(4)	Sept. 2001	(16%)	6

(3) MANAGEMENT OF TRADING POSITIONS

The trading positions are the result of the Bank's activity as a market maker and a result of dynamic management of its liquid financial asset portfolio. The trading activity is intended at creating income while enabling exposure within the approved risk range for this activity, and maintaining daily and sub-daily monitoring and control.

Limitations on trading activity were determined by the Board of Directors of the Bank in terms of scope of activity, sensitivity to risk factors and theoretical losses incurred, including in extreme scenarios, and in terms of the value at risk (VAR).

(4) 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").

(5) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

The Board of Directors has determined the mode of operation of the Bank in derivative financial instruments, maximum volume of activity and the range of financial instruments in which the Bank may engage (whether on behalf of its customers or of its own account). During the year, the Board of Directors approved the significant expansion of the operating frameworks for some of the derivative financial instruments. The volume of operations for each derivative financial instrument has been determined in addition to other limitations, this, among other things, in order to restrict the operational risk involved in such operations.

The Bank's transactions in derivative financial instruments are made partly with banking institutions or Tel-Aviv Stock Exchange members, who are subject to capital adequacy requirements or compliance with the level of security required by the Tel-Aviv Stock Exchange, and partly with other customers of the Bank, who provide security in accordance with the Bank's procedures.

These transactions are implemented both for the Bank's customers and for the Bank itself, for hedging and for other purposes. The dealing room implements trading activity and risk hedging activity for customers as part of its market risk management. Subject to the limitations set out by the Board of Directors, further internal limitations were fixed for the dealing room with regard to this area of operations.

The Bank is active in a wide range of derivative financial instruments both in shekels and in foreign currency, and acts also as a "market maker" for some of which including regular options and "exotic" options of certain types. A substantial part of the transactions are made "over the counter" (OTC) in accordance with customer needs and those of the Bank. The price determination for these transactions is based on returns and prices of base assets using accepted pricing models and taking into account market competition.

The exposure created both with regard to linkage base and with regard to interest as a result of this activity, is included in the limitations set by the board of directors on exposure to linkage base, interest and options.

The exposure is measured and controlled by the Middle Office on a current basis.

Following are data as to the volume of operation in derivative financial instruments of the Bank and its consolidated subsidiaries (in NIS millions):

	As at December 31	
	2007	2006
Hedging derivatives	1,109	*981
ALM derivatives	87,531	*50,244
Other derivatives	46,826	*45,158
Credit derivatives and SPOT foreign currency	6,929	4,879

* Reclassified.

Accounting aspects. The accounting policy with regard to the measurement of the value of derivative financial instruments and the results thereof is stated in Note 1(m) and 20 to the financial statements.

According to the said directives of the Supervisor of Banks, most of the transactions in derivative financial instruments made by the Bank for managing market risks resulting from its financial base assets (ALM) are classified as "other transactions" and not as "hedging transactions". In terms of the said directives more stringent criteria have to be complied with so that transactions in derivative financial instruments could be considered as "hedging transactions".

The majority of base assets, the exposure of which to market risk, as stated, was hedged by derivative financial instruments, are not marketable. Income and expenses generated by such assets are recognized on the accrual basis while the results of the transactions in derivative financial instruments defined as "other transactions" are computed, due to the absence of a market, according to "fair value". Accordingly, no correlation exists between the recording of the base assets and the results they produce in accordance with generally accepted accounting principles and the transactions in derivative financial instruments in respect of those base assets, which are classified as "other transactions". The effect of the above was an increase in the earnings from financing operations by NIS 11 million in 2007, compared with a decrease of NIS 33 million in earnings from financing operations in 2006.

Details of financing income from derivative financial instruments are presented in Note 23 to the financial statements.

Activity in the Ma'of market. The Bank operates in the Ma'of share index market only on behalf of customers, while maintaining the security level required by the Tel-Aviv Stock Exchange. The Bank operates in options on the dollar exchange rates in the Ma'of market both on customers' behalf and on behalf of the Bank itself. The Bank permits selected customers to operate on credit in the Ma'of market while monitoring closely, on an ongoing basis, the risk involved in the portfolio as compared with security received.

Credit risk involved in financial instruments. The Bank's activity in derivative financial instruments involves special risk factors including credit risks. The credit risk relating to such transactions is derived from the fact that the stated value of the transaction does not necessarily reflect the credit risk involved therein. This risk is measured according to the maximum amount of the loss, which the Bank may incur in case the other party to the transaction will not honor its obligations, net of the effect of enforceable setoff agreements.

The credit risk during the period of the engagement is assessed according to the cost of engagement in a similar transaction, had this been entered into at the reporting date with the same customer and for the remaining period until its expiration.

The Bank's policy as to the required security for customer activity in derivative financial instruments is similar to its policy in respect of other credit, except for customer activity in the Ma'of market. The required security may be of different kinds. Furthermore, the Bank may grant the customer a credit line without security, as the case may be. Additional risk factors deriving from transactions of the Bank in derivative financial instruments, is the market liquidity risk resulting from the fact that it is not always possible to eliminate the exposure swiftly, particularly in low trading markets.

The Bank continuously monitors the credit risk inherent the derivative financial instrument activity of major customers.

In 2007 the Bank integrated a system for monitoring credit exposure relating to the activity of principal customers in derivative financial instruments, in the field of foreign currency. Considering that the derivative financial instrument activity also involves operational risks, the Board of Directors approves a monetary framework for each of these instruments in addition to other limitations (such as stress tests) applying to the activity in specific instruments.

(6) SHARES POSITION IN THE BANK'S PORTFOLIO

Within the framework of the policy for the diversification of investments, the Bank acts in two principal areas:

- Private equity funds, venture capital funds and a fund of hedge funds;
- Direct investments in companies considered as non-financial investments.

For details as to the investment policy and the entities in which the Bank invests, see "Non-financial companies sub-segment" under "Activity of the group according to principal segments of operation".

Following is the composition of the available-for-sale share portfolio - consolidated:

As at December 31, 2007			
in NIS millions			
	Marketable	Non-marketable	Total
Cost	571	*905	1,476
Adjustment to fair value	284	-	284
Fair value	855	905	1,760
Market value	875	-	

* Including an investment in the original amount of NIS 407 million in a fund of hedge funds. Since the date of this investment its fair value has diminished by NIS 44 million. Since this impairment is not of a temporary nature, the said amount has been recognized in the statement of income.

(7) 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.

Whereas this is a situation of uncertainty where a liquidity risk always exists, the Bank has determined the maximum exposure to liquidity risk that it is ready to accept. The current measurement of the exposure to liquidity risk is intended to provide decision makers with indicators that forewarn the intensification of this risk, allowing the Bank a period of time in which it may counteract the risk without having to sustain material losses.

Liquidity risk management. 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. This model was approved by the Board of Directors and is updated periodically.

The model is based, among other things, on the following principles:

- Separation between short-term and long-term liquidity;
- Separate management of the liquidity risks in the shekel segment (including CPI linked and foreign currency linked) and in the foreign currency and foreign currency linked segment;
- Differentiation between depositors according to behavioral pattern;

The banking subsidiaries in Israel also manage their liquidity risk in accordance with the requirements of Proper Banking Management Directive No. 342.

In the internal model, the Bank classifies its assets and liabilities in accordance with the maturity period on an economic basis, while adjusting assets and liabilities, as follows:

- Assets serving as a reliable source of cash inflow are added to the balance of assets in the maturity period.
- Payments that would bring the balance of liabilities to the amount expected to be redeemed, based on estimate of the Bank, are added or deducted from the balance of liabilities.

The parameters for the classification of assets are based on the assessments of the Bank regarding the quality of borrowers, on the Bank's policy and trends in the financial markets, and the classification of liabilities is based on the rate of recycling according to historical series. In determining the parameters, the Bank takes into account the possible implications on liquidity of other risks, including credit risks, market risks and operational risks. The Bank also takes into account the Bank's goodwill and rating, size of the marketable securities portfolio and its spread, the size of the market and volatility of prices, the structure and spread of deposits, and the effect of flows that are not taken into account in computing the liquidity.

Limitations on the exposure to liquidity risks. The limitations determined by the Supervisor of Banks prescribe that the total liquidity resources should not fall below possible liquidity requirements (under an extreme scenario). During 2007, the Bank complied with the limitations on exposure to liquidity risks. The Bank has recently determined a limitation on liquidity gaps based on division to sub periods as defined in the Bank of Israel instruction.

As part of the preparations with respect to the possibility of an exceptional situation and as part of the requirement of Proper Banking Management Directive No. 342, the Bank formulated a contingency plan, which defines the strategy for the management of a liquidity crisis, the management team responsible for handling such a crisis, and the procedures and actions to be implemented by the Bank in handling the crisis. In addition, a number of indicators were defined as an alert against exceptional growth in the liquidity risk (KRI's).

(8) MAIN CHANGES IN EXPOSURE POLICY AND RISK MANAGEMENT PROCEDURES

The principal changes that occurred in 2007 in the Bank's exposure policy and in its risk management procedures are as follows:

- The Board of Directors of the Bank has approved a significant increase in the limitations on the volume of operations in derivative financial instruments. This, in continuation to the significant growth in the Bank's operations in these financial instruments, principally interest rate instruments. Concurrently, the Bank has approved the adaptation of the operating and control systems as preparations made for the said growth in operations.

- The Bank has decided to vary its “nostro” investments and to gradually divert a part of its investments in government bonds to corporation bonds and to externally managed investments.

MEANS OF CONTROL AND APPLICATION OF THE POLICY

(1) RISK MANAGEMENT OBJECTIVES AND POLICY

The risk management policy is designed to increase profit expectancy as part of the means of attaining the business goals set by the Bank, while maintaining an approved and controlled risk level.

The market risk management issues, which among other things include the policy, exposure and authorizations determined for their management and the nature of their monitoring and control, are tabled once every quarter for discussion and approval by the Board of Directors within the framework of the exposure document. This document also relates to additional classes of risk at the Bank and at its principal subsidiaries. Furthermore, the Risk management Committee of the Board supervises, among other things, the market and liquidity risks management at the Bank, including the examination of various issues which arise from time to time, such as: the implementation of new proper banking management directives published by the Bank of Israel, the determination of new limitations, and suchlike. During the year, the Board of Directors and its Risk Management Committee discussed various issues relating to risk management.

(2) THE STRUCTURE AND ORGANIZATION OF THE RISK MANAGEMENT FUNCTION

A Risk Managers Committee, headed by the Bank's Risk Manager, operates with the Bank. In 2007 the Bank has also established a Risk Management Department as part of the Finance Division.

A Risk Management Committee of the Board of Directives operates within the framework of the Board of Directors' operations.

Authority and responsibility in respect of risk management is designated to specific Bank entities. The highest forum for risk management in the Bank is the Asset and Liability Management Committee headed by the Bank's President and CEO which convenes once a month. Market and liquidity risk management policy is discussed, reported and controlled within the framework of this Committee, subject to limitations and guidelines determined by the Board.

A financial forum headed by the Head of the Finance Division is responsible for the current risk management. The Bank's exposure to market risk is reviewed and discussed at the weekly forum's meetings. The forum implements decisions regarding the risk to which the Bank may be exposed in the short term, subject to guidelines determined by the Asset and Liability Management Committee.

(3) HEDGING POLICY AND POLICY EFFECTIVENESS MONITORING PROCEDURES

The Bank's policy as regards market risks management is based on the management of exposure to market risks, within the framework of quantity active limitations determined with respect to such exposure.

The means used for compliance with the determined limitations include:

- The purchase and sale of marketable instruments in all linkage segments (mainly securities for various periods);
- Investment in and raising of non-marketable financial instruments (mainly deposits by banks and large customers)
- Activity in derivative financial instruments with banks and large customers.

- (4) INTERNAL CONTROL MECHANISM REGARDING THE PREVENTION OF DEVIATION FROM THE POLICY OF EXPOSURE TO MARKET AND LIQUIDITY RISKS AND ITS MANAGEMENT**
- The Bank operates control mechanisms for the prevention of deviation from the market and liquidity risks management policy. The Bank's procedures requires those who accept the risk and the control factors to report to the Head of the Finance Division in respect of any exceptional events, e.g. loss exceeding the predetermined limit.
- The risk management department in the Finance Division reports weekly to the Risk Manager and to the various forums for market and liquidity risk management, regarding the Bank's exposure to market risk and its compliance with limitations.
- The Middle Office unit of the Finance Division performs a general control over the trading activity of the dealing room, including a measurement and independent reporting of income and compliance with determined risk limitations.

Any deviation from the limits is reported to the Market and Liquidity Risk Manager.

The Risk Manager and the Internal Auditor monitor independently the risk management process in order to identify and draw attention to any failures in risk management and deviations from the determined policy.

No deviations in the implementation of the determined policy were recorded during 2007, except for several pinpoint deviations of the dealing room, for short periods of time.

- (5) MANAGEMENT OF POSITIONS IN THE TRADING PORTFOLIO**
- Limitations on trading activities are defined in the framework of Board procedures. The limitations relate to portfolio size, types of risks to which the Bank may be exposed, the permitted instruments, factors of management and control etc.

The trading activity is conducted while measuring, on a daily basis, the compliance with limitations by the person managing the portfolio as well as daily control of compliance with the limitations and of the profitability performed by a control entity.

MEASUREMENT OF MARKET AND LIQUIDITY RISKS

(1) THE VALUE AT RISK (VAR)

General. As detailed above, the Bank implements various measures to manage exposure to market risks, in addition to the probability model - the VaR model. This model is compatible with directives for risk management issued by the Supervisor of Banks. The VaR comprises a principal indicator to the extent of the Bank's exposure to market risks. An analysis of its results and examination of changes therein over time allow management to obtain information as to the market risk level inherent in the overall activities of the Bank.

The Bank is required to manage the exposure to market risk by means of an information system based on an internal model, which enables a current measurement of the Bank's overall exposure to market risk by assessing the VAR. 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 nature and scope of the risk reporting and measurement systems. The VaR computation (at the Bank's level) is made, on a weekly basis, by the Iris/Riskpro system. The Riskpro System serves as a financial data base in which the financial data required for risk management assembles and which relates to the variety of financial instruments transacted by the Bank, including embedded options as well as to market data (such as indices, exchange rates and interest rates), their extent of volatility and the statistical correlation between them as well as financial and behavioral models. By using the system, the VaR is computed on the overall activity of the Bank and on operations/portfolios, similarly additional risk indices and simulations are carried out and the limitations on interest rate exposure are measured.

The VaR is computed by a parametrical model based on the historical behavior of the various market risk factors in the period preceding the computation (one year) and on the assumption that the changes in parameters are normally divided. The computation regarding the entire Bank is performed on a weekly basis and on a daily basis regarding the trading activity.

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.

	2007				2006			
	At year end	Yearly average	Maximum	Minimum	At year end	Yearly average	Maximum	Minimum
Estimate of VaR amount								
(in NIS millions)	98	77 ⁽¹⁾	171	33	44	66	89	34

Footnote:

(1) The VaR assessment at the end of 2007 for a single day's range was NIS 30 million.

The VaR measurement results show that most of the exposure to market risks stems from exposure to interest rate risk found in the CPI linked and the non-linked Shekel segments.

The weight of the VaR in relation to the shareholders' equity of the Bank as of December 31, 2007, is 1.06%, compared with 0.6% at the end of 2006.

In addition to the weekly parametric measurement, the VaR is also assessed monthly by the historic simulation method, and the two methods of measurement are compared. The historic simulation enables measurement of the risk without reliance on a specific probability structure.

The VaR relating to the option portfolio is tested both by the parametric model and by the VaR computed by the "Monte Carlo" simulation (in order to reflect the non-linear risk components). The resulting difference between the two methods is immaterial.

Back Testing. The VaR model, as a statistical model, requires concurrent testing of the reliability of its forecasts, through post factum measurement (Back Testing). This test computes the actual change in the economic value of the Bank. The validity of the model is tested according to quantitative deviation of the loss amount from the VaR estimate. The tests that have been implemented to date confirm the model's validity.

Limitations of the VaR model. As stated, the VaR constitutes a statistical tool that bases assessment of the value at risk on previous market performance and on assumptions regarding future cash flow performance. The limitations of the model are sourced in:

- The model assumes that the changes in risk factors are divided normally. While this assumption is required for approximation purposes, it does not necessarily reflect market performance;
- The computation of the VaR for a holding period of ten days assumes that the positions are realizable or could be terminated within that period. In certain market circumstances such an assumption may not materialize and the loss would be greater;
- Utilization of a significance level of 99% disregards losses that may be realized beyond this level of significance (end distribution);
- Utilization of historical data may not include extraordinary events in the sample.

Accordingly, the VaR does not assess a loss that may occur in such circumstances and its results should not be treated as a real loss barrier, which the Bank might sustain in extreme scenarios. A more appropriate assessment may be obtained through examination of the potential loss in an extreme scenario (as detailed below).

(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 (e.g. war, political upheaval, natural disaster, etc.) 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. The risk management process is intended, inter alia, to protect the Bank from an extreme loss that may be incurred as a result of such events. 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 Bank has established a stress test forum that examines extreme scenarios, at least once every quarter. The Bank's Market and Liquidity Risk Manager chairs the forum, while its members include the Chief Economist and representatives of the ALM, the risk evaluation and the dealing room departments. In the forum meetings, the results of defined scenarios are reviewed and their effect on the portfolio of the Bank are examined. The forum also sets additional extreme scenarios which ought to be examined. The limitation on the maximum economic loss in the event of extreme scenarios determines that the decrease in the economic value of the equity should not exceed 12.5% of the Bank's equity. During 2007, the Bank complied with this limitation.

(3) THE NET INTEREST INCOME (NII) MODEL AND THE EARNINGS AT RISK (EAR)

In addition to a sensitivity test of the economic value of the equity, the Bank examines the impact of defined changes in interest rates on interest income. This examination is implemented through dynamic simulation of the net interest income for the coming year, in order to test the impact of various strategies for asset and liability management on the Bank's future interest income. The EAR index measures the sensitivity of interest income to changes in market yield.

**(4) BEHAVIORAL
ASSUMPTIONS APPLIED
IN THE ASSESSMENT OF
MARKET AND
LIQUIDITY RISKS**

Premature redemptions of savings deposits model. In evaluating the exposure to interest rate and liquidity risks, the Bank addresses the possibility of premature withdrawal of funds from savings deposits ("breaking of a deposit"). The Bank's assessment is based upon historical data at its disposal. For the purpose of the model, savings deposits at the Bank were classified into several groups having similar behavior patterns, and a forecast model was established by using a decay factor that grants a higher weight to subsequent observations. The rates of premature withdrawal are computed as from the end of the first two years of the period of the deposit and at each "exit point" until the end of the deposit period.

Background assumptions on which the model is based:

- A relationship exists between the age of the savings deposit and the rate of early withdrawals;
- The rate of early withdrawals may be estimated by examining withdrawals in recent years;
- The Bank utilizes a compensating mechanism in cases of early withdrawals not at predetermined "exit points" ("breaking of a savings deposit").

The average maturity of total liabilities, taking into account the above assumptions, is 4.32 years, lower than the average maturity according to the initial cash flow from savings deposits, which is 4.43 years. The internal rate of return margin, taking into account the above mentioned assumptions, is 0.63%, compared with an internal rate of return margin of 0.52% according to the original cash flow.

The internal rate of return and average maturing not including the assumption of premature redemption of savings deposits:

	December 31, 2007			December 31, 2006		
	Non-linked	CPI linked	Foreign currency	Non-linked	Foreign currency	CPI linked
Internal rate of return (in percentages)						
Assets	5.97	4.91	4.99	5.06	5.11	5.09
Liabilities	2.98	4.39	3.29	2.10	4.49	3.48
Average maturity (in years)						
Assets	0.84	4.15	0.24	0.68	3.82	0.28
Liabilities	0.45	4.43	0.21	0.28	4.39	0.23

Creditary current accounts spread model. Schedule "D" hereunder presents current account balances according to Bank of Israel directives as deposits on demand and up to one month. However, for purposes of assessing the exposure to liquidity risks, the Bank assumes that a significant part of current account balances is not expected to be withdrawn immediately and is distributed over periods of one to seven years, in accordance with behavioral assumptions that are updated from time to time. In accordance with these assumptions, the average maturity of liabilities in the non-linked segment is higher and reaches 0.67 years, compared with 0.45 years for the initial cash flow. The internal rate of return margin is 3.90% compared with the internal rate of return margin of 2.99% according to the initial cash flow.

**(5) THE STANDARD
APPROACH TO THE
ALLOCATION OF
CAPITAL TO MARKET
RISKS**

The Bank computes the capital allocation required in respect of the exposure to market risks in accordance with the standard approach, as prescribed by Proper Banking Management Directive No. 341. The allocation of capital to market risks is done as follows:

- Interest rate and shares risk - allocation in respect of the portfolios managed at the Bank for trading purposes, including the overall operations of the dealing room;
- Foreign exchange rate and inflation risk - allocation in respect of the overall activity of the Bank;
- Option risks - allocation in respect of the Bank's overall activity, including embedded options.

Following are details of capital allocation to market risks according to the standard approach:

Capital allocation as of December 31,		
	2007	2006
In NIS millions		
The Bank: Interest rate risk	109	60
Foreign exchange rate and inflation risk	17	44
Share risk	-	-
Option risk	44	7
Total for the Bank	170	110
Total for subsidiary companies	21	38
Total for the banking Group	191	148
Allocation in risk terms	2,126	1,649

The allocation to market risks in risk asset terms comprises 1.7% of the total risk assets as of December 31, 2007.

**CREDIT RISK
MANAGEMENT
POLICY**

General. The Bank's credit management policy includes the credit policy as well as procedures and work processes that define the authorization principles at the Bank and the management and control of the existing credit portfolio. The procedures define the granting of credit authority, areas of responsibility, the ranking of the credit committees, approval and control procedures, required collateral and the monitoring of credit portfolios.

The role of all of these is to secure an appropriate management of the Bank's credit portfolio, reducing to the extent possible of the credit risk.

The procedures for the treatment of credit, collateral and the relevant information systems are being updated on a current basis, with a view of improving the credit management.

The Bank makes ongoing use of analysis and control tools, with the objective of identifying quality borrowers and locating, as early as possible, borrowers who might become problematic.

For details regarding the Bank's credit policy, see "Credit to the public" under "Developments of assets and liabilities".

Credit authorization procedures. The Bank has determined credit authorization ranking for managers and for the various credit committees, going up to the Board of Directors. According to the Board's

procedures, credit requests by the Bank's customers are directed to the credit committees based on the volume of the customer's credit facility or of the group of borrowers to which he belongs.

The Bank's credit committees discuss and take decisions on credit matters relating both to new credit applications and existing indebtedness at routine and periodic meetings.

Considerations for the granting of credit to a business customer are based mainly on the quality of the customer, prior experience with him, his repayment ability, financial stability, business position, business management ability and the quality of the collateral.

The consumer credit at the Bank is typified by relatively small amounts widely distributed. The methodology and procedures for examining credit applications of private customers is directed more at focusing on the acquaintance with the customer, on socio-economic parameters and on his financial stability, in addition to an examination of the collateral.

A structured process of authorizing credit applications exists at the Bank. Following a loan application by the customer an authorization process begins which includes referring the application to the relevant credit committee based on the scope of the customer's credit facility or of the group of borrowers to which he belongs.

The process of handling and authorizing a credit application is made up of several stages and includes:

- Application by the customer to the Bank for the granting of credit;
- Definition of the customer's needs and examination of the substance future of the customer's operations;
- Discussions with the customer with a view of obtaining indications as to the terms of the credit and the customer's repayment ability;
- Examining the reasonableness of the application by authorized officers having experience at the Bank as part of the process of handling the application;
- An economic and business analysis of the customer in order to identify and evaluate credit risks existing in the operations of the customer;
- Discussion by the credit committee - the committee considers whether authorization of the credit reflects the taking of a reasonable risk on the part of the Bank alongside appropriate return and profitability.

Emphasis is put on a quick examination of the credit application and on providing a prompt response to the customer. In addition, overall financing packages are offered, which the Bank endeavors to adapt to the particular customer needs.

The current discussions at the credit committees are held at intervals prescribed in the work procedures. Preparation and updating the customer follow-up files are made prior to the meetings. As part of the discussions, developments and principal changes in the business situation of the borrower are reviewed, including compliance with the credit terms, changes in profitability of the credit, the customer's financial position and his indebtedness rating.

Organizational change of the credit risk management function. The Bank is preparing for the implementation of the Basel II guidelines, a process that requires organizational and infrastructural changes:

- The establishment of a risk management department at the Finance Division (ERM), which includes, among other things, the subject of credit risk management. The unit is to engage,

among other things, in the development of models for credit risk assessment, formation of a general policy for credit risk management and the development of data base in the risk management field;

- As part of the implementation of the Basel II guidelines regarding credit risk management, the guidelines, among other things, provide that the entity taking the risk should be separate from that managing the risk. In the course of 2007, with the cooperation of an international consulting company main points were drawn up, outlining the credit risk management process of the Corporate Banking Division. Within this framework, a unit responsible for the implementation of Basel II guidelines will be established within the Corporate Banking Division, a unit which is intended to become a credit supporting unit. This unit will be responsible, among other things, for validating and ratifying credit deviating from the current credit policy, in accordance with defined criteria, such as: the type of transaction, its volume, price, etc. In addition, the unit will be responsible for the credit policy aspects, adaptation of credit procedures, participation in the development of models, definition of requirements regarding information systems, and so forth.

REDUCING CREDIT RISK

Processes and tools for reducing credit risk:

- Methodology and procedures exist that relate to the manner of preparing credit applications and the financial analysis of the borrower's position. Various methods developed by the Bank exist for evaluating the borrowers' loan repayment ability and for evaluating credit reasonableness. The methods are adapted to the customer type and structure of the transaction;
- Credit applications undergo economic and business analysis focusing on identifying and evaluating credit risks existing in the borrower's activity;
- Ongoing analysis is performed of up to date financial statements of the Bank's business customers as well as the ongoing monitoring of their financial position;
- Financial rating of business customers and rating of their debt - the Bank has developed a financial and statistical rating model based on financial statements and on financial ratios reflected in such statements.

In addition, the Bank has developed a model for debt rating, which evaluates the quality of the debt by way of uniform criteria adjusted to the various segments and which relates to industry risk, activity, business environment, organizational-managerial risks, compliance with credit terms, volume and quality of the collateral and various financial indices.

The rating is used for evaluating the risk level of a specific borrower, comparing him with other borrowers in the industry as well as monitoring at various profiles developments in the Bank's credit risk level over time.

Bank customers are periodically rated by both financial and indebtedness rating.

According to the Bank of Israel's instructions, all customers having an indebtedness of over NIS 400 thousand, are to be rated at least twice yearly by the indebtedness rating model.

As of December 31, 2007, some 94% of the indebtedness to be rated (before provision for doubtful debts) according to the instruction of the Bank of Israel has been rated.

A new financial rating model compatible with the requirements of Basel II is in its early stages of development;

- Bank personnel at all levels engaged in the credit field undergo training and instruction in order to maintain and update the existing know-how and the staff's professional level.

Collateral management and evaluation - policies and procedures. The Bank provides credit to customers against collateral of various kinds, including: liquid assets, fixed assets, pledges and various types of guarantees.

The scope and quality of the collateral is derived from the level of credit risk, so that in certain cases, such as: a borrower having a high indebtedness rating, a reliable borrower, it is possible to grant credit with no collateral and/or covenants by the borrower.

To the extent possible, the collateral matches the credit it secures from the aspects of length of period of the credit, currency of the loan, one-off or renewable credit.

The collateral management policy and the determination of its value for purpose of security are based on principles and rules determined within the framework of the Bank's procedures for the granting of credit.

Detailed procedures exist for collateral management and for determining the value for security purposes of different assets in accordance with the nature of the asset.

The rate of coverage of the debt by the collateral is adjusted to the character of the borrower, his financial position and the sector of activity and industry in which he operates.

As a condition for reliance on a material security, the Bank requires an insurance policy in respect thereof.

The determination of the value for security purposes of various collaterals is derived from their nature, their quality and the availability of their speedy realization, including changes in their value due to slowdown or growth situations in the business environment of the borrowers.

Likewise, maximum reliance rates for security purposes have been fixed in accordance with the type of the asset so as to reduce the risk in case of realization of the security.

The collateral is periodically appraised by the Bank's economists. The value for security purposes is assessed by the economists by determining the value of the asset and the appropriate reliance rate, not to exceed the maximum rate set in the procedure. The principal collaterals accepted by the Bank are:

- Mortgages and pledges on property rights;
- Fixed pledge on fixed assets, including motor vehicles, machines and equipment;
- Pledging deposits and savings deposits;
- Marketable commercial papers including: credit card slips, documentary credits, fixed pledge on equity and debt securities;
- Floating pledge on the assets of the borrower;
- Various guarantees: personal guarantees of shareholders or other interested parties in the borrower, guarantee by a corporation, owners' guarantee or third party guarantee, guarantees of various banks in Israel and overseas, State guarantee and guarantee of a foreign trade risks insurance company.

Assessment of the value of property as security for credit is performed by the real-estate assessors department of the Bank and/or by independent certified assessors, when an up-to-date assessment is required in accordance with the period of reliance specified by the Bank's procedures.

Bank procedures also determine guidelines for assessment of the floating pledge, frequency of updating the value of the floating pledge, the rates of reliance on the various assets and calculation of the Bank's share of the pledge. Registration of a floating pledge is based upon up-to-date information, familiarity with the activity of the borrower, the nature of the active assets and the availability of their realization. In the event that the information available for evaluating the floating pledge is insufficient, the Bank reduces the reliance rates accordingly.

The value of marketable securities is determined according to their market value, the rate of reliance thereon for security purposes being determined by the Bank's securities department.

Where transactions for the acquisition of means of control are involved, assessment is performed of the value of the shares to be acquired in the transaction based on the value of the transaction, market value or independent valuation.

In some of the cases financial covenants are included as security for the loan. Compliance with the covenants is examined periodically, their violation constituting a cause for demanding the immediate repayment of the loan or the augmentation of the collateral.

Reducing the risk in respect of concentration of credit. Spreading of the credit risk is reached, among other things, by the spreading of the credit portfolio over a large number of borrowers/groups of borrowers in various economic sectors and industries. In order to reduce the credit risk, the Bank monitors on an ongoing basis the concentration of the credit portfolio and is taking action to reduce concentration. In this framework, the Bank assesses the risk level of the various sectors. According to the Bank of Israel instructions, the Bank prepares on a quarterly basis an exposure document that discusses the exposure existing in the banking corporation. The document describes, among other things, the overall credit risks, to which the Bank is exposed, compliance with the Bank of Israel limitations as well as internal limitations relating to exposure and reporting for follow-up and control purposes. The exposure document is presented to Management and to the Bank's Board of Directors.

The exposure document addresses the following exposures: exposure to linkage segments, exposure to operating segments, exposure to economic sectors, and exposure to large borrowers/groups of borrowers. In addition the quality of the credit portfolio is examined based on the division of the indebtedness rating of the borrowers, the scope of the problematic debt and the expense for provision for doubtful debts.

Reducing the credit risk in respect of the concentration of borrowers/groups of borrowers - the Bank performs an ongoing follow-up of the situation of large borrowers/the six large borrower groups and compliance with the Bank of Israel limitations.

In addition, the Bank discusses each borrower group periodically and establishes internal limitations for each borrower group.

The Bank complies with the Bank of Israel limitations and with internal limitations in respect of a single borrower and in respect of the six large borrower groups.

The Bank performs surveys of borrower groups in order to assess the credit risk at the group's level. The increase in weight of medium and small borrowers, including credit to private customers, in the total credit portfolio contributes to the spread and to the reduction of concentration in the credit portfolio. Reduction in credit risk in respect of concentration according to economic sectors - The Bank performs industry surveys of various economic sectors as well as current surveys of the situation of the economic sectors in Israel in order to evaluate the credit risk at the industry level. In accordance therewith the Bank determines the policy regarding credit exposure to the various economic sectors, and a follow-up of this exposure is carried out in the credit exposure document. Within the framework of the individual application for credit, an analysis of the economic sector of the borrower is performed and it is examined whether the application is in line with the credit policy according to economic sectors.

The Bank complies with the Bank of Israel limitations and with internal limitations in respect of economic sectors, including the specific limitations regarding the real-estate industry.

Reduction in exposure to exchange rate risks - The Bank is preparing for the minimization of possible changes in the exchange rate of the Shekel as against foreign currencies, among other things, by way of testing the sensitivity of borrowers in foreign currency to changes in the exchange rate. Regarding borrowers defined as being highly exposed, the Bank is taking steps to reduce the exposure by way of increasing the collateral and demanding hedging transactions.

A computer model exists allowing the production of an aggregate report regarding customers who are sensitive to changes in the exchange rate.

Credit risk reporting and measurement systems. The Bank has a computerized system for the management of credit facilities and management of customer debts, which also allows for the monitoring of the scope of the credit portfolio according to the various distributions. The system covers all Bank customers having indebtedness of over NIS 400 thousand.

In addition there is a computerized system for the analysis of financial statements. The system covers financial statements of Bank customers having an indebtedness of over NIS 1 million. The system enables the loading and analysis of financial statements of corporations showing comparative data for prior years. The system produces a wide mix of financial ratios on a multi-year basis. A financial rating of the borrower is obtained from the borrower's financial statements data and the related financial ratios.

The Bank is in the midst of a process of integration of the credit risk management computerized system in accordance with the Basel II requirements.

Credit control systems. A current review of credit portfolios is performed from time to time. This includes an examination of the implementation of decisions taken by credit committees, including documents relating to credit transactions (loan agreements, documents of pledge, compliance with financial covenants, availability of current reporting by the customer, etc.).

The business control unit at the Corporate Banking Division is engaged in the daily monitoring of deviations from credit terms and development of signs indicating a problematic debt.

The Bank has a credit control unit subordinated to the Chairman of the Board, which monitors and performs a periodic evaluation of the propriety of credit management, of the credit risk level granted to customers, evaluations of the reliability of the indebtedness rating and the evaluation of the quality of collateral. The credit control covers 45% of the total credit to the public under a three-year work plan. In addition credit portfolio sample test checks are being performed by the Internal Audit Department. These tests cover 10% of the total credit portfolio of the Bank. The Internal Audit examines procedures authorizing the granting of credit, credit management, customer loan portfolios as well as the compliance of work procedures with the procedures set out by the Bank. In addition the Internal Audit performs across the board examinations of credit matters.

Treatment of problematic debts. The Bank has a unit engaged in handling problematic debts of business customers. The unit operates teams of business managers responsible for the control, monitoring and the current handling of borrowers defined as problematic, this with a view of reaching collection arrangements and improved debt repayment and/or the realization of the collateral for the maximum consideration for the Bank.

The Bank takes action to reduce the problematic debt and the non-income producing credit, while continuing the intensive activity of improving the credit portfolio, focusing and improving the debt collection operations and debt arrangements. The Bank establishes goals for the reduction of non-income producing debt and for the reduction in the provision for doubtful debts.

The Bank runs the Debt Collection Department that handles problem debt portfolios forwarded for treatment by the business functions at the Retail Division. The Bank engages external law offices for this purpose. Their activity is controlled and supervised by the Debt Collection Wing with the objective of maximizing to the extent possible the collection of problematic borrower debts.

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 in respect of these transactions, including the procedures required to close off the exposure as regards the transaction and the customer.

Exposure related to credit risk of the counterparty

Exposure related to credit risk of the counterparty						
December 31, 2007						
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts	Total
	Shekel/CPI	Other				
in NIS millions						
Positive gross fair value of derivative instruments	11	380	1,244	180	21	1,836
Net of set-off agreements	-	-	147	17	-	164
Net credit exposure	11	380	1,097	163	21	1,672

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 agree with 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 credit risks 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:

- Tier 1 - minimum capital requirements - its objective is to expand and improve the measurement framework for computing the minimal capital requirements.
- Tier 2 - includes the addressing of risks not included in Tier 1, as well as: addressing stress tests; adaptation of the Bank's managerial structure to the risk management requirements of Basel II, an internal process of evaluating the adequacy of the capital allocated to risks (ICAAP -Internal Capital Adequacy Assessment Process); the supervisory review process.
- Tier 3 - Fair disclosure and market discipline by means of wider disclosure than in the past of risks to which the Bank is exposed. The information would be both qualitative and quantitative and would allow the market to evaluate the Bank's risk profile.

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, whereas the capital requirement with respect to operational risks, according to the basic indicator approach, required for the first time by Basel II, relates to gross income.

The Supervisor of Banks informed that as from the end of 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. Already during the year 2009 banking corporations would be required to submit to the Supervisor of Banks quarterly reports also according to the standard Basel II approach.

Concurrently with the publication of the said directive, the Supervisor of Banks issued drafts for discussion of Basel II issues, which include the Supervisor's preliminary positions on various issues as well as a draft directive that includes the suggested stages for the adoption of the disclosure requirements included in the third layer of Basel II in the public reporting directive.

Preparations of the Bank for the implementation of the requirements of Basel II. A supreme group steering committee headed by the President and CEO of the Bank with the participation of

senior officers of the Discount Group is leading the Bank's and the Group's preparations for the implementation of the Basel II requirements.

The Risk Management Committee of the Bank is in charge of the Bank's preparations. The Bank is assisted by Israeli and foreign consulting services in order to advance its preparations. The Bank participates in discussions and in working teams held by the Bank of Israel in the matter of the Basel II guidelines and their adaptation.

In the course of 2006 the Bank has completed the first stage, which included the formation of an appropriate risk management strategy, a comprehensive gap analysis and the preparation of a project program.

In 2007 the second stage of the preparations continued, focusing on the definition of risk governance issues, including the definition of the appropriate organizational structure for enterprise risk management (ERM), risk management charter, determination of a framework for policy documentation, regarding risk management. This being part of the Bank's preparations for the implementation of the requirements of the Tier II of Basel II.

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, including the mapping and planning of the required computer system activities, and the selection of a designated information system that would serve the Bank in the implementation of the three tiers of Basel II.

According to the Bank's assessment, the preparation taken as a whole would require the investment of considerable resources. Changes and adjustments will be required, inter alia in work procedures and infrastructure systems, and 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. The Bank is also examining its preparedness for the development of models required for advanced approaches.

The Bank has also begun preparations for the implementation of Tier II, defining a suitable and overall organizational structure for handling risks.

OPERATIONAL RISKS

General background. 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. The Discount Group offers its customers a wide range of financial services, starting with banking products such as deposits and commercial loans, continuing with foreign currency services, securities services, advisory and distribution services for pension plans, and ending with investment portfolio management, underwriting services, mortgage loans and so forth. Realizing that a sizable operational risk is inherent in such a wide range of services and banking operations provided by the Bank and its subsidiaries, their endeavors to minimize the exposure to operational risk.

Within this framework, the Bank seeks to arrive at a wide reporting of events, also including events where the Bank has not sustained any direct monetary. The Bank has also established a wide and comprehensive data base of failure events, enabling the creation of a risk map, analysis

of the reasons for these failure events and the handling of the risk centers to be identified, the formation of risk indicators, that will allow in the future, the use of advanced models for the assessment of operational risks.

Organizational structure of the operational risk management function. Within the framework of the preparations for the implementation of the Basel II guidelines, the Bank began in the course of 2007, to implement an organizational change process in the field of risk management, with the professional assistance of an international consulting company. During the last quarter of 2007, the operational risk management department was transferred from the Operations and Information Systems Division to the Risk Management Department in the Finance Division.

Until the said transfer, the Operational Risk Manager was responsible for the Bank as a whole. In the last quarter of 2007, it was decided that each division or layout head at the Bank would be responsible for the management of operational risks in the areas of operations under his control. For this purpose, the designation of risk management functions in the divisions and layouts of the bank is planned for 2008, the task of which will include assistance to the heads of divisions and layouts in managing operational risks, cooperation with the Risk Management Department and reporting to it. The Risk Management Department, which is subject to the Chief Risk Manager, is in charge of formulating the operational risk management policy as well as of the implementation of this policy, of the analysis of operational risks at the Bank and reporting the results to the Risk Managers Committee and to the Board of Directors.

This structure of risk management enables the separation between those who take the risks at the various divisions and layouts and those who directly create the exposure to the risk and manage it, and those who engage in formulating the policy, the methodology, the development of tools to implement the methodology, and analysis and reporting processes. Concurrently, the control entities - risk controllers, internal audit and compliance officer are independent entities who report directly to Management or to the Board of Directors.

The subsidiary companies are to formulate an organizational structure to support the management of their operational risks along the same lines mutatis mutandis. Such an organizational structure will enable an efficient and optimal overall Group management of the operational risks in the Group.

Operational risk management policy. During 2004, an operational risk management policy was formulated and approved by the Board of Directors. Within the framework of the preparations for Basel II, a process of updating this policy has recently begun.

The existing policy states as follows:

- The Board of Directors and Management are to formulate core principles in the field of operational risk management, while solidifying and strengthening the operational risk management layout;
- The Chief Risk Manager is responsible for the formation of working instruments and evaluation and assessment systems of the operational risk, in order to create an effective, active and quality operational risk management at the Bank and at the Group level. The Chief Risk Manager is also responsible for reporting to Management and to the Board of Directors;

- In each division and layout, the functions taking the risk, starting with the lowest managerial level and up to the senior management level, are responsible for the risk and for its current management, through identifying the risk, evaluating its level, monitoring it, determining and implementing of plans to reduce the residual risk level, as well as the reporting to their superiors and to the Risk Management Department;
- The Risk Management Department is in charge of integrating an operational risk management layout Department the definition of optimal work processes and procedures in this field;
- The operational risk tolerance level shall be defined for the Bank and for the Group, taking into consideration operational failure events that occurred in Israel and elsewhere as forward looking indicators;
- The limitations on exposure to operational risks at the Bank and Group level are to be general with the objective of enabling efficient, responsible and cost conscious operational activity;
- Once in every period, an examination, analysis and evaluation of the operational risks and their potency is to be conducted in each risk center, taking into consideration material changes, such as: relevant regulatory instructions, economic and business conditions in Israel and elsewhere, organizational structures and processes at the Bank, information systems supporting the various processes, business or operational processes, the scope of operations at the Bank, technological tools, the implementation of control means, etc.

Operational risk survey. In the second half of 2007, the Bank launched an operational risk survey with the assistance of an external consulting company.

The survey includes the mapping of the overall business and operational processes at the Bank and at its subsidiaries. The basic inherent risks of each process and/or sub-process are being identified as well as their level and the existing controls in respect of each such risk. The integration between them enables a quality evaluation of the residual risk (low, moderate, high or very high).

Further on, plans for the reduction of high level residual risks are to be defined. These reduction plans are to include recommendations for new controls that reduce the probability for the realization of the risk and/or the volume of the loss that might be caused upon realization of a risk.

The survey is expected to be completed by the middle of 2008. At the end of the survey, the reviewed units are to implement risk reduction plans with the assistance of a technological system for operational risk management.

Upon conclusion of the survey, the Risk Management Department will report to Management and to the Board of Directors the principal and material risks that had been identified by the survey, at the Bank and Group levels, the level of such risks and plans for possible reduction thereof for the purpose of current monitoring.

Current management of operational risks. The Bank examines on a regular basis the exposure to operational risks as well as failure events that had occurred and applies controls to the various processes and improves its information systems.

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. The Bank collects the findings regarding these risks and the handling thereof, the formation of processes, design of procedures and the creation of routine reporting.

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” and in the legislation concerning local authorities). 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, as detailed in the section “Legislation and supervision” hereunder. 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), 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.

Procedures and supporting systems. 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.

Control and supervision. 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.

The internal audit constantly and continuously examines all areas of operation of the Bank. For details of the activities of the internal audit, see the section "The internal audit in the Group" below. The compliance officer is appointed according to Proper Banking Management Directive No. 308 with the object of assisting the board of directors and management in managing the responsibility for compliance with the instructions of the law and regulations in the consumer area. A compliance officer who reports directly to the President and CEO operates at the Bank under the Chief Legal Advisor. The compliance officer monitors the Bank's preparations for compliance with the law and regulations in the area of bank-customer relations ("consumer instructions"), including consumer instructions relating to the new activities of the Bank, as well as follows the correction of various deficiencies in the matter of compliance to consumer instructions. For the purpose of her work, the compliance officer is assisted by the coordination committee that meets once in every quarter. The compliance officer serves also as compliance officer of several subsidiaries of the Bank. The compliance officer submits periodic reports to the President and CEO, as well as an annual report to the board of directors. The banking subsidiaries in Israel have also appointed compliance officers in accordance with the said instruction.

The officer in charge of money laundering prohibition was appointed in accordance with the Prohibition of Money Laundering Law and related regulations, and coordinates the activity of the Bank in this respect and in respect of the prohibition of the financing of terror. The relevant subsidiaries in Israel have also appointed officers in charge of this issue as required by law. See "Prohibition of Money Laundering Law and Prohibition of the Financing of Terror Law" in the section "Legislation and supervision" below.

RISK FACTORS TABLE

Banking corporations in Israel are required to include in their report a table indicating risk factors, classified as follows, according to their impact on the business of the banking corporation: high impact, medium or low impact. This table relates to the risks at the level of the Bank (on a stand alone basis). Considerable difficulties exist in evaluating the risks and their impact. Evaluation of the effect of a risk requires assumptions regarding the intensity of the future event and the probability that such an event will in fact occur. Reliable implementation of such evaluation requires utilization of advanced mathematical models, which are usually not available at this stage.

Evaluation of risks and their impact, as presented in the following table, therefor, constitutes a subjective process implemented by the Bank's Management. For the purpose of this assessment, the effect of the risks was defined as follows:

- The effect was defined as high to the extent that the realization of the risk might cause a material damage to the Bank's operations;
- The effect was defined as moderate to the extent that the realization of the risk might affect the Bank's business goals;
- In all other cases the effect was defined as low.

In view with the above, utmost care should be taken in examination of risk factors and evaluation of their impact, and in comparison between banks.

RISK FACTORS TABLE

The risk	Risk factor impact	Risk description
1. Overall impact of credit risk	Medium	A risk of the impairment in the value of the Bank and its profitability as a result of a decline in the ability of borrowers to honor their obligations. The Bank reduces the risk by determining a credit policy and exposure limitations relating, among other things, to the type of borrowers, market sectors, segments of operation, collateral, credit control, etc.
1.1 Quality of borrowers	Medium	A risk of the impairment in the value of the Bank and its profitability and collateral risk as a result of the quality of borrowers being in effect poorer than previously estimated and/or the collateral provided by the borrowers having a lower value than previously assessed. The Bank reduces the risk, among other things, by way of monitoring and control over the borrowers, examination of the propriety and value of the collateral in accordance with the policy of collateral reliance, with adaptations to the credit policy of the Bank.
1.2 Industry concentration risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of a decline in the business activity of a particular sector of the economy. The Bank adopts a conservative policy as regards industry concentration of credit. The highest industry credit concentration at the Bank is in the construction and real-estate sector, in which the broad distribution of loans and the quality of borrowers and collateral reduce the risk.
1.3 Borrower/ groups of	Low	A risk of the impairment in the value of the Bank and its borrowers concentration risk profitability as a result of a decline in the business activity of a borrower/large group of borrowers. Directives of Bank of Israel determine limits for the concentration of indebtedness of borrowers and groups of borrowers. The Bank has not deviated from these limits and maintains ongoing control in this regard. The Bank analyses and monitors the activity and financial stability of the said borrowing groups.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk factor impact	Risk description
2. Overall impact market risks	Low	A risk of the impairment in the value of the Bank and of its profitability as a result of changes in various economic parameters that affect the value of the Bank's assets or its liabilities. The overall exposure to market risks, as assessed by the VaR model and various stress tests, is low in relation to the equity of the Bank, does not deviate from the exposure limits determined by the Board of Directors and is being controlled on a current basis.
2.1 Interest rate risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of future changes in interest rates and their possible impact on the present value of assets and liabilities of the Bank. The exposure to interest risk, which is assessed by means of accepted tools, is relatively low, does not deviate from the exposure limits and is controlled on a current basis.
2.2 Inflation rate risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of changes in inflation rates due to the difference between assets and liabilities, including the impact of future transactions. The Bank's exposure to inflation risk is not material in relation to its volume of operations and its shareholders' equity, does not deviate from the limits and is controlled on a current basis.
2.3 Exchange rate risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of exchange changes due to the difference between assets and liabilities, including the effect of future transactions. The Bank's exposure to exchange rate risk is not material in relation to its volume of operations and its shareholders' equity, does not deviate from the limits and is controlled on a current basis.
2.4 Share price risk	Low	A risk of the impairment in the Bank's value of the Bank and its profitability as a result of changes in the market price of securities held by the Bank. The Bank owns a considerable amount of securities held as an investment and not for trading. However, a decline in the value of such securities might impair the value of the Bank's equity.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk factor impact	Risk description
3. Liquidity risk	Low	A risk to the income and equity of the Bank resulting from the inability to provide for its liquidity requirements and/or an uncertainty existing as to the availability financial resources. The exposure, as measured by a model and additional indicators, is low, does not deviate from the limits and is controlled on a current basis.
4. Operating risk	Low	A risk of a loss deriving from deficient data processing systems, human error and the absence of proper control and examination procedures. Past experience shows that the realization of operational risks exposed the Bank to low to medium losses. The Bank monitors on an ongoing basis both the exposure to operational risks and the events of realization of such risks, applies controls regarding the various procedures and acts towards securing the survival and recovery abilities of which The Bank takes steps towards the full mapping and quantification of the overall operational risks.
4.1 Compliance risks	Low	Risks deriving from the non-compliance with legislative provisions, including regulatory provisions binding on a banking institution. The Bank operates ongoing monitoring and control tools, which are believed to reduce this risk.
5. Legal risk	Low	A risk of loss as a result of the inability to enforce compliance with an agreement by legal means. The Bank has not suffered material losses as a result of this risk and believes that the legal controls applied by it are appropriate.
6. Goodwill risk	Low	A risk for impairment in the business position of the Bank as a result of impairment in the Bank's image, resulting from various publications, whether correct or incorrect, in the eyes of customers, correspondent banks, investors, regulatory authorities and others. The Bank takes action to minimize this risk through ongoing supervision and control over the implementation of instructions and procedures as regards customers, suppliers and employees.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk factor impact	Risk description
Additional risks relevant to the Bank:		
7. Legislation risk	Low	Changes in legislation and regulatory developments which impose, among other things, restrictions on the activity of the Bank, which may affect its operating results, including the risk of retroactive legislation. The Bank believes that its monitoring of expected legislative changes and its preparations towards their implementation minimize this risk.
8. A political/security risk	Medium	A risk of the impairment in the value of the Bank and its profitability as a result of instability of the financial markets or impairment in the position of borrowers as a result of the political or security situations.

ACTIVITY OF THE GROUP ACCORDING TO PRINCIPAL SEGMENTS OF OPERATIONS GENERAL

Public reporting instructions. In December 2001, the Supervisor of Banks in Israel issued directives concerning segment information reporting in a banking corporation, which followed the approval of Accounting Standard No. 11 regarding segment reporting by the Israeli Accounting Standard Board and in view of the application abroad of accounting standards concerning segment information, and in particular the application of the US Accounting Standard (Disclosure about segments of an enterprise and related information) FAS 131, implementing certain modifications concerning the special characteristics of banking corporations, mostly on the basis of the disclosure prevalent in the US banking system.

According to the directives, a segment of operations is a component of a banking corporation having the following three characteristics:

- (a) Engaged in business activities that may produce income and bear expenses (including income and expenses deriving from transactions with other components of the same banking corporation);
- (b) The results of its operations are reviewed on a current basis by Management and the Board of Directors in order to make decisions as to the allocation of resources to the segment and evaluate its performance;
- (c) Separate financial information exists with regard to the segment.

In addition, the directives determine the disclosure requirements and the manner of presenting the financial results of segments in the financial statements.

The Supervisor of Banks clarified in January 2002, that he expects that a banking corporation heading a banking group would include disclosure as to the following segments: corporate banking, retail banking, middle market banking, private banking, real estate and construction, mortgages, credit card operations, capital market operations, non-financial companies.

In July 2005, the Supervisor of Banks published a “Questions and Answers” file in the matter of the disclosure of segment information. The issued circular clarified that the answers appearing in the said file were to be regarded as a Statement of Opinion (SOP) of the Supervisor of Banks’ staff regarding guidelines for implementation so long as the Supervisor of Banks has not issued Directives in the matter.

In the said file the number of segments that would require disclosure in the relevant note to the financial statements were, among other things, reduced to the following: Households, Private Banking, Small Businesses, Middle Market Banking, Corporate Banking, Financial Management and Other (if relevant, on a specific basis in the reporting banking corporation). The segments relating to banking products (such as: credit cards, capital market activity and mortgage loans) are to be reflected in the relevant customer segments. Notwithstanding, it is required to include in the Directors’ Report, in respect of each segment in a separate column, a disclosure as to the banking product.

Implementation in the financial statements of public reporting instructions. In accordance with the above, beginning with the financial statements as of December 31, 2005, the product segments, which were reported in the past as separate segments (credit cards, capital market operations, construction and real-estate activity, and mortgage loans), are reflected now in the relevant customer segments, and in addition disclosure is given in their respect in the Section “Additional details regarding activity in certain products” hereunder. Activity of the “Non financial companies” which had also been presented in the past as a separate segment is presented as a sub-segment of the “Financial management segment”.

The said file 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. Beginning with the financial statements as of December 31, 2006, IDB New York completed its preparations for presenting the data according to the required segmentation. The data for the international operations segment is presented in the form that the operations of the Group in Israel are presented. In addition a disclosure is included regarding the said operations in the item “International operations”.

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 due to the short time that has elapsed since the system was put into operation, and since the system as a whole has not yet been completed and implemented, the use of it 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, as discussed above, together with the fact that the system is not able to provide retroactive data, a periodic series of data segmented according to operating segments has not yet been created, which are 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 required.

It should be noted that in the said questions and answers file, the Supervisor of Banks requires banking corporations to consolidate the data of their subsidiaries according to quantitative characteristics determined by the parent company. Providing such data requires the maintenance of a double database for earnings and segments of subsidiaries and involves great difficulties. Mercantile Discount Bank completed its preparations in this respect and accordingly, starting with the financial statements as of December 31, 2007, the Bank consolidates the data of Mercantile Discount Bank according to quantitative characteristics set by the Bank. As it is not possible to retroactively produce the required data according to the said premises, the comparative figures for 2006 are presented based on segments operations as reported by Mercantile Discount Bank, without adjustments it to the differences between activity characteristics of the Bank's customers in a particular segment and those of the customers of Mercantile Discount Bank in the same segment.

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.

The main differences between the managerial reporting format and the public reporting format. The segment reporting presented in the financial statements and in the Directors' report have been prepared in accordance with the instructions and guidelines of the Supervisor of Banks in this matter. Certain differences exist between the managerial reports presented to the Bank's Management and the segment data and format presented in the financial statements.

The reports to the Bank's Management include, at this stage, a report of the Corporate Division's data and the Retail Division's data at the Bank level, up to the "earnings before tax" line. The Retail Division's data include the household segment customers, the small business segment and the private banking segment. The data for the Corporate Division include the corporate banking segment and the commercial banking segment.

As stated, there are several principal differences between the reports to Management and the segment reporting in the financial statements:

- The report to Management does not address the allocation of profits from the severance pay fund as is the case in segment reporting according to the public reporting instructions;
- The financial activity segment includes both the activity of the "Nostro" management and the risk management of the Bank, which is subject to the responsibility of the Financial Division, as well as the investments in non-financial companies, which is not managed by that Division, and as stated, the activity of this segment is not presented in the said reports to Management;
- In the segment reporting according to the instructions of the Supervisor of Banks, Tier I and Tier II capital are allocated to each segment in accordance with each segment's risk assets, at the expense of the financial segment.

Following is the quantification of the main differences between the formats of managerial reporting and the reporting format dictated by the public reporting instructions:

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management	Total Consolidated
In Nis millions							
For the year ended December 31, 2007							
Reported net income	654	227	347	103	43	(109)	1,265
Net income for Management reports	622	208	320	86	41	(12)	1,265
Difference	32	19	27	17	2	(97)	-

Following is the composition
of the differences:

Income from financing activities before provision for doubtful debts	14	18	31	19	1	(83)	-
Profit from severance pay funds	38	13	12	8	3	(74)	-
Total Income that was transferred	52	31	43	27	4	(157)	-
Provision for taxes on operating income	20	12	16	10	2	(60)	-
Difference	32	19	27	17	2	(97)	-

For the year ended December 31, 2006							
Reported net income	241	46	217	9	31	292	836
Net income for Management reports	218	32	180	(6)	30	382	836
Difference	23	14	37	15	1	(90)	-

Following is the composition
of the differences:

Income from financing activities before provision for doubtful debts	16	17	57	20	1	(111)	-
Profit from severance pay funds	22	7	6	5	1	(41)	-
Total Income that was transferred	38	24	63	25	2	(152)	-
Provision for taxes on operating income	15	10	26	10	1	(62)	-
Difference	23	14	37	15	1	(90)	-

ADMINISTRATIVE STRUCTURE

The Discount Group operates in Israel and overseas by way of the Bank, subsidiaries, branches and representative offices, in all areas of banking and financial services.

The business operations of the Bank are conducted by four divisions: Retail Division, Corporate Banking Division, Finance Division, and Asset Management Division.

The Retail Division conducts business with households, VIP customers, small companies and businesses, foreign residents, private banking customers and customers of direct banking.

The Corporate Banking Division conducts business with large and medium size companies and provides services to specific customer sectors: diamond industry, construction companies (real estate project financing) and "approved enterprises". In addition, that division conducts business with middle market business customers and coordinates the operations of the business centers, foreign trade department, and the Tel-Aviv main branch.

The Finance Division is responsible for the Bank's financial investments and for management of the Bank's own account and liquidity and for the management of market and liquidity risks.

The Asset Management Division is responsible, itself and through subsidiaries, for the providing of a variety of capital market services to all segments of customers, including: securities and financial assets advisory services, securities purchase and sale services, portfolio management, services to portfolio managers who manage customer portfolios at the Bank, forward contracts activities, basket certificates and structured products.

For details regarding the change in the organizational structure, within the framework of which the Commercial Banking Division was merged into the Corporate Banking Division, see hereunder under "Corporate banking segment".

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. This general section includes several subjects that relate jointly to the two said segments.

THE BRANCHES AS THE CENTER OF RETAIL OPERATIONS

The branches are the central link in the relations between the Bank and the retail customer, the retail experience taking place at the meeting point of the retail customer with the Bank - in the branch.

A customer visiting a branch should undergo a retail experience as a result of a combination of four major components: A pleasant appearance of the branch and its staff, quality service throughout his stay at the branch, clarity and simplicity of the products offered and messages given to him and the availability and timeliness of consumption - simple processes and efficient performance.

The Retail Division is in the midst of an advanced process of modifying the branches to a customer-focused structure, where against each group of customers the Bank provides a separate and different arrangement.

BANK BRANCHES At the end of 2007, the Bank operated 129 branches across the country, organized within the framework of five areas. For details regarding the modification of the branch network, complementary services and the consultation layout, see "The household segment" hereunder.

Opening of New Branches. During 2007, the Bank opened 5 specialty branches designated for State employees as well as 3 branches of the "Household Discount" line. For further details of the adjustment of the branch layout, see "Household Segment" hereunder.

TARGETS AND BUSINESS STRATEGY In 2004, the Bank adopted the humane banking vision. As part of this vision a target has been set to become the leading bank in retail banking thereby creating a differentiation from its competitors. For this purpose, the Bank's Retail Division established customer focused departments - the service and sales department, the business customer department for credit management and the affluent foreign residents customer department.

As part of the strategy the branch layout was adjusted through the merger of branches and establishment of unique concept branches (see hereunder: "Adjustment of the branch layout" under "Household segment").

The traditional Discount branches are undergoing a "face lift". Within this framework, each branch is divided into two areas: the daily banking area - "Discount rapid" and the specialized banking area. In order to provide an inviting and pleasant customer experience, the branch appearance has been changed to suit the retail business by introducing a branch commercialization as well as installing closed circuit TV screens and audio systems.

In addition intensive action is taken to improve the work process more by removing the operational activity from the branch allotting more time to initiative and marketing activity.

The retail segment focuses on the development of the consumer credit field as a growth generator.

THE SEGMENT STRATEGY A strategy that outlines a way according to which a distinct differentiation is to be made between customers in order to succeed in maintaining the customers and exhaust the potential inherent in them. The way of applying the strategy of differentiation between segments:

- A correct segmentation of customers;
- Differentiation in service - organizational attachment to a certain team and modification of complementing channels;
- Development of customer relations with customers of the segment: Initiative and service;
- The increase of consumer slice and segment - attracting customers and intensifying operations.

CUSTOMER SEGMENTATION **Private Sector.** Four principal segments of customers have been identified in the private sector: VIP customers; preferred private customers; private customers (households); the growing segment. The segments are defined in relations to parameters of the amount of salary and/or financial wealth, measured according to the assets held with the Bank. The growing segment is defined as a customer population having a potential growth: students, servicemen and young persons.

In recent years emphasis was put on the private sector and all its segments. Based on the segmentation

of the private sector, different strategic emphasizes have been determined as regards the activity with respect of each segment in accordance with its characteristics, requirements and order of preference of the Bank. Based on the segmentation of the private sector, account channels have been established allowing the granting of structured credit facilities while offering unique channels to customers having financial wealth and/or salaried customers. These customers were offered a credit line of 30% of their net available financial wealth and/or up to five times the amount of their salary, respectively. Modifying the credit facilities to the said population segments is achieved by initiating approach to the customer and accordingly adjusting the credit facility to the requirement of the customer, his repayment ability, and the acquaintance with him over the years as regards structured credit lines, in which the interest rate decreases gradually in line with the increasing utilization of the credit facility. This activity supports the development of the consumer credit field at the Bank, allows full compatibility with the needs of the customer and leads to a significant decline in overdrawn current accounts.

The business sector includes three principal kinds of customers: business, business plus and extended business.

The segments are defined in relation to parameters of volume of operations vis-à-vis the Bank, as measured mainly in the credit field.

SERVICE CONCEPT

The service concept has been formed with the view of providing comprehensive services to the customer, deriving from the understanding that the customer is interested in receiving service from a banker who is aware of all his financial needs, and will modify the services and products in accordance with his unique characteristics.

Accordingly, the overall service concept has been formed, the principles of which are:

- One stop shop - A comprehensive service to the customer at one service point;
- Team service - provides a response for a more comprehensive service at one address at the branch;
- Deployment according to spheres - teams that specialize in the customer sphere (rather than in the product sphere);
- Humane banking - familiarity and warm and humane relations on the part of the service providers;
- Service initiative - anticipating the customer's needs and customizing products or services to such needs;
- The allocation of resources based on the customer needs and the Bank's priorities.
- Expert banking - provision of various professional services in the credit and investment sectors, including customizing the product to customers' needs and requirements.

The service layouts are to absorb in 2008 a customer focused supporting system.

This system positions the customer in the center, while customer adapted products are to be offered paralleling major milestones in the customer's life cycle. Using this system the Bank will be able to adapt the product to the customer's needs and to favor to such products and operations regarding customers.

CUSTOMER RELATIONS WITH THE SEGMENT AND SALES

Following the segmentation of branch customers and separating the service in their respect, the implementation of the segment strategy focuses on the manner of conducting operations in respect of each arena - specialization in the arena.

The service team is required to intensify its activity with its customers: to develop customer relations with the segment served by it and conduct initiated activity.

For this purpose the following is required:

- Familiarization with customer characteristics (banking activity, needs and preferences);
- Customization of the professional level and the required qualifications to the needs of the customer - for this purpose the Bank has devised courses, seminars and instruction classes on various subjects for the staff of the branches. Studies are conducted both by way of self study and at the Discount college;
- Customizing products focused on customer needs in the investments and credit fields;
- Broadening the personal acquaintance with customers;
- Customizing the manner of approach and sales to the various customers.

INCORPORATING THE RETAIL CULTURE

Within the strategic framework of advancing retail banking, the Bank inaugurated, at the beginning of July 2005, a retail banking school, the first of its kind in the banking industry - a retail banking school. The retail banking school will train managers and employees of the Bank's branches and will focus on attaining the following goals: to incorporate retailing culture into the Bank's branches, to provide management teams of the Bank's branches with tools for the implementation of the retail concept, and to train staff in a wide variety of courses.

The retail banking school operates within the framework of the Discount College and its lecturers are drawn from the field of retail activity in Israel and abroad.

As part of the implementation of the "humane banking" vision, the Bank launched in the second half of 2007 the maneuver of absorbing a business culture, which includes uniform business standards. This, in order to provide every customer entering any one of the Bank's branches with a uniform service experience.

RETAIL BANKING SECTOR - HOUSEHOLD SEGMENT SEGMENT CUSTOMERS

This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as 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 of a volume not exceeding NIS 200 thousand and deposits of a volume not exceeding NIS 500 thousand. As of 2006 the data for the segment includes the data of the International operations activity in the household segment.

SERVICE

Customers of the household segment receive services through 129 branches of the Bank located throughout Israel, from Kiryat Shmoneh to Eilat, organized geographically under five regions.

Mercantile Discount Bank's household segment customers receive service through 70 branches located throughout Israel.

The principal banking products available to customers of this segment include current account management, credit, deposits, capital market activity and credit card services, as well as loans for the purchase, lease, enlargement, renovation or construction of residential units, and the granting of loans for any purpose, secured by a mortgage on a residential unit.

Customer preservation. Discount Bank customers are a precious asset of the Bank. Therefore, the treatment and service provided to them constitute a supreme value. During 2006, the Bank established a customer preservation department whose main objective is to identify customers with a declining scope of activity or disappointed customers, to examine the reasons therefore and to provide solutions to the satisfaction of the customers.

ADJUSTMENT OF BRANCH LAYOUT

As part of the Bank's move towards differentiation specialized concept branches were established in a process that began towards the end of 2003. These branches are intended to provide response adapted to the various needs of retail customers.

"Discount Rapid". Discount Rapid is located at the front of the branch and provides rapid response to daily banking services. Rapid banking centers include several information desks, ATM machine, Telebank machine and Internet stations. Most importantly, Discount Rapid is manned by professional bank personnel and is open during special hours, from 8:00 - 20:00. 25 "Discount Rapid" centers were opened since the year 2006.

"Discount Your Way". These branches, located in shopping malls, serve as service and sales points to customers of these malls, and are tailored to the retail environment of the malls. Opening hours are adapted to customers' needs and convenience: 10:00 - 22:00. Five branches of the "Discount Your Way" line were opened since 2006: at the "Malcha" Shopping Mall in Jerusalem, at the "Avnat" shopping mall in Petach Tiqva, at the "Negev" Shopping Mall, Beer-Sheva, at the "Across the Park" shopping mall in Ra'anana and at the "Giva'tayim shopping mall" in Giva'tayim.

"Household Discount". A branch designated at serving private retail customers only, based on an economic and efficient model for the penetration into residential areas and focused centers. These branches are located in large neighborhoods in cities and serve private customers until late hours. Business hours are adapted to the needs of customers living in the vicinity, the activity in hospitals, industrial areas, etc.

Program for 2008. The master plan for the disposition of the Discount chain, which parallels the strategic plans of the Bank, includes the detailed programming of establishing new branches, the handling and adaptation of the chain to the type of differentiated retail banking service.

The plan for 2008 is to refurbish 18 branches, in the framework of which, 18 "Discount Rapid" centers are to be established at the front of the branches, as well as opening one more "Discount Your Way" branch and six "Discount Home" branches.

COMPLEMENTING SERVICES

Direct and complementary service layouts that serve as an alternative to the services provided in the branches:

The “Bank gateway” project. Customer telephone answering service - automatic direction to direct banking for customers calling the branch switchboard (and not the direct lines of the staff). This project enables improvement of the quality of telephone reply on the one hand, and gives the branch staff more free time for developing initiative, sales and the improvement of service to the customer on the other hand.

Telebank Internet. Development and improvement of the service channel via the Internet. Encouraging customers to use this channel results in significantly lower costs as compared with the cost of identical services provided at the branches.

CONSULTING SERVICES LAYOUT

Investment centers. Customers having deposits of over NIS 750,000 or customers active in the capital market are entitled to receive comprehensive consultancy services regarding their funds at eleven investment centers. The account of the customer is managed at the branch, however the service is provided at the investment centers by expert investment consultants.

Consulting services in Bank branches. Intended to intensify branch investment consulting services in that began in 2006. Customers benefit from personal and innovative consulting services in a variety of capital market channels. The service is provided in the branches by authorized investment consultants designated only for the capital market. Receipt of this service requires liquid deposits in the range of NIS 250-750 thousand. This activity was continued and extended to additional branches in 2007. The process is expected to be completed in 2008 at the absolute majority of the Bank's branches.

Pension advisory services. In March 2008 Discount Bank began providing pension advisory services at the Bank's branches and at the investment centers. For this purpose, the bank trained consultants from among the staff as well engaging new consultants. The advisory service in this field is objective and supported by a consulting system which adapts to customer needs the product and pension basket. The Bank views this field as an important growth generator in the field of retail banking, and is to provide such services also to those who are not customers of the Bank. (For additional details see hereunder “Capital market activities” in the Chapter “Additional details regarding the activity in certain products”).

Portfolio management. Directing customers to outside and inhouse portfolio managers.

NEW PRODUCTS AND SERVICES

“Discount MAXGRADE” benefit card. A unique benefits club to the Bank's customers provides a variety of benefits in the culture, entertainment and leisure fields at tens of business houses all over the country. Club members enjoy attractive sales campaigns, cheaper flights and vacations at special prices. The “Max Bonus” club for State employees was launched this year, granting in addition to “Max Grade” benefits also “unique” benefits to State employees.

SMS - “Discount personal”. A new service providing SMS notices (in Hebrew only) that include information regarding the current account, enables registration for service to telephone numbers of all the cellular networks operating in Israel which support SMS notices in the Hebrew language. The customer is able to define his preferences according to the type of notices in respect of which he wishes to receive information, their frequency and range of hours for receiving notices.

Statement of account. The Bank has begun sending its customers statements by mail in a new format, enabling them to receive in a summary form all the information required by them in a friendly and accessible manner. These mailed statements implement the concept of approaching the customer in a clear and simple language, by way of a uniform structure of notices regarding each of the contact points with the Bank - by mail, by automatic machines, by the Internet and at the branch.

The new design, in a fixed structure appearing on all the channels, is very friendly, easy to read and of pleasant colors. This design was done as part of a wider process of upgrading the notices issued by the Bank to customers and adaptation to the strategy of humane banking. In this framework, the notices written in advance and phrased in a more simple language, clear and easy to understand.

MARKETING AND DISTRIBUTION

Marketing and distribution are conducted by way of advertising campaigns on the printed media, television, radio and billboards. In addition, this activity is conducted through the following channels:

- At the branches - frontal activity through plasma screens located in areas where customers await service;
- Through the telephone either by way of an initiated approach to the customer or in response to an approach by the customer;
- By Discount TeleBank - either by way of an initiated approach to the customer or in response to an approach by the customer;
- At the Discount website on the Internet, which provides marketing messages and marketing offers;
- Direct mailing to customers (to which is attached a statement of account) and through the automatic service machines (ATM and Information Desk).

TARGETS AND BUSINESS STRATEGY

As from 2002, the Bank has been engaged in a marketing effort to attract private customers - "Circles campaign". This marketing decision is rooted in the Bank's strategy, which is to lead retail banking in Israel while focusing on the retail segment as a major source of growth and profitability.

Since the beginning of the "Circles" campaign, the Bank has attracted approximately 400 thousand new customers, mainly from the household sector.

Various steps were taken in 2007 towards the strengthening of the strategy for leadership of retail banking:

- The State employee tender - the Bank was successful in obtaining the tender for loans to State employees at the Accountant General's terms and additional banking services (see below for the "Tender for provision of services to state employees");
- The teaching personnel tender - the Bank was successful in obtaining the tender for loans to teaching personnel at the Accountant General's terms (see below for the "Tender for provision of services to state employees");
- Discount outline - A joint marketing campaign with Discount Mortgage Bank, focusing on turning the mortgage loan into a center product for attracting new active customers, by the offering attractive interest rates especially to customers who will arrange to have their salaries paid through Discount Bank. This move has increased the market share of Discount Mortgage Bank in providing new mortgage loans and it is estimated by the Bank that this will also increase

the retail business at the Bank (for additional details see “Mortgage activity - Housing loans” in the Chapter “Additional details regarding the activity in certain products”).

POINTS OF EMPHASIS FOR THE COMING YEAR

- Continued realization of the Bank’s vision - leadership in personal and professional service;
- Continued development and adaptation of unique products for customers;
- Absorbing of State employees and teaching personnel as customers, among other things by way of a benefit basket especially structured for them and by the personal and humane service which they get from Bank employees;
- Focus on service and maintenance of new and long standing customers;
- Continued country-wide distribution of “Discount Rapid” stations open to the public until 20:00 hours, in order to ensure the Bank’s adaptation to customers’ needs and requirements. Furthermore, efforts will be implemented to increase customer satisfaction by upgrading the experience of visiting the branch and benefiting from optimal service.

COMPETITION

As of today, the Bank’s principal competitors are the four other major banks in Israel - Bank Hapoalim, Bank Leumi, the First International Bank and Mizrachi-Tefahot Bank. Israel Discount Bank is third in size amongst the five banks.

The Bank may be differentiated from its competitors from the point of view of both quality of service and by way of obtaining attractive products adapted to the needs of customers of this.

“Off banking” financial entities, e.g. credit card companies, have entered the competitive market in recent years with respect to consumer credit, investment and insurance companies - inter alia with respect to capital market transactions.

DEVELOPMENT IN THE SEGMENT’S MARKETS AND CHANGES IN CUSTOMER CHARACTERISTICS

No material changes occurred in 2007 in the characteristics of customers in this segment. Notwithstanding, a continuous trend exists in respect of direct banking activity (ATM, Discount Telebank and the Internet).

TECHNOLOGICAL CHANGES THAT MAY AFFECT THE SEGMENT

In the course of 2007 the Bank’s Internet website was updated, including the addition of payment options to Government and Municipal agencies, and online access of copies of paid checks. The Bank’s securities’ website was also updated, enabling customers to receive information and to conduct banking transactions. The telephone answering service for customers was improved, by referring part of the calls to “Discount Telebank”.

CRITICAL SUCCESS FACTORS IN THE SEGMENT

- Distribution of service stations and adaptation of business hours to the region and to the characteristics of the local population;
- Expansion of exposure and access to direct technological channels;
- Timely response to customers’ needs and requirements;

- The structuring of customer adapted products in the various banking channels;
- Flexibility and sensitivity to market changes, including regulatory requirements.

**PRINCIPAL SEGMENT
ENTRY AND EXIT
BARRIERS**

- Investment in branches layout all over the country;
- Investment in the establishment of advanced technological means, and in their maintenance and upgrading;
- Training of skilled service personnel engaged in providing a variety of banking products and activity;
- Maintaining the reputable service level, leadership, professionalism and reliability established over many years.

**TENDER FOR
PROVISION OF
SERVICES TO STATE
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 (services provided until this point by Yahav Bank 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 eligible State employees are granted under subsidized terms, at the Accountant General interest rate (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 facilities in amounts exceeding NIS 7,000 out of Bank funds, at an interest rate not exceeding the prime rate + 1.4%.

As part of its success in winning the tender, the Bank obtained the right to collect repayments of loans granted by the Bank to State employees by withholding the amounts from their salaries.

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 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, Yahav Bank branches are presently located. The agreement does not include the government's commitment to vacate these branches.

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 banking services to State employees, in the scope, terms and quality defined in the terms of the tender. The Bank is preparing, as required, for the commencement of operations (see below).

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. To the best of the Bank's knowledge, the Accountant General decided that Yahav Bank shall continue to handle the existing loan portfolio.

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 state employees are deposited with current accounts managed at Yahav Bank.

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.

Following the success in the public tender, competition has developed between the Bank and Yahav Bank with respect to the provision of services to State employees, which, inter-alia, was reflected in an advertising campaign launched by Yahav Bank to attract new customers and to preserve existing customers from among State employees, as well as in motions to the Supreme Court (see hereunder).

Preparations by the Bank. Shortly after attaining the tender the Bank had begun preparations to modify the Bank's computer systems to accommodate the operations required by the tender. All the developments required in order to adapt the computer systems have been completed. Concurrently, great effort has been invested in the construction field: renovation of existing branches and the setting up of new branches. The Bank abides by the timetables specified in the tender.

The cost of the preliminary preparations made in 2007 for providing services amounted to NIS 38 million, not including the cost of manpower at the branches. The Bank estimates that the cost of preparations for the provision of services in 2008 will amount to an additional sum of NIS 21 million.

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.

Notwithstanding the tender only coming into effect on January 1, 2008, the Bank decided that attracting State employees as customers should begin as of July 17, 2007. As from that date, the Bank grants the full benefits to which State employees are entitled under the terms of the tender, whether these State employees are new customers or long-standing customers of the Bank, as well as services and off-banking benefits adapted especially to the needs of State employees. The Bank

has started an extensive marketing campaign, within the framework of which thousands of new customers from among State employees have joined the Bank.

As part of the marketing operations, the Bank has established, among other things, a service center designated for State employees interested in receiving information regarding activities at Israel Discount Bank. In addition, a specialized website has been launched on the Internet containing comprehensive information about the terms and benefits offered to customers who are State employees, which also provides on-line consulting ("chat") between "surfers" and representatives of the State Employees Center allowing them to fix consulting appointments or refer various questions. According to the tender requirements, 25 Bank teams commenced operations at the beginning of September 2007, at venues with high concentrations of State employees. The teams, being assisted operationally by a specialized back-office especially setup for this purpose, open accounts in the field to whoever wants to join the Bank. The process of opening an account by means of these teams affords a unique experience to new customers - at the end of the process the customer receives the account opening documents as well as the banking products ordered at that time, such as: check books and credit cards, by courier directly to his home. In addition, a VIP service is offered to new customers wishing to transfer their activities to the Bank. In addition, emphasis is to be put on developing ties with customer who are State employees, and for this purpose service standards have been defined and will to be absorbed by Bank branches and supporting systems have been developed for the management and control over Bank-customer relations.

The Bank is preparing to open 11 new branches at locations of Government offices and of health service institutions, of which 6 branches had opened by the end of 2007. Furthermore, the Bank will reinforce existing branches located near areas with a high concentration of State employees. It should be mentioned that within the framework of the tender, not all populations belonging to public sector's employees have been defined by the Accountant General as eligible to special terms and benefits. However, following the Bank's success in the tender, various organizations of public sector employees not included in the State employee benefits, have applied to the Bank in order to define a benefit arrangement for their members.

Branches of the State employees tender project. Within the framework of the State employees tender, the Bank has opened until now six branches: Tel Hashomer Hospital Branch at the shopping mall on the hospital grounds; Assaf Harofeh Hospital Branch at the shopping mall on the hospital grounds; the Nahariya Hospital Branch; the Binyanei Ha'Uma branch, opened temporarily in the Binyanei Ha'Uma building, scheduled to be moved, at the beginning of 2008 to the parking lot compound located across from the Knesset and the Supreme Court; the Jubilee Building Branch, opposite the Azrieli Towers in Tel Aviv and the Barzilai Hospital extension, at the exit of the Barzilai Hospital in Ashkelon. These new branches are designed to serve State employees and their working hours are tailored to the needs of these employees with a view to provide State employees with high quality and readily available service.

Until December 31, 2007, 10,250 new accounts of State employees were opened. As of a date proximate to the publication of the financial statements the Bank had around 28,550 accounts of

State employees, of which about 15,500 new accounts opened since the beginning of the activity with State employees.

In view of the fact that the marketing campaign directed at State employees began only in the last months of 2007, the campaign had no material effect, at this stage, on the activity of the Bank in general and on the household segment in particular.

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.

On September 11, 2007, the Court decided to dismiss the plea. As part of the decision, the Bank declared that it had acted and will continue to act in accordance with the law and with the terms of the public tender, without prejudicing Yahav Bank's right to apply to the Supervisor of Banks in this respect.

The approval of the Bank of Israel for the opening of special branches was received on September 24, 2007, as well as an approval for opening of 25 special branches as part of the Bank's preparations for the implementation of the terms of the tender. The permit expired on December 31, 2007, and on January 1, 2008, the

Bank was granted an additional permit to operate special branches and to transact business with State employee customers. This permit is in effect until April 30, 2008.

Additional motion to the Supreme Court. On February 13, 2008, Yahav Bank filed an additional motion with the Supreme Court against the Minister of Finance, the Accountant General at the Ministry of Finance and against Discount Bank. Within the framework of the motion, the Court was asked to issue orders whereby Yahav Bank would be able to continue the direct deduction of loan repayments granted by this bank from State employees' pay slips.

Within the framework of the motion Yahav Bank argues that the new criteria determined by the Accountant General for direct deduction of amounts from State employees' pay slips are criteria that discriminate in favor of Discount Bank and constitutes unwarranted interference on the part of the Accountant General in favor of Discount Bank within the context of the competition between the banks.

In addition Yahav motioned for an interim order whereby it would be able to continue the direct deduction from State employees' pay slips of the repayments of loans granted by it, until the Court's ruling in the matter is given.

On March 24, 2008, The Supreme Court ruled that there was no cause for the issue of an Interim Order. The State and the Bank have submitted their response to the motion and requested its dismissal.

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 that time by the First International Bank of Israel Ltd.). The loans will be granted at the Bank's responsibility. On September 26, 2007, the Bank signed an agreement in this matter.

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

Within the framework of the tender, the Bank has transferred 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. As of November 1, 2007, Israel Discount Bank is the only bank which grants loans out of State funds to teachers employed by the Ministry of education and to education students. The Bank has decided to expand its operation also to other teaching personnel employed by other institutions and to offer them preferred terms. In addition to loans the Bank also offers teaching personnel a benefit package with respect to commissions and credit facilities at preferred interest rates.

Notwithstanding the tender coming into effect only on November 1, 2007, the Bank had already decided to attract customers from among teaching personnel, by means of a marketing campaign, which began on October 8, 2007, under the heading "It is best to be a teacher at Discount". The

Bank views this sector as a strategic arena, and is conducting a variety of marketing activities with a view of attracting customers from among this sector.

Following the success in the tender competition has developed between the Bank and Massad Bank and the First International Bank. The Bank believes that this competition may intensify.

**SCALE OF OPERATIONS
AND NET INCOME OF
THE SEGMENT**

Net income of the segment in 2007 amounted to NIS 654 million compared with NIS 241 million in 2006, an increase of 170.5%. Disregarding certain components (see hereunder), net income would have amounted to NIS 260 million in 2007, compared with NIS 144 million in 2006, a decrease of 80.5%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 55.4% in 2007, compared with 23.4% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 22.0% in 2007, compared with 13.9% in 2006.

Provision for doubtful debts in this segment amounted in 2007 to NIS 123 million, compared with NIS 109 million in 2006, an increase of 12.8%.

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

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 domestic operations	Banking and financing	Total
For the year ended December 31, 2007							
Income from financing activities before provision for doubtful debts							
- From externals	(249)	208	7	172	138	6	144
- Intersegmental	1,177	(55)	7	(65)	1,064	-	1,064
Total income from financial activity	928	153	14	107	1,202	6	1,208
Operating and other income	491	746	296	48	1,581	1	1,582
Total Income	1,419	899	310	155	2,783	7	2,790
Provision for doubtful debts	71	41	-	10	122	1	123
Operating and other expenses	1,367	578	175	113	2,233	4	2,237
Operating Income (loss) before taxes	(19)	280	135	32	428	2	430
Provision for taxes on operating income	(31)	112	49	4	134	-	134
Net income	12	114	502	24	652	2	654
Net income disregarding certain components ⁽¹⁾	32	115	87	24	258	2	260
Yield on capital (percentage)	3.2	35.8		5.1	55.8	18.0	55.4
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	8.5	36.0		5.1	22.1	18.0	22.1
Average Assets	7,214	6,667	10	10,519	24,410	207	24,617
Average Liabilities	50,915	-	-	2,401	53,316	74	53,390
Average Risk-assets	6,217	5,331	10	7,923	19,481	207	19,688
Average assets of provident and mutual funds ⁽²⁾	-	-	11,408	-	11,408	-	11,408
Average customers' securities	-	-	27,689	-	27,689	-	27,689
Average other assets under management	-	-	1,423	2,130	3,553	-	3,553
Components of income from financing activities:							
Margin from credits activity	332	150	-	85	567	5	572
Margin from deposits activity	570	-	-	-	570	1	571
Other	26	3	14	22	65	-	65
Income from financing activities before provision for doubtful debts	928	153	14	107	1,202	6	1,208

(1) The following components have been eliminated: expenses in connection with early retirement plan and the gains on sale of the provident funds activity and the activity of KAHAL.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

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

	domestic operations				International		
	Banking and financing*	Credit cards	Capital market	Mortgage	Total domestic operations	Banking and financing	Total
For the year ended December 31, 2006							
Income from financing activities before provision for doubtful debts							
- From externals	191	108	12	159	470	2	472
- Intersegmental	648	(5)	3	(43)	603	-	603
Total income from financial activity	839	103	15	116	1,073	2	1,075
Operating and other income	378	*630	*378	48	1,434	1	1,435
Total Income	1,217	733	393	164	2,507	3	2,510
Provision for doubtful debts	60	31	-	18	109	-	109
Operating and other expenses	1,385	*482	*265	86	2,218	2	2,220
Operating Income (loss) before taxes	(228)	220	128	60	180	1	181
Provision for taxes on operating income	(82)	79	*56	26	79	-	79
Net income (loss)	(146)	78	286	22	240	1	241
Net income (loss) disregarding certain components ⁽¹⁾	(50)	82	*87	24	143	1	144
Yield on capital (percentage)	(54.1)	*27.4		5.1	23.5	2.7	*23.4
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	(18.2)	*28.5		5.3	13.9	2.7	*13.9
Average Assets	5,532	*4,294	8	9,704	19,538	59	19,597
Average Liabilities	50,858	-	-	2,418	53,276	70	53,346
Average Risk-assets	4,474	*4,811	289	7,525	17,099	59	17,158
Average assets of provident and mutual funds ⁽²⁾	-	-	25,381	-	25,381	-	25,381
Average customers' securities ⁽²⁾	-	-	22,543	-	22,543	-	22,543
Average other assets under management	-	-	1,283	2,269	3,552	-	3,552
Components of income from financing activities:							
Margin from credits activity	257	103	-	74	434	1	435
Margin from deposits activity	546	-	-	1	547	1	548
Other	36	-	*15	41	92	-	92
Income from financing activities before provision for doubtful debts	839	103	15	116	1,073	2	1,075

* Reclassified.

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.

HUMAN CAPITAL	In 2007, the average number of positions in the segment amounted to 4,583 including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, compared with 4,303 positions in 2006, an increase of 6.5%.
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 Antitrust Commissioner, the Securities Authority 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 was 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);
- 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. It should be mentioned that the Bank had taken the necessary action even prior to the publication of the Directive for the replacement of overdrafts by proper loans and credit facilities and for the reduction of deviation rates of its customers.

Upon publication of the Directive the Bank has acted intensively for its implementation, among other things by replacing overdrafts with loans, adapting credit facilities to the needs of the customer and his activity, offering loans at attractive prices, the establishment of unilateral credit facilities in accordance with the Directive, arranging seminars for customers in the matter of management of the family budget, and more.

Letters have also been mailed to customers explaining the principal points of the Directive, its meaning and implications on the customer's account, and customers were requested to refer to their branch in order to adjust their credit facility to their needs and operations.

As part of the Bank's preparations for the implementation of the new directive, 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 mail the agreements back 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 Deviation (over NIS 1,000 for more than three days, excluding a problematic debt in arrears) 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 December 31, 2007 the said rates stood at 0.94% and 2.73% 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 2007 by NIS 5 million.

The public and parliamentary activity in the matter of bank commissions continues also in the years 2006 and 2007, and 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").

Following the enactment of the Law, the Governor of the Bank of Israel published on January 8, 2008, the Banking Rules (Customer Service)(Commissions), 2008. Amendments were also made to the Proper Banking Management Directives dealing with commissions.

In addition to the Rules, the full commission tariff (applying to customers receiving full banking service) and the shortened tariffs (applying to customers receiving partial banking services). The said tariffs apply to two segments of customers: individuals and corporations whose annual income turnover does not exceed NIS 1 million (hereinafter: "small businesses").

The main changes reflected in the Rules and tariffs attached to them are:

- The number of overall commissions in the new tariffs has been significantly reduced compared to their present number (at a rate of about 66%) and it was clarified that commissions that are not included in the new tariffs may not be charged to the customer segments to which the Rule applies;
- An individual will be exempt from payment of ledger fees in respect of a current account, with the exception of transactions in his account effected by a teller or through direct channels as detailed below;
- Commission may be charged to an individual customer in respect of the allocation of a credit facility only if this customer has made no use of the credit facility allotted to him. A customer who has made a partial or full use of the credit facility will be charged interest or credit facility allocation commission, the higher of the two;
- Commission for the handling of credit may not be charged to small businesses and to individual customers in respect of loans in an amount not exceeding NIS 50,000. In addition this



commission may not be charged upon renewal of a credit facility which does not involve a change in or an increase of the security for the credit. In the event of an increase in the credit facility, a commission may be charged in respect of the additional credit amount only;

- Differentiation has been made between the commission charged for current account services provided by a teller (which include a closed list of eight types of transactions), and commission charged for such services provided through direct channels (which include a closed list of ten types of transactions).

Banking corporations must inform their customers by April 5, 2008, of the service charges included in the tariffs. At the request of the banking corporations in Israel the Governor of the Bank of Israel applied to the Knesset Economics Committee requesting its approval for the deferment of the effective date for a period of three month until July 5, 2008. The Economic Committee consented to a deferment until June 5, 2008, only.

The Bank believes that the entire extended period specified by law is required for completing the computer and operational preparations required for such a complex maneuver. Concern therefore exists that the said approved extension would not be sufficient in order to complete the preparations in a proper manner.

The bank has begun preparing for the establishment of a tariff in accordance with the format determined in the said principles.

Implementation of the new Rules requires the segmentation of the Bank's customers according to various parameters, part of which are not available to the Bank at this stage. Accordingly, and due to the fact that the amount of certain commissions included in the tariff has not yet been fixed by the Bank, it is difficult to accurately assess the implications that the new Rules will have on the future income of the Group.

The Bank believes that upon completion of the process, the Group's income from operating commissions will be adversely affected in an amount initially assessed at about NIS 160 million a year. Nevertheless, in view of the uncertainties noted above, it is possible that actual implications would in fact differ from this assessment.

For additional details in these matters, see "Legislation and arrangements regarding banking commissions" under "Legislation and Supervision" hereunder.

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" and Note 33 to the financial statements.

THE RETAIL SEGMENT AT THE MERCANTILE DISCOUNT BANK

Most of the customers of Mercantile Discount Bank belonging to the household segment of this bank, receive banking services by means of the Mercantile Discount Bank branches organizationally belonging to the Acco and Nazareth regions (27 branches). Such branches are located in areas where the population has an absolute "non-Jewish" majority. Mercantile Discount Bank management believes that most of the customers belonging to such populations receive services from Bank Leumi and Bank Hapoalim, while the balance of the activity is divided among the remaining banks.

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 undertook several steps in 2007 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), and six new branches were opened during the year, in areas having a high potential of providing banking services to the household segment, including three branches in the Nazareth and Acco regions.

**RETAIL BANKING
SECTOR - SMALL
BUSINESSES SEGMENT
SEGMENT CUSTOMERS**

This segment includes customers of the Bank's Retail Division and customers of Mercantile Discount Bank which are defined as small companies and small businesses with borrowings of up to NIS 10 million. Until December 31, 2006 the segment also included the customers of Mercantile Discount Bank in that bank's small business segment - that bank's small business segment customers (individuals and corporations) whose granted volume of credit does not generally exceed NIS 1 million.

**SCALE OF OPERATIONS
AND NET INCOME OF
SEGMENT**

Net income of the segment in 2007 amounted to NIS 227 million compared with NIS 46 million in 2006, an increase of 404.4%. Disregarding certain components (see hereunder), net income would have amounted to NIS 185 million in 2007, compared with NIS 74 million in 2006, an increase of 150.0 %.

The return on equity in 2007, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 36.3%, compared with 7.8% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 29.5% in 2007, compared with 12.3% in 2006.

Provision for doubtful debts in this segment amounted in 2007 to NIS 128 million, compared with NIS 183 million in 2006, a decrease of 30.0%.

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 year ended December 31, 2007						
Income from financing activities before provision for doubtful debts						
- From externals	765	7	3	89	33	897
- Intersegmental	(127)	-	-	(25)	(10)	(162)
Total income from financial activity	638	7	3	64	23	735
Operating and other income	290	7	45	15	2	359
Total Income	928	14	48	79	25	1,094
Provision for doubtful debts	107	-	-	13	8	128
Operating and other expenses	631	8	36	17	8	700
Operating Income before taxes	190	6	12	49	9	266
Provision for taxes on operating income	66	2	5	18	2	93
Net income	124	4	62	31	6	227
Net income disregarding certain components ⁽¹⁾	135	4	8	32	6	185
Yield on capital (percentage)	24.9			56.7	10.3	36.3
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	27.3			57.1	10.3	29.5
Average Assets	9,465	-	4	1,441	1,013	11,923
Average Liabilities	9,154	-	-	595	217	9,966
Average Risk-assets	8,271	243	4	893	1,017	10,428
Average assets of provident and mutual funds ⁽²⁾	-	-	1,861	-	-	1,861
Average customers' securities	-	-	4,748	-	-	4,748
Average other assets under management	-	-	300	-	-	300
Components of income from financing activities:						
Margin from credits activity	486	7	-	52	26	571
Margin from deposits activity	116	-	-	7	-	123
Other	36	-	3	5	(3)	41
Income from financing activities before provision for doubtful debts	638	7	3	64	23	735

(1) The following components have been eliminated: expenses in connection with early retirement plan and gains on sale of the provident funds activity and the activity of KAHAL.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

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Following are 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 year ended December 31, 2006						
Income from financing activities before provision for doubtful debts						
- From externals	622	7	5	77	25	736
- Intersegmental	(167)	-	-	(27)	(6)	(200)
Total income from financial activity	455	7	5	50	19	536
Operating and other income	252	11	47	19	2	331
Total Income	707	18	52	69	21	867
Provision for doubtful debts	158	-	-	25	-	183
Operating and other expenses	573	10	28	11	12	634
Operating Income (loss) before taxes	(24)	8	24	33	9	50
Provision for taxes on operating income	(4)	3	*9	14	4	26
Net income (loss)	(20)	5	39	19	3	46
Net income disregarding certain components ⁽¹⁾	*27	5	*18	21	3	74
Yield on capital (percentage)	(4.7)	16.7		22.7	4.7	*7.8
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	6.5	18.3		23.8	4.7	*12.3
Average Assets	8,501	-	4	2,320	1,182	12,007
Average Liabilities	6,767	-	-	519	276	7,562
Average Risk-assets	*6,898	*440	4	1,480	1,185	10,007
Average assets of provident and mutual funds ⁽²⁾	-	-	3,499	-	-	3,499
Average customers' securities ⁽²⁾	-	-	4,347	-	-	4,347
Average other assets under management	-	-	283	-	-	283
Components of income from financing activities:						
Margin from credits activity	335	6	-	36	12	389
Margin from deposits activity	89	1	-	6	-	96
Other	31	-	*5	8	7	51
Income from financing activities before provision for doubtful debts	455	7	5	50	19	536

*Reclassified.

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.



HUMAN CAPITAL In 2007, the average number of positions in the segment amounted to 1,537 including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, compared with 1,252 positions in 2006, an increase of 22.7%.

SERVICE TO SEGMENT CUSTOMERS The small business segment provides a variety of services to small and medium size business customers. Customers entitled to a credit facility of up to NIS 500 thousand receive these services through personnel in branches specializing in the needs of this segment, and through direct banking channels (Internet and Discount Telebank). Customers entitled to a credit facility exceeding NIS 500 thousand receive services through regional credit centers. The foreign trade department serves customers engaged in international trade. Every customer benefits from the entire range of the Bank's foreign trade services in specialist industry units that deal with all aspects of foreign trade, viz., exports, imports, financing, future financial instruments, electronic communication and relevant information on customers and suppliers. Activities of business clubs are also provided to customers of this segment. (For further information, see below, 'Corporate Banking Segment').

CREDIT CENTERS As part of the innovative and breakthrough concept of the Retail Banking Division for dealing with small business customers, the handling of the business activity of customers having a credit facility exceeding NIS 500 thousand, has been transferred to the regional credit centers. The credit centers are manned by teams of officers specializing in the credit field who provide quick and focused response adapted to the customer needs in this segment, which is to constitute the central target arena of the Retail Division of the Bank. The professional service provided and the operational efficiency contributes to the improvement of service and supports the leading values of retail business and humanity engraved on the flag of the Bank. Five credit centers in a nation wide distribution were opened since 2005: the Sharon Credit center, The Tel Aviv credit Center, the Haifa Credit Center with an northern extension in Nazareth, The Lowland Credit Center and the Jerusalem credit center with a southern extension in Beer-Sheva. The credit centers serve as professional service bureaus, while the account of the customer and its current activity remain in the related branch office.

COMPETITION The existing activity in this segment is mainly in the banking sector. The Bank's principal methods to cope with competition include timely response to customers' requests, development of personal relationships with customers and proposal of viable comprehensive professional solutions for financial requirements.

THE SMALL BUSINESS SEGMENT AT THE MERCANTILE DISCOUNT BANK The small business segment at the Mercantile Discount Bank is one of the outstanding segments of this bank and accordingly is a central target in its business development. Around one half of the customers of Mercantile Discount Bank who belong to this segment live in areas where the population has an absolute "non-Jewish" majority and receive banking services by means of 27 branches of this the bank belonging organizationally to the Acco and Nazareth

regions. Mercantile Discount Bank management believes that most of the customers belonging to such populations receive their services from Bank Leumi and Bank Hapoalim, while the balance of the activity is divided among the remaining banks.

In implementing its policy, which views the retail banking segment a central goal of its business development, Mercantile Discount Bank has instituted several moves aimed at increasing its share in this segment of operations. Among other things, six new branches were opened in 2007 in areas having a high potential for the granting of banking services to the small business segment, of which three branches in the Acco and Nazareth regions.

CORPORATE BANKING SEGMENT SEGMENT CUSTOMERS

This segment mainly includes companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 50 million who are customers of the Bank and of Mercantile Discount Bank. The segment included, up to December 31, 2006, customers of the business segment of the Mercantile Discount Bank - corporations whose annual business turnover generally exceeds NIS 150 million and public companies handled by the corporate division of Mercantile Discount Bank and customers with a scope of transactions less than NIS 150 million and a scope of credit exceeding NIS 15 million.

REVIEW OF DEVELOPMENTS IN THE BUSINESS SECTOR IN 2007

The increase in the volume activity in the business sector continued in 2007. The business product increased by 6.1%, compared to 6.5% in 2006. Growth was recorded in all economic sectors including the product of the residential real-estate sector, which grew at the rate of 5.5%.

The growth was reflected in the expansion of the volume of activity of domestic companies as a result of the increase in private consumption and in the levels of domestic demand. In addition, investments in fixed assets also increased by 14.2%, after an increase of 10.1% in 2006.

The growth rate of export based industries increased in 2007 compared to 2006. Exports of goods and services increased by 8.4%, compared to an increase of 5.9% in 2006. The growth in exports was led in 2007 by the electronics, chemistry-pharmaceutical industries and defense industries, alongside the contribution of the traditional industries to the overall growth which also increased, mostly metal, plastics and foodstuffs.

The increase in the volume of domestic activity and export contributed an improved margin of operating income, in cash flows and the debt repayment capability of most of the Bank's customers in the business sector.

The growth rate of the business product, levels of demand in the Israeli and foreign economies, volume of investments in the various economic sectors including the construction industry, all have a material impact on the development of the volume of operations and business results in the Bank's corporate segment.

DEVELOPMENTS IN THE OFF-BANKING CREDIT MARKET

Since 2002, there has been an intensifying trend of replacing bank credit with off-banking credit (principally direct and indirect credit by financial investors purchasing bond instruments). As a result, the weight of the off-banking credit in the total credit to the business sector has doubled from 22% in 2001 to 44% in 2006.



The annual growth rate of credit to the business sector in the years 2005-2006, being 9%, continued to grow also in 2007, reaching a rate of 11%. This growth stems from a growth of 22% in the off-banking credit and from a growth of 2% in bank credit. The increase in bank credit was reflected mainly in the first half of 2007, following a continued downward trend in recent years. As a result of this development, the downward trend of the share of the commercial banks in the business credit continued, falling from 55% at the end of 2006 to 51% at the end of 2007. The moderation in the downward trend of the weight of bank credit in the second half of 2007 derived from the following:

- A decline in the volume of bond issues by the business sector which started in the second half of the year. While in the first half of 2007 the business sector raised NIS 48 billion in bond issues, the volume decreased to NIS 29 billion, in the second half of the year. The total amount raised through bond issues in 2007 by the business sector amounted to NIS 77 billion, double the amount raised in 2006.
- A decline in the difference between growth rate of the off-banking credit compared to the growth rate of bank credit.

**EFFECT OF THE
ANTICIPATED
SLOWDOWN IN
ECONOMIC GROWTH
ON THE DEMAND FOR
BANK CREDIT**

The Bank anticipates slowdown in the rate of growth of credit to the business sector is anticipated in 2008 on the background of the anticipated slowdown in economic growth and the increase in returns and interest margins. Nevertheless, the Bank believes that a certain acceleration is expected in the rate of growth of bank credit to customers of the sector as a result of demand being diverted from the off-banking market and foreign markets to the local banking industry, due to the following developments:

- A decrease in the volume of bond issues by corporations compared to the first half of 2007, due to a more extensive examination on the part of institutional investors of the quality of the issuers;
- An expected decrease in the raising of funds by corporations on the background of the weakness of the primary market and a drop in prices of securities;
- Large volume of redemption of bonds issued in the years 2003-2007 by raising bank credit;
- The liquidity crisis in some of the developed markets caused Israeli corporations to divert their financing sources from foreign markets to the Israeli banking industry.
- The liquidity crisis in some of the developed markets is expected to adversely affect the ability to raise financing sources by Israeli corporations operating abroad, particularly with respect to financing large merger and acquisition transactions, a fact that will increase the demand for financing sources from the domestic banking industry.

**EXPECTED
DEVELOPMENTS IN THE
SEGMENT'S MARKETS**

The volume of operations of the business sector is expected to continue growing in 2008, though at a lower growth rate compared to 2007, influenced mainly by the following developments:

- The rate of growth in exports of goods and services is expected to slow down as a result of a decline in demand in the developed countries and the United States in particular, to which an important part of Israeli exports are directed, particularly that of the hi-tech industries. The

continued appreciation in the exchange rate of the Shekel as against the dollar is expected to result in the continued decline in income from exports and intensify the harm caused to the exporters' profitability;

- The "subprime" crisis causes a decline in supply of financial resources, a slowdown in the volume of real-term operations of global companies, causing a decrease in their investment budgets, bringing about a decline in demand for investment products of domestic companies;
- The rate of growth in private consumption is expected to decline as a result of a reduction in workforce, mainly in export based industries, on the background of economic slowdown and decline in profitability, increased inflationary pressure (increase in the prices of food, energy and raw materials) and a fall in the consumer confidence index due to the "wealth effect" being adversely affected on the background of the declining capital market and the escalation in the defense situation.

The above information constitutes forward-looking information. The said information may not be realized if a significant slowdown takes place in the rate of growth of domestic and external demand as a result of a marked slowdown in activity of the global markets, changes in interest rates in world and domestic markets, an intensified weakness of the capital market, worsening political and security situation and other developments in macro-economic conditions that are not under the Bank's control.

**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 Antitrust Commissioner, the Israel Securities Authority etc. The principal restrictions applicable to this segment are briefly described hereunder.

Limitations on indebtedness of a single borrower, a group of borrowers and all the six large borrower groups. The Proper Bank Management directives contain restrictions with respect to the extent of the indebtedness allowed to any single borrower or group of borrowers, and the extent of the total indebtedness allowed to the bank's six largest borrower groups and to certain customers defined as 'related persons'. These restrictions may have adverse implications on the manner and scope of the Bank's business segment operations insofar as they relate to these customers.

As of December 31, 2007, the limitation on groups of borrowers was computed at the rate of 30% of the Bank's equity while the limitation on the total indebtedness of the six largest borrowers and groups of borrowers was computed at the rate of 135% of the Bank's equity, this in accordance with Proper Banking Management Directive no. 313.

The Bank determined an internal policy according to which the total debt of the borrower group will not exceed 25% of the Bank's equity.

As of December 31, 2007 no deviations existed to the limitations regarding a single borrower, groups of borrowers and the six largest groups of borrowers, as set in the Supervisor's directives.

As from April 1, 2008 the Bank will compute the limitation on groups of borrowers at the rate of

25% of the Bank's equity while the limitation on the total indebtedness of the six largest borrowers and groups of borrowers will be computed at the rate of 150% of the Bank's equity, this in accordance with the approval of the Supervisor of Banks.

The limitation on "related parties". The permit granted by the Governor of Bank of Israel to the Bronfman-Schron Group determined that the members of the Bronfman Group and Mr. Schron are to reduce their indebtedness to the Bank, in order to comply with the provisions of Proper Banking Management Directive No. 312, regarding the business of a banking corporation with related parties. During January 2006, proximately prior to the receipt of the permit, the members of the Bronfman-Schron Group reduced their indebtedness. In the third quarter of 2006, the Bank was informed by the Supervisor of Banks of a new guideline concerning a certain change in the computation of the limitation relating to the controlling shareholders, compared with Proper Banking Management Directive No. 312. As of December 31, 2007, there were no deviations from the said limitations.

Basel II. The Basel Commission published new guidelines, commonly known as Basel II, which came into effect in certain countries towards the end of 2006. As part of its preparations for meeting the requirements in this issue, the Bank of Israel has, for the present, provided guidelines in relation to the grading of customers (for further information on this matter, including information on the Bank's preparations see "Exposure to risks and risk management" above).

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2007 amounted to NIS 347 million compared with NIS 217 million in 2006, an increase of 59.2%. Disregarding certain components (see hereunder), net income would have amounted to NIS 354 million in 2007 compared with NIS 261 million in 2006, an increase of 35.6%

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 14.7% in 2007, compared with 9.9% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 15.0% in 2007, compared with 11.9% in 2006.

Provision for doubtful debts in this segment amounted in 2007 to NIS 60 million compared with NIS 159 million in 2006, a decrease of 62.3%.

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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 year ended December 31, 2007								
Income from financing activities before provision for doubtful debts								
- From externals	552	-	497	1,049	174	21	195	1,244
- Intersegmental	(102)	1	(201)	(302)	(14)	-	(14)	(316)
Total income from financial activity	450	1	296	747	160	21	181	928
Operating and other income	149	41	14	204	22	4	26	230
Total Income	599	42	310	951	182	25	207	1,158
Provision for doubtful debts	7	-	42	49	8	3	11	60
Operating and other expenses	346	23	70	439	100	10	110	549
Operating Income before taxes	246	19	198	463	74	12	86	549
Provision for taxes on operating income	87	7	74	168	37	2	39	207
Net income	159	16	125	300	37	10	47	347
Net income disregarding certain components ⁽¹⁾	163	12	126	301	43	10	53	354
Yield on capital (percentage)	12.6		17.3	15.1	11.7	17.1	12.5	14.7
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	13.0		17.4	15.2	12.9	17.1	13.5	15.0
Average Assets	22,181	25	8,563	30,769	5,801	945	6,746	37,515
Average Liabilities	9,340	3	2,495	11,838	4,634	3	4,637	16,475
Average Risk-assets	20,909	24	12,040	32,973	5,501	966	6,467	39,440
Average assets of provident and mutual funds ⁽²⁾	-	99	-	99	-	-	-	99
Average customers' securities	-	39,488	2	39,490	-	-	-	39,490
Average other assets under management	-	152	-	152	-	-	-	152
Components of income from financing activities:								
Margin from credits activity	362	-	189	551	130	18	148	699
Margin from deposits activity	24	-	7	31	29	-	29	60
Other	64	1	100	165	1	3	4	169
Income from financing activities before provision for doubtful debts	450	1	296	747	160	21	181	928

(1) The following components have been eliminated: expenses in connection with early retirement plan gains on sale of the provident funds activity and the activity of KAHAL and the cost of performing examinations and improvements at IDB New York.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

Following are 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 year ended December 31, 2006								
Income from financing activities before provision for doubtful debts								
- From externals	787	3	512	1,302	(53)	15	(38)	1,264
- Intersegmental	(305)	-	(183)	(488)	123	-	123	(365)
Total income from financial activity	482	3	329	814	70	15	85	899
Operating and other income	122	*32	15	169	10	4	14	183
Total Income	604	35	344	983	80	19	99	1,082
Provision for doubtful debts	103	-	51	154	3	2	5	159
Operating and other expenses	396	11	72	479	69	7	76	555
Operating Income before taxes	105	24	221	350	8	10	18	368
Provision for taxes on operating income	43	*10	91	144	6	3	9	153
Net income	62	16	130	209	2	7	9	217
Net income disregarding certain components ⁽¹⁾	95	*13	139	247	7	7	14	261
Yield on capital (percentage)	4.6		18.8	10.4	2.2	14.0	5.1	9.9
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	7.3		19.5	12.3	4.9	14.0	7.1	11.9
Average Assets	22,298	29	*10,253	32,580	3,385	760	4,145	36,725
Average Liabilities	9,387	3	1,359	10,749	3,652	7	3,659	14,408
Average Risk-assets	21,590	21	*11,890	33,501	2,383	781	3,164	36,665
Average assets of provident and mutual funds ⁽²⁾	-	227	3	230	-	-	-	230
Average customers' securities ⁽²⁾	-	25,435	34	25,469	-	-	-	25,469
Average other assets under management	-	130	-	130	-	-	-	130
Components of income from financing activities:								
Margin from credits activity	374	1	204	579	38	14	52	631
Margin from deposits activity	43	-	5	48	31	-	31	79
Other	65	2	120	187	1	1	2	189
Income from financing activities before provision for doubtful debts	482	3	329	814	70	15	85	899

*Reclassified.

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan, payments to the supervisory authorities in the US, the cost of performing examinations and improvements at IDB New York and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.

HUMAN CAPITAL In 2007, the average number of positions in the segment amounted to 902, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment compared with 1,004 positions in 2006, a decrease of 10.0%. A relatively high percentage of this segment's personnel has an academic education. Currently, within the Bank framework, these personnel undergo professional training in various banking sectors and in management services. The personnel are required to analyze complex credit requests and to provide high level service.

ORGANIZATIONAL CHANGES A decision was taken in October 2006 regarding the reorganization of the business layout at the Bank. In this context, the Commercial Banking Division was merged into the Corporate Banking Division, in the form of the commercial banking division under a member of Management, the head of the Corporate Division.

The merger of these two divisions enables focus and deployment in the risk management area, enabling the system and decision making process more effective, and a renewed deployment of the Bank's business formation layout.

This decision is intended to achieve several principal goals:

- A "one stop shop" business service system - The new deployment will enable business customers of the Bank to receive an all inclusive service, while setting professional standards, which will provide full response to their needs, both in the active and passive fields.
- Efficiency - The new deployment enables the unification of the two divisions creating one unit and accordingly, more efficient procedures.

SERVICE TO SEGMENT CUSTOMERS The business segment enjoys professional banking services provided by the Corporate Division. In 2007, the division intensified its expertise in the comprehensive financial guidance (One Stop Shop), i.e., an in-depth examination of the company's needs and the adoption of creative financial solutions. Customers are provided with personal, professional and quality service that relates to all their financial needs by offering customized various banking products in the credit, exchange-rate hedging, international trade, settlement through the use of credit cards, financing, specialist capital market investments, etc.

Concurrently, solutions are also devised for meeting the financial needs of the owners of companies, and their executives and staff, who thus benefit from arrangements that afford them the status of preferred customers.

The rolling finance arrangements for the big companies are implemented through business managers in the corporate company department of the Corporate Division. The teams are allocated to customers by reference to the field of business activity in which the companies are engaged. The teams include a business manager, a business banker, economists and credit officers. Such a team provides the banking support for all the financial needs of the business customer.

The various banking services are provided through the branches.

The Diamond Exchange Branch serves diamond industry customers. The branch specializes in accounts of diamond merchants as well as in all the special services required by the diamond industry. **The Bank's Project Financing Department** works with those customers entitled to benefits from the State by providing finance for the acquisition or construction of equipment and buildings, and for the establishment or expansion of tourist and industrial projects, by virtue of the provisions of the Law for the Encouragement of Capital Investments.

The foreign trade department serves customers engaged in international trade (for further information, see below).

Discount Leasing Ltd., a company wholly owned by the Bank, implements financing transactions for customers, in a variety of areas.

Some of the segment's customers utilize the services of the Bank's trading desk (see below, 'Finance management segment') and the overseas offices of the Bank (see below, 'International operations segment').

The services of the **Tel Aviv Main Branch** are also at the disposal of the customers. This branch is unique due to the large amount of assets and liabilities managed there. The branch focuses on the Bank's large business customers and on providing services to financial and institutional entities, including custodian services to foreign institutions.

FOREIGN TRADE OPERATIONS

General. The foreign trade department operates within the framework of the Bank's Corporate Banking Division, and offers a range of services to customers from the various business segments engaged in international trade.

Scale of operations. 2007 was characterized by the continued acceleration of the import and export activities in the market. According to the data of the Central Bureau of Statistics, the import of goods (excluding services and diamonds) recorded a growth of 20.2% as compared with 2006 and the export of goods (excluding services and diamonds) recorded a growth of 16.5% as compared with the year 2006.

Import transactions made through the Bank increased in 2007 by 22% compared with 2006, and the Bank's share in the total activity of the banking industry in this field in 2007 comprised 10.96%.

An increase of 12% was recorded in export transaction at the Bank in 2007 compared with 2006 and the Bank's share in the total activity of the banking industry stood at 8.5% in 2007, compared with 8.6% in 2006.

The business activity of the foreign trade department coordinates in each department all the services in the foreign trade field that the customer requires (import, export, finance, financial instruments, etc.). The personal and direct relations with the customer are particularly emphasized alongside the current communication of the customer with his business manager at the Bank, with the view of intensifying the activity with customers.

The business development activity expanded in 2007, and according to the formed plan, an initiated activity for the identification of potential customers was carried out. Concurrently, activity with existing customers was intensified, while providing customers with a professional and personal service.

Improvement of service. Within the framework of the continued effort for improving the quality of customer service, the operating hours of the Division were extended on Mondays and Thursdays until 18:30 hours. These operating hours are in addition to the “green route” whereby quick service is provided also beyond regular operating hours at times of heavy work load.

During 2007 the Bank continued to concentrate the foreign trade operations at the three centers - Tel Aviv, Haifa and Jerusalem and to reduce the number of branches dealing independently with foreign trade operations. The process is to be completed in 2008, when the activity of the remaining 18 branches will be integrated.

Technological improvements. A system for conducting foreign trade activity through the Internet has been acquired. The system’s characterization and pilot stages have been completed, and as from the beginning of 2008 it enables transacting direct import payments and the transfer of foreign currency.

**DEVELOPMENTS IN THE
SECTOR’S MARKETS
AND IN CUSTOMER
CHARACTERIZATION**

The large customers and the large borrower groups in the economy form a substantial part of the Bank’s corporate customer portfolio. The increase in recent years in the volume of mergers and acquisitions activity in the market contributed to the increase in the weight of large borrowers and large borrower groups in the activity of the corporate segment at the Bank. Many of this segment’s customers have increased the volume of their activity outside Israel in recent years. In this manner the granting of credit to these customers is sometimes used for the expansion of their activity abroad.

**TECHNOLOGICAL
CHANGES THAT MAY
HAVE A MATERIAL
IMPACT ON THE
SEGMENT**

The information systems serving this segment are designed to support procedures of analyzing customer needs and control and marketing processes.

The corporate banking segment is engaged currently in updating and upgrading its information systems that are utilized to analyze and to measure various risks (mainly credit risks) and to monitor and to control customer activity in “real time”.

The segment focuses on improving the systems for measuring customer profitability and for reliable assessment of the customer’s contribution to profitability.

**CRITICAL SUCCESS
FACTORS IN THE
SEGMENT**

- Committed and long-term customer relationships, quality service, prompt response to credit requests and to the overall related services (foreign trade operations, security investment, derivative financial instruments, banking services to corporate executives and owners, etc.);
- Efficient management of the credit portfolio from the aspects of measurement, costing and sophisticated risk management “in real time”, focusing on credit risks, while maintaining proper credit control systems for identifying and minimizing risks;
- The professional training of quality and proficient manpower;
- Improvement of the technical ability to provide services;
- Relations with large banks in Israel and abroad for the purpose of participation in syndication transactions led by them.

(For details regarding the Antitrust Commissioner’s instruction in this issue, see “Principles of conduct” under “Legislation and supervision”).

**PRINCIPLE ENTRY AND
EXIT BARRIERS OF THE
SEGMENT**

Customers of the segment transact business concurrently with several other banks, so that The relative advantage of the segment is based upon long-term relationships with the customers, including continued satisfaction with the quality of service and providing prompt and suitable solutions to complex financing needs.

A large number of large corporations have adopted a balanced leverage policy, reflected in the use of bank financing sources together with use of off-banking means of finance, on the background of the improvement in opportunities of raising finance on the capital market and the reduction in financing costs.

Entry and exit barriers may arise as a result of the need for the appropriate allocation of capital and compliance with regulatory limitations of the Bank of Israel, which impact the manner and volume of activity vis-à-vis borrowers and groups of borrowers.

Expanding financing operations and related services to Israeli corporations operating abroad, and/or to Israeli-owned foreign corporations, requires The enlargement of infrastructure in a suitable geographic disposition, which includes the establishment of additional extensions and/or branches abroad.

The long-term resources available to the Bank for credit financing are limited in relation to the short and mid term resources. Accordingly, cooperation with institutional investors is required for financing long-term projects in the income generating real-estate and infrastructure fields and/or by way of the sale of a part of the long-term bank credit.

**SUBSTITUTES FOR
PRODUCTS AND
SERVICES OF THE
SEGMENT AND
CHANGES THEREIN**

As a substitute for bank credit to customers of the business segment, alternative financing products offered by off-banking financial institutions in general and institutional entities in particular have been developed.

These bank credit substitutes include the raising of finance by way of the issue of shares, bonds and other securities on the capital markets in Israel and abroad, including direct credit offered by such entities.

The off-banking finance constitutes an alternative financing source, mainly for long and medium term credit products, which contributes to the reduction in volume of such credit in the credit portfolio reflecting the activity of the segment.

**COMPETITION IN THE
SEGMENT AND
CHANGES THEREIN**

The business segment is exposed to ever-increasing competition from the other four large banking groups as well as from foreign banks (HSBC, Citigroup, BNP) that intensify their activity in the local market.

The level of competition on the part of institutional bodies also increased in recent years, mainly insurance companies and pension funds, which established off-banking credit departments.

The increased competition between the banks stems mainly from the improvement in capital adequacy and the increase in the supply of financial resources on the part of the off-banking system. The increased competition between the banks alongside the increase in the issue of debt securities by corporations resulted in a significant increase in the market share of the off-banking financing

of the total financing resources available to corporate customers (see “Developments in the banking and off-banking credit market” above).

The accelerated competition has contributed, as from the second half of 2004, to a continuous process of reduction in financial margins and in operating commissions that typify this segment.

MARKETING AND DISTRIBUTION Activity of the corporate banking segment in marketing credit and related services to existing and new customers is implemented principally by business managers engaged in the adaptation of financing solutions to the various transactions. Identification and analysis of comprehensive banking needs of customers and in appropriate adaptation of the Bank's products of the Bank to these customers' needs and requirements, as well as in the “real-time” provision of such services. The bank's products are also marketed and distributed relative to owners, executives and employees of the corporations.

DEALING WITH COMPETITION The high level of competition in the segment is reflected in the quality and sophistication of the service, prompt reaction and the cost of credit and commissions. The segment's main tools in facing competition include the provision of personal, professional and quality service and the establishment of a long-term relationship with customers, while acquiring an overall understanding of their financial needs.

PRODUCTS AND SERVICES The services offered include current financing according to customer needs, including among other things, foreign trade activity and the trading desk, financing of investments for maintaining and expanding activity, the financing of acquisitions and mergers, granting credit to capital market operators, participating in credit and/or risk offered by the large local banks or foreign financial institutions extending credit to Israeli corporations operating abroad. In addition, these include related services such as deposit accepting and investment activities, derivative financial instrument activities, granting financial guarantees, advances, execution and so forth. The increase in demand for credit required for financing acquisitions and mergers continued in 2007 on the background of the many transactions carried out in this field. The Bank participated in these transactions and even led several such transactions.

TARGETS AND BUSINESS STRATEGY

- Providing financing solutions to every transaction conducted by the Bank's customers;
- Competing for the large financing transactions carried out in the market;
- Expansion of the activity with institutional investors and capital market operators;
- Recruitment of new customers and intensifying activity with existing customers;
- Providing credit to large corporations by way of acquiring a share of the credit organized by local and foreign banks;
- Improving the quality of the Bank's credit portfolio, and increasing debt and collection activity;
- Improving the quality of service, while moving to an overall view of customer needs and providing overall solutions;

- Preparation for the implementation of the "Basel II" provisions;
- Skillful management of the credit portfolio while monitoring the risk profile;
- Continued improvement of the technological infrastructure supporting the identification, measurement, analysis and control of various risks, focusing on credit and operational risks.

**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 10 - 50 million who are customers of the Bank and of Mercantile Discount Bank. The segment also includes Mercantile Discount Banks commercial banking customers - business 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.

**SCALE OF OPERATIONS
AND NET INCOME OF
THE SEGMENT**

Net income of the segment in 2007 amounted to NIS 103 million compared with NIS 9 million in 2006. Disregarding certain components (see hereunder), net income would have amounted to NIS 93 million in 2007 compared with NIS 70 million in 2006, an increase of 32.9%.

The return on equity in 2007, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 7.5% in 2007 compared with 0.6% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 6.8% in 2006 compared with 5.8% in 2006.

Provision for doubtful debts in this segment amounted in 2007 to NIS 124 million, compared with NIS 117 million in 2006, an increase of 6.0%.

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	Domestic operations					International operations				
	Banking and financing	Credit cards	Capital market	Construction and real estate	Mortgage	Total financing	Banking and real estate	Total	Total	Total
For the year ended December 31, 2007										
Income from financing activities before provision for doubtful debts										
- From externals	668	2	2	126	38	836	240	158	398	1,234
- Intersegmental	(391)	(1)	-	(59)	(26)	(477)	2	(39)	(37)	(514)
Total income from financial activity	277	1	2	67	12	359	242	119	361	720
Operating and other income	114	1	26	11	2	154	30	20	50	204
Total Income	391	2	28	78	14	513	272	139	411	924
Provision for doubtful debts	100	-	-	10	(1)	109	9	6	15	124
Operating and other expenses	341	-	14	23	1	379	217	89	306	685
Operating Income (loss) before taxes	(50)	2	14	45	14	25	46	44	90	115
Provision for taxes on operating income	(25)	1	6	17	4	3	21	17	38	41
Net income (loss)	(25)	1	37	28	10	51	25	27	52	103
Net income (loss) disregarding certain components ⁽¹⁾	(21)	1	9	28	10	28	35	31	65	93
Yield on capital (percentage)	(5.0)	14.5		19.9	31.8	7.4	6.1	10.1	7.6	7.5
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	(3.9)	14.8		20.2	31.8	4.1	8.4	11.5	9.6	6.8
Average Assets	9,395	15	1	1,971	545	11,927	5,477	3,692	9,169	21,096
Average Liabilities	5,869	3,715	-	411	-	9,995	6,697	824	7,521	17,516
Average Risk-assets	8,508	78	1	2,389	519	11,495	6,973	4,347	11,320	22,815
Average assets of provident and mutual funds ⁽²⁾	-	-	906	2	-	908	-	-	-	908
Average customers' securities	-	-	11,853	34	-	11,887	-	-	-	11,887
Average other assets under management	1,040	-	555	-	-	1,595	-	-	-	1,595
Components of income from financing activities:										
Margin from credits activity	213	1	-	50	9	273	151	103	254	527
Margin from deposits activity	30	-	-	4	-	34	90	15	105	139
Other	34	-	2	13	3	52	1	1	2	54
Income from financing activities before provision for doubtful debts	277	1	2	67	12	359	242	119	361	720

(1) The following components have been eliminated: expenses in connection with early retirement plan, the cost of performing examinations and improvements at IDB New York and gains on sale of the provident funds activity and the activity of KAHAL.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

Following are 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 year ended December 31, 2006										
Income from financing										
activities before provision										
for doubtful debts										
- From externals	908	1	2	77	23	1,011	182	27	209	1,220
- Intersegmental	(645)	-	-	(43)	(15)	(703)	82	71	153	(550)
Total income from										
financial activity	263	1	2	34	8	308	264	98	362	670
Operating and										
other income	108	1	*25	7	-	141	30	7	37	178
Total Income	371	2	27	41	8	449	294	105	399	848
Provision for										
doubtful debts	86	-	-	18	1	105	5	7	12	117
Operating and										
other expenses	367	1	18	*5	1	392	247	69	316	708
Operating Income										
(loss) before taxes	(82)	1	9	18	6	(48)	42	29	71	23
Provision for taxes										
on operating income	(29)	-	*3	*6	3	(17)	23	10	33	16
Net income (loss)	(53)	1	8	12	3	(29)	19	19	38	9
Net income (loss) disregarding										
certain components ⁽¹⁾	(18)	-	7	11	4	4	42	24	66	70
Yield on capital (percentage) (10.6)	-	-	-	12.1	9.9	(5.2)	4.6	10.2	6.4	0.6
Yield on capital disregarding										
certain components ⁽¹⁾										
(Percentage)	(3.7)	-	-	19.7	9.9	0.5	10.1	13.0	11.0	5.8
Average Assets	8,766	16	1	1,547	629	10,959	8,156	3,647	11,803	22,762
Average Liabilities	6,988	*1,623	-	142	-	8,753	4,026	487	4,513	13,266
Average Risk-assets	8,288	16	1	912	642	9,859	6,942	3,185	10,127	19,986
Average assets of provident										
and mutual funds ⁽²⁾	-	-	1,505	-	-	1,505	-	-	-	1,505
Average customers'										
securities ⁽²⁾	-	-	10,992	-	-	10,992	-	-	-	10,992
Average other assets										
under management	1,030	-	554	-	-	1,584	-	-	-	1,584
Components of income from										
financing activities:										
Margin from credits activity	199	1	-	26	6	232	124	97	221	453
Margin from deposits activity	38	-	-	2	-	40	140	-	140	180
Other	26	-	2	6	2	36	-	1	1	37
Income from financing										
activities before provision										
for doubtful debts	263	1	2	34	8	308	264	98	362	670

*Reclassified.

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan, payments to the supervisory authorities in the US, the cost of performing examinations and improvements at IDB New York and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.

HUMAN CAPITAL In 2007, the average number of positions in the segment amounted to 1,273, including positions of employees directly related to the segment and positions of staff members at various levels, whose employment costs are charged to the segment, compared with 1,426 positions in 2006, a decrease of 10.7%.

SERVICE TO SEGMENT CUSTOMERS The commercial banking segment enjoys professional banking services provided through the Commercial Banking unit of the Corporate Banking Division. Customers are provided with personal, professional and quality service that relates to all their financial needs by offering customized various banking products in credit, exchange-rate hedging, international trade, settlement through the use of credit cards, financing, specialist capital market investments, etc. Concurrently, solutions are also provided for meeting the financial needs of the owners of companies, and their executives and staff, who thus benefit from arrangements that afford them the status of preferred customers. The products and services are adapted to the business requirements of customers and also include, alongside the varied credit products foreign trade services, risk hedging by way of financial instruments and investment services in various channels: deposits, securities and the handling of business and private accounts.

Customer service is provided at business centers situated in the Dan, Sharon, Tel Aviv, Southern, Jerusalem and Haifa as well as through the Corporations Department at the Tel Aviv Main Branch. The service provided by the centers is integrative, provided by teams that include business bankers, economists, investment advisors and credit officers. In order to adapt the service to the business customer, the customer is referred to a business-oriented branch of the Bank at which unique service teams are set up to meet customer requirements as and when they arise.

With the objective of upgrading the quality of customer service and with a view of providing an overall financial solution, it has been decided to improve the branch-business center interface. A pilot run has been conducted at two business centers, within the framework of which most of the operational activity carried out at the branches has been transferred to the business centers. Customer satisfaction surveys show ample satisfaction from this change and accordingly it has been decided to expand the pilot run to all business centers.

The foreign trade department serves customers engaged in international trade. Every customer benefits from the entire range of the Bank's foreign trade services in specialist industry units that deal with all aspects of foreign trade, viz., exports, imports, financing, future financial instruments, electronic communications, and relevant information on customers and suppliers. (For further information, see above, "Corporate Banking Segment").

Discount Leasing, a wholly owned subsidiary of the Bank, implements financing transactions for customers.

ACCUMULATING INVESTMENTS AND SAVINGS AT BUSINESS CENTERS In 2007, the liabilities side of the medium corporation segment at the business centers increased by 12.7%. This growth is reflected in all investment channels having a widespread selection of customers, both corporations and executives of customer corporations. These fine results, derive, among other things, from the positioning of investment consultants at the business centers.

COMPETITION 2007 was characterized by the decline in the business risk in the market, the continued improvement in the condition of corporations, the increase in trade and foreign trade turnovers and the growth in business activity. As a result of these changes, a continued erosion in financial margins and increased competition between the banks, insurance companies and the primary market.

PRIVATE BANKING This segment includes, as part of the Bank's domestic operations customers of the Bank's Retails
SEGMENT Division (individuals and corporations), who maintain their accounts at private banking centers.
SEGMENT CUSTOMERS These customers are generally Israeli customers having deposits of NIS 2 million and over, as well as foreign residents. The segment also includes customers of Mercantile Discount Bank of medium and high wealth and all the activity of the subsidiary in Geneva and the private banking customer activity at IDB New York.

STRUCTURE OF The International Private Banking Division was set up at the beginning of 1999, and has since
SEGMENT grown in the extent of its assets. At the end of 2001, the Bank embarked on a plan of intensifying its efforts to recruit and retain customers, including those of the domestic private banking segment responsibility for which had been assigned to the division.

The International Private Banking Division provides services to foreign residents, foreign corporations and Israeli citizens permanently residing abroad and to local private banking customers and Israelis of considerable financial wealth, according to a set profile.

In addition the Division's Global Center supports operations of the Bank's overseas extensions, working in full cooperation with them. These activities include assistance in attracting new customers, providing information regarding the overseas extensions and enhancing the awareness of branches and Head Office employees to the services of the Group.

In 2007, private banking at Discount Bank continued to position itself as a suitable service layout at the Bank's branches to this segment's customers, while preserving the maintenance of their accounts at the branches.

STRATEGIC EMPHASIS In the international private banking arena emphasis is placed on initiated professional and specialized service, while being committed to discretion and to a rapid response to the customers' needs, both in the field of investments and in the field of credit.

Providing service both to Israelis and to foreign residents in one layout, as stated above, provides customers with an advantage of high accessibility to the global arena. This advantage is also enhanced by the synergy between the Bank's infrastructure in the fields of information and operations, which are designed for the needs of this unique segment of customers.

Another strategic basis can be found in the private banking services provided to customers, without them having to transfer their accounts for this purpose. This mode of operation intensifies the ties between the customer and the Bank without severing the warm and humane ties that accompanied him prior to his attachment to the private banking layout.

**SCALE OF OPERATIONS
AND NET INCOME OF
THE SEGMENT**

Net income of the segment in 2007 amounted to NIS 43 million compared with NIS 31 million in 2006, an increase of 38.7%. Disregarding certain components (see hereunder), net income would have amounted to NIS 43 million in 2007 compared with NIS 56 million in 2006, a decrease of 23.2%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 18.3% in 2007 compared with 21.1% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 18.4% in 2007 compared with 39.2% in 2006.

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 year ended December 31, 2007							
Income from financing activities before provision for doubtful debts							
- From externals	127	1	128	6	-	6	134
- Intersegmental	(22)	-	(22)	202	-	202	180
Total income from financial activity	105	1	106	208	-	208	314
Operating and other income	34	44	78	12	50	62	140
Total Income	139	45	184	220	50	270	454
Provision for doubtful debts	-	-	-	5	-	5	5
Operating and other expenses	118	31	149	195	37	232	381
Operating Income before taxes	21	14	35	20	13	33	68
Provision for taxes on operating income	7	6	13	22	3	25	38
Net income (loss)	14	21	35	(2)	10	8	43
Net income disregarding certain components ⁽¹⁾	17	9	26	6	11	17	43
Yield on capital (percentage)	47.2		118.9	(0.9)		3.7	18.3
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	58.8		88.9	2.9		8.1	18.4
Average Assets	1,085	8	1,093	2,857	-	2,857	3,950
Average Liabilities	18,736	-	18,736	18,610	-	18,610	37,346
Average Risk-assets	737	8	745	3,205	-	3,205	3,950
Average assets of provident and mutual funds ⁽²⁾	-	1,250	1,250	-	-	-	1,250
Average customers' securities	-	8,078	8,078	-	8,646	8,646	16,724
Average other assets under management	-	615	615	93	-	93	708
Components of income from financing activities:							
Margin from credits activity	19	-	19	27	-	27	46
Margin from deposits activity	85	-	85	181	-	181	266
Other	1	1	2	-	-	-	2
Income from financing activities before provision for doubtful debts	105	1	106	208	-	208	314

(1) The following components have been eliminated: expenses in connection with early retirement plan, the cost of performing examinations and improvements at IDB New York and gains on sale of the provident funds activity and the activity of KAHAL.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

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

	Domestic operations			International operations				Total
	Banking and financing	Credit cards	Capital market	Total	Banking and financing	Capital market	Total	
For the year ended December 31, 2006								
Income from financing activities before provision for doubtful debts								
- From externals	(59)	-	1	(58)	872	-	872	814
- Intersegmental	146	-	-	146	(658)	-	(658)	(512)
Total income from financial activity	87	-	1	88	214	-	214	302
Operating and other income	28	-	48	76	35	19	54	130
Total Income	115	-	49	164	249	19	268	432
Provision for doubtful debts	-	-	-	-	2	-	2	2
Operating and other expenses	104	1	33	138	220	17	237	375
Operating Income (loss) before taxes	11	(1)	16	26	27	2	29	55
Provision for taxes on								
operating income	6	-	9	15	17	-	17	32
Net income (loss)	5	(1)	15	19	10	2	12	31
Net income disregarding certain components ⁽¹⁾								
	18	-	9	27	26	3	29	56
Yield on capital (percentage)	15.8	-		73.7	8.2		8.9	21.1
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	65.1	-		101.9	22.6		24.6	39.2
Average Assets	1,221	1	7	1,229	2,304	-	2,304	3,533
Average Liabilities	17,814	-	-	17,814	19,664	-	19,664	37,478
Average Risk-assets	630	1	7	638	1,759	-	1,759	2,397
Average assets of provident and mutual funds ⁽²⁾								
	-	-	1,262	1,262	-	-	-	1,262
Average customers' securities ⁽²⁾	-	-	7,489	7,489	-	9,901	9,901	17,390
Average other assets under management								
	-	-	499	499	127	-	127	626
Components of income from financing activities:								
Margin from credits activity	16	-	-	16	51	-	51	67
Margin from deposits activity	68	-	-	68	163	-	163	231
Other	3	-	1	4	-	-	-	4
Income from financing activities before provision for doubtful debts								
	87	-	1	88	214	-	214	302

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan, payments to the supervisory authorities in the US, the cost of performing examinations and improvements at IDB New York and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.

HUMAN CAPITAL In 2007, the average number of positions in the segment amounted to 542, including positions of employees directly related to the segment and positions of staff members whose salaries are attributed to the segment compared with 475 positions in 2006, an increase of 14.1%. Personnel in the private banking segment undergo training, including professional and administrative courses and studies for the position of investment consultant, leading to receipt of a consultant's license from the Securities Authority.

SERVICE TO CUSTOMERS Private banking customers are offered an "enveloping" service package, which commits the Bank's and the Group's resources to providing an optimal response to customers' needs alongside a commitment towards taking the initiative in dealings with them.

Segment customers enjoy the highest level of banking services in five private banking centers, in which bankers, experienced in the field of financial investments in Israel and abroad are at their disposal. Most of the staff has a command of foreign languages compatible with the language of the customer they serve. In addition, customers benefit from direct access to dealing rooms, direct banking via the Internet, as well as services provided by subsidiaries of the Bank: trusteeship, family office and investment banking, compatible with the needs of this segment's customers.

The private banking center, located at the Ayalon Insurance building, in the Diamond Exchange area in Ramat-Gan, offers overall banking solutions, tailored to the needs of its high net worth customers, both Israelis and foreign residents including corporations, while focusing on unique investment products as well as credit and finance facilities. The center has a "long-arm" in Haifa, for service of customers residents of Haifa and the North.

At the International Private Banking centers in Tel Aviv, Jerusalem and Netanya, specialized services are provided to foreign residents, individuals and overseas corporations including Israelis residing overseas. These centers provide both investment and credit services. In 2007, the activity of providing loans for the purchase of real estate in Israel continued to increase, concurrently with the increase of investments in this field by foreign investors.

The Business Promotion Department operates "Global Centers", that enable private customers and corporations to enjoy the maximum benefit from the international network of the Bank. The segment also supports the business development of the Bank's branches, especially relative to foreign residents, and reinforces the Bank's head office activity with respect to this unique customer segment.

DEVELOPMENTS IN THE SEGMENT'S MARKETS Customers of the private banking segment are exposed to a variety of financial investment products, focusing more and more on global financial instruments.

AND COMPETITION The year 2007 was characterized by the continued gradual increase in the activity of Israeli customers in foreign markets, following the equalization of taxes on domestic and foreign investments by Israeli residents. Furthermore, Israeli and foreign resident customer activity has grown significantly in the field of non-financial investments and real-estate in Israel and private banking has prepared to provide a response for the financing needs of customers also in this field too.

Extensive competition exists in the private banking segment, reflected in the tendency of customers to maintain accounts at several banks, in Israel and abroad. Most Israeli banks have expanded service

and marketing efforts in respect of private banking customers, in accordance with the composition of this segment at each bank. Competition exists also with respect to branches and local representative offices of foreign banks, including Israeli banks operating overseas, and with respect to insurance companies and investment houses, which offer services to the same target group.

MARKETING AND DISTRIBUTION

Most of the marketing efforts as regards private banking are based on the referral of customers by “word of mouth”. Marketing an “enveloping” service package is carried out by means of personal meetings whether at the customer’s location or at the Bank’s offices as well as at focused conventions for private banking customers, led by key personnel in the fields of finance as well as culture and arts. In addition, the Bank is active in Jewish communities around the world in providing added value and contribution to community life while creating image differentiation.

THE PRIVATE BANKING SEGMENT AT MERCANTILE DISCOUNT BANK

Mercantile Discount Bank established a private banking center in 2007, offering specialized banking services to customers of this segment at this bank.

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 for their own account operations of the Bank and Mercantile Discount Bank involving securities and other banks, as well as management of market and liquidity risks and dealing room operations, including those involving 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 included the Discount Group activity in non-financial investments. This sub-segment’s main activity is the Bank’s investment in Harel (most of which was sold in 2006) and investments made by the subsidiary Israel Discount Capital Markets and Investments (“DCMI”) and by the Bank directly.

DEVELOPMENTS IN THE SEGMENT

Legislation in respect of mutual funds. For details regarding the Mutual trust Investments regulations which came into effect at the end of 2007, see “Legislation and supervision” hereunder. **Asset Backed securities.** The Bank’s securities portfolio as of December 31, 2007 includes investment in asset backed securities, primarily in mortgage backed securities (MBS) in the amount of US\$2.2 billion, which are held for the most by IDB New York. About 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 subprime market.

In light of the decrease in interest rates in the United states, the mortgage backed securities (MBS) portfolio as of March 21, 2008, included unrealized gains of US\$20 million. For further details see Note 3 F to the financial statements.

The policy regarding the “nostro” securities portfolio. 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 is working on expanding the range of its investments and on gradually increasing the exposure to corporate bonds in Israel and abroad, to investment alternatives and others.

The Bank decided in 2007 to vary the “nostro” investments by gradually diverting a part of its investments in Government bonds to corporate bonds and to investments managed by external entities. Among other things, the Bank invested an amount of US\$100 million in a fund of hedge funds. As of December 31, 2007, a provision for impairment of NIS 44 million was recorded in respect of this investment, one half of which stemming from the decrease in the dollar exchange rate (see Note 25 to the financial statements). A further impairment of NIS 29 million occurred in January-February 2008, the greater part of which being in respect of the decrease in the dollar exchange rate.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net loss of the segment, in 2007 amounted to NIS 128 million compared with a net profit of NIS 137 million in 2006. Disregarding certain components (see hereunder), the net loss would have amounted to NIS 30 million in 2007 compared with a net profit of NIS 16 million in 2006.

Total revenues amounted in 2007 to NIS 381 million, of which NIS 108 million from domestic activity, compared with NIS 415 million in 2006, and they include three major components:

1. Earnings from operations in the “Nostro” portfolio in Israel in the amount of NIS 58 million, of which NIS 48 million from losses on sale of securities and from adjustments to fair value of trading securities, compared with NIS 331 million “Nostro” earnings in 2006, of which NIS 52 million from gains on sale of securities and from adjustments to the fair value of trading securities.
2. Net loss from the management of positions taken and from currency and financial derivatives brokerage in Israel in the amount of NIS 50 million in 2007, compared with a net loss of NIS 98 million in 2006.
3. Earnings on international operations in the amount of NIS 273 million, compared to NIS 182 million in 2006.

The return on equity in 2007, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was a negative rate of 4.6% in 2007, compared with a rate of 7.1% in 2006. Disregarding certain components (see hereunder), the return on equity would have reached a negative rate of 1.1% in 2007, compared with a rate of 0.8% in 2006.

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

	Domestic Operations	International Banking	Total	Domestic Operations	International Banking	Total
	For the year ended December 31 2007			For the year ended December 31 2006		
Income from financing activities before provision for doubtful debts	110	246	356	164	162	326
Operating and other income	(2)	27	25	69	20	89
Total Income	108	273	381	233	182	415
Operating and other income	430	80	510	368	156	524
Operating Income (loss) before taxes	(323)	187	(136)	(135)	26	(109)
Net income (loss)	(171)	43	(128)	198	(61)	137
Net income (loss) disregarding certain components ⁽¹⁾	(76)	46	(30)	63	(47)	16
Yield on capital (percentage)	(7.3)	9.7	(4.6)	*15.4	*(9.2)	*7.1
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	(3.2)	10.5	(1.1)	*4.9	*(7.1)	*0.8
Average Assets	45,714	19,351	65,065	*33,886	25,517	59,403
Average Liabilities	14,804	6,531	21,335	*8,367	12,531	20,898
Average Risk-assets	10,680	7,252	17,932	8,599	10,972	19,571

*Reclassified.

Footnotes:

(1) The following components have been eliminated: 2007 – expenses in connection with early retirement plan, the cost of performing examinations and improvements at IDB New York, the Bank's share in the gains of the First International Bank from sale of its provident fund activity, and a provision for taxes in respect of the Bank's share in the earnings of the First International Bank.
2006 – Privatization bonus, expenses in connection with early retirement plan, the effect of reversal of the provision in respect of the holdings in the First International Bank and payments to the supervisory authorities in the US and the cost of performing examinations and improvements at IDB New York.

HUMAN CAPITAL In 2007, the average number of positions in the segment amounted to 862, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, of which 748 position in domestic operations, compared with 702 positions as aforementioned in 2006, an increase of 22.8%.

TEL AVIV TREASURY In the course of 2007 a Tel Aviv Treasury Office was established, which coordinates the operations of the dealing room with the operations of the Bank's assets and liabilities management.

General. The expanded dealing room is engaged in four principal areas of activity: trade in currencies, trade in interest rates, trade in foreign securities and management of liquidity in Israeli currency and in foreign currency. The dealing room is available to customers and to the Bank's branches and provides personal and professional service in the global money and capital markets with respect to financial instruments and implementation of special transactions in foreign exchange, interest rates and the capital market.

Dealing room customers include local and foreign banks, corporations, investors and institutional entities.



Advanced technology and a computer system, which is one of the most advanced systems utilized by dealing rooms in Israel, enable the dealing room to provide customers with timely professional service. **Trading in foreign currency and in interest rates.** The dealing room is a principal focus for customers engaged in financial instruments, whether for investment or hedging purposes. The principal transactions provided by the dealing room include foreign currency, interest rate and index future contracts and options (including exotic options), swap transactions and fixed and variable interest rate swap transactions.

Market maker in shekel interest rate trading. A reform was implemented in the Government bond/debenture market in September 2006, converting this market into the largest and most liquid financial market in Israel.

Discount Bank is one of the principal market makers out of 18 domestic and foreign institutions. As a market maker, the Bank is entitled to participate in the principal bond tenders issued by the Treasury, and to engage in lending bonds out of the central lending pool operated by the stock exchange. The duties of the Bank as a market maker are to provide the market with purchase and sale margin quotations. Since the market reform, the Bank leads the market maker activity and off-market transactions activity.

Trading in foreign securities. The foreign securities desk is active in a large variety of equity and financial markets worldwide, utilizing complex financial instruments and offering a wide range of instruments: trading in shares on foreign markets, trading in options, in Government bonds and in corporate bonds and debentures, mutual funds and hedge funds, and in arbitration activity.

The dealing room develops and “constructs” the various transactions in accordance with customer needs and, inter alia, develops structured products based on currencies, interest rates and share quotations.

COMPETITION

The financial management segment includes, as stated, the customer activity of the dealing room. Activity of dealing rooms in Israel and worldwide is highly competitive. The principal competitors in Israel are the four large local banking groups. Involvement of foreign banks and other financial corporations in the foreign currency and interest rate markets has increased in recent years significantly. Most companies managing mutual funds launched at the beginning of 2008 a new product, a monetary mutual fund, based on a permit issued for this product by the Ministry of Finance. Funds deposited with the monetary mutual funds are invested in liquid deposits and bonds, bearing a high return, while the management fees collected are very low. This product competes directly with bank deposits and it is expected accordingly that competition existing in this field will increase.

BUSINESS STRATEGY AND TARGETS

The strategic plan of the finance division for the coming years includes the establishment of a Global Treasury network to coordinate activity in assets and liabilities and activity of dealing rooms of the comprehensive Group in Israel, New York and Switzerland.

The acquisition of a group risk management system is being considered as part of the strategic plan. The above forward-looking statement is based on the Bank's plans as of publication of the financial report. The plan may not materialize, inter alia, as a result of implementation, technological and regulatory difficulties.

NON-FINANCIAL COMPANIES SUB-SEGMENT SUB-SEGMENT DEFINITION	This sub-segment includes the Group's operations with respect to non-financial investments. The greater part of the sub-segment's operations relate to investments of the Bank in Harel Ltd., and investments undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd. (hereinafter: "DCMI"), as well as direct investments by the Bank itself. 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 below and Note 6 H to the financial statements).
LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SUB 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 at the Finance Ministry, The Commissioner of the Antitrust Authority, the Securities Authority etc. The principal restrictions applicable to this sub segment are briefly described hereunder. Section 23 A of the Banking (Licensing) Law, specifies that the amount of any means of control held by a banking corporation in non-financial corporations shall not exceed the following proportions of the capital of the banking corporation, as shall be determined for this purpose in rules prescribed by the Governor, after consultation with the Advisory Committee and with the approval of the Minister of Finance - (1) Up to fifteen per cent of its capital - in any non-financial corporation; (2) Up to a further five per cent of its capital - provided that it does not hold in corporation more than five per cent of a certain class of means of control and it is not entitled to appoint a director; (3) Up to a further five per cent of its capital - in non-financial corporations which are foreign corporations that do not conduct any material and continuing business operations in Israel. As of December 31, 2007, the amount of the Bank's investment in non-financial corporations was less than the amount of the above restriction. The legislation passed in the wake of the Bachar Committee recommendations included limitations on the holdings of controlling interests in non-financial corporations being an insurer or a corporation controlling an insurer or whoever holds 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 decision taken by the Bank to engage in pension consultation, see Note 33 to the 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 2007 amounted to NIS 19 million, compared with NIS 155 million in 2006, a decrease of 87.7%. Disregarding certain components (see hereunder), net income would have amounted to NIS 19 million in 2007, compared with NIS 51 million in 2006, a decrease of 62.7%. The return on equity in 2007, calculated on the capital allocated to the sector on the basis of the average balance of sub segment risk assets, was 31.7% in 2007, compared with 431.2% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 31.7% in 2007, compared with 143.3% in 2006.

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

	2007	2006
Loss from financing activities	(36)	(18)
Operating and other income	32	13
Total loss	(4)	(5)
Operating and other expenses	4	4
Loss from ordinary operations before taxes	(8)	(9)
Bank's equity in income of affiliated companies	21	56
Extraordinary income on the sale of investments	-	104
Net income	19	155
Net income disregarding certain components*	19	51
Return on equity	32.3	431.2
Return on equity disregarding certain components*	32.3	143.3
Average balance of assets	956	307
Average balance of liabilities	248	24
Average balance of risk assets	958	601

Footnote:

* The following components have been disregarded: 2006 - the profit on the sale of shares of Harel Insurance Investments.

HUMAN CAPITAL

In 2007, the average number of positions in the sub segment amounted to 5, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, compared with 4 positions as aforementioned in 2006.

PRINCIPAL AREAS OF OPERATION IN SEGMENT

The investments of the Discount Group in non-financial companies are divided into two principal categories, as under:

- **Investment in private equity funds and in venture capital funds.** Investment in this field is made primarily through the subsidiary DCMI, directly by the Bank itself and through the subsidiary of Mercantile Discount Bank.
- **Investments in companies.** The principal investments in this field are the investment in Kardan Financial Services B.V. (see below), and the investments in two companies controlled by Mayer Cars and Trucks Co. Ltd. (see below); in Bezeq the Israel Telecommunication Corp. Ltd. (see Note 3 to the financial statements) and in HOT Cable Communication Systems Ltd. In the past, up to the sale of the holdings in Harel Insurance Investments Ltd., this investment was a significant component of the sub-segment activity in this field (for details regarding the sale of the holdings in Harel, see below and Note 6 H to the financial statements).

NON-FINANCIAL INVESTMENTS POLICY

In 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 the subsidiary 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 the existing investment 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.
- Within the framework of the approved policy for investment in non-financial assets as above, an outline has, among other things, been determined as to the recommended volume of investments in the years 2007-2009.

INVESTMENTS OF THE GROUP IN CAPITAL FUNDS

In the field of venture capital funds and private equity funds, the subsidiary Israel Discount Capital Markets and Investments Ltd. participates in several funds, including:

First Israel Mezzanine Fund (FIMI) - in conjunction with foreign investors. The size of the fund is US\$91 million. DCMI's share in the investment commitments in the fund reached US\$16 million, of which US\$13.3 million had already been invested by December 31, 2007. The fund has concluded its investment program and realized holdings in some of its investments.

The Israel International Fund, specialized in export-oriented projects. The size of the fund is US\$40 million, and DCMI's share in the investment commitments is due to reach US\$8.1 million. As of December 31, 2007, DCMI had invested US\$7.7 million in this fund. The Fund completed the realization of its remaining investment portfolio and started liquidation proceedings in accordance with the partnership agreement.

Vertex Venture Management (III) Capital Fund (hereinafter: "the First Vertex Fund"). This fund's size is US\$36 million, and DCMI's share is US\$5.3 million. The Fund has terminated its investments, and subsequent to balance sheet date completed the realization of the balance of its investment portfolio. Following the success of the First Vertex Fund, the **Vertex Israel II Venture Capital Fund** was established. The size of the fund is US\$160 million, and DCMI's share in the investment commitments in the fund is due to reach US\$15 million. As of December 31, 2007, DCMI had invested US\$14.2 million. **Vertex Israel III Fund**. This fund's size is US\$150 million, and DCMI's share will reach US\$13.5 million. As of December 31, 2007, DCMI had invested an amount of US\$4.6 million.

Vitalife Fund. DCMI has initiated the establishment of a venture capital fund for investment in the field of the life sciences. Following the completion of the initial capital raising, the Fund will reach a size of US\$50.3 million, of which DCMI's share will amount to US\$10 million. As of December 31, 2007, DCMI had invested an amount of US\$9.2 million in this fund.

FIMI Opportunity II Fund. The Fund reaches a total of approximately US\$293 million. DCMI's share in the investment commitments in the fund will reach US\$50 million, of which an amount of US\$17.8 million has been invested up to December 31, 2006.

FITE - First Israel Turnaround Enterprise Fund. The size of the fund is US\$129 million, and DCMI's share in the investment commitments in the fund is due to reach US\$12.5 million. Up to December 31, 2007, the Bank had invested US\$3.1 million in the fund.

DCIM, together with Foresight Ltd. established the **Golden Gate Bridge Fund**, which engages in providing bridge financing for hi-tech start-up companies. The size of the fund is US\$6 million. DCMI's share is due to reach US\$2 million, of which US\$1.7 million had already been invested by the end of 2007. The Golden Gate Bridge Fund is jointly managed with the Plenus Technologies Fund since 2002.

Plenus Venture Lending II Fund. The Fund, which amounts to US\$55 million, engages in the granting of bridging loans and credit facilities to technology companies. DCMI has undertaken to invest up to US\$5 million in the fund. As of December 31, 2007 DCMI had invested an amount of US\$2.9 million. DCMI jointly with Bezeq and others, established the **Stage One Venture Capital Fund**, which is to invest in companies engaged in communications and information technology fields. The primary volume of the fund was US\$30 million. Following the increase in the fund in 2007, the fund's volume reached US\$40 million. DCMI's share is due to reach US\$15 million, of which US\$12.1 million had been invested by the end of 2007.

Alon Fund. DCMI has invested in a venture capital fund, of the Gaon Financial Management Group, which invests in late stage technology companies. The size of the fund is US\$30 million, and DCMI's share is US\$2 million, which were fully invested.

Fortissimo Capital Fund. The size of the fund stands at US\$78 million. DCMI has undertaken to invest US\$5 million in the fund, of which US\$3 million had been invested by the end of 2007.

Edmond de Rothschild Europorties. This fund is a member of the Rothschild Group. The size of the fund is Euro 100 million. During 2007, DCMI committed to invest Euro 11.3 million in this fund. As of December 31, 2007, Euro 6.4 million was invested.

Investment in Apax VII Fund. Israel Discount Capital Markets and Investments Ltd committed to invest Euro 7.4 million in the Fund, which amounts to Euro 10 billion. The Fund was established recently as a European private equity fund in the Apax Group, and is expected to operate mainly in Europe. Until December 31, 2007, DCMI invested an amount of Euro 1.7 million in the said Fund.

Investment in Plenus III Fund. DCMI has committed to invest in the Fund an amount of US\$15 million, out of over US\$120 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. Until December 31, 2007 DCMI invested a total of US\$2.6 million in the said fund.

Investment in a real estate fund. DCMI has 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. Up until December 31, 2007, DCMI invested US\$1.6 million in the said Fund.

Investment in a European real estate fund. DCMI has committed to invest Euro 10 million in a European real estate fund of approximately Euro 400 million, managed by the French AXA Group. Until December 31, 2007, DCMI invested an amount of Euro 0.76 million in the said Fund.

Additional investment in funds. In addition to the investment in funds through DCMI, the Bank has made a direct investment in an additional fund:

FIMI Opportunity Fund I. The size of this fund is US\$114 million. The Bank's share in the fund is due to reach US\$23 million, of which US\$18.6 million had been invested by December 31, 2007. Furthermore, Mercantile Discount Bank is committed to investments in five venture capital funds. As of December 31, 2007, the investment of Mercantile Discount Bank in these funds amounted to US\$5.2 million. As of December 31, 2007, the maximum commitment for the future investments in these funds amended to US\$0.7 million.

INVESTMENTS IN CORPORATIONS

As part of investments in corporations several investments in several companies were made, including: **Investment in activities abroad.** In September 2007 agreements were signed for investments in two companies under the ownership of Mayer Motor and Cars and Trucks Co. Ltd. (hereinafter - "the Mayer Group") according to which DCMI has undertaken to invest an amount of up to Euro 40 million in Mayer (Keshet) Real Estate Ltd. (hereinafter: "Mayer Real Estate") and an amount of up to Euro 30 million in Mayer Europe Ltd. (hereinafter: "Mayer Europe").

The Bank's said commitment is subject to a parallel commitment on the part of Mayer Group to invest an amount of up to Euro 160 million in Mayer Real Estate and an amount of up to Euro 120 million in Mayer Europe. Mayer Real Estate is a holding company established at the beginning of 2007, centralizing the entrepreneurial real estate activities of the Mayer Group in Israel and abroad, including the hotel field. Mayer Europe is a holding company established in 2006, centralizing the leasing, trading, rental and import activities of new and used private vehicles of Mayer Group in European countries. Mayer Europe holds the Hertz leasing franchise in Hungary and might enter similar operations in additional countries in the near future.

The investment in the said companies would entitle DCMI to an equity interest of 20% and to the right to appoint one of five Directors in each of these companies.

Up until December 31, 2007, DCMI invested an amount of Euro 7.4 million in the two companies of the Mayer Group.

DCMI is committed to provide its share of the shareholder financing to Mayer Real Estate and Mayer Europe on the dates to be determined by the Board of Directors of each of the companies. In the event that DCMI would not provide its relative share of the financing in accordance with monetary limits and dates determined in the agreements, it would become exposed to the dilution of its share as well as to the exercise of a CALL option arising to the Mayer Group for the purchase of the shares held by DCMI. Furthermore, a CALL option will arise to the Mayer Group for the purchase of the shares held by DCMI in the said companies in the event that requirements of the Authorities and/or regulations applying to DCMI would impose material limitations on the activities of the said companies, in accordance with terms prescribed in the agreements. Moreover, DCMI, so long as it holds at least 10% of the equity of the said companies has veto rights with respect to certain resolutions of Mayer Real Estate and Mayer Europe, has the right to participate in future share

offerings by these companies and has a “tag along” right in the event that the Mayer Group decides to sell its holdings in these companies, a “bring along” obligation in the event that the Mayer Group decides to sell its control in these companies, the Mayer Group has the right of first refusal in case DCMI decides to sell its shares in the companies, everything in accordance with the terms of the investment agreements. The agreements also imposed limitations on transactions with interested parties in the companies or in the Mayer Group and limitations on the transfer of shares of these companies to third parties. The investment agreement applying to Mayer Real Estate also states that Mayer Real Estate would serve as the operating arm of the Mayer group and of the Discount Group regarding everything connected with investments in income generating real estate and in promotional real estate in Israel and abroad, and through which the parties would invest in real estate in Israel and abroad, excluding passive financial investments, and which shall have preference in realizing business opportunities in the field of real estate investments, and provided that with respect to the Discount group it is made clear that the above stated relates to investments in “non-financial corporations” in the real estate field, as this term is defined in the Banking Law (Licensing), and everything in accordance to the terms and qualifications determined in the investment agreement relating to Mayer Real Estate and until the date on which DCMI will complete its investment in Mayer Real Estate in the above stated amount.

Similar provisions have been included in the investment agreement regarding Mayer Europe in everything related to the trading, leasing, rental etc. of private vehicles in Europe.

Up to December 31, 2007 DCMI invested about Euro 7.4 million in the two companies of the Mayer Group.

Investment in “KFS”. On December 30, 2007, DCMI Kardan Financial Services BV (“KFS”) and Kardan NA (“Kardan”) entered into an agreement according to which DCMI will acquire by way of an issue of shares 11.01% of the issued and paid share capital of KFS at date of issue (and 11% of the issued and paid share capital of KFS fully diluted), in consideration of Euro 55.6 million. KFS is a holding company incorporated in Holland engaged in financial services in central-eastern European countries, in former Soviet Union countries and in Turkey. Most of the operations of KFS are conducted through its holdings in TBIF Financial Services BV (“TBIF”) and in TBIH Financial Services Group NV (“TBIH”). TBIF, in which KFS has a 90.4% equity interest, is active in the banking, financing services (retail credit, leasing and mortgages) as well as asset management, while TBIH, in which KFS has an equity interest of 40%, is engaged in the fields of insurance and pension savings.

Within the framework of the investment agreement, the parties have determined certain arrangements between them with respect to their rights and obligations as shareholders of KFS, among other things, it has been determined that as long as DCMI holds at least 7.50% of the issued share capital of KFS and the company has not been issued to the public, DCMI shall have the right to appoint 20% of the members of the Board of Directors (excluding in certain circumstances as prescribed in the agreement). DCMI has also been granted veto rights regarding certain resolutions of KFS, the right to participate in future share issues by KFS, “tag along” right in the event that Karden sells its control in KFS and a right of “first offer” in the event that DCMI

would wish to sell its shares in KFS to a third party, everything in accordance with the provisions of the investment agreement.

The investment transaction was consummated on December 31, 2007. DCMi is considering the allocation of the excess of cost of this investment over its share in the equity value of KFS (amounting to NIS 203 million). In addition, the Bank provided KFS with a credit facility of up to Euro 225 million. The credit is to be provided in installments, for various periods and subject to compliance with certain conditions as determined in the agreement between the parties.

Investment in "Menif" - Financial Services Ltd. ("Menif"). Menif engages in complementing equity capital of building contractors as required by banks financing building projects in a closed project format. Complementing the equity capital is effected by way of providing guarantees in favor of the project in consideration for a share of the profits. 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. As of December 31, 2007, guaranties have been provided in the amount of NIS 37.7 million. In 2007, guaranties in the amount of NIS 7 million provided by DCMi were realized.

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 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.

The sale of holdings in Harel. On November 1, 2006, the transaction for the sale of 10.1% of the share capital of Harel and for an option to sell all the remaining shares that the Bank held in Harel on May 28 2007, 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. The net gain from the sale of shares amounted to approximately NIS 104 million, and was recorded in 2006 as profit from extra ordinary operations.



FURTHER DETAILS AS TO ACTIVITY IN CERTAIN PRODUCTS

CREDIT CARD

OPERATIONS

GENERAL INFORMATION

ON THE CREDIT CARD

FIELD

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 at a rate of 71.8% by the Bank, and by the issue as co-issuers 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.

In recent years, the credit card serves as one of the principal means of payment in the market. The credit card is issued to the customer by the credit card company and the customer uses it for payment, as an alternative for cash or checks. The credit card company issues credit cards of two types: most of the cards are being issued to customers of banks, for the customers of such banks (hereinafter - "banks included in the arrangement"). The remaining cards are being issued directly by the credit card companies to customers, not by way of banks (hereinafter - "off-banking credit cards").

Credit cards have constituted an instrument of payment in Israel since the 1970s.

Israel is considered an advanced country in the credit card field. ICC estimates that approximately 75% of the adult population in Israel uses credit cards as an instrument of payment, the Israeli consumer holding on an average of 1.3 credit cards. ICC also estimates that as of December 31, 2007, approximately 4.5 million credit cards were issued in Israel (of which, according to ICC's data, 89% were active cards).

STRUCTURE OF THE FIELD OF OPERATION

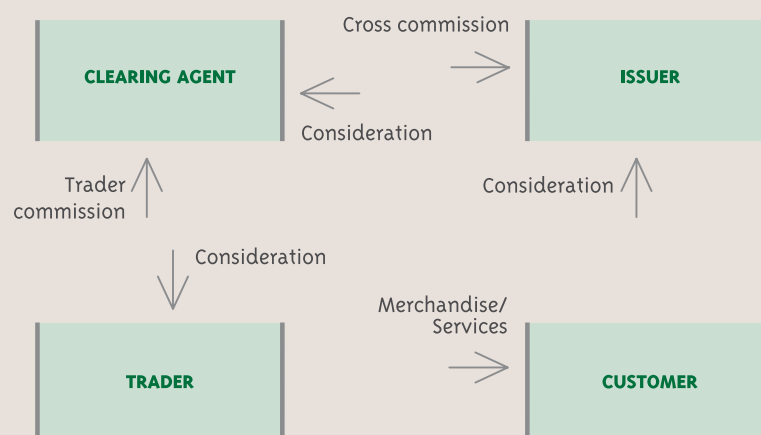
The use of a credit card as an instrument of payment is enabled, subject to the existence of several cumulative factors: an issuer, a clearing agent, a trader and a customer (the credit card holder), all of which are bound by separate and independent agreements (direct or indirect agreements, by virtue of the issuer and the clearing agent being members of an international organization that provides the franchise in respect of the credit card brand name). These contractual engagements provide the infrastructure for communicating the relevant data for settling the payments relating to transactions paid by credit cards.

There is a social and a consumer need of the existence of the above mentioned agreements, in order to facilitate transactions, thereby increasing market efficiency and improving the economy. Accordingly, customers can conduct transactions with a large number of traders and traders can sell their goods or services to a large number of customers.

As stated, the credit card system is composed of four factors: **Issuer** - the entity issuing credit cards to its customers; **Customer** - the holder of a credit card; **Trader** - the entity accepting a credit card; **Clearing agent** - the financial institution through which the trader receives payment. The trader enters into an agreement with the clearing agent. In this framework, the clearing agent, in consideration for a commission, undertakes to credit the trader related to it, in a manner secured in advance, with the consideration due to the trader for the transactions made with him

by the customers holding the credit card of the brand that is being cleared. The commission collected by the clearing agent in respect of clearing services to the trader is the **“Trader commission”**. The clearing agent, on his part, pays the issuer an issuance commission called **“Cross commission”**. This commission is embedded in the trader commission collected by the clearing agent. Namely, the trader commission is composed of the clearing commission and the issuer commission.

FLOWCHART OF CREDIT CARD TRANSACTIONS



THE OPERATIONS OF ICC

ICC operates in two sectors of activity in the credit card market, constituting together the core activity of a credit card company: (a) issuance of credit cards; and (b) clearing of credit card transactions.

ICC is engaged in the issuance and operation of credit cards and the clearing of credit card transactions under the international brand name “VISA”. It also markets and operates, exclusively in Israel, the “Diners” credit card and, in a very limited scope, also “MasterCard” credit cards.

As part of the credit cards issuance operation, ICC offers credit to customers holding credit cards issued directly by ICC. In addition, ICC provides clearing services for transactions made on the Internet for various traders in Israel and abroad.

In the issuance field, ICC issues (directly and through Diners, a company under its control) credit cards under two routes: (a) issuance of cards to customers of banks in the arrangement with which ICC has agreements for co-issuance or distribution agreements (above and hereunder - “co-issuance”); (b) issuance of cards directly by ICC, mostly through clubs and unique organizations. In addition, ICC

provides credit to customers holding off-banking cards. Such customers are offered various credit channels with respect to transactions made by them through their credit cards. ICC is entitled to the interest income and to the commissions related to the credit so granted, this differently from the credit offered to holders of cards Issued by ICC as a co-issuer, the granting of which is generally made by the relevant bank and the bank is the one that in this case is entitled to a payment from the customer in respect of the credit extended to him.

Within the framework of the clearing channel ICC conducts the clearing of credit cards in Israel. An additional activity conducted in the clearing field is the granting of credit to traders with whom ICC has clearing agreements, by way of discounting credit card slips, advancing payments in respect of transactions made and the granting of loans on account of future payments.

Following are quantitative data regarding the activity of ICC:

Number of valid cards ⁽³⁾		
	As of December 31,	
	2007	2006
	(in thousands)	
Bank cards ⁽¹⁾	957	950
Off-banking cards ⁽²⁾	449	397
Total	1,406	1,347
Transactions turnover ⁽⁴⁾		
	For the year ended December 31,	
	2007	2006
	(in NIS millions)	
Bank cards	31,100	29,437
Off-banking cards	7,523	6,661
Total	38,623	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

General. The volume of credit card transactions increases annually. The increase in the use of credit card derives both from an increase in the volume of transactions (as a result of population growth and the existence of a younger population that is accustomed to using credit cards as part of its consumer culture) and from an increase relative to transactions paid for through other means.

ICC estimates that approximately 65,000 traders and marketing chains in Israel (comprising approximately 73.5 thousand points of sale) enable purchases through credit cards.

Net income from the operations in 2007 amounted to NIS 119 million, compared with NIS 83 million

in 2006, an increase of 44.6%. Disregarding certain components (see hereunder), net income would have amounted to NIS 120 million in 2007, compared with NIS 87 million in 2006, an increase of 37.9%.

The return on equity was 35.2% in 2007, calculated on the capital allocated to the operations on the basis of the average balance of the operations risk assets, compared with 26.2% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 35.5% in 2007, compared with 27.4% in 2006.

Provision for doubtful debts amounted in 2007 to NIS 41 million, compared with NIS 31 in 2006, an increase of 32.2%.

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

	Domestic operations			
	Households	Small Businesses	Middle market banking	Total
For the year ended December 31, 2007				
Income from financing activities before provision for doubtful debts				
- From externals	208	7	2	217
- Intersegmental	(55)	-	(1)	(56)
Total income from financial activity	153	7	1	161
Operating and other income	746	7	1	754
Total Income	899	14	2	915
Provision for doubtful debts	41	-	-	41
Operating and other expenses	578	8	-	586
Operating Income before taxes	280	6	2	288
Provision for taxes on operating income	112	2	1	115
Net income	114	4	1	119
Net income disregading certain components ⁽¹⁾	115	4	1	120
Yield on capital (percentage)	35.8	-	14.5	35.2
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	36.0	-	14.8	35.5
Average Assets	6,667	-	15	6,682
Average Liabilities	-	-	3,715	3,715
Average Risk-assets	5,331	-	78	5,652
Components of income from financing activities:				
Margin from credits activity	150	7	1	158
Other	3	-	-	3
Income from financing activities before provision for doubtful debts	153	7	1	161

(1) The following components have been disregarded: expenses in respect of early retirement incentive.

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

	Domestic operations				
	Households	Small Businesses	Middle market banking	Private Banking	Total
For the year ended December 31, 2006					
Income from financing activities before provision for doubtful debts					
- From externals	108	7	1	-	116
- Intersegmental	(5)	-	-	-	(5)
Total income from financial activity	103	7	1	-	111
Operating and other income	630	11	1	-	642
Total Income	733	18	2	-	753
Provision for doubtful debts	31	-	-	-	31
Operating and other expenses	482	10	1	1	494
Operating Income (loss) before taxes	220	8	1	(1)	228
Provision for taxes on operating income	79	3	-	-	82
Net income (loss)	78	5	1	(1)	83
Net income disregarding certain components ⁽¹⁾	82	5	-	-	87
Yield on capital (percentage)	27.4	16.7			26.2
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	28.5	18.3			27.4
Average Assets	4,294	-	16	1	4,311
Average Liabilities	-	-	*1,623	-	1,623
Average Risk-assets	4,811	440	16	1	5,268
Components of income from financing activities:					
Margin from credits activity	103	6	1	-	110
Margin from deposits activity	-	1	-	-	1
Income from financing activities before provision for doubtful debts	103	7	1	-	111

(1) The following components have been disregarded: the privatization bonus and expenses in respect of early retirement incentive.

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.

The Commissioner of the Antitrust Authority. The Commissioner of the Antitrust Authority 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 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. ICC has prepared to act in accordance with the requirements of the amended Order. As from December 2007, the Order has come into effect in stages. To implement the Order, ICC must apply procedures that prolong the process of attracting new customers.

Proper Banking Management. In 2005 the Supervisor of Banks issued Proper Banking Management Directive No. 470, the purpose of which is regulating the charge card operations of credit card companies both in the field of risk management and in various consumer fields. In the risk management field, the Supervisor applied to the credit card companies additional Proper Banking Management Directives, such as "the board of directors", "risk management", "fraud and embezzlement by employees", "banking insurance" and so forth. In the consumer field the instruction relates to several principal issues, including: rules for the issue of credit cards, their delivery, their renewal and cancellation, the information provided as part of the monthly statement, rules regarding point/stars drives, rules regarding the conversion of transaction in foreign currency into Shekels, and so forth.

Reporting to the public by credit card companies. Further to the initiative of the Supervisor of Banks regarding disclosure of activity of credit card companies, and based on a reporting framework formulated by a team appointed for this purpose including representatives of the Supervisor of Banks, the Israel Securities Authority, banking corporations controlling credit card companies, credit card companies and their auditors, the Supervisor of Banks published a public reporting format for credit card companies. Accordingly, in March 2007, credit card companies published their financial statements for the first time to the public. Subsequently, the Supervisor of Banks applied to the credit card companies similar reporting requirements to those applied to banks, including a Directors' Report, Management Review and declarations as to disclosures in the financial statements.

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 Bank of Israel (existing clearing agents shall be entitled to a license); The Supervisor of Banks shall be entitled to require mutual clearing between the three existing credit card companies and between them

and any new company in this field, and to require a large issuer to allow any clearing agent 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. A private Bill was tabled before the Knesset in March 2007, which is based on the Commission's report. The Bill has not yet undergone preliminary reading.

Additional legislation and arrangement initiatives. Various State agencies have 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, which at this stage are not supported by the Government.

TECHNOLOGICAL CHANGES

Use of the "smart card". As part of the effort to reduce misuse and forgery of credit cards, the international VISA organization and the international MasterCard organization are adopting various measures to improve the security of credit cards carrying their brand names. These organizations have directed their members to introduce the use of a credit card with special features that complicate its use and/or forgery by unauthorized factors (hereinafter: "the smart card"). In accordance with these directives, the Company commenced preparations for introduction of the smart card. The issuance aspect mainly includes upgrading of the technology acquired by the Company in the past and its adaptation for issuance of smart cards, and upgrading and/or acquisition and/or development of sophisticated POS instruments and their installation in various businesses with which ICC has clearing agreements. Smart cards are expected to be issued to ICC customers during a period of two and a half years beginning in the second half of 2007.

Upgrading of the information systems. ICC jointly with Oracle is examining the possibility of replacing a part of its existing core system. If this solution is chosen, ICC will begin a comprehensive project which will take three years to complete.

CRITICAL SUCCESS FACTORS

- An operating network including technological information systems, teleprocessing and advanced infrastructures;
- Authorization to issue brand name credit cards under a franchise granted by the international organizations;
- Cooperation with banking corporations;
- Ability to recruit customers and their maintenance through an extensive marketing layout;
- Consummation of agreements for the establishment of consumer clubs;
- Ability to offer customers attractive credit products;
- A developed and effective risk management system;
- The ability to borrow funds from financial institutions at attractive terms.

OBSTACLES TO MARKET

ENTRY

Principal entry barriers into the issuance field:

- Activity as an issuer requires the existence of an extensive, complex, costly operating system, with sophisticated information and communications systems, including information security systems, customer service, etc;
- A massive and ongoing investment is required for country-wide marketing, distribution and sales channels in order to compete in the issuance field, especially through a distribution chain for credit cards is required in accordance with agreements with banks and/or customer clubs;
- High financial stability is required for purposes of issuing sources for financial activity, i.e. ability to borrow extensive funds at more preferable conditions compared to conditions offered to "regular" customers;
- Maintenance of control of the issuer by banking corporations is required for purposes of recognition and membership in international organizations that manage leading international brand names;
- The existence of a recognized and efficient system for rating credit risks.

Principal entry barriers into the clearing field:

- Entry into the credit card clearing field involves, primarily, obtaining a license from the international organization to which the clearing activity is related. Receipt of such a license requires that the applicant have a banking connection and compliance with business and financial standards that will secure its activity, in addition to payment of membership fees to the international organization.
- An entity requesting entry into the clearing field should establish a communications network enabling on-line clearing of credit card transactions (or should acquire the services of Electronic Banking Services, which maintains such a system in Israel).
- The existence of a solid, credible information system for billing management.

ALTERNATIVE PRODUCTS

In addition to the classic alternatives to a credit card, e.g. checks, cash and bank transfers, additional instruments and services exist, constituting an advanced technology and which, in contrast to the above stated instruments and similarly to credit cards, are characterized by availability and convenience:

- Payment service through cellular phone;
- Internet transactions for transfer of funds without disclosing the credit card details of the customer/details of the customer's bank account;
- Alternative instruments to credit instruments are the many credit instruments offered on the market - whether by the banks or by other factors (private companies that offer off-banking credit, including the "grey market").

A very wide range of credit products having various characteristics, exist in the market, all of which serve as alternatives for one another. Notwithstanding, most of the customers purchase a credit product provided by the entity known to them (namely, their bank), therefore every customer sees various alternatives to products offered by ICC.

- An alternative product in the clearing channel is the check discounting service.



- Alternative products in the clearing field on the Internet are being developed all the time in view of the fact that the trade on the Internet is an activity being continuously developed.

NEW PRODUCTS

The issuance field. ICC attributes great importance to the maintenance of a wide range of products with unique features offered to its credit card customers and therefore invests efforts to develop a line of products and services designed especially for these customers. Most of the products constitute instruments of payment and credit products offered to holders of ICC credit cards.

- As from 2005, ICC offers its customers revolving credit under the brand name "Active".
- As from 2006, ICC began to offer customers a virtual VISA credit card ("a credit card without a card"), developed in cooperation with the VISA international organization. A customer signing up with VISA within this framework receives a card number and a code, with which he can effect transactions in the account (in an amount up to a predetermined ceiling) without the existence of a plastic card.
- The "Wish-U-Card" was launched in the first quarter of 2006. This product is a gift card which can be loaded with predetermined amounts to be used for purchases at the selected leading chain stores.
- In June 2006, the "YOU" Club card was launched jointly with the Dor-Alon Group. The card is an off-bank card issued within the limits of a customer club, which grants the holders thereof benefits at the chains of the Dor-Alon Group.

"It's easier to get more with ICC". In August 2007, ICC launched a new loyalty plan "It's easier to get more with ICC", which replaces the "points" system that had been in operation until now. For the first time in the credit card market, the plan offers a permanent and significant monetary discount to each customer joining the plan and having selected the marketing chains reflecting his consumption pattern out of some 40 leading marketing chains operating in the market.

The clearing field. ICC provides clearing services for transactions effected on the Internet on behalf of various trading houses in Israel and abroad.

As from June 2007 ICC began the clearing of MasterCard credit cards in addition to those of VISA and Diners.

The foreign operations field. ICC also serves as a clearing agent in the electronic trade field overseas. ICC has the required clearing license from VISA, MasterCard and Diners. Within the framework of this activity, ICC mostly settles transactions made on the Internet for foreign trading houses that operate these websites. These transactions are of a missing document type.

In addition, ICC issues a VISA virtual pre-paid credit card marketed under the brand name WWWCARD for transacting business on the Internet.

CUSTOMERS

The issuance field. The majority of ICC customers in the credit card issuance field are customers holding credit cards issued in conjunction with the banks included in the arrangement (including the Bank and Mercantile Discount Bank). ICC is investing special effort to increase the part of off-banking credit cards and to issue off-banking credit cards through consumer clubs or special cards.

The clearing field. ICC customers in the clearing field are those traders that accept VISA or Diners credit cards.

MARKETING AND DISTRIBUTION

The issuance field. The banks that are a party to the arrangement constitute ICC's "base recruiting level" for customers ordering credit cards through their banks. Consumer clubs serve as an additional "base recruiting level", through which ICC recruits off-banking customers through direct distribution. The marketing of credit products offered by ICC to holders of off-banking credit cards is made through the advertising of credit products by way of the media.

The clearing field. The marketing operations in this field are directed towards the traders, with special emphasis on traders that have several points of sale (marketing chains generally utilize one clearing agent for all their branches). Sales representatives market clearing services to the traders. These sales representatives remain the contact persons for the traders also after the clearing agreements have been signed.

COMPETITION

The structure of competition. Competition in the field of credit card issuance is derived from the competition between the banks over customers. In addition, the competition is over the heart and pocket of the customer with the aim of convincing the customer to pay for the major part of his current consumption by means of the cards issued by ICC, and at the same time increasing the number of credit cards issued by it. In providing credit in the issuance channel, ICC competes with bank credit as well as with other entities providing off-banking credit. In the clearing field, competition is over traders to whom clearing services and complementing services are being provided.

The issuance field. Three credit card companies operate in Israel, all of which are owned or controlled by banks:

- **ICC** issues and clears VISA credit cards and Diners credit cards (through Diners, exclusively). ICC also issues a limited number of MasterCard credit cards.
- **IsraCard**, a group of private companies all of which are controlled by Bank Hapoalim Ltd., issues and clears Isracard (exclusively) and MasterCard, credit cards. IsraCard is a brand name owned by IsraCard, which issues credit cards under this brand name for use within Israel only. To the best of ICC's knowledge, as of date of this report, the activity of IsraCard in the issuance field of VISA credit cards is negligible; however, its activity in the issuance field of MasterCard credit cards comprises most of the activity under this brand name in Israel. American Express is issued by an affiliated company of IsraCard (exclusively).
- **LeumiCard**, a private company which is wholly owned by Bank Leumi, issues and clears VISA credit cards, and issues MasterCard credit cards.

Competition in the issuance field focuses today on off-banking issuance in order to recruit new customers and to increase the number of customers to whom ICC can offer credit products.

The clearing field. The players in the field of credit card clearing includes:

- **ICC**, which clears VISA credit cards and Diners credit cards (through Diners, exclusively);
- **IsraCard**, which clears IsraCard (exclusively), "American Express" (exclusively) and MasterCard;

- **LeumiCard**, which clears VISA credit cards.

In accordance with an agreement of October 30, 2006 between ICC, LeumiCard, IsraCard and the banking corporations controlling these companies, regarding the opening of the clearing market for VISA and MasterCard credit card by the three companies, the operational ability of ICC (and of LeumiCard) in respect of clearing MasterCard credit cards in Israel has increased. In June 2007 ICC began clearing MasterCard credit cards in Israel after activating the joint interface.

Following the signing of the new agreement, Isracard joined the local agreement for cross clearing between ICC and LeumiCard with respect to the VISA brand name, after which the competition in the credit card clearing field is expected to increase (for further details see below).

DEVELOPMENTS IN THE SEGMENT

A joint issuance agreement between ICC and the First International Bank ("FIBI") and between ICC and the Bank. Among other distribution agreements signed by ICC (including Diners) with several banks, are also agreements signed with FIBI with ICC for the joint issue of VISA and Diners credit cards to customers of FIBI 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.

FIBI 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, FIBI informed ICC of its wish to conduct, as early as possible, a fast 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 issuing agreement was extended until November 15, 2007.

On November 20, 2007, a three year agreement for a joint issuance was signed, following which the agreement will be renewed for an additional period of three years, unless either of the parties gives a six month notice of his wish to terminate the engagement.

ICC 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, ICC and the Bank are conducting negotiations regarding the change in the agreement conditions.

Arrangements between FIBI and the IsraCard Group. In the reports of FIBI regarding the agreement signed in January 2006 with Bank Hapoalim for the purchase of means of control in Otsar Ha-Hayal Bank Ltd., it is stated, among other things that the parties to the agreement determined "arrangements as to the continued engagement between Otsar Ha-Hayal and the IsraCard Group and for cooperation between the bank and the IsraCard Group".

The approval for the merger, granted by the Antitrust Authority, to the First International Bank and to Otsar Ha-Hayal Bank, stipulated that the said banks would not be party to exclusivity arrangements, unless prior approval is granted by the Commissioner. The said banks and Bank Hapoalim were ordered to annul any exclusivity arrangement to which they are a party, so that no restrictions shall apply to the said banks as regards the marketing of credit cards that are not credit cards issued by Bank Hapoalim or a corporation under its control.

An exclusivity arrangement is any arrangement according to which any of the said banks have undertaken to market credit cards of Bank Hapoalim or corporations under its control, including any undertaking with regards to the number of Bank Hapoalim Group credit cards to be marketed by the said banks, or with regards to a percentage of Bank Hapoalim Group credit card to be marketed out of the total number of credit cards marketed by the said banks.

The holdings in Diners. On August 22, 2006, the Supervisor of banks approved the move by which ICC purchased from its shareholders the remaining balance of shares in Diners, in accordance with the agreement of January 2005. Following this acquisition, ICC holds 100% of the equity and voting rights in Diners.

The establishment of the YOU customer club and the sale of the means of control in Diners.

On November 29, 2005, ICC entered into an agreement with Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together - "the Purchasers") according to which ICC has committed to sell to the Purchasers 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter - "Diners") in consideration of NIS 21.3 million. Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The transaction was consummated on December 18, 2006, following fulfillment of all relevant conditions.

Within the framework of the agreement, ICC received preference "A" shares that entitle it to receive that part of the profits of Diners attributed to the operations that are not related to the activity of YOU Club, and this until such time that YOU Club reaches a level of operations determined in the agreement.

The consideration for the shares has been financed by a loan granted to the Purchasers by ICC. The shares sold are to serve as collateral for the loan, which is to be repaid at different dates over eight years, during which the Purchasers are entitled to decide on returning the shares to ICC instead of repayment of the loan, and ICC on its part is entitled to demand the return of the shares, all in accordance with the terms stated in the agreement for the sale of the shares, therefore the sale was not recognized in the financial statements.

This agreement provides, among other things, the formation of a joint enterprise of the company and of the purchasers for a joint activity under the brand name "YOU". In terms of the agreement, the entities of the Dor-Alon group are to establish a consumer club, which shall award its customers with various benefits at the Blue Square supermarket chain, at the Dor-Alon petrol stations and at additional stores owned by the Dor-Alon group. As part of joining the club, customers would be offered a club credit card to be issued by Diners as an off-banking credit card. The agreement determined the amounts of service fees payable by Diners to ICC based on Diners' volume of activity.

It should be noted that to the Bank's best knowledge, the purchasers in accordance with this agreement include certain controlling shareholders which, at the time of entering into and consummation of the transaction, constituted part of the purchasers in accordance with the agreement for the purchase of the control core of the Bank, or were related thereto (see "Control of the Bank" hereunder).

Arrangements between credit card companies. At the beginning of September 2001, ICC, The First International Bank, Israel Discount Bank, Bank Leumi Le'Israel B.M. and Leumi Card (hereinafter together - "the appellants") filed motions with the Antitrust Court (hereinafter - "the court") for the approval of a binding arrangement between them, concerning the cross clearing of VISA cards, as well as motions for temporary permits, allowing them to operate in accordance with this arrangement. In the motions, the Court was requested to approve the issuer commission rates, according to a mechanism, which among other things, would bring about a gradual reduction in the higher categories of the issuer's commission.

Within the framework of the Court proceedings, the appellants presented a methodology for the determination of the Cross Clearing Commission rate. The Commissioner of the Antitrust Authority opposed the methodology proposed by the appellants and offered a different one.

On August 31, 2006, the Antitrust Court handed down a ruling regarding the methodology for the determination of the Cross Clearing Commission, while adopting the principal points of the Commissioner's position on the matter. ICC, the Bank and the First International Bank appealed the Court's decision.

Concurrently with the procedures in court, negotiations have been conducted between the Commissioner and the credit card companies - ICC, LeumiCard and Isracard - regarding the agreement for the formation of a cross clearing system for VISA cards and MasterCard. In view of the said negotiations, the appellants requested the Commissioner to issue a provisional permit, enabling them to complete the negotiations prior to the expiration of the provisional arrangement between them.

On September 6, 2006, the Commissioner of the Antitrust Authority granted the request, extending the exemption granted to the existing arrangement between the parties until October 31, 2006.

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 expire on July 1, 2013 (hereinafter: "the period of the agreement") unless the Court rules otherwise at a prior date.

The arrangement has been submitted for approval of the Antitrust Court, and five opposing motions have been submitted to the court in this respect. As part of the preliminary hearing of the opposing motions the Antitrust Court ruled on November 11, 2007, to appoint an expert whose duty will be to examine the cross commission rate determined in the arrangement, and among other things to also evaluate the implications that this commission has on competition.

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, among other things, prohibit the inter-dependence between various types of credit cards being cleared by a trader 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 trader.

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 trader 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 trader that clears with it transactions with 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 the implications of the Agreement as a whole. 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. In March 2007 an agreement was 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, ICC entered into an agreement with Harel for the establishment of a joint company in which ICC 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 the Antitrust Authority requested clarifications from ICC regarding the agreement. Therefore the joint company has not yet commenced activity. Notwithstanding, The Commissioner of the Antitrust Authority has granted approval for the commencement of operations as a club within ICC Company.

Acquisition of a company in the United States. ICC signed an agreement for the acquisition of a company in California engaged in credit card clearing. The transaction was subject, inter-alia, to

obtaining regulatory approvals in Israel and abroad. The transaction was cancelled as the said approvals had not been received by the end of the specified period.

An accord between Mizrahi-Tefahot Bank and IsraCard. According to reports of Mizrahi-Tefahot Bank Ltd., a memorandum in principle was signed on November 13, 2007, between this bank, IsraCard Ltd. and Europay (Eurocard) Israel Ltd., according to which, inter-alia, the parties will conduct accelerated negotiations for the signing of a new agreement (for a period of ten years) the objective of which is the issue of "Mizrahi-Tefahot" branded credit cards, and for the determination of operating and provision of services arrangements by IsraCard and/or Europay for credit cards to be issued by them and distributed by Mizrahi-Tefahot Bank to its customers. ICC cannot assess at this stage the implications of such an agreement, if signed, on competition in the credit card market in general and on the operations of ICC in particular, if at all.

SEASONAL FACTORS

The company's operations are affected by certain seasonal factors related to patterns of consumption; in the periods immediately prior to religious festivals and during the summer months, the company experiences an increase in its operations.

INTANGIBLE ASSETS IN THE CREDIT CARD FIELD

Brand names and trademarks. Following the commencement of competition in the VISA credit card field, ICC started to develop a distinct symbol in order to differentiate it from the other VISA issuers, using the brand name "ICC" or "Cal".

Furthermore, ICC owns many registered trade marks in Israel, including "ICC", "Cal" "Active" and "WWWCard". ICC is also in the process of registering several additional trade marks.

Licenses and franchise. ICC is a Principal Member of the international VISA organization, which granted ICC a license to use the VISA trade marks and a franchise to issue and clear credit cards in Israel under this brand name.

Diners has an exclusive license for the use in Israel of the "Diners" trademark, granted by the Diners International Organization, and for the operating of issuance and clearing services of Diners credit cards in Israel.

ICC also serves as the Principal Member in the International MasterCard Organization, which granted it the license to use the trademarks of "MasterCard", "Eurocard", "Cirrus" and "Maestro" in Israel.

Data base. ICC holds three data bases of registered customers holding VISA, Diners (through Diners) and MasterCard credit cards, as well as of traders accepting these cards.

GOALS AND STRATEGY

The issuance field. ICC aims at leading the market through utilization of the banking channel and providing customized solutions for customers, and marketing of cards through the off-banking channel in existing consumer clubs and through cooperation with various entities for the establishment of additional consumer clubs.

Converting ICC into a significant player in the consumer credit market, distribution of off-banking cards, principally rolling credit cards of the "Active" type, constitute an infrastructure for issuing customer credit. In addition, ICC will promote itself as an entity providing varied credit services

(including through credit cards), without dependence on banks, and will develop additional products in this field.

The clearing field. ICC's strategy is intended to convert the Company to a clearing agent marketing a comprehensive basket of products to traders, while enlarging its market share in the clearing field. Furthermore, ICC will endeavor to develop and market additional products to be offered to traders, in addition to discounts and the advancement of payments offered at the present time. As part of its efforts in this field, ICC signed an agreement for the acquisition of the E.R.N. shares, a company engaged in providing collateral for checks and services for discounting checks.

OPERATIONS IN THE CAPITAL MARKET

The operations in the capital market includes securities activity (excluding activity for the Bank's own account), portfolio management, mutual funds, supplementary training funds, provident funds and severance pay funds. The operations include the activity of the Bank's securities department, as well as the operations of specialized subsidiary Tachlit Investment House and the operations in the capital market of Mercantile Discount Bank. Up to June 30, 2007 the activity included that of provident fund management. Until June 30, 2006, the activities included those of the specialized subsidiary Ilanot Discount, that has been sold.

OPERATIONAL STRUCTURE

The Asset Management Division of the Bank, which is responsible for the operations in the capital market, is comprised of the following units and investee companies:

- Securities department;
- Business development (product development department and Ma'of department);
- Product development department;
- Tachlit Investment House (subsidiary);
- Discount Gemel (subsidiary);
- Discount Trust (subsidiary) (the operations of this company are included in the financial management segment);
- Green Bull Capital Markets Ltd. (hereinafter: "Green Bull").

TREND OF EVENTS AND DEVELOPMENTS IN THE MACRO-ECONOMIC ENVIRONMENT

The mutual funds market. The mutual funds market expanded during 2007 to the tune of 8.0%, from a level of market value of NIS 111.5 billion in December 2006 to a level of NIS 120.6 billion in December 2007. The weight of mutual funds investing in the CPI linked channel increased in 2007 compared to the decrease in weight of the mutual funds investing in the non-linked and equity channels. The weight of mutual funds investing in foreign currency remained unchanged. The volume of assets of the CPI linked funds increased from NIS 23.2 billion in December 2006 to NIS 36.2 billion in October 2007. Assets of funds investing in equities increased in this period from a level of NIS 19.6 billion to a level of NIS 21.7 billion. The non-linked funds' assets increased from a level of NIS 44.2 billion to a level of NIS 46.3 billion. Assets of the foreign currency funds increased from a level of NIS 5.1 billion to a level of NIS 5.9 billion. Assets of mutual funds investing abroad decreased from a level of NIS 19.4 billion to level of NIS 18.5 billion.

The provident fund market. The provident fund market is rounding up the process of transferring management these funds' assets to the non-banking entities.

Another significant process that began in 2007 is the increase of about 1% in management fees of the former bank managed funds, to equal the management fees charged by the private investment houses prior to the transfer of ownership of the bank provident funds (about 2% per annum).

According to data published by the Capital Market Department at the Ministry of Finance, provident funds of the "Provident and Personal Severance Pay Funds" class had in 2007 a net negative accumulation in the amount of NIS 536 million. This compared to a net negative accumulation of NIS 25 million in 2006, and a net positive accumulation of NIS 2,962 million in 2005. The said data reflect, among other things, the impaired attractiveness of the investment in provident funds following the changes in legislation, including Amendment No. 3 to the Income Tax Regulations (Principles for the Approval and Management of Provident Funds).

The basket certificate market. In 2007, 140 new basket certificates were issued and at the end of the year 240 basket certificates were traded on the Tel-Aviv Stock Exchange.

In 2007, the daily turnover of trading in basket certificates amounted to NIS 370 million, comprising about 18% of total daily trading volume on the Tel Aviv Stock Exchange. The volume of trade in basket certificate continued its upward trend, among other things, as a result of the issuance of new series. The volume of activity in basket certificates in 2007 amounted to NIS 23.5 billion, an increase of 75% compared to 2006.

**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" in the section "Legislation and regulation" hereunder, as well as Note 33 to the financial statements.

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 a consultant who is not connected to the entities generating the products, and the activities of a promoter 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 assurance product distribution market.
- The amendment made at the end of 2007 to the Pension Consulting Law, specified that the limitation on advisory services by insurance funds shall also apply to a banking corporation the equity of which and of corporations controlling it, or being controlled by it, does not exceed NIS 10 billion (which includes the Bank), and this until the end of 2008 only. As to the large banks, the amendment specifies that they may provide advisory services regarding insurance funds to customers residing in peripheral areas starting with January 1, 2009, and to customers residing in central areas of the country starting with April 1, 2009. Concurrently, the two large banks have reached an agreement with the Commissioner of the Capital Market as to a gradual entry into advisory services field for employed

persons, in a manner where full advisory services to all types of customers (employed and self employed) and with respect to all pension products would begin as from August 1, 2010 only.

The Minister of Industry, Trade and Employment signed on December 30, 2007, an Expansion Order according to which the agreement between the New Federation of Labor and the Economic Organizations Coordination Bureau is to apply to all employees and employers. The said agreement relates to the institution of compulsory pension payment for every employee starting January 1, 2008. An amendment to the Provident Funds Law passed at the beginning of 2008, provides that as from now onwards there will be two classes of pension provident funds: a pension paying provident fund and a non-pension paying provident fund. Amounts saved as from January 1, 2008, shall be designated in the first place for the payment of pension. The capital provident funds that had existed up to that date shall become non-pension paying provident funds, and no withdrawal of funds shall be permitted therefrom (except for withdrawals in respect of the severance pay component), unless by transfer to a pension paying provident fund. Upon retirement, the member of the fund shall be entitled to capitalize a part of the pension monies and withdraw one lump sum, and this only after leaving with the fund an amount sufficient to secure a minimum monthly pension payment of NIS 3,850. The aim of the amendment is to secure a minimum monthly pension in the above amount upon retirement from work of each fund member. The decision regarding the balance of the saved amount (whether to draw it as a pension payment or to capitalize it and draw one lump sum) is to be taken only upon retirement from work. In addition, taxation principles and tax benefits applying to savings by way of the various pension products have been amalgamated. In March 2008 the "pension mobility" Regulations were also published, whereby, starting with the date on which these Regulations become effective at the end of 2008, each member would be entitled at any time he wishes, to transfer the amounts accumulated in his favor in one pension product to another pension product and/or to another management company at no cost. The member would be entitled, at his discretion, to transfer the funds from a life assurance policy to a pension fund and vice versa, and from a capital provident fund to a pension fund (though not vice versa). In the Bank's opinion the said amendment to the Law will result in material changes in the two planes of pension advisory services:

- Simplified consultation - providing the service would become simpler and quicker than would have been expected prior to the passing of the Amendment, as some of the decisions to be taken by the customer are now deferred to the date retirement.
- Simplification of the operation with salaried employees - Equalizing the tax benefits and maximum tax rates of the capital and pension savings channels, will enable direct clearing between the employer and the consultant without the need for mediators.

The far reaching amendments regarding the pension savings field, including the mobility reform and the institution of a compulsory pension for each employee, may considerably increase the population requiring pension advisory services.

Notwithstanding, the deferment of the date on which the employee is required to decide upon the use to be made of the funds saved and the limitation put on his possible choices by compelling

him to accept a minimum pension, may reduce the demand for consulting services. In addition, the need to develop computer tools for the support of the pension advisory services and conducting transactions for customers in continuation thereof, both at the Bank and in the market in general, is expected to consume considerable resources as well as complex learning and trial processes of all players in the pension savings market during the early years of operations.

As to details concerning the Securities Regulations (Joint Investment Trust) approved by the Knesset Finance Committee in November, 2007, see "Legislation and supervision" hereunder. The Israel Securities Authority is promoting at present a comprehensive amendment to the Joint Investment Trust Law, 1994, that will allow the offering of participation units in foreign mutual funds in Israel. For details as to the guidelines regarding information as to the needs and instructions of a customer seeking investment advice and regulations regarding the documentation of consulting see "Legislation and Supervision" hereunder.

**SCALE OF OPERATIONS
AND NET INCOME**

Net income of the operations in 2007 amounted to NIS 648 million, compared with NIS 367 million in 2006, an increase of 76.6%.

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

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

	Domestic operations					International operations:		Total
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Private Banking		
For the year ended December 31, 2007								
Income from financing activities before provision for doubtful debts								
- From externals	7	3	-	2	1	13	-	13
- Intersegmental	7	-	1	-	-	8	-	8
Total income from financial activity	14	3	1	2	1	21	-	21
Operating and other income	296	45	41	26	44	452	50	502
Total Income	310	48	42	28	45	473	50	523
Operating and other expenses	175	36	23	14	31	279	37	316
Operating Income before taxes	135	12	19	14	14	194	13	207
Provision for taxes on operating income	49	5	7	6	6	73	3	76
Net income	502	62	16	37	21	638	10	648
Net income disregarding certain components ⁽¹⁾	87	8	12	9	9	125	11	136
Average Assets	10	4	25	1	8	48	-	48
Average Risk-assets	-	-	3	-	-	3	-	3
Average Liabilities	10	4	24	1	8	47	-	47
Average assets of provident and mutual funds ⁽²⁾	11,408	1,861	99	906	1,250	15,524	-	15,524
Average customers' securities	27,689	4,748	39,488	11,853	8,078	91,856	8,646	100,501
Average other assets under management	1,423	300	152	555	615	3,045	-	3,045

(1) The following components have been eliminated: expenses in connection with early retirement plan, the cost of performing examinations and improvements at IDB New York and gains on sale of the provident funds activity and the activity of KAHAL.

(2) The assets of the provident funds that had been sold were included in the average balance until their sale.

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

	Domestic operations					International operations:		
	Small Corporate		Middle Market		Private	Private		
	Households	Businesses	Banking	Banking	Banking	Total	Banking	Total
For the year ended December 31, 2006								
Income from financing activities before provision for doubtful debts								
- From externals	12	5	3	2	1	23	-	23
- Intersegmental	3	-	-	-	-	3	-	3
Total income from financial activity	15	5	3	2	1	26	-	26
Operating and other income	378	47	32	25	48	530	19	549
Total Income	393	52	35	27	49	556	19	575
Operating and other expenses	265	28	11	18	33	355	17	372
Operating Income before taxes	128	24	24	9	16	201	2	203
Provision for taxes on operating income	56	9	10	3	9	73	3	87
Net income	286	39	17	8	15	365	2	367
Net income disregarding certain components ⁽¹⁾	87	18	13	7	9	134	3	137
Average Assets	8	4	29	1	7	49	-	49
Average Risk-assets	-	-	3	-	-	3	-	3
Average Liabilities	289	4	21	1	7	322	-	322
Average assets of provident and mutual funds ⁽²⁾	25,381	3,499	227	1,505	1,262	31,874	-	31,874
Average customers' securities ⁽²⁾	22,543	4,347	25,435	10,992	7,489	70,806	9,901	80,707
Average other assets under management	1,283	283	130	554	499	2,749	-	2,749

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan, payments to the supervisory authorities in the US, the cost of performing examinations and improvements at IDB New York and the gains on sale of shares in Ilanot Discount.

(2) Until the exclusion of Ilanot Discount from consolidation, securities of mutual funds managed by Ilanot Discount were included in the average balance assets of provident funds and mutual funds, and following that in the average balance of securities.

**DATA RELATING TO THE
SCALE OF OPERATIONS
IN DIFFERENT AREAS**

Securities. On December 31, 2007, the balance of securities held for customers amounted to NIS 102.3 billion, including NIS 10 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 24.6%. For details as to income from security activities, see Note 24 to the financial statements.

Investment portfolio management. On December 31, 2007, Tachlit was managing 1,623 investment portfolios, which together were valued at approximately NIS 2,375 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 4.1% in the number of portfolios managed and to an increase of approximately 2.9% in the monetary value of the managed portfolios.

For details as to restrictions imposed on investment portfolio management companies and on the ownership and control thereof by banking corporations in accordance with legislation enacted in the wake of the Bachar Committee recommendations, see Note 33 to the financial statements.

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, at the end of 2007, to NIS 7,227 million, compared with NIS 3,815 million at the end of 2006, an increase of 89.4%.

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.

Up to December 5, 2007, Mercantile Discount Bank managed, either directly or through a consolidated subsidiary, eight provident funds for severance and provident payments, further training and a central fund for sick pay. The total assets of these funds at the above date amounted to NIS 3.8 billion. The sale of control of the operations of the said provident funds was completed on December 5, 2007.

Employees' Supplementary training funds. For details regarding the sale of Kahal, see hereunder.

**DEVELOPMENTS IN THE
OPERATIONS**

General. Concurrently with the legislative process in the wake of 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 the Bank. The Bank began to apply several moves intended to enhance its preparations for capital market activities in the post Bachar Committee era, as detailed hereunder.

Agreement in Principle for the sale of shares of Ilanot Discount Ltd. and the operations of Discount Management of Provident Fund. On November 7, 2005, the Bank approached several parties with respect to the possible sale of the Bank's holdings, in whole or in part, in Ilanot Discount Ltd. and in Discount Management of Provident Fund Ltd. (hereinafter: "the Provident Funds"). The said approach included certain conditions precedent. The Bank advised that it does not undertake to accept the highest offer or any particular offer of the offers, and that the Bank reserves the right to change the terms of sale, the process of sale, the determined schedules or totally discontinued the sale process.

On November 9, 2005, an agreement in principle was signed between the Bank and Clal Insurance Enterprises Holdings Ltd., whether itself or by way of a company under its control (hereinafter - "the Purchaser") for the sale of all shares of Ilanot Discount Ltd. and for the sale of the operations of Discount Management of Provident Fund Ltd., as one package, in consideration for NIS 1,310 million, subject to adjustments.

The consideration for the sale of the shares of Ilanot Discount Ltd. was set in the Agreement in Principle to NIS 600 million, subject to adjustments, and the consideration for the sale of the operations of the Provident Funds was set in the Agreement in Principle to NIS 710 million, subject to adjustments.

The Agreement in Principle determined, among other things, that following the consummation of the transaction, the Bank shall provide Ilanot Discount and the Provident Funds with distribution services in consideration for a distribution fee equal to the rate of fees stated in the draft regulations regarding distribution commissions payable by mutual funds and provident funds, respectively, as well as operating services and additional services.

The sale of the shares of Ilanot Discount. On April 11, 2006, the Bank, Clal Finance Batucha Management and Investments Ltd. (hereinafter - "the Purchaser") and Clal Insurance Enterprises Holdings Ltd. (both of the IDB Group), signed an agreement for the sale by the Bank to the Purchaser of all the shares of Ilanot-Discount (hereinafter - "the Sales Agreement"). In addition, the Bank is to assign to the Purchaser the right to receive management fees from Ilanot Discount and will also sell to the Purchaser the goodwill it acquired in the field of mutual fund management. In consideration for the above, the Purchaser will pay the Bank NIS 580 million, subject to adjustments that may arise from the difference between the expenses of Ilanot Discount and the actual payments made to the Bank in the period from January 1, 2006 until date of closing of the transaction, in comparison to the amount of expenses determined in the Sale Agreement.

The sale agreement came into effect on June 18, 2006, after the completion of all conditional terms for its execution. As part of the completion of the sale, the following agreements were signed between the Bank and Ilanot Discount: an operational agreement, according to which the mutual funds managed by Ilanot Discount would gradually be transferred for operation by the Bank, and a distribution agreement (replacing a previous agreement) according to which the Bank would distribute the mutual funds managed by Ilanot Discount.

The Sales Agreement includes, inter-alia, provisions as to additional services that the Bank may provide to Ilanot Discount. The Sales Agreement also stipulates indemnification arrangements between the Bank and the Purchaser under certain circumstances.

Correspondingly with the completion of the sale, the Bank paid IDB and DCMI a sum of NIS 12.5 million, as additional consideration for the 45% of Ilanot Discount shares that it acquired from them in September 2005.

As above mentioned, the profit derived from the sales transaction amounted to approximately NIS 256 million, net after tax, and has been recorded in the 2006 financial statements as of net gain from extraordinary items.

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 (hereinafter: "the sold provident funds") including and additionally, 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, 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.

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 from the closing of the transaction 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 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 Provident. Compensatory arrangements subject to fulfillment of certain conditions were also included in the agreement.

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 has accepted 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 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 384 million and was recognized under "Net income from extraordinary items, net of taxes".

For further details, see Note 6 E to the 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 Ltd. (1965). 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 approx. 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 net gain derived from this transaction totalled NIS 74 million, and was recognized under "Net income from extraordinary items, net of taxes".

For additional details see Note 19 C 20 to the financial statements.

Distribution of mutual funds. In the first half of 2006, the Bank entered into distribution agreements with most of the companies managing mutual funds. In the second quarter of 2006, the Bank commenced charging distribution fees in respect of mutual fund units held by its customers, in accordance with the applying regulations that came into effect on April 1, 2006. According to the said regulations, the Bank will enter into agreements with all mutual funds managers who wish to do so, for the distribution of mutual funds managed by them, in consideration for the payment of distribution fees for this service, at identical rates and payment terms.

Preparations towards pension consulting. In view of the changes anticipated in the provident and pension market and within the framework of the possibilities offered by the recommendations of the Bachar Committee, the Bank is preparing for providing pension advisory services to its customers and for this purpose a pension layout department has been established to handle pension advisory services.

The preparations constitute a comprehensive preparation at the Bank level, which includes among other things, recruiting and training professional staff for the pension advisory operations, structuring computer systems to support advisory services and distribution of pension products and the signing of distribution agreements with the manufacturers of pension products, all this under

the concept that the pension advisory field is of strategic and business importance to the Discount Bank Group. The Bank is obliged to sign a distribution agreement with all providers of pension products (such as provident funds and pension funds excluding insurance products) who wish to do so, for the distribution of their products in consideration for a distribution commission at identical rates and payment terms for identical service.

In 2007 the Bank finalized following steps required by law: the sale of the provident fund activity and the sale of the Bank's part in "Kahal" as detailed above. Also concluded was the transaction for the sale of control of the provident fund operations of Mercantile Discount Bank. This follows the completion of the Bank's sale of its holdings in Ilanot Discount and Harel. The process of transferring control over the provident funds of the employees and the transition of the Fund into a scheme managed by the management company owned by the employee committee at the Bank is expected to be completed presently. This, following the approval on January 29, 2008 of the General Meeting of members of the Fund.

Accordingly, in February 2008, the Bank received a license for the granting of pension advisory services and in March 2008, the Bank has started providing this service to customers.

Presentation of new services having a leading value in the capital market. As part of the preparations made by the Bank as regard the capital market operations, the Bank is seeking complementary services having a high added value to customers. The Bank intends making use of its holdings in Green Bull. The Bank owns 20% of the equity in Green Bull, a company specializing in global investment portfolio management. Green Bull signed an agreement for the joint management of investments with CMA, a US corporation showing record yields of US and global investment portfolios. Green Bull manages the investment portfolios using unique statistical models for choosing companies, business sectors and countries. Furthermore, Green Bull provides "Family office" services, which is a unique consulting service in Israel. This service includes assistance to the customer in forming an overall investment strategy as regards his total assets, a review of his existing investment position (including investments managed by various portfolio managers, various banks, deposits, pension saving, further training funds, real estate and so forth) and taking action modify existing investments to the desired strategy of the customer.

MARKETING AND DISTRIBUTION

The distribution of products and services is undertaken by segment employees through the use of the Bank's existing distribution apparatus, the branch network, investment centers, private banking centers, staff units and the Bank's subsidiary companies. For additional details, see "Consulting services system" in the Section "The retails sector - General" in the Chapter "Activity of the Group according to principle segments of operation" above.

No dependence exists on marketing channels, though attention should be drawn in this respect to the changes described above, following the implementation of the Bachar Committee recommendations.

As stated above, following the new legislation for the implementation of the Bachar Committee recommendations, the Bank has become a financial and pension consultant independent of the providers of the products, and distributes a range of financial and pension products.



COMPETITION In the capital market activity, the Bank competes both with other banks and with private brokers. In the field of financial products competition exists against the consulting entities as well as against the marketing entities (the providers of the products) as regards the sale to customers of one or another financial product.

In the field of pension products the Bank began in March 2008 pension consulting services activities. This activity requires a continued pension consulting agreement between the consultant or the marketer and the customer. Accordingly, fierce competition is expected regarding the preferences of the customer in an effort to create a long-term relationship, within its framework the Bank is committed to maintain a continuous connection with the customer. In this respect, competition is expected against all the consulting entities on the one hand and the marketing entities as well as against the providers of the products (insurance companies, insurance brokers, pension funds, etc.) on the other hand.

For details as to the conditions required for entry into the pension-consulting field and new legislation and regulatory activities in the matter, see above and also Note 33 to the financial statements.

- GOALS AND BUSINESS STRATEGY**
- Intensifying the activity in the field of pension consulting that began in March 2008 and the continued development of systems supporting this activity;
 - Completing the preparations for operating as a “supermarket” for financial and pension products;
 - Improvement in securities trading by means of the Internet, development of the activity of arbitrage player and capital market players;
 - Cultivation and distinction of the status of the investment consultant;
 - Providing operating services to provident funds and mutual funds.

CAPITAL MARKET ACTIVITY OF MERCANTILE DISCOUNT BANK **Preparation for pension advisory services.** Mercantile Discount Bank has also started preparations for entry into the pension advisory services market. Within the framework of these preparations, the establishment of a nation wide organizational infrastructure for the offering of pension advisory services has begun, including the training of 25 of Mercantile Discount Bank’s investment advisors for work in this field., as well as the training of additional advisors in the next few month to the extent required for attaining this goal; development of computer systems designed to provide support for pension consulting and the distribution of pension products, in cooperation with the Bank, and the preparation of the appropriate legal infrastructure (consultation agreements, distribution agreements, procedures, etc.). At the same time Mercantile Discount Bank 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 and the 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, as amended on December 5, 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 76 million, subject to adjustments. This amount reflects a rate of 4.25% of the volume of assets amounting to NIS 3.8 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 options, 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 exercisable at the final exercise date, or earlier, if Mercantile Discount Bank exercises the first option to acquire 5% of the equity of the purchasing company (or 10%, on condition that the scope of activity of the purchasing company in the field of provident funds, at date of exercise of the option, is not material).
- The exercise price of the option shall be derived from the relative part of the price to be paid for the remainder of the activity of the provident funds (as stated above) and the value of the relative part of the activity of the purchasing company (excluding the provident fund activity), as determined by an appraiser agreed upon by the parties. During a period of ten years from date of acquisition, Mercantile Discount Bank will be entitled to sell to the owners of the purchasing company its own holdings in that company at a price to be based on the mechanism used in determining the purchase price.

The sale process was completed on December 5, 2007, following completion of all qualifying conditions specified in the agreement. Following the sale, Mercantile Discount Bank holds 49% of the new company, Hadas Mercantile Provident Funds, established under the agreement and which took over its provident fund activity. The remainder of the shares are held by the purchasers' group. Within the framework of the agreement, the validity of the guarantee given in the past to members of "Mercantile Central Severance Pay Fund" has been extended (see Note 19 c 19 to the financial statements). Under the agreement the guarantee shall expire no later than at the final exercise date. The net gain (after tax) derived from the first stage of the transaction totalled NIS 49 million and was recognized under "Net income from extraordinary items, net of taxes".

The income of Mercantile Discount Bank from provident fund management, amounted in 2007 to NIS 26 million similar to 2006.

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

holds 51% of the equity in the new company, and the remaining shares will be held by the partners. The company commenced operations in October 2007.

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.

MARKET DEVELOPMENTS

General. 2007 saw an improvement in the activity of the construction and real-estate industry which was reflected in an increase in the product at the rate of 5.5%. The volume of investments in residential construction increased at a moderate rate of 2.9% (6.0% in 2006) while investments in non-housing and other construction projects increased at the rate of 11.4% (an increase of 11.8% in 2006). Several developments occurred in 2007 which may indicate a continuous improvement trend in all segments of the real-estate market:

Residential construction. The demand for residential units on the part of young couples and those wishing to upgrade living conditions continued in areas in demand in central Israel and in the periphery. The increase in sale of luxury apartments to foreign residents continued mainly in Jerusalem and in Tel Aviv. The leading construction companies reported a significant increase in the volume of income from residential construction stemming from the rise in the average price per apartment sold as well as from the number of apartments sold. The increase in demand was not supported by a parallel increase in supply, which resulted in the reduced inventory of available apartments in the private building sector. Data of the Central Bureau of Statistics which reflect a moderate increase in investments in residential construction are general and relate to all areas in the country, while a significant increase occurred in demand areas both in the sale of apartments and in their prices.

Income generating real-estate - office buildings. Rent prices continued to rise in 2007 and office occupancy rates increased in demand areas in Tel Aviv and the center of the country, this in continuation to the price increase trend noticed since 2005. However, the rate of increase in rent prices reflected moderation compared to the growth rates in the years 2005-2006.

Income generating real-estate - commercial buildings. The increase in demand for quality commercial space on the part of private local and foreign investors continued in 2007, accompanied by a rise in prices and a decline in yield.

Real-estate activity abroad. The expansion in income generating and entrepreneurial real-estate activities abroad accelerated in 2007, particularly in the housing and commercial construction fields in Central, Eastern and Western Europe, India and China, as a result of high return in investment and profitability characteristics on the capital invested.

Developments in the off-banking credit market. The year 2007 saw an increase in the volume of bonds issued by corporations operating in this sector. A part of the issues comprised non-rated bonds issued by medium and small sized corporations having no recognized and continued

business record. In some of the cases the proceeds of the issues were used as capital and shareholder loans for the expansion of the income generating and entrepreneurial real-estate activities in the local and foreign markets. The rate of fund raising decreased considerably in the second half of 2007 as a result of the weakness of the capital market and of a deeper scrutiny of the quality of the issuing corporations on the part of institutional investors.

CREDIT POLICY IN THE CONSTRUCTION REAL ESTATE ACTIVITY

The Bank's credit policy is based on the following principles:

- The greater part of the credit facilities made available to the real estate sector will be processed through a professional project finance unit;
- Future credit policy will be selective, insofar as preference will be given to the financing of projects which bear a relatively low exposure vis-à-vis the slowdown in the industry;
- The financing of residential construction projects and income generating real-estate projects is to be executed by the "construction lending" method, which allows close supervision of the project being financed.
- The provision of credit facilities for the acquisition of land and/or construction purposes will be conditioned on minimum capital investment rates on the part of the promoters;
- The release of unutilized facilities will be subject to simultaneous compliance with rates of sales and minimum rates of performance.

The preferred areas for granting of credit facilities:

- Construction of low-grade housing projects and more improved housing units in areas of demand;
- Luxury housing construction in distinct demand areas.
- Land is available for construction in areas of demand with respect to which the Bank is prepared to provide closed financing for construction projects;
- The provision of credit facilities to established real estate companies for the purpose of financing current projects and/or investment projects. Preference will be accorded to large well-established financially sound companies.
- Financing of national infrastructure projects, in conjunction with banks and/or off-banking financing corporations.

Discount Mortgage Bank focuses on construction lending for medium and small residential projects and projects in demand areas. Credit for the acquisition of income generating properties is granted after an in-depth scrutiny of the quality of the transaction. As described under - "Mortgage and housing loan activity" hereunder, Discount Mortgage Bank regards housing loans as its main activity.

EXPECTED DEVELOPMENTS IN THE SECTOR'S MARKETS

The Bank believes that the continued growth is expected in 2008 in the product of the domestic real estate and construction industry, though the rate of growth will slow down in comparison to 2007. The segments that would lead the growth are the income generating real estate (in the office and commercial properties field) and the national infrastructure segment, while the residential construction segment expects stability in its operations.

Following are the developments expected in the various segments:

Income generating real estate, office and commercial property. Continued growth in volume of investments in this segment due to increase in property prices, increase in demand on the part of local and foreign investors and institutional bodies and shortage of quality property in demand areas.

Infrastructure. Increase in volume of investments in projects in the national infrastructure field, on the background of numerous projects in respect of which financing agreements have been reached between the promoters and the financing entities.

Residential construction. Stability in the volume of investments in this segment as a result of price increases in recent years and a decline in demand on the part of those wishing to improve their housing conditions on background of the decline in the consumer confidence index.

Financing operations abroad. The continued investment activity of Israeli corporations in promotional and income generating real estate projects, principally in central and eastern Europe and in south east Asia, on background of a considerable profit margin and a high return on capital invested.

The Bank believes that an acceleration is expected in 2008 in the rate of growth of bank credit to customers of the segment as a result of demand being diverted from the off-banking market to the banking industry, due to the following developments:

- A decrease in the volume of bond issues by corporations on background of the increased selectiveness in investments on the part of institutional investors;
- A decrease in the volume of raised capital on the background of the weakness in the sector's share prices on the primary issues market - as from the second half of 2007 the prices of shares of the real-estate sector in Israel, Europe and the United States dropped sharply, reflecting a drop in multipliers and a drop in the value of the shares in comparison to the net asset value (NAV) of corporations.;
- The expected redemption of bonds issued in recent years by means of bank credit;
- Following the "subprime" crisis, financial institutions in the world are expected to reduce the rate of finance for income generating and entrepreneurial real-estate projects outside Israel in comparison to the rates that were customary in the past. This would require increasing the rate of capital provided by the investors, part of which would be financed, most likely by bank credit.

The above constitutes a forward-looking statement, which may not materialize in the event of a decline in the level of domestic demand as a result of an adverse security-political situation, moderation in the rate of growth of the economy, significant slowdown of activities in the global markets, including the US market, considerable worldwide interest rate changes and in the domestic economy and other developments in macro-economic conditions that outside the Bank's control.

SCALE OF OPERATIONS AND NET INCOME

General. In view of the slow recovery in this sector the Bank has increased its business activity with enterprising construction companies by way of approval of new credit facilities for the purpose of land acquisition and/or the building of residential projects in preferred areas both in central and peripheral regions.

In addition, the business activity has been extended by way of approval of new credit facilities to

finance both current and investment operations, according to the Bank's policy.

A reasonable volume and rate of sales were reported in respect of projects in the process of construction.

Net income from the operations in 2007 amounted to NIS 221 million compared to income of NIS 187 million in 2006, an increase of 18.2%. Disregarding certain components (see hereunder), net income would have amounted to NIS 227 million in 2007 compared with NIS 202 million in 2006, an increase of 12.3%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 17.8% in 2007 compared to a rate of 17.3% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 18.2% in 2007 compared with 18.5% in 2006.

Provision for doubtful debts amounted in 2007 to NIS 74 million compared with NIS 103 in 2006, a decrease of 28.2%.

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

	Domestic operations				International operations			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
For the year ended December 31, 2007								
Income from financing activities before provision for doubtful debts								
- From externals	89	497	126	712	158	21	179	891
- Intersegmental	(25)	(201)	(59)	(285)	(39)	-	(39)	(324)
Total income from financial activity	64	296	67	427	119	21	140	567
Operating and other income	15	14	11	40	20	4	24	64
Total Income	79	310	78	467	139	25	164	631
Provision for doubtful debts	13	42	10	65	6	3	9	74
Operating and other expenses	17	70	23	110	89	10	99	209
Operating Income (loss)								
before taxes	49	198	45	292	44	12	56	348
Provision for taxes on operating income	18	74	17	109	17	2	19	128
Net income	31	125	28	184	27	10	37	221
Net income disregarding certain components ⁽¹⁾	32	126	28	186	31	10	40	227
Yield on capital (percentage)	56.7	17.3	19.9	20.0	10.1	17.1	11.4	17.8
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	57.1	17.4	20.2	20.2	11.5	17.1	12.5	18.2
Average Assets	1,441	8,563	1,971	11,975	3,692	945	4,637	16,612
Average Risk-assets	595	2,495	411	3,501	824	3	827	4,328
Average Liabilities	893	12,040	2,389	15,322	4,347	966	5,313	20,635
Margin from credits activity	52	189	50	291	103	18	121	412
Margin from deposits activity	7	7	4	18	15	-	15	33
Other	5	100	13	118	1	3	4	122
Income from financing activities before provision for doubtful debts	64	296	67	427	119	21	140	567

(1) The following components have been eliminated: expenses in connection with early retirement plan and the cost of performing examinations and improvements at IDB New York.

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

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

	Domestic operations				International operations*			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
For the year ended December 31, 2006								
Income from financing activities before provision for doubtful debts								
- From externals	77	512	77	666	27	15	42	708
- Intersegmental	(27)	(183)	(43)	(253)	71	-	71	(182)
Total income from financial activity	50	329	34	413	98	15	113	526
Operating and other income	19	15	7	41	7	4	11	52
Total Income	69	344	41	454	105	19	124	578
Provision for doubtful debts	25	51	18	94	7	2	9	103
Operating and other expenses	11	72	5	88	69	7	76	164
Operating Income before taxes	33	221	18	272	29	10	39	311
Provision for taxes on operating income	14	91	6	111	10	3	13	124
Net income	19	130	12	161	19	7	26	187
Net income disregarding certain components ⁽¹⁾	21	139	11	171	24	7	31	202
Yield on capital (percentage)	22.7	18.8	*12.1	*18.5	10.2	14.0	10.9	17.3
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	23.8	19.5	19.7	20.0	13.0	14.0	13.2	18.5
Average Assets	2,320	*10,253	*1,547	14,120	3,647	760	4,407	18,527
Average Risk-assets	519	1,359	*142	2,020	487	7	494	2,514
Average Liabilities	1,480	*11,890	*912	14,282	3,185	781	3,966	18,248
Margin from credits activity	36	204	26	266	97	14	111	377
Margin from deposits activity	6	5	2	13	-	-	-	13
Other	8	120	6	134	1	1	2	136
Income from financing activities before provision for doubtful debts	50	329	34	413	98	15	113	526

* Reclassified.

(1) The following components have been eliminated: privatization bonus, expenses in connection with early retirement plan and the cost of performing examinations and improvements at IDB New York.

LEGISLATIVE AND REGULATORY LIMITATIONS AND SPECIAL CONSTRAINTS APPLYING TO THE ACTIVITY	The limitations described above applying to the business segment also apply to construction and real-estate operations. In addition, it should be noted that as part of Proper Banking Management Directives, a limitation applies to industry credit concentration, where that part of the credit being the responsibility of the banking corporation (including off-balance sheet credit) granted to a certain industry, as defined in the Directive, exceeds 20% of total credit to the public being the responsibility of the banking corporation. The rate of Bank's exposure as regards credit to the construction and real-estate industry as of December 31, 2007, amounted to 17.8% (16.6% at the end of 2006). Legislation and regulation in the matter of securing the investments of residential units purchasers. For details regarding the Bill for the amendment of the Sale Law (residential units) (Securing the investments of residential units purchasers) and the instructions of the Supervisor of Banks in the matter of project financing and transactions to which the said Law applies, see Chapter "Legislation and supervision" below.
SERVICE TO CUSTOMERS OF THE SEGMENT	Most of the business activity in the real estate and construction segment is carried out by the project financing department of the Bank. The department provides a wide range of banking services both to the large and medium level corporations engaged in the promotion and investment in residential and income generating real estate. In addition the financing operations of the segment are also conducted by business managers at the large corporations wing. In 2007, a unit was established for the handling of complex transactions for the finance of investments in infrastructure projects (electric power stations, desalination plants, toll roads, BOT and PPP projects, etc.). The unit studies the projects and structures suitable financing packages with the possible participation of other banks and institutional investors in financing the project. At the Group's level, the activity is conducted by means of the following subsidiaries: Discount Mortgage Bank provides the service to its customers through four of its branches (Jerusalem, Haifa, Ramat Gan Stock Exchange and Modi'in) and through 57 sub-branches located within branches of Discount Bank. Mercantile Discount Bank. The construction project financing department, providing services to customers Mercantile Discount Bank engaged in the construction field - construction companies in the real estate segment, including financing under the "closed construction finance" method, for the purpose of executing projects for the construction of buildings (especially housing projects).
TECHNOLOGICAL CHANGES THAT MIGHT HAVE A MATERIAL EFFECT ON THE SEGMENT	The information systems used by the segment are designed to assist in the analysis of customer needs, in the day to day dealings with them, in the analysis and measurement of credit risks and in monitoring and control of their operations. Updating and upgrading of the various technological systems is being carried out on a current basis benefiting the segment.

CRITICAL SUCCESS

FACTORS OF THE OPERATIONS

The critical success factors of the segment include:

- current communication with customers, qualitative service, continued customer satisfaction as regards the quality of service and the financing of projects that had been completed;
- Providing prompt response to applications for credit and other related services;
- The offer of competitive terms as regards project financing, the volume of the equity capital required and the financing costs and commissions;
- Adequate understanding and mapping of the market is required in order to identify risks/opportunities in various sectors, e.g. standard housing construction, luxury housing construction, rental office and commercial property.

THE MAIN ENTRY AND EXIT BARRIERS OF THE OPERATIONS

Operations customers conduct business with several banks at any given time, so that the relative advantage of the operations is based upon the long-term relationship of the Bank with its customers, including continued satisfaction as regards the quality of service and the financing of projects. In order to provide quality customer service, highly proficient personnel are required, with comprehensive familiarity with customers of this segment, nature of their activity and analysis of their needs and requirements, while adapting the Bank's products to such needs. In addition, systems are required to monitor and control exposure and risks relating to project financing.

The said close-end system of project financing is, prima facie, supposed to allow the construction company to finance each project at another bank.

Nevertheless, considering the fact that surplus created in respect of projects financed by the Bank or current credit facilities allotted to promoters is being used in many cases as capital for leveraging other projects, a certain difficulty exists as regards the transfer from bank to bank, mostly with respect to the small and medium sized customers.

Suitable preparation is required for the purpose of compliance with regulatory as well as internal limitations prescribed by the Board of Directors with respect to the rate of exposure of the Bank in financing this segment.

ALTERNATIVES TO PRODUCTS AND SERVICES OF THE OPERATIONS AND CHANGES THEREIN

Off-banking financing constitutes an alternative financing source for segment customers as to long and medium-term credit used for the financing of investments and/or the purchase of income producing property, while in building projects, customers generally prefer the use of medium-short term bridging finance for the set up period.

STRUCTURE OF THE COMPETITION PREVAILING IN THE OPERATIONS AND CHANGES THEREIN

Most of the competition prevailing in the operations lies within the banking industry. The off-banking finance comprises, primarily, an alternative long-term financing source required for the construction and/or acquisition of income producing property in Israel and abroad, financing capital of residential construction projects.

Some institutional entities (insurance companies and pension funds) extend guarantees to apartment

purchasers, in accordance with relevant provisions of the Sales Law (Apartments).

In addition, foreign banks are active in providing long-term finance for investment in income generating properties.

COPING WITH COMPETITION

Providing professional service, timely response and establishment of a comprehensive and ongoing communication system with customers, while maintaining an overall view of their financial needs, constitute the principal means to confront competition successfully.

Deepening the current communication with segment customers is carried out by providing them with information packets several times a year, which include up to date banking information as well as an attractive set of offers, tailored to the needs of business people and companies.

PRODUCTS AND SERVICES

The services offered include:

- Credit for the finance of housing projects and/or income generating properties projects (primarily office and commercial space considerable parts thereof are marketed in advance);
- Credit for the construction and acquisition of income generating properties intended for commerce or office premises;
- Credit for current financing and/or investments in Israel and abroad;
- Providing guarantees under the Sales Act to purchasers of dwelling units and performance guarantees to the rights owners in land in the context of combination transactions or clearing and construction transactions;
- Extending credit to infrastructure projects.

For further information relating to services provided to segment customers, see above, 'Corporate segment.'

MORTGAGE AND HOUSING LOAN ACTIVITY

SEGMENT CUSTOMERS

This activity includes the 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.

DEVELOPMENT IN THE MORTGAGE MARKET

The mortgage market is typified by intense competition between the banks operating in this market. Competition in the market increased in the second half of 2007.

The volume of credit granted by mortgage banks in 2007, excluding credit out of State funds, reached an amount of NIS 28,198 million, excluding internal refinancing, compared to NIS 20,231 million in 2006. The downwards trend in the volume of credit granted out of State funds continued in 2007, reaching NIS 1,938 million (including standing loans and conditional grants in the amount of NIS 0.2 billion), compared to NIS 2,110 million in 2006 (including standing loans and conditional grants in the amount of NIS 0.3 billion), a decline of 8.2%.

The volume of housing loans out of bank funds granted by the mortgage banks in 2007, reached an amount of NIS 24,527 million, excluding internal refinancing, in compared to NIS 16,904 million in 2006, an increase of 45.1%.

**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 operation is diminishing due to the policy of the Finance Ministry to reduce the scope and advantage of the loans to entitled individuals. In recent years, the Accountant General reduces the commission paid to the banks for handling loans to entitled individuals. The said reduction in commission rates caused the commission income of the Group in respect of new loans from State funds to become immaterial.

The activity regarding the granting of rent subsidies from State funds to entitled borrowers, in accordance with directives of the Ministry of Construction and Housing and the Accountant General's department at the Ministry of Finance, which was implemented in previous years by the 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 assurance. In the course of 2005, the Supervisor of Banks in conjunction with the Supervisor of Insurance Business determined new arrangements as regards the marketing of insurance policies by mortgage banks while granting housing loans. The above notwithstanding, an insurance policy entered upon before October 1, 2005 may be continued or renewed.

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

At the beginning of 2007, Discount Mortgage Bank's insurance agent license was renewed until December 31, 2007. Following the Supervisor of Insurance Business consent whereby the existing insurance activity of Discount Mortgage Bank will continue unchanged and it will continue to handle the existing portfolio, including the periodic renewal of property insurance policies, even though it does not hold a valid insurance agent license, Discount Mortgage Bank surrendered its insurance agent license.

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 2007, the insurance agency's losses amounted to NIS 175 thousand, compared with NIS 862 thousand in 2006. According to the Supervisor of Banks' directives, as from 2007 property insurance of borrowers will not include third party liability. At this stage, Discount Mortgage Bank is unable to estimate the effect of this change.

BUSINESS STRATEGY

Discount Mortgage Bank regards the housing loan field as its principal activity and as the leverage for its future expansion thereby directing most of its marketing efforts and sales towards this activity. Discount Mortgage Bank is of the opinion that the financial margin of the credit products offered by the mortgage banks has reached its lowest point alongside the adverse effect on the operating income of the mortgage banks caused by the intense competition in this market. Discount Mortgage Bank faces this challenge by improving its service and by working within the framework of "Discount outline" (see hereunder).

SCALE OF OPERATIONS AND NET INCOME

The volume of housing loans granted. In 2007, the volume of housing loans granted amounted to NIS 3,121.7 million, compared to NIS 1,425.7 million in 2006, an increase of 119%. The above amount includes some NIS 106 million of loans recycled in 2007, compared to NIS 48.7 million in 2006, an increase of 118%. The impressive growth in housing loans granted mostly during the second half of the year, is the direct result of the mortgage marketing campaign (see hereunder). **Net income** from the operations in 2007 amounted to NIS 40 million, compared with NIS 28 million in 2006, an increase of 42.9%. Disregarding certain components (see hereunder), net income would have amounted to NIS 40 million in 2007, compared with NIS 31 million in 2006, a decrease of 29.0%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 7.1% in 2007, compared with 5.4% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 7.1% in 2007, compared with 5.6% in 2006.

Provision for doubtful debts in 2007 to NIS 17 million, compared with NIS 19 in 2006, a decrease of 10.5%.

Provision for doubtful debts in accordance with the extent of delinquency. On January 1, 2006, Bank of Israel published guidelines with respect to calculating the provision for doubtful debts of credit to the public. In practice, Discount Mortgage Bank had already applied most of the provisions of the new guidelines so that its effect on the doubtful debts provisions recorded by Discount Mortgage Bank in the financial statements for December 31, 2006, was minor, increasing the provision by only NIS 1 million.

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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 year ended December 31, 2007				
Income from financing activities before provision for doubtful debts				
- From externals	172	33	38	243
- Intersegmental	(65)	(10)	(26)	(101)
Total income from financial activity	107	23	12	142
Operating and other income	48	2	2	52
Total Income	155	25	14	194
Provision for doubtful debts	10	8	(1)	17
Operating and other expenses	113	8	1	122
Operating Income before taxes	32	9	14	55
Provision for taxes on operating income	4	2	4	10
Net income	24	6	10	40
Net income disregading certain components ⁽¹⁾	24	6	10	40
Yield on capital (percentage)	5.1	10.3	31.8	7.1
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	5.1	10.3	31.8	7.1
Average Assets	10,519	1,013	545	12,077
Average Risk-assets	2,401	217	-	2,618
Average Liabilities	7,923	1,017	519	9,459
Average other assets under management	2,130	-	-	2,130
Margin from credits activity	85	26	9	120
Other	22	(3)	3	22
Income from financing activities before provision for doubtful debts	107	23	12	142

(1) The following components have been disregarded: expenses in respect of early retirement incentive.



Following are 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 year ended December 31, 2006				
Income from financing activities before provision for doubtful debts				
- From externals	159	25	23	207
- Intersegmental	(43)	(6)	(15)	(64)
Total income from financial activity	116	19	8	143
Operating and other income	48	2	-	50
Total Income	164	21	8	193
Provision for doubtful debts	18	-	1	19
Operating and other expenses	86	12	1	99
Operating Income before taxes	60	9	6	75
Provision for taxes on operating income	26	4	3	33
Net income	22	3	3	28
Net income disregading certain components ⁽¹⁾	24	3	4	31
Yield on capital (percentage)	5.1	4.7	9.9	5.4
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	5.3	4.7	9.9	5.6
Average Assets	9,704	1,182	629	11,515
Average Risk-assets	2,418	276	-	2,694
Average Liabilities	7,525	1,185	642	9,352
Average other assets under management	2,269	-	-	2,269
Margin from credits activity	74	12	6	92
Margin from deposits activity	1	-	-	1
Other	41	7	2	50
Income from financing activities before provision for doubtful debts	116	19	8	143

(1) The following components have been disregarded: the privatization bonus.

**LEGISLATIVE
RESTRICTIONS**

Restriction on the credit concentration. 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 December 31, 2007, the said rate at Discount Mortgage Bank amounted to 2.14%, and the provision required in this respect amounted to NIS 1.9 million.

Law proposal in the matter of securing alternative housing. For details regarding this law proposal, see "Amendment of the Execution Law" under "Legislation and supervision". At this stage it is not possible to estimate how the proposed amendment to the Execution Law will affect conduct of the mortgage banks and their customers.

Legislation and regulation in the matter of securing the investments of residential units purchasers. For details regarding the Bill for the amendment of the Sale Law (residential units) (Securing the investments of residential units purchasers) and the instructions of the Supervisor of Banks in the matter of project financing and transactions to which the said Law applies, see Chapter "Legislation and supervision" below.

COMPETITION

Most of the banks compete in the mortgage market: mortgage banks, mortgage banks that have been merged and turned into a division of a commercial bank, as well as commercial banks. In addition, some of the insurance companies also offer mortgage loans. Competition in this market is fierce and is clearly price directed.

**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 57 counters located inside branches of Israel Discount Bank Ltd. or in their vicinity. Discount Mortgage Bank engages in the marketing and advertising of its many varied products, customizing them to the changing requirements of the public, to changing economic conditions and to market trends.

Concurrently, Discount Mortgage Bank continues to expand its activity with varied populations, such as: purchase groups, foreign residents, the Jewish Orthodox sector, students, VIP's and others. 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 2007-2008.

Part of the information presented above comprises a forward-looking statement. Such information is based upon Discount Mortgage Bank's plans and assessments as of date of preparation of the financial statements. These assessments and plans may change due to changes in market conditions, regulatory restrictions, etc.

Housing loans in Mercantile Discount Bank are currently granted through 13 specialized branches of this bank. Following a renewed study of this subject, performed during the reported period, the

Management of Mercantile Discount Bank has decided to gradually increase the number of branches specializing in this field over a period of three years.

**A MORTGAGE
MARKETING CAMPAIGN
- "DISCOUNT LAYOUT"**

The Bank in conjunction with Discount Mortgage Bank launched in July 2007 an attractive interest rate mortgage layout, accompanied by an extensive advertising campaign. The campaign was intended to enlarge the credit portfolio of Discount Mortgage Bank and its share in the mortgage market.

Prior to launching this layout, Discount Mortgage Bank examined the economic advisability of the layout and found it profitable.

The bank determines who are those entitled to the Discount layout and issues them a confirmation entitling them to the interest terms of the layout.

Discount Mortgage Bank grants such entitled customers mortgages under attractive interest terms, subject to criteria determined by the Bank (as of 2007 - a monthly salary of NIS 4,000 and over or personal capital of over NIS 0.5 million).

The customer has to comply with these conditions for a period of at least five years. If the customer does not abide by the entitlement terms, the interest rate will be increased according to guidelines of the bank (and concurrently the deposit interest would be increased at the same rate). The entitlement confirmation issued by the Bank allows the customer to refer to Discount Mortgage Bank for obtaining the attractive interest rate, but it does not oblige that bank to grant mortgage loans under the layout channel since it is Discount Mortgage Bank which bears the credit risk.

The Bank provides Discount Mortgage Bank with financial resources in accordance with the terms of the marketed mortgages (back to back) less a predetermined margin (hereinafter - "the Deposit"). It has been agreed that in cases of early redemption or recycling of the loan, the Deposit made by the Bank would be concurrently redeemed or recycled.

According to an agreement which has existed between the parties for several years, Discount Mortgage Bank pays the Bank a one-off commission in respect of referral of existing customers of the Bank. The accounting treatment adopted by the Bank and by Discount Mortgage Bank with respect to the said campaign is in accordance with the accounting treatment applied to transactions of granting other loans for housing purposes and to transactions involving the receipt of other deposits from banks or other deposits made with banks.

Upon launching the campaign, Discount Mortgage Bank prepared for increased demand. The preparations were made in conjunction with the Bank and Discount Mortgage Bank has prepared for the anticipated increase in applications from customers.

The success of the advertising campaign was greater than anticipated and during that period one half of all applicants for housing loans approached Discount Mortgage Bank.

According to the Bank of Israel data, the market share of Discount Mortgage Bank in mortgage housing loans, which in the period from January to June was 5.6%, increased significantly following the new layout to 13.6% in the third quarter of 2007 and to 15.2% in the fourth quarter of the year. Discount Mortgage Bank believes that its market share in the next months will continue to be high relatively in comparison to that existing prior to the launching of the layout.

A part of the information given above constitutes a forward-looking information, based upon the assessment of Discount Mortgage Bank, taking into account the growth recorded in the market share since the layout has been put into operation.

The total credit for housing purposes granted within the framework of the "Discount layout" in the period from July 6, 2007 to December 31, 2007, amounted to NIS 1,692.1 million. The total credit for housing purposes granted outside the framework of the "Discount layout" in the said period amounted to NIS 297.7 million. Most of the credit for housing purposes outside the framework of the "Discount layout" was granted in July and August 2007, when the layout started operations. The total deposits made by the Bank within the framework of the "Discount layout" amounted to NIS 1,580.6 million.

	CPI linked	Non-linked	Foreign currency linked	Total
	(in NIS millions)			
"Discount layout" housing loans	1,385.7	305.4	1.0	1,692.1
Non-"Discount layout" housing loans	225.6	69.6	2.5	297.7
Deposits provided by the Bank	1313.3	266.3	1.0	1,580.6

An amount of NIS 111.5 million was deposited at the beginning of January 2008, of which NIS 72.4 million in the CPI linked segment and NIS 39.1 million in the non-linked Shekel segment at variable prime interest rate.

The average interest rate on loans granted within the framework of the "Discount layout" in the CPI linked segment was 3.8%. The average interest rate on loans granted within the framework of the "Discount layout" in the non-linked Shekel segment was variable prime interest of 4.27%

The resources provided by the Bank to Discount Mortgage Bank bear interest at the rate charged on the loan less a predetermined economic margin.

INFORMATION SYSTEMS

Discount Mortgage Bank's computer systems are old fashioned and their ability to support modern banking activity requirements is limited. In addition, the existing system's ability to offer solutions to future needs, such as the implementation of Basel II recommendations, is also limited. In February 2007, the Board of Directors of Discount Mortgage Bank approved the "Sky" Project, which objective is the upgrading of the existing information systems. The Project is expected to be completed in four years time and its total cost, both direct and indirect is expected to reach US\$12 million.

INTERNATIONAL OPERATIONS GENERAL

The overseas operations of the Discount Group are mainly carried out 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.

**LEGISLATIVE
RESTRICTIONS,
REGULATIONS AND
SPECIAL CONSTRAINTS
APPLICABLE TO THE
INTERNATIONAL
OPERATIONS**

The principal restrictions applicable to the international operations are briefly described below:

Exposure restriction with regard to overseas extensions. 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 extensions. The volume of the risk assets held by these extensions was determined as a risk index. The “imputed capital” in respect of the risk assets of overseas extensions is calculated in accordance with the provisions of the relevant directive, at a rate of 16% of the risk assets of the extension (calculated in accordance with the weighting determined by the Proper Banking Management Directive No. 311 which deals with the minimum capital ratio) is multiplied by the coefficient determined by reference to risk factors and the nature of the supervision in the country in which the extension is situated. In this connection, it has been determined that the coefficient shall be 1 for countries of the OECD and 4 for all other countries. The Bank’s exposure with respect to the operations of its overseas extensions is calculated by multiplying the “imputed capital” by the coefficient determined by reference to risk factors and the nature of the banking supervision in the relevant country, as required by the directives.

The rate of exposure is calculated as a proportion of the calculated “imputed capital”, as determined by Appendix A of directive no. 311, which deals with the ratio of capital to risk components.

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

The main overseas office is the New York subsidiary. The subsidiary’s profitability and the high ratio of capital to risk components have allowed the subsidiary to continue to develop its business, which has, in turn, contributed to the increase in the calculated risk assets of the Bank’s overseas extensions. In contrast to the above, however, the Bank’s losses in 2000-2001 and the first half of 2002 led to an erosion of capital. The outcome of both the above processes constituted a deviation on the part of the Bank from the rules governing exposure restrictions with regard to overseas extensions.

As on December 31, 2007, the calculated rate of exposure of the Bank with respect to overseas extensions stood at 33.69%, as compared to a rate of 36.95% on December 31, 2006.

It should be noted that, in the regulatory letter from the Bank of Israel, no mention was made of sanctions to be applied in the event that the Bank were to deviate from the imposed limitation. Nevertheless, the Supervisor of Banks recently pursued the matter of changes to the Bank’s calculated rate of exposure and requested that the Bank take steps to reduce the deviation. In addition, the Bank itself reviews, at monthly intervals, developments in the calculated rate of exposure regarding its activity at the overseas extensions.

Overseas regulatory supervision. Operations of the international segment in the various countries are subject to regulatory supervision on the part of the appropriate authority in the country in question. 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” and Note 6 D to the financial statements hereunder.

SCALE OF OPERATIONS AND NET INCOME

Net income in 2007 amounted to NIS 152 million, compared with a loss of NIS 1 million in 2006. Disregarding certain components (see hereunder), net income would have amounted to NIS 183 million in 2007, compared with NIS 63 million in 2006, an increase of 190.5%.

The return on equity in 2007, calculated on the capital allocated to the international operations on the basis of the average balance of segment risk assets, was 8.9% in 2007, compared with (0.1)% in 2006. Disregarding certain components (see hereunder), the return on equity would have been 10.6% in 2007, compared with 4.0% in 2006.

Provision for doubtful debts amounted in 2007 to NIS 38 million, compared with NIS 19 in 2006, an increase of 100.0%.

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 year ended December 31, 2007						
Income from financing activities before provision for doubtful debts	6	181	361	208	246	1,002
Operating and other income	1	26	50	62	27	166
Total Income	7	207	411	270	273	1,168
Provision for doubtful debts	1	11	15	5	6	38
Operating and other expenses	4	110	306	232	80	732
Operating Income before taxes	2	86	90	33	187	398
Provision for taxes on operating income	-	39	38	25	144	246
Net income	2	47	52	8	43	152
Net income disregarding certain components ⁽¹⁾	2	53	65	17	46	183
Yield on capital (percentage)	18.0	12.5	7.6	3.7	9.7	8.9
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	18.0	13.5	9.6	8.1	10.5	10.6
Average Assets	207	6,746	9,169	2,857	19,351	38,330
Average Risk-assets	74	4,637	7,521	18,610	6,531	37,373
Average Liabilities	207	6,467	11,320	3,205	7,252	28,451

(1) The following components have been disregarded: expenses in respect of early retirement incentive and the cost of implementing improvements and examinations in IDB New York.

Following are 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 year ended December 31, 2006						
Income from financing activities before provision for doubtful debts	2	85	362	214	162	825
Operating and other income	1	14	37	54	20	126
Total Income	3	99	399	268	182	951
Provision for doubtful debts	-	5	12	2	-	19
Operating and other expenses	2	76	316	237	156	787
Operating Income before taxes	1	18	71	29	26	145
Provision for taxes on operating income	-	9	33	17	87	146
Net income (loss)	1	9	38	12	(61)	(1)
Net income (loss) disregarding certain components ⁽¹⁾	1	14	66	29	(47)	63
Yield on capital (percentage)	2.7	5.1	6.4	8.9	(9.2)	(0.1)
Yield on capital disregarding certain components ⁽¹⁾ (percentage)	2.7	7.1	11.0	24.6	(7.1)	4.0
Average Assets	59	4,145	11,803	2,304	*25,517	43,828
Average Risk-assets	70	3,659	4,513	19,664	*12,531	40,437
Average Liabilities	59	3,164	10,127	1,759	*10,972	26,081

* Reclassified.

TAXATION Under an agreement made with the Israeli tax authorities, the income of the Bank's overseas banking subsidiaries is added to the Bank's chargeable income, such that the Bank pays tax on the pre-tax accounting income of its overseas subsidiaries to the extent of the difference between the tax notionally payable in Israel on that income at the tax rate applicable to the Bank in Israel and the tax payable to overseas tax authorities.

DEVELOPMENTS IN THE SEGMENT **Switzerland.** Within the framework of the action taken by the Bank for the expansion of the activity in Switzerland, the bank signed on February 6, 2008, an agreement for the acquisition of shares in Arzi Bank, located in Zurich, Switzerland. The said agreement has been signed following prolonged negotiations with representatives of the sellers.

The transaction amounts to SFR 40.5 million.

Consummation of the transaction is conditional upon the fulfillment of qualifying conditions determined in the agreement as well as upon obtainment of the regulatory approvals required in

Israel and in Switzerland. According to the agreement, Discount Bank is entitled to have an observer present at meetings of the Board of Directors and Management of Arzi Bank in the period up to the consummation of the transaction.

The bank intends to merge the operations of Arzi Bank with those of its subsidiary Israel Discount Bank (Switzerland) SA. The above information is considered a forward-looking statement and it reflects the plans of the Bank as they are known at date of publication of the financial statements. The realization of the merger is conditional upon completion of the transaction for the purchase of Arzi Bank and the obtainment of the required regulatory approvals in Israel and in Switzerland.

London. The approval of the regulatory authorities in the U.K. was received in October 2006, 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. IDB Capital Corp. (hereinafter in this section - "the Company") operated as a broker-dealer in the capital market. In 2006, a change in the organizational structure has been decided upon, in the framework of which IDB Capital Corp. would be transferred to the ownership of Bankcorp. Concurrently it has been decided to appoint Ms. Alexandra Lowenthal as President of the company. It should be noted that at that time Ms. Lowenthal acted as member of the Board of IDB New York. In 2007, the move for the change in the organizational structure was suspended. In an agreement signed in September 2007, it was agreed to sell to Ms. Alexandra Lowenthal and to a corporation related to her, a certain part of the business of the Company that had been added to its operations since October 2006 and to terminate the association with her. The transaction was completed in February 2008 and the said business was sold for US\$2.1 million. At the same time, IDB Capital Corp. made a loan of US\$3million to the said Company, guaranteed personally by Ms. Lowenthal. A reorganization of IDBNY Realty Inc. (Reat) was effected at the end of 2006. This reorganization is intended to allow IDB New York to file consolidated income tax returns to the tax authorities of the State of New York and to the City of New York.

Asset-Backed Securities. For details as to the Bank's investments in asset backed securities, see above: "Financial management segment" and Note 3 F to the financial statements.

SERVICE TO SEGMENT CUSTOMERS

Europe. 2007 witnessed the continuing growth of assets of customers of Israel Discount Bank (Switzerland), a wholly owned subsidiary of the Bank. Israel Discount Bank (Switzerland), located in Geneva, focuses on exclusive private banking operations, by which it has succeeded in attracting customers and expanding the extent of its business. The Bank's Swiss office provides advanced private banking and investment management services to existing and potential customers of the Group, both foreign residents and residents of Israel, at an international financial center.

The Bank also maintains a branch in London, which provides commercial and private banking services. In addition, the Bank maintains a representative office in France (Paris).

United States. I.D.B. New York ("IDB Bank") continues to be the largest of the Israeli banks operating overseas. This bank maintains two branches in New York, three branches in Florida, two

branches in California and one branch in the Cayman Islands. IDB Bank has an Uruguayan banking subsidiary, Discount Bank (Latin America), and representative offices situated in various centers in South America.

**SERVICES AND
PRINCIPAL PRODUCTS
OF IDB BANK**

Credit - IDB Bank, and its leasing subsidiary, provides financing to a variety of US based corporations and also, at times, to the principals of these privately held companies. The leasing subsidiary provides equipment financing to IDB customers and 3rd party lessors.

Middle Market - IDB Bank has a significant niche in Middle Market Lending in a wide variety of industries, particularly in the New York Metropolitan Area, South Florida and Los Angeles. Examples of some of the industries in which IDB Bank is active are diamonds and jewelry, apparel and accessories, food, finance companies, retail, not-for-profit, sports and entertainment.

Asset Based Lending - This includes accounts receivable financing, inventory/equipment financing, letters of credit, terms loans as well as funding for mergers and acquisitions, for middle market companies. Asset Leveraging, is the process by which IDB Bank values and leverages a client's assets to provide working capital.

The distinction between asset-based loans and other secured loans resides in the amount of monitoring required to ensure the existence, value and integrity of the collateral. It is this constant collateral appraisal and field process that functionally differentiates asset based loans from other secured commercial loans.

Factoring - One of the Division's strengths is its ability to custom-design a factoring package to suit each client's needs. IDB Factors serves a wide range of diverse companies in many different industries. Clients are provided with a full range of services and financings, including accounts receivable management, customer credit guarantees, collections, advances against accounts receivable and inventory, seasonal over advances and import financing.

Commercial Real Estate Lending - Principal products include lines and letters of credit and fixed and floating rate loans for all real estate asset classes, e.g., facilities for the acquisition and adaptive re-use of retail, office, residential and hotel properties. There are also longer term loans on stabilized projects, including participations with other U.S. financial institutions. Focus is always put on maintaining a high degree of credit quality. IDB Bank continues to be committed to help support the development and revitalization of neighborhoods, in 2007, a new policy was implemented for granting non-recourse credit in a selective manner.

Trade & Finance - Letters of credit and related documentary collections continue to be a significant source of fee income for IDB Bank. IDB Bank continues to be a major issuer of documentary letters of credit in its peer group and also continues to be ranked within the top 10% of all U.S. commercial banks as reported by Documentary Credit World, out of the 300 banks on their list. IDB Bank's Automated Letter of Credit Customer Initiation System is a state-of-the-art, personalized Internet-based Letter of Credit system that connects a company's personal computer directly with IDB Bank's Amending Letter of Credit Department. The software makes issuing and amending Letters of Credit faster, easier and more accurate than ever before.

Household Banking - Offers the gamut of banking products and services, including personal and business checking accounts, money market accounts, time deposits, etc.

International Private Banking - This segment provides highly personalized service to non-U.S. clients. As in all segments of IDB Bank, building solid relationships with clients is paramount. Deposits from non-U.S. clients represent some 65% of IDB Bank's entire deposit base. The products and services of IDB Bank's broker-dealer subsidiary, IDB Capital Corp., are also available to International Private Banking customers. Officers of the International Private Banking Department are also licensed representatives of IDB Capital Corp.

U.S. Private Banking - 2007 was a year of moderate growth, both in terms of new accounts and additional investments. Deposits made by U.S. customers in IDB Bank's innovative Structured Time Deposits with Principal Protection have doubled. Customers include personal and corporate clients alike. The products and services of IDB Bank's broker-dealer subsidiary, IDB Capital Corp., are also available to these customers.

Investment Products - The department continued to create and launch a variety of innovative bank deposit alternatives that provided its U.S. and international clients with compelling opportunities for upside gain, without risk to principal. These Structured Time Deposits with Principal Protection, which are also adaptable for the needs of IRAs, continue to enhance the diversification of IDB Bank's deposit mix and accounted for more than one-half of IDB Bank's time deposits at year-end 2007, versus less than one-third at year-end 2003.

Deposits - The largest part of IDB New York's customer deposits, approximately 61%, are from residents of Latin America. These same depositors vary their investment patterns between deposit based products offered by IDB Bank and investing with IDB Bank's brokerage subsidiary; dependent upon interest rates and maturities vs. opportunities in the bond and equity markets.

International Banking - This department continued in 2007 to expand IDB Bank's relationships with premier global financial institutions and highly rated corporations. In both emerging and non-emerging markets, IDB Bank dealt with financial institutions and corporations consistent with IDB Bank's conservative risk assessment policy and risk-reward criteria. Business was transacted either directly with financial institutions or by purchasing assets in the primary and secondary markets.

STRUCTURE OF THE BANKING GROUP

The Bank's Group is composed of commercial banks in Israel and overseas, a mortgage bank and financial services companies.

Total investment in the consolidated and affiliated companies as at December 31, 2007, amounted to NIS 8.0 billion, compared with NIS 6.6 billion on December 31, 2006.

Following is the distribution of net income by main operating segments (in NIS millions):

	Contribution to Group's results		Disregarding the effects of coverage of investment ⁽¹⁾	
	2007	2006	2007	2006
In NIS millions				
Banking Activity:				
Commercial banks:				
In Israel - the Bank				
(including branches overseas)	415	95	228	(29)
- Mercantile Discount Bank	166	60	166	60
- First International Bank	⁽²⁾ 25	133	⁽²⁾ 25	133
Overseas - Bank offices	(60)	(138)	127	(14)
Discount Mortgage Bank	22	23	22	23
Other Activities:				
Israel Credit Cards	87	55	87	55
Other financial services	52	87	52	87
Total operating (gain) loss	707	315	707	315
Income (loss) from extraordinary				
operations	558	521	558	521
Net income	1,265	836	1,265	836

(1) The Bank in Israel created a surplus of liabilities in foreign currency, constituting coverage for the Bank's investment in Discount Bancorp, Inc., and as from May 2001 also in Israel Discount Bank (Switzerland), with the aim of preventing exposure to fluctuations in the exchange rate of the shekel against the US dollar and the Swiss Franc.

In the Statement of Income of the Bank in Israel, income and expenses arising from exchange rate differentials on the surplus of liabilities mentioned above are presented under the item "income from financing activities before provision for doubtful debts". This income and expenditure is taken into account in the calculation of provision for taxes. Income and expenses arising from exchange rate differentials on overseas investments are presented under the item "Bank's share in operating income of investee companies, net of tax effect".

This method of treatment has an effect on the presentation of the Bank's after-tax operating income and on the contribution of the overseas units to net income. In 2007, the shekel was revalued in real terms as against the US dollar by 9.0%, compared with an appreciation of 8.2% in 2006. In 2007, the shekel was appreciated in real terms against the Swiss Franc by 1.3%, compared with a revaluation of 0.9% in 2006. The said revaluation resulted in a decrease in the Bank's net operating income after tax in Israel by NIS 186 million, compared with an increase of NIS 123 million in net operating income in 2006. Concurrently, there was a decrease/increase in the positive contribution by overseas extensions to the results of the Bank.

(2) Including a provision for taxes in the amount of NIS 130 million in respect of the Bank's share in earnings of the First International Bank (See Note 6 G to the Financial Statement).

**MAIN INVESTEE
COMPANIES**

At the end of 2007, 21.9% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 24.3% were assets of overseas consolidated companies and branches. The contribution to the net results by the consolidated companies in Israel totalled NIS 382 million in 2007 (in 2006 the contribution totalled NIS 183 million). The contribution to the net results by overseas consolidated companies totalled in a loss of NIS 60 million in 2007 (in 2006 the contribution totalled in a loss of NIS 138 million), and the contribution to the net results by affiliated companies totalled NIS 96 million in 2007 (in 2006 the contribution totalled NIS 178 million).

The total contribution by both domestic and overseas investee companies to the net results of the Bank amounted to NIS 418 million in 2007, compared with NIS 223 million in 2006, a decrease of 87.4%. Disregarding the effect of the coverage of the investment in overseas subsidiaries, net of the tax effect, the contribution of both domestic and overseas investees to the net results of the Bank in 2007, would have been NIS 604 million, compared with 346 million in 2006, a decrease of 74.6%.

Sale of main investee companies. As part of its preparations for capital market activity in the post-Bachar Committee era, in 2006 the Bank sold its holdings in two main investee companies:

- Ilanot Discount was a subsidiary of the Bank that engaged in mutual funds management. In June 2006, the transaction for the sale of all the shares in Ilanot Discount came into effect. For further details see "Capital market activity" under "Further details as to activity in certain products" above and Note 6 E to the financial statements.
- Harel constituted an associated company of the Bank, the investment in which was considered a strategic investment intended to diversify the Bank's income sources. In November 2006, the transaction for the sale of 10.1% of the share capital of Harel came into effect. For further details see "Non-financial companies sub-segment" under "Activity of the Group according to principal segments of operations" above and Note 6 H to the financial statements.

Following are the main developments in principal investee companies.

**DISCOUNT BANCORP,
INC.**

Discount Bancorp, Inc. (hereinafter: "Bancorp") is a wholly owned subsidiary of the Bank, which is a bank holding company, incorporated in accordance with the law of the State of Delaware. Bancorp is the 100% shareholder of Israel Discount Bank of New York (IDB New York). IDB New York is the largest Israeli bank operating overseas.

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 notice. A legend to this effect appears on the share certificate of IDB New York.

Total assets at the end of 2007 amounted to US\$9,136 million, compared with US\$8,822 million at the end of 2006, an increase of 3.6%.

For details regarding investments by IDB New York in mortgage backed securities, see "Development of assets and liabilities" above and Note 3 to the financial statements hereunder.

Total credit at the end of 2007 was US\$3,758 million, compared with US\$3,120 million at the end of 2006, an increase of 20.4%.

Total deposits stood at US\$6,242 million as at the end of 2007, compared with US\$6,937 million at the end of 2006, a decrease of 10%.

Shareholder's equity totalled US\$631 million at the end of 2007, compared with US\$582 million at the end of 2006, an increase of 8.5%.

The ratio of capital to risk assets was 11.01% as at December 31, 2007, compared with 11.88% at December 31, 2006.

Net income in 2007 totalled US\$38 million, compared with US\$28 million in the preceding year, an increase of 35.7%.

Return on equity was 6.8% in 2007, compared with 5.1% in 2006.

The contribution of the Bank's investment in Bancorp to the net results of the Bank was a loss of NIS 61 million in 2007 (after deducting a provision for additional taxes of NIS 21 million that applies to the Bank in Israel), compared with a loss of NIS 141 million in 2006 (after deducting provision for additional taxes of NIS 23 million that applies to the Bank in Israel).

The said contribution is comprised of Bancorp's net income in 2007 (after deducting the provision for tax as aforesaid) of NIS 159 million disregarding exchange rate differentials on the investment of NIS 220 million, compared with net income of NIS 71 million (after deducting a provision for taxes as aforesaid) and disregarding exchange rate differentials on the investment of NIS 212 million in 2006. Together with exchange rate differentials on the said investment, the Bank in Israel recorded financing expenses in 2007 and financing expenses in the preceding year, in respect of the surplus foreign currency liabilities that the Bank created as coverage for the investment in Bancorp.

For details as to a third party notice served by Arab Bank, see Note 19 C 15.7.

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 "Significant legal proceedings settled in 2007" under "Legal proceedings"). 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. 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 98% 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. In September 2007, KPMG completed the preparation of an assessment report summarizing the findings of an examination performed by KPMG in order to evaluate the effectiveness of the efforts undertaken by IDB New York to reduce the gaps identified by them in the past. Out of 352 previously identified gap issues, the Bank's effort with respect to 95% of these has been rated as "highly" responsive; 5% have been rated as "moderately" responsive and no measure has been rated as having a "low" level of responsiveness. The report was submitted to the authorities in September 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 was carried out which as of the date of preparation of the financial statements has been completed. A report that includes the findings of a "backward review" has been relayed to the authorities.

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\$13.3 million in 2007. According to IDB New York, additional costs will be incurred during 2008 for implementation of improvements and examinations in an amount between US\$5 million - US\$6 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 to the financial statements. 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 examination report, including arguments regarding the unfair influence of IDB New York’s management on the draft examination report’s preparers. These arguments were passed on to an American legal firm for examination, as detailed hereunder (see item 5 hereunder).

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 Bancorp, 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) In July 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) At the beginning of September 2007, the final report was submitted to the Bank and to the committee. The report indicates deficiencies in the procedures for approval of the transactions examined, deficiencies stemming from the presence on the Board of IDB New York of representatives of shareholders and the non-compliance with proper corporate governance principles at IDB New York. The writers of the report concluded that the major part of the deficiencies had been corrected with the termination of office of Messrs. Grunstein, Bronfman and Raubinooff as Directors of Discount Bancorp and IDB New York. The writers of the report also determine that the Parent Company should take action to develop supervisory mechanisms over Discount Bancorp and IDB New York and to consider the adoption of corporate governance principles designed to comply with the provisions of the law in Israel, with respect to everything related to the approval of transactions with interested parties to them. No recommendations were made in this respect.
- (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).
- (8) As stated in Section 5 above, the findings of the examination in the matter of the arguments of the former Chairman of IDB New York, Mr. Grunstein, against the draft examination report of January 2007 were submitted. With the receipt of the findings, according to which there was no basis whatsoever to of Mr. Grunstein's claims, the draft examination report was brought to completion and at the beginning of November 2007, the final report was submitted to the Board of Directors of IDB New York.

In the opinion of the writers of the report, the final report indicated deficiencies in the approval process of several transactions made by controlling shareholders with IDB New York and Discount Bancorp.

The deficiencies relating to the granting of a loan to a company controlled by one of the controlling shareholders, for the purpose of renovating the 12th floor, sub-leased to that company, and the non-payment of rent in respect of the said property for a period of nine months may constitute a breach of various regulatory provisions. The conclusions of the report and its implications have not yet been discussed by the committee and by the Board of Directors. The report was relayed to the authorities in September 2007.

- (9) In view of the recommendations of the examination report, the company paid IDB New York interest in respect of the delay in the payment of rent.

Furthermore, according to the recommendations of the report, an opinion of an independent appraiser was sought out and received with respect to the appropriate amount of rent as of the date of the examination report. In view of the opinion of the assessor, IDB New York negotiated to change the rental fees and it has been agreed to increase such fees by US\$4 per square foot. The amendment of the agreement regarding the amount of rental fees has been approved by the authorized organs of IDB New York and will be submitted for approval by the authorized organs at the Bank as an entitled transaction. At the present stage, the transaction is being discussed by the Audit Committee of the Bank and the discussion has not yet been completed.

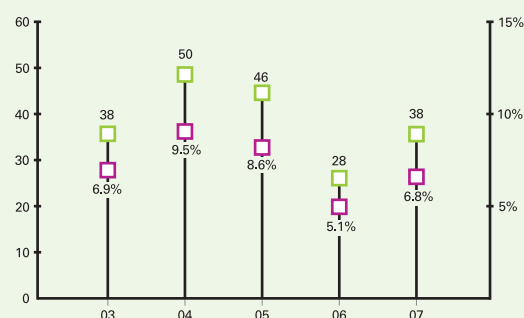
- (10) In February 2008, the recommendations of the ad-hoc committee on the new York issues were presented to the Board of Directors.

The committee recommended that part of the transactions that had been examined by it should be examined according to the rules approved within the framework of Discount Group's "Corporate Governance" code (see item 7 above). The committee further recommended, among other things, that rules be determined for the treatment of material transactions at IDB New York; for the composition of the Board of Directors of IDB New York and for the selection and approval of nominees to this Board, and all with a view of strengthening the independence of IDB New York's Board as against the controlling shareholders and strengthening the control of the Bank over IDB New York; to determine reporting principles to the Bank's Board regarding IDB New York.

The Bank's Board of Directors has adopted the committee's recommendations.

BANCORP. — DEVELOPMENT OF NET INCOME AND RETURN ON EQUITY

□ Net income - in US\$ millions
□ Return on equity



MERCANTILE DISCOUNT BANK LTD.

Mercantile Discount Bank Ltd. ("Mercantile Discount") is a wholly-owned subsidiary of the Bank. At the end of 2007, Mercantile Discount Bank operated through 70 branches, compared with 65 branches in 2006.

Total assets at the end of 2007 amounted to NIS 18'860 million, compared with NIS 17,280 million at the end of 2006, an increase of 9.1%.

Total credit granted to the public at the end of 2007 was NIS 13,027 million, compared with NIS 12,583 million at the end of 2006, an increase of 3.5%.

Total deposits from the public at the end of 2007 amounted to NIS 15,736 million, compared with NIS 14,484 million at the end of 2006, an increase of 8.6%.

Shareholder's equity at the end of 2007 amounted to NIS 1,363 million, compared with NIS 1,160 million at the end of 2006, an increase of 17.5%.

The ratio of capital to risk assets was 13.2% as at December 31, 2007, compared with 12.7% as at December 31, 2006.

Net income was NIS 214 million in 2007, compared with NIS 61 million in 2006, an increase of 250.8%. The results reported in 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) (hereinafter, together - "the privatization bonus"). Disregarding the effect of the privatization bonus, net earnings for 2006 would have reached NIS 94 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 85 million compared with 2006), a decrease in the provision for doubtful debts (a decrease of NIS 18 million compared with 2006), an increase in operating and other income (an increase of NIS 41 million compared with 2006) and from an increase in earnings from extraordinary items following the sale of the provident fund operations (an amount of NIS 47 million).

Return on shareholders' equity in 2007 was 17.2%, compared with 5.6% in 2006. Disregarding the effect of the privatization bonus, the return on equity would have reached an annualized rate of 8.6% in 2006.

Investigation of suspected employee violations of the Prohibition of Money Laundering Law. On March 7, 2006, police arrived at the Ramla Branch of Mercantile Discount Bank and detained the branch manager, his deputy and another employee, on suspicion of violations of the Prohibition of Money Laundering Law.

It should be mentioned that over a several month prior to the said date, an undercover investigation was conducted in this matter, with the knowledge of some of the members of the of Mercantile Discount Bank's management, who assisted the Israel Police investigation as required, and who signed a "non disclosure agreement" relating to this investigation so as to prevent disrupting its process.

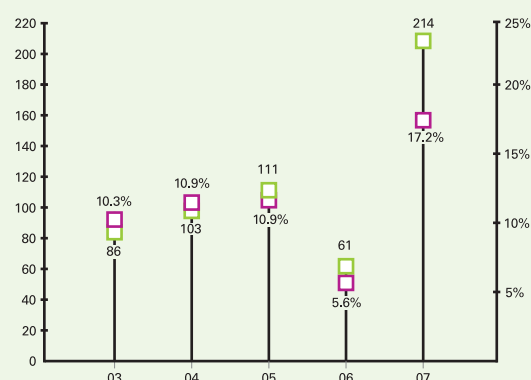
Four of Mercantile Discount Bank's employees connected with the branch were detained for four days during the investigation, and several other employees were interrogated, including four members of Mercantile Discount Bank's management, among whom was the President and CEO. In

addition, according to a Court order, the activity of several accounts of customers of the branch with an insignificant volume of credit was frozen.

To the best knowledge of the Bank and Mercantile Discount Bank, the investigation in this matter has been largely completed and the material has been passed to the State Prosecutor Office, who has decided to file an indictment only against one of the former employees of the branch (who was already suspended from office during the course of the investigation) and to terminate the investigation against the remainder of the staff. To the best of the Bank's and Mercantile Discount Bank's knowledge, the suspicions do not involve Mercantile Discount Bank itself. In view of the above, the managements of the Bank and Mercantile Discount Bank are of the opinion that the investigation will not have a material impact, if at all, on the future financial results of Mercantile Discount Bank and/or the Bank. See Note 19 C to the financial statements, articles 14.2 and 15.1 as regards a request for approval of an action as a class action suit against Mercantile Discount Bank in the matter of a share hiking affair. As regards a motion for the approval as a class action of an action filed against Mercantile Discount Bank and against the Bank, in the matter of the method of calculating excessive interest, see Note 19 C 15.7 to the financial statements. As regards a request for approval of an action as a class action suit against, among others, Mercantile Discount Bank and the Bank in the matter of payments received in respect of foreclosure imposed by execution through the magnetic media, see Note 19 C 14.7 to the financial statements.

MERCANTILE – DEVELOPMENT OF NET INCOME AND RETURN ON EQUITY

Net income in NIS millions
Return on equity



DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank is a subsidiary of the Bank. As of December 31, 2007, the Bank held all 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 6 I to the financial statements).

Discount Mortgage Bank operates through two main branches (Tel-Aviv and Haifa), two independent branches (the Stock Exchange Branch in Ramat-Gan and the Modi'een Branch) and through 57 counters located all over the country within branches of the Bank or adjacent to them (compared with 55 counters and branches at the end of 2006). Furthermore, Discount Mortgage Bank operates a telephone center that enables applicants to obtain an immediate approval in principle for a loan.

Total assets at the end of 2007 amounted to NIS 11,503.1 million, compared with NIS 10,448.8 million at the end of 2006, an increase of 10.1%.

Total credit granted to the public amounted at the end of 2007 to NIS 11,200.2 million, compared with NIS 9,838.7 million at the end of 2006, an increase of 13.8%.

Shareholder's equity amounted to NIS 870.7 million at the end of 2007, compared with NIS 844.5 million at the end of 2006, an increase of 3.1%.

Net income totalled NIS 26.2 million in 2007, compared with NIS 35.3 million in 2006, a decrease of 25.8%.

Return on shareholders' equity in 2007 was 3.0%, compared with 4.3% in 2006.

The ratio of capital to risk assets was 10.6% as at December 31, 2007, compared with 12.2% as at December 2006.

The Contribution of the Bank's investment in Discount Mortgage Bank to the net results of the Bank totalled NIS 22.5 million in 2007, compared with NIS 23 million in 2006, a decrease of 2.2%.

Purchase offer for all shares of Discount Mortgage Bank held by the public. On March 14, 2007, the Bank issued a purchase offer for all the shares of Discount Mortgage Bank held by the public, i.e., 460,735 ordinary shares of NIS 1 par value each, comprising 34.93% of the issued and paid share capital and voting rights of Discount Mortgage Bank.

According to the offer, holders of the shares were invited to sell them to the Bank, until April 30, 2007 (hereinafter - "the last date of acceptance"), at a price of NIS 575 per share, under terms detailed in the purchase offer issued by the Bank. The total consideration in respect of these shares at the above stated price amounted to NIS 256 million.

The Bank's commitment to purchase the shares under the purchase offer is subject to receipt of the following approvals: (a) Permit from the Governor of the Bank of Israel, in accordance with the conditions of Section 34 of the Banking Law (Licensing), according to which the Bank is permitted to hold the total means of control in Discount Mortgage Bank; (b) Approval from the Antitrust Commissioner, insofar as required.

The Bank has obtained all the approvals required for the purchase of the shares in accordance with the purchase offer.

The Bank's commitment to purchase the shares is also subject to 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.

See Note 19 C 14.5.1 to the financial statements for details of the uncertainties relating to the Discount Mortgage Bank Ltd. in the matter of charging commission in respect of life assurance and property insurance of borrowers and in the matter of insuring property for amounts exceeding its reinstatement value, and 14.5.2 and 15.4 in the matter of 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 December 31, 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 in 2007 totalled NIS 67 million, compared with NIS 130 million in 2006. The said amount is presented net of a provision for taxes of NIS 130 million (see hereunder).

Return on shareholders' equity in 2007 was 14.6%, compared with 11.5% in 2006.

The ratio of capital to risk assets stood at 11.4% on December 31, 2007, compared with 10.1% at the end of 2006.

Provision for impairment in value. For details regarding a provision for impairment in value made in the financial statements as of March 31, 2003 according to an instruction of the Supervisor of Banks, see Note 6 F 1 to the financial statements. The Bank received an opinion and updates thereto according to which the recoverable value of the investment does not fall below the equity value of the investment on all reporting dates since December 31, 2002. For details as to the reversal of the provision in the financial statements as of March 31, 2006, see Note 6 F 3 to the financial statements.

Public issuance by FIBI. In an immediate report dated March 13, 2007, FIBI announced that its Board of Directors decided to act towards the possibility of increasing its share capital through issuance of rights to shares and/or issuance of rights to other securities, which would improve its capital structure, to be offered to all its shareholders, including a possible benefit component relative to the market price of its shares.

It should be noted that in view of its share capital structure and the provisions of the Securities Law, FIBI may issue and list for trading on the Stock Exchange only shares and/or rights to shares of NIS 0.01 par value each, which are the class of shares with preferred voting rights thereby may change.

Management of FIBI recommends preparations for the raising of capital in the amount of NIS 500 million to NIS 700 million.

FIBI noted that no certainty exists that the offering and/or offerings will, in fact, materialize and, if materialized, that the structure of the offerings and/or the amount to be raised thereby may change. 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 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 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, 2007, 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.

Following the above, the parties conducted negotiations, which at this stage were not successful. In continuation to the above and on the background of the disputes between the parties, FIBI informed on November 19, 2007, that it will refrain from providing the Bank with certain data of its financial statements prior to their publication, as has been the custom in the past.

FIBI based its notice on the claim that recently, following and on grounds of the said dispute, it has allegedly transpired that the use of the equity basis method by the Bank in presenting its investment in FIBI is improper. FIBI further informed that the Securities Authority had been approached in order to obtain its opinion thereon, but this has not yet been received.

On December 25, 2007, the Bank wrote to the Securities Authority informing it that it happened to hear, through a representative of FIBI, that the Securities Authority had taken a decision in the matter. The Bank requested information as to this decision, especially since the Securities Authority had not approached the Bank in this matter, had not informed it as to any proceedings existing in the matter and that prima facie it was an approach made by a party who was engaged in a commercial dispute with the Bank. In its reply, the Securities Authority stated that the Supervisor of Banks will be the one to decide on the issue, that the Authority had not formed its final opinion regarding this issue and that in any event the Bank is free to present its opinion in the matter. At this stage it has been agreed with the Securities Authority to wait until the Supervisor of Banks gives his ruling on this issue.

It should be noted that ever since the acquisition of the means of control in FIBI, no changes have occurred in the arrangements between the shareholders of FIBI, in the rate of holdings of means of control that the Bank has in FIBI or in the permit granted by the Governor of the Bank of Israel for the acquisition of the said means of control. Furthermore, in recent years no changes have occurred in the relevant accepted accounting principles applying to this matter.

The Bank's investment in FIBI has been presented using the equity basis method since the acquisition of the means of control in FIBI over twenty years ago. The Bank's opinion has been and remains such that the proper accounting treatment of the investment in the First International Bank is the one using the equity basis method.

Approach by the Antitrust Commissioner. On January 22, 2008, the Antitrust Authority informed the Bank that the Antitrust Commissioner is examining certain aspect relating to the holdings of the Bank in FIBI. In this respect, the Bank has been asked to forward to the Antitrust Commissioner various documents and data.

In an additional letter of the same date, the said Authority clarified that in view of the fact that the issue of the Bank's holdings in FIBI is being examined by it, "the parties are taking a legal and commercial risk with respect to any change in the existing situation, which may strengthen the affinity between the two banks". Following contacts in the matter held between the Bank and the Antitrust Authority, it has been decided to arrange a meeting between the parties, even prior to the Bank submitting its response to the subject at hand. The meeting has not yet taken place. As stated above, the Bank has not as yet responded addressing the substance of the approach by the Antitrust Authority, however, according to the position taken by the Bank and its legal counsel, the Bank is lawful in protecting its rights as a minority shareholder in the FIBI, and the Antitrust Authority has also been informed accordingly.

Under the circumstances, the Bank considered 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.

Following negotiations between the parties, the Bank, with the knowledge of the Bank of Israel and pursuant to its request, has suspended the filing of proceedings at this stage.

In this respect, the Board of Directors directed the Bank's Management to act so that in the event that an arrangement is established to include an outline, in the framework of which the Bank would reduce its holdings in FIBI, then such outline shall be subject to maintaining the terms under which the Bank may continue recording the investment in the said bank by the equity method of accounting, to the amendment of the shareholder agreement of 1983 and subject to additional terms to the extent required to preserve the rights of the Bank.

Any arrangement between the Bank and the First International Bank, if and so far as established, is subject to the approval of the Board of Directors.

It had been assumed in financial statements published hitherto that the investment in shares of FIBI would be a long-term one and therefore no provision for taxes had been recorded in the past in respect of the Bank's share in retained earnings of the investee bank. In view of that stated above, it is no longer certain that the assumption of continuous holding is viable in its entirety and therefore the Bank decided to record a provision for taxes of NIS 130 million, in relation to that part of the investment in respect of which a continuous holding as above cannot be assumed.

For details regarding a legal action filed against FIBI in the matter of life assurance commissions and property insurance in contravention of the law and regarding a request to approve it as a class actions, see Note 19 C 16 to the financial statements.

ISRAEL CREDIT CARDS LTD.

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2007, the Bank owned 71.8% of the equity and 79.0% of the voting rights in ICC (for details as to the acquisition of the control in ICC, see Note 34 A to the financial statements). ICC issues and operates "VISA", "Diners" and "MasterCard" credit cards.

Total assets amounted, at the end of 2007, to NIS 6,750 million, compared with NIS 6,148 million at the end of 2006, an increase of 10%.

Total capital resources amounted, at the end of 2007, to NIS 519 million, compared with NIS 335 at the end of 2006. In 2007, ICC distributed to its shareholders a dividend amounting to NIS 50 million (2006: NIS 110 million).

The ratio of equity to risk assets at December 31, 2007, was 14.6%, compared with 11.3% at the end of 2006.

Total income amounted in 2007 to NIS 946 million, compared with NIS 811 million in 2006, an increase of 17%.

Net earnings amounted in 2007 to NIS 184 million, compared with NIS 126 million in 2006, an increase of 46%.

Return on equity reached 44.1% in 2007, compared with 39.3% in 2006.

The contribution of the Bank's investment in ICC to the net results of the Bank in 2007, amounted to NIS 87 million, compared with NIS 54 million in 2006.

For details regarding the activity in the credit card field, see "Credit Card Operations Activity" under "Further details as to activity in certain products" above. As for details regarding changes in arrangements concerning the credit card field in Israel, see Note 34 B to the financial statements.

ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

Israel Discount Capital Market and Investments Ltd. (hereinafter: "DCMI"), a fully owned and controlled consolidated company of the Bank, is engaged in investment in private investment funds and venture capital funds, in investment banking and in the underwriting and management of public offerings of securities (through a subsidiary).

Total assets as at December 31, 2007 amounted to NIS 733 million, compared with NIS 240 million at the end of 2006, an increase of 205.4%.

Net income in 2007 amounted to NIS 11 million, compared with NIS 19 million in 2006, a decrease of 42.1%.

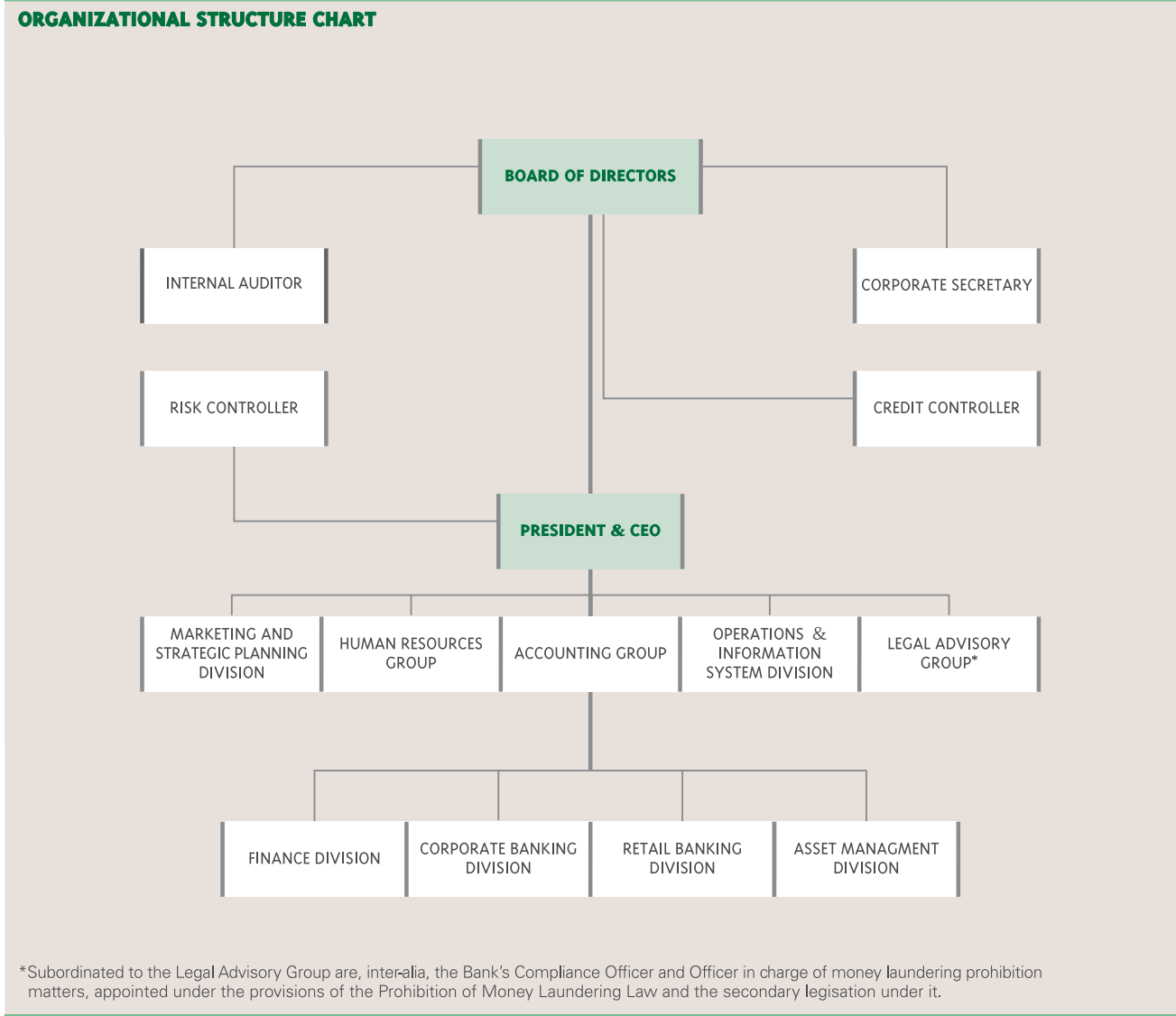
Return on equity in 2007 reached a rate of 7.0%, compared with 14.2% in 2006.

Contribution of the Bank's investment in DCMI to the Bank's results amounted in the first nine months of 2007 to NIS 7.6 million, compared to NIS 16.8 million in 2006 (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).

During 2007, DCMI, through a subsidiary, participated in 23 public offerings of securities with a total volume of approximately NIS 6.755 billion (26 public offerings with a total of approximately NIS 4.8 billion in 2006), and in 8 private placements of securities with a total volume of approximately NIS 2.757 billion (30 private placements with a total volume of approximately NIS 7.4 billion in 2006).

As to an indictment filed against DCMI and against two of its former employees, see Note 19 C 15.5 to the financial statements.

HUMAN RESOURCES



LABOR FORCE AND PAYROLL COSTS

The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas branches) amounted to 5,875 in 2007, as compared with 5,552 in 2006, an increase of 323 employees on a monthly average, 5.8%.

There were 6,400 employees in full-time positions in the Bank in Israel at the end of 2007, compared with 5,674 at the end of 2006, an increase of 12.8%.

The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2007, was 9,705, compared with 9,166 at the end of 2006, an increase of 5.9%.

There were 10,396 full-time positions in the Group at the end of 2007, compared with 9,301 at the end of 2006, an increase of 11.8%.

Following are the labor force data of the Group and the Bank, in terms of positions⁽¹⁾:

	As of December 31		Monthly average in	
	2007	2006	2007	2006
The Bank in Israel	6,400	5,674	5,875	5,552
Domestic subsidiaries	3,044	2,799	2,907	2,732
Group total in Israel	9,444	8,473	8,782	8,284
Overseas branches	37	31	35	30
Overseas subsidiaries	915	797	888	852
Group total overseas	952	828	923	882
Group total overseas and Israel	10,396	9,301	9,705	9,166

(1) Position - Full-time position, including specific overtime hours, hours worked by subcontractor employees and others.

Following are details of the cost per position, in NIS thousand:

	2007	2006	change in%
The annual average direct cost per employee position in the Bank in Israel	221	247	(10.5)
The annual average direct cost per employee position in the Bank of Israel, disregarding bonuses ⁽¹⁾	221	219	0.9
The total annual average cost per employee position in the Bank in Israel, not including voluntary early retirement expenses	321	356	(9.8)
The total annual average cost per employee position in the Bank in Israel, not including voluntary early retirement expenses, bonuses, value added tax on salary relating to the change in the law and the provision relating to the change in the mortality tables	321	322	(0.3)
The average annual overall payroll cost per employee of the Group in Israel and abroad, excluding the change in the salary tax expense.	312	349	(10.6)

(1) 2006: An award regarding the sale of the controlling interest in the Bank.

LABOR RELATIONS

General. Labor Relations at the Bank are based on the Labor Charter, collective labor agreements and employment arrangements that are consummated mainly in negotiations between the Bank's management and the employees' representatives.

Labor Charter. "Labor Charter for the Employees of Israel Discount Bank Ltd.", which was signed in 1974 (hereinafter - "the Labor Charter") constitutes a wide base outlining and incorporating employment conditions, disciplinary provisions, arbitration procedures and additional procedures and regulations. During the last thirty years, dozens of collective labor agreements were consummated in addition to the Labor Charter. These other agreements include wage and other agreements intended to supplement and expand the Labor Charter, to

change the Labor Charter or to cancel certain provisions of the Labor Charter.

The "Employee Agreement" signed on February 1, 2005 (see "Employer agreement" under "Control of the Bank" below), inter alia, extends the validity of the Labor Charter as a collective labor agreement at Discount Bank for a period of five years, i.e. until December 31, 2009, and states that at the end of this period the parties will act with respect to the validity of the Labor Charter, in accordance with the provisions of the Charter. The Labor Charter provides that it remains in effect until March 31, and unless notified otherwise three months prior to that date, by the Bank's management to the Employees' Representative Committee, or by the Employees' Representative Committee to Bank's management, it will remain in effect for an additional year, and will be renewed automatically for additional years.

Rights of association. The tenured employees of the Bank are organized within the framework of the national Employees' Representative Committee. The Representative Committee is divided internally in such a way that employees at the clerical level are included in the come under the Clerks' Committee and authorized signatories and managers are organized under the Managers' Representative Committee. Most of the issues are agreed and signed between the Bank's management and the Employees' Representative Committee. A retirees' Committee also exists, under which retirees of the Bank are organized.

Bank participation in the budget of the Employees' Representative Committee. The Bank contributes monthly to the budget of the Employees' Representative Committee, in an amount double the monthly amount contributed by the employees. Five out of the 21 Committee members are officers of the Committee engaged on a fulltime basis and receiving a full salary. The other members of the Committee fulfill various positions in the Bank and serve as Committee members in addition to their regular work. In addition, the Bank provides office premises for the Committee's use and covers the maintenance costs thereof.

The Bank also participates in the budget of the retirees committee, providing the committee with premises for its activities, bearing maintenance costs and paying salaries of the committee's employees. The Bank also finances the maintenance and operation costs of retirees clubs in Jerusalem, Jaffa and Haifa.

**PRINCIPAL
CATEGORIES WITH
RESPECT TO
EMPLOYMENT
CONDITIONS**

Employees of the Bank are classified into three categories for purposes of employment conditions:

Tenured employees. The employment terms of tenured employees are arranged, as stated, in accordance with the Labor Charter, special collective labor agreements and other employment arrangements. On December 31, 2007, there were 3,855 tenured employees in the Bank (December 31, 2006 - 3,887 tenured employees). The majority of the tenured employees are permanent employees of the Bank, while a minority constitutes new employees on a trial period.

Temporary employees. The employment conditions of temporary employees are arranged mainly in several special collective labor agreements, which detail the conditions and maximum period of their employment. Their maximum period of employment is five years that, under special circumstances, may be extended up to seven years. Temporary employment may be terminated at any time, at the

discretion of management. On December 31, 2007, there were 1,731 temporary employees in the Bank (December 31, 2006 - 1,293 temporary employees). Furthermore, in accordance with an agreement between the Bank and the employees' representatives signed in 2002, 244 employees, known as "temporary computer staff" are employed by the Bank. These employees are engaged in the information technology systems and may be employed for up to seven years as temporary personnel (December 31, 2006: 140 temporary employees).

According to the agreement between the Bank and the Employees' Representatives Committee, the total number of temporary employees is limited to 30% of the total number of employees of the Bank (including temporary personnel but excluding cleaning personnel, and temporary computer personnel).

Personal employment contracts: Employees engaged under personal employment contracts sign, prior to their engagement with the Bank, a personal contract, which precludes the Labor Charter and the collective labor agreements for these employees. Employees engaged under a personal contract include members of Bank management, part of the information technology staff and a defined and specified agreed list of position holders, mainly senior personnel. At present, the scope of personnel employed in accordance with personal employment agreements may reach approximately 80 positions. As of December 31, 2007, the Bank employed, in practice, 54 personnel (including members of management) under personal employment agreements (December 31, 2006: 48 employees engaged under personal contracts).

In addition, the Bank acquires services of manpower company employees and software houses.

As of December 31, 2007, 300 manpower company personnel were employed by the Bank. These employees are engaged mainly in security, cleaning and short working week employees (employees that serve as backup staff following the transition to a short working week) and teller task (as of December 31, 2006: 300 manpower company personnel). As of December 31, 2007, 1,115 software house personnel were employed in the Bank. These employees are engaged mainly in software development tasks (as of December 31, 2006: 1,010 software house personnel).

To date, the Bank's supervision of manpower companies focused mainly on the agreement aspect, including compliance with appropriate provisions ensuring the social benefits of such personnel employed in the Bank. In view of the increased awareness regarding vulnerability of such employees, and following a Labor Court ruling that determined, in the case of another bank, that the said bank was a co-employer of a cleaning woman employed through a manpower company, the Bank is increasing its supervision, inter alia, by supervising the wage components of manpower company personnel employed by the Bank.

DEVELOPMENTS IN LABOR RELATIONS

On November 26, 2007, a wage agreement was signed with the Clerk Committee and the New Histadrut Federation of Labor, according to which Bank employees of the clerk grade will receive wage additions for the years 2007-2008, at an average rate of between 10% (5% in respect of each year). Furthermore, the employees are committed under the agreement to maintain industrial peace until April 30, 2009, with respect to the matters regularized by the agreement.

Two agreements were signed on November 22, 2007, with the Employees' Representative Committee, as follows:

An agreement with respect to the redemption in cash of the "Jubilee vacation", entitling employees to redeem these vacations of a special nature and as determined in agreements with the Bank, in one immediate amount or in installments, upon the rights of each employee to such vacation reaching maturity. This agreement also cancelled the right of new employees to "Jubilee vacation" and to kindergarten and summer camp payments, as stated in agreements with the Bank.

An agreement regularizing the continued activity of the Bank employees' provident fund, in a manner that the fund company will turn into a company owned solely by the employees, to be managed in trust, as required by law, while the Bank continues to bear all its expenses. The agreement is subject to approval of the authorized organs of the Bank and the company, and it will be carried out in line with the outline to be approved by the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance.

On January 13, 2008, the New Histadrut Federation of Labor declared a labor dispute and a strike with respect to the demand for the signing of an agreement determining the selective salary increase to the manager echelon at the Bank for the years 2007-2008. In fact, the managers' committee applied intermittent sanctions in the period between January 27, 2008 and February 14, 2008.

A wage agreement was signed on February 17, 2008, whereby most of the Bank employees of the manager echelon will receive salary increases for the years 2007-2009, at an average rate of 15% for the whole period of the agreement, while the remainder of the manager echelon, which includes senior employees and/or highly paid employees will receive salary increases at an average rate of 7% for the entire period of the agreement plus an award equal to several salaries to be granted on a differential basis.

In addition, it has been agreed to do away with wage components in respect of: newspaper, telephone and the "April 1992 agreement" and to update the component in respect of transportation. Furthermore, the parties have committed to maintain industrial peace until April 30, 2010, with respect to the issues settled in the agreement.

EMPLOYEE REMUNERATION

The principal salary components include the basic salary which includes a seniority increment, representation and signature fees to each employee in accordance with his seniority and position. The basic salary constitutes the basis for salary increments and for the payment of split working hours' remuneration at the rate of 2.5% of the salary (to entitled employees only), shift remuneration (to entitled employees only), overtime and 13th month salary. Part of the employee's remuneration is linked to the CPI. Employees are also entitled to various additional benefits. Bank employees are promoted by grades only and are also entitled to a long-service bonus equal to several monthly salaries plus additional vacation days, at the end of 20, 30, and 40 years of service in the Bank. A collective labor agreement dated November 22, 2007, granted employees an option to redeem in cash the "Jubilee vacation" days to which they will be entitled during their period

of employment, in amounts determined by the parties to the agreement. The labor agreement further specified that new employees shall not be entitled to "Jubilee vacation" as well as wage components in respect of nursery school and summer camp.

Part of the employees is entitled to global overtime payment and, for other employees, payable overtime is subject to approval by the employee's authorized superior. The Bank does not have a computerized system for determining the number of hours actually worked by the employees ("time clock").

Most of the Bank's employees are entitled to recreation pay in an amount significantly higher than the amounts provided by law. Employees are also entitled to accepted provident and continuing education funds contributions.

The Bank's liability to severance pay for its employees is calculated according to the employee's basic salary, global overtime payment, 1/12 of the employee's 13th month salary and other additional benefits.

Bank employees are also entitled to certain benefits after their retirement.

The Bank is preparing for the required changes in provisions for severance compensation under the Expansion Order regarding the establishment of compulsory pension for every employee and under Amendment No. 3 to the Provident Fund Law, which are effective January 1, 2008. For further details, see Note 33 to the financial statements.

According to the Expansion Order, the Bank is required to contribute for severance compensation on a personal basis and up to a maximum rate (as from January 1, 2013 onwards) of 5% of the employee's salary or of the average wage in the economy, whichever is lower. According to the Amendment to the Provident Fund Law, the Bank's contributions for severance compensation shall not be deposited in a central severance pay fund, as hitherto was the practice, starting January 1, 2008 in respect of new employees and starting January 1, 2011 in respect of other employees. For further details see Note 16 to the financial statements.

**SPECIAL
REMUNERATION TO
MANAGERIAL
PERSONNEL**

A managerial rank employee who has been promoted is entitled to a 5% salary increase (provided that at least 12 months have elapsed since the date of his last entitlement to such increase due to promotion and/or transfer). A managerial rank employee who has been transferred to another position is entitled to an increase of 2% to 7% of the salary according to the salary table (basic salary components), at management's discretion, taking into account the additional responsibility and/or the special managerial effort required for adaptation to the new position following the transfer, and provided that at least 12 months have elapsed since the date of his last entitlement to such increase due to promotion and/or transfer.

Employees of the three most senior ranks (senior manager, assistance CEO, senior assistance CEO) are entitled to a company vehicle and to full reimbursement of expenses in respect of one telephone line in the senior employee's home. As at December 31, 2007, the staff of the managerial grade numbered 1,160 (December 31, 2006: 1,079 employees).

**OFFICERS AND SENIOR
MANAGEMENT
MEMBERS GROUP OF
THE BANK**

Members of this group of employees are subject to a prior notice period larger than the period set by the law, and to a defined period of limitation on occupation (between two to twelve months), in respect of which they are entitled to an adaptation grant (2-12 monthly salaries). For details regarding a stock option plan for senior officers of the Bank (excluding the Chairman of the Board of Directors and the President and CEO), see Note 13 D to the financial statements.

**AWARD PLAN TO
EMPLOYEES AND
MANAGERS OF THE
BANK IN 2007-2008**

In March 2007, the Board of Directors approved an award plan to employees and managers of the Bank for 2007 (See Note 16 to the financial statements). The budget for the plan would be determined on the basis of the annual return to capital of earnings from ordinary operations. The awards would be granted according to the rate of return. The aim of the plan is to create a structured relation between the success of the Bank and the remuneration of employees and managers in the short and long term. In March 2008 the Board of Directors approved a similar stock option plan for 2008.

**WORK ON THE DAY OF
REST**

Personnel on duty at the computer center and security personnel of the Bank work on rest days as defined in the Work and Rest Hours Law, 1951. Work on these days requires a special permit, which has not yet been issued to the Bank. For details of an investigation conducted in the matter of work on the weekly day of rest in contradiction to the Law, see "Proceedings regarding Authorities" under "Legal Proceedings" below.

**RETIREMENT OF
EMPLOYEES**

In the years 2000-2007, the Bank encouraged early retirement of employees, directed at an employee population having defined characteristics, in respect of which a focused effort was made to encourage their early retirement at beneficial terms. One of the goals of the human resources activity includes encouraging retirement, with the employee's consent and without pressure or imposition. Retirement promotes targets such as the reduction in the average cost per employee position and rejuvenation of the workforce.

172 employees retired during 2007, of which 103 employees took early retirement. 262 employees retired during 2006, of which 205 employees took early retirement. 53 employees retired during 2005, of which 3 employees took early retirement.

In total, 1,541 employees retired from the Bank in the period 2000-2007, of which 1,073 took early retirement.

Early retirement plan (2007). In March 2008, the Board of Directors approved a plan for the encouragement of early retirement of employees having predefined characteristics who would be offered retirement under beneficial terms. A provision of NIS 50 million has been included in the financial statements as of December 31, 2007, in respect of the said plan.

Early retirement plan at the Mercantile Discount Bank. In the last quarter of 2007, the Board of Directors of mercantile Discount Bank approved a voluntary retirement plan in the amount of NIS 23 million.

Early retirement plan (2006). Additional alternatives were offered in 2007 for severance indemnities: severance payment at the rate of 100% and the conversion of the award into a gross

monthly payment, linked to the CPI, for a period to be determined by the employee but not in excess of 25 years from retirement. The employee would be entitled to determine the date on which the monthly payments would begin, provided the last payment shall not be later than the above date (25 years since retirement). The payment plan elected by the employees is guaranteed in any case, including death of the retiree.

Following an agreement with the Employees Committee, a further alternative was made possible, according to which the employee would receive the tax exempt part of the severance pay on the spot, while the balance (the amount exceeding the exemption and the additional award) would be paid in monthly installments.

A provision in the amount of NIS 70 million was included in the financial statements as at December 31, 2006.

The average cost per retired employee was NIS 753,000 in 2007 (2006: NIS 873,000). The said amounts do not include wage tax, the rate of which was 15.5% in 2007 (2006: 16.25%).

An early retirement plan at IDB New York (2006). In July 2006, the Board of Directors of IDB New York decided on a plan for the encouragement of early retirement of members of management and of some 120 employees. The financial statements as at December 31, 2006 included a provision of NIS 73 million in respect of the said plan. The total number of staff, including members of management, who have retired from the bank in New York in 2006 was 127. 77 employees retired under a voluntary retirement plan.

DEVELOPMENT OF HUMAN RESOURCES

Development of human resources at the Bank reinforces the Bank's ability to address successfully its business and organizational challenges, through:

- Constructing, cultivating and reinforcing the Bank's comprehensive managerial backbone by means of a managerial training plans which support the strategy, including four managerial training courses:
 - Training reserves for position appointments (junior management, intermediate management and senior management levels);
 - position maintenance training and customized training for managers in various departments.
 A dual process of personal and professional enhancement and development has been instituted for the first time with respect to branch managers, deputy regional managers and regional managers: evaluation of superiors by subordinates and manager feedbacks, as well as a continued coaching process - personal counseling for improving "gentle" skills, and success in the business field;
- The establishment and positioning of the "Branch Managers Forum" - a professional forum that enhances the organizational positioning of the post and increases the managers' ability to lead changes. In addition, the forum serves as a colleague meeting place for joint learning;
- Training adapted to the needs of managers in the various divisions (corporate division, finance division, information systems department and operations department);
- Formation and absorption of career courses for core banking positions: from formation and internalization of career courses for temporary personnel (in branches, in personal service



sectors and in concept branches), through development of courses for investment consultants and for career management personnel.

- Organizational development activity in an organic unit with a multi-disciplinary approach adapted to the needs of the unit.

Professionals from various disciplines (management development, organizational consulting, training and know-how management) assist the unit manager in order to create a vision for the unit, diagnosing the unit's present situation and devising an operational development program to narrow gaps between them, through development of the human resources and improvement of work procedures in the unit.

As part of the activities of the organic units, several units commenced upgrading of business promotion and business management skills, including formulation of theory, processes and procedures adapted to the unit's business activity and absorption thereof.

- The units in which the organizational development activity was instituted in 2007 were: Jerusalem Main Branch, International Private Banking Department and the Credit Centers.

Organizational/managerial consulting for the establishment of branches, structuring work teams and assisting managers in assuming their position.

- Within the framework of the State employees project, for example, consulting assistance was provided in 2007 in seven State employee branches.

IMPROVEMENT OF SERVICE

The customer service issue at Discount Bank constitutes a component creating a competitive advantage. Accordingly, the Bank invests considerable resources in a continuous effort to provide customers with a unique and unforgettable "service experience".

Discount Bank is currently in the midst of a multi-annual process of transition to a culture that places the customer at the center of the organizational existence. Several years ago, management of the Bank etched on the Bank's banner the strategic target according to which each customer (whether internal or external) will be satisfied. For this purpose the Bank began extensive operations among the staff intended to create within the staff a developed service conviction moved by the understanding of and identification with customers. In addition the activity is directed towards providing suitable tools, including infrastructure, processes and organizational structures supporting the creation of an outstanding service experience. The process of the cultural change relies primarily on implanting within all managers in the organization the conviction that they in fact manage service units (both internal and external).

For the past several years the Bank has been conducting training and assimilation activity of service management principles in all frontline and supporting head office units.

The field of professional training that accompanies the employee from the moment he enters the organization, integrates all required service dimensions in handling customers, with the view that this service forms part of the employee's professionalism.

In the course of 2007 the Bank continued the process of handling customers identified as exhibiting signs of potential "desertion". The staff at the branches have been trained to identify a dissatisfied customer and how to prevent his desertion.

The “Business culture” issue was formed and launched in 2007 - principles of business conduct in the field of verbal communication, work desk and personal appearance the objective of which is realization in practice of professional and personal values and the “Discount way” to banking professionalism and leading quality service.

Measurement of service quality. The quality of service provided in actual fact to external and internal customers, is tested at many crossroads: telephone service, face-to-face service, handling of complaints and internal interface. The various marks provided by periodic measurements constitute a basis for analysis and drawing of conclusions and assist the process of professional decision making as well as the recognition and appreciation systems for the staff, the executives and the organizational units.

As part of the encouragement of initiative in service, the Bank instituted in 2007 a new standard for compensation and appreciation of staff excelling in the banking system - a memorable trip abroad.

INFORMATION MANAGEMENT

Drawing conclusions, transferring duties and congruent period processes are also accompanied by designated management and information tools. Further systems and applications enable the use of computerized forms and the management of insight and competitive information. Tools and forms are developed for varied operational purposes, while emphasizing efficiency and savings aspects. The information management operation serves an essential layer of staff professionalism management in the organization comprises part of the work processes and provides an answer to several central challenges:

- Transfer of the center of gravity of the professional information from the head office to the field units by assembling knowledge and insight from the field and constructing and disseminating it to the entities requiring it;
- Turning covert knowledge to overt knowledge and managing knowledge through cooperation and study processes;
- Preservation of professional knowledge for ongoing use;
- Shortening of reaction time and the transfer of required knowledge in the fastest and most efficient manner;
- Presentation of an updated picture of the professional level of the organization;
- The improvement of operations and compliance with the business goals of the organization.

The organization portal on the Intranet has become a central tool of information management. The portal provides infrastructure for the supply of relevant, readily available and up-to-date information. Over one hundred substance experts are engaged in the current updating of information communities and information sites that provide the general population of the Bank with the professional and personal information required for their current operations. The professional sites and the information communities are tied into the core business activity and to central organizational processes, thereby supporting raising the level of the employees professionalism and customer satisfaction. A notable example is the establishment in 2007 of a website designated at the State employees project.

Statistical data indicate the increasing use made by the staff in this channel allowing the optimal sharing of professional and organizational information.

Additional organizational and cultural processes, such as the selection of outstanding employees and units, are accompanied by designated sites planned to provide a response both as to current information regarding the process and as to the possibility of interactive staff operation.

TRAINING

In 2007, the staff at the Bank received a widespread response to their professional requirements through extensive and focused training and guidance.

In the reported year, a training response was given to the Bank's strategic moves, such as the loans and services tender for State employees as well as entry into the pension advisory service field:

- The success in winning the tender for providing loans and services to State employees created the need for training of staff for granting of professional service in this subject; banking and general conduct training to selected groups as well as training for backup staff in the branches layout and in concept branches.

Training was provided to varied groups including members of service teams, field teams, staff of designated centers, back office staff and branch staff in general. Training programs adapted to particular duties had been developed and put into action.

- Within the framework of the preparations for providing pension advisory services, an extensive training program was conducted qualifying some 220 employees: new certified pension consultants, integrated consultants (investment consultants also having a pension consultant license) and investment consultants studying for the Ministry of Finance's pension consultant qualifying examinations.

The knowledge gaps in various areas were filled in during the year according to the identification of needs conducted at the various units.

A mapping of information in the credit field has been conducted for the first time with the objective of identifying gaps and structuring programs for closing them; this in order to improve the level of professionalism of Bank employees engaged in the credit field.

A long preparation process of forming a large question data base on all issues preceded the mapping, as well as presentation of the process to managers, the structuring of independent learning environment in a form at similar to the mapping and allowing coordinators and business bankers to perform a self tests.

250 credit coordinators and business bankers of the corporate and the retail banking divisions participated in the information mapping, which encompassed all issues of specialization that the said participants are expected to demonstrate in the course of fulfilling their duty. The results were processed and analyzed, and will form as a basis for training programs in the course of 2008.

As part of improving professionalism and within the framework of the policy for providing professional and training response to all issues relating to expertise of investment consultants, the training of investment consultants also continued during the reported year.

In retail banking: within the managerial team at the branches, emphasis has been put on the formation of monthly work plans that include task and target management as well as training and developing work teams. Training of the bankers focused on the improvement of initiative performance in conducting the relations with customers. Officers at the regional managements had been provided assistance in the absorption of management routines.

Ofek - Since 2007 a change has taken place in the attitude to the launching of computer applications supporting banking operations, from "Ofek roll-outs" to "Distribution editions" of computer software including Ofek applications.

Four editions have been issued in this year concerning salary payments by employers and demobilized servicemen awards, bankers checks in foreign currency, magnetic cards and outgoing transfer of funds. A part of the courses was provided by study flashes, their distinction being in their rapid arrival at the employee's "work desk" and in the uniformity and clarity of the message transmitted to a particularly large population.

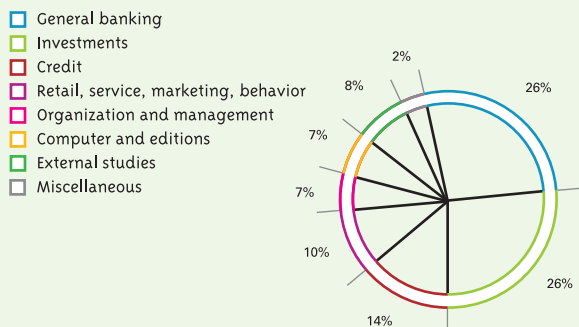
The number of training days in 2007 reached 40,830 compared with 37,198 training days in 2006. This data indicates a rise of 10%. This increase stems mainly from training relating to a new area of activity at the Bank (pension consulting) as well as from the training of staff in respect of the State employees issue.

The data relate to actual training days on the College premises, and do not reflect individual study activity that was widely implemented with respect to all subjects and sectors.

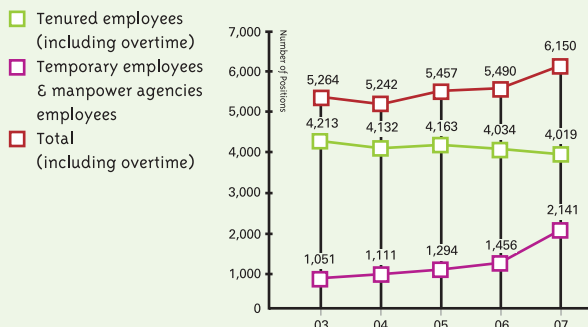
Investment in training. The Bank's investments in training and in the development of human resources amounted to NIS 19.7 million in 2007, compared with NIS 22 million in 2006. The amount includes the training of employees on various subjects of (developing and conducting training activities as well as training consultation). The amount also includes the cost of financing academic studies for Bank employees as well as expenses for professional training, seminars, etc. The amount does not include indirect expenses for instructors fees and rent of premises. The amount does not also include the relative part of employee payroll in respect of the participation of the staff in providing training courses, in the training framework of the Bank, in self study by means of the distant learning computer systems and participation in outside training frameworks.

Furthermore, for the purpose of conducting the training, the Bank appoints mentors and training partners who are Bank employees and who, in addition to their regular work, assist in training and in the preparation of training material. The cost in this respect is not included in the above amount. The above amount in respect of 2007 includes the preparations towards the implementation of the State employees project in the area of training and developing human resources. The overall said data do not reflect in money terms the thousands of self study hours and study flashes in the various banking issues, conducted by means of remote computer study programs.

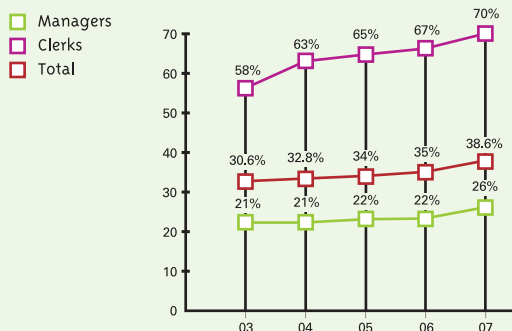
TRAINING DAYS BY TOPICS - 2007



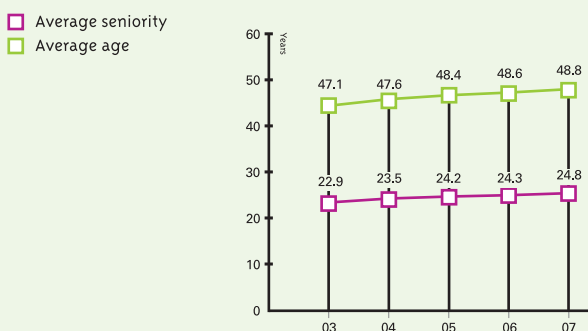
NUMBER OF BANK POSITIONS



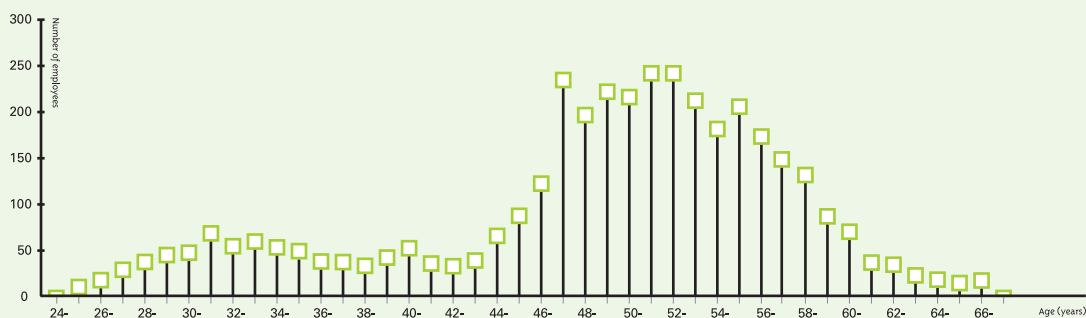
THE RATE OF UNIVERSITY GRADUATES ACCORDING TO GRADE



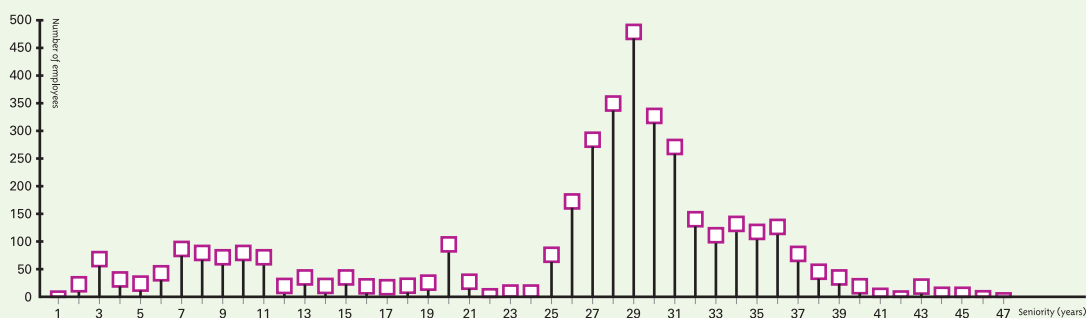
AVERAGE SENIORITY AND AVERAGE AGE



DISTRIBUTION OF THE PERMANENT STAFF BY AGE - WORK FORCE AT DECEMBER 2007



DISTRIBUTION OF THE PERMANENT STAFF BY SENIORITY - WORK FORCE AT DECEMBER 2007



CONTROL OF THE BANK

In consequence of the crisis on the shares market in October 1983, with respect to the “regulation” of this market, and as part of the measures taken to confront the situation that had occurred, The Government of Israel, on behalf of the State of Israel, entered into a series of agreements that created an arrangement to finance the acquisition from the public of the shares in each of the banking groups that were involved in the crisis.

In accordance with the Bank Shares in Arrangement (Temporary Provision) Law, 1993, (hereinafter - “the Bank Shares in Arrangement Law”), the shares of the Bank were transferred to the ownership of the State of Israel on October 31, 1993, which as from that date became the controlling owner of the Bank, due to its holdings of the shares of the Bank.

According to the Bank Shares in Arrangement Law, use of the voting rights attached to the shares held by the State of Israel shall be exercised by the Committee for the shares of the Bank for and on behalf of the State of Israel.

Up to January 31, 2006 the State held 559,870,403 Ordinary “A” Shares of NIS 0.1 each par value of the Bank, comprising 57.09% of the outstanding capital of the Bank and of the voting rights therein. This, after two offers for sale by the State of the Bank shares made in 1996 and 1997 to the public and to the employees of the Bank, in accordance with Prospectuses published by the State and the Bank, and after a private placement of the Bank’s shares made to institutional investors in 2001.

On January 31, 2006 (hereinafter: “the closing date”), upon the closing of the transaction for the sale of controlling interest in the Bank, as described hereunder, control of the Bank was transferred to the Bronfman-Schron Group.

ENTITIES IN POSSESSION OF BANK SHARES

According to information provided to the Bank, upon the closing of the Agreement for the Sale of a Controlling Interest in the Bank the Bronfman-Schron Group holds 254,966,194 ordinary A Shares of NIS 0.1 each par value of the Bank, comprising approx. 26% of the outstanding capital of the Bank and of the voting rights therein, the State held 304,904,209 ordinary A Shares of NIS 0.1 each par value of the Bank (hereinafter: “the ordinary shares”), comprising at that date approx. 31.09% of the outstanding capital of the Bank and of the voting rights therein. The Bronfman-Schron Group has an option to purchase a further 25% of the outstanding capital of the Bank and of the voting rights therein.

In May 2006 the State sold shares comprising 6.09% of the issued share capital of the Bank which constituted the balance of the State’s holdings in the shares of the Bank, i.e. the shares held by the State over and above the number of shares in respect of which the State granted the option to the Bronfman-Schron Group.

See hereunder for details as to the effective price of the transaction for the sale of the control core of the Bank, in accordance with the Opinion provided to the Bank by M.I. Holdings Ltd. and for the price paid for the balance of the shares held by the State.

The Bronfman-Schron group’s holdings in the Bank’s shares are as follows:

152,979,716 ordinary shares, representing approx. 15.6% of the Bank’s issued capital and of the voting rights therein, are held by the limited partnership Treetops Acquisition Group LP (hereinafter: “Treetops”);



101,986,478 ordinary shares, representing approx. 10.4% of the Bank's issued capital and of the voting rights therein, are held by the limited partnership Treetops Acquisition Group II LP (hereinafter: "Treetops II").

Treetops is a limited partnership that was incorporated in the Cayman Islands. The limited partners in Treetops are members of the Bronfman Group, as set forth below:

- Edgar Miles Bronfman IDB Trusts A through G (seven trusts), the beneficiary whereof is Edgar M. Bronfman, hold approx. 64.273% of Treetops;
- Matthew Bronfman personally holds approx. 6.424% of Treetops;
- Matthew Bronfman IDB Trust, the beneficiary whereof is Matthew Bronfman, holds approx. 6.424% of Treetops;
- Holly B. Lev IDB Trust, the beneficiary whereof is Holly B. Lev, holds approx. 6.424% in Treetops;
- Adam R. Bronfman IDB Trust, the beneficiary whereof is Adam R. Bronfman, holds approx. 6.424% of Treetops;

Edgar M. Bronfman is the father of Matthew Bronfman, Holly B. Lev and Adam Bronfman. All the trusts specified above are hereinafter jointly referred to as "the Bronfman Trusts". The trustees of each of the Bronfman Trusts have empowered the beneficiary of the Trust (and with regard to the Trusts the beneficiary whereof is Edgar M. Bronfman, the head of the family - the power of attorney has been given to Edgar M. Bronfman and Matthew Bronfman, provided that in the event of a dispute between them, Mr Edgar M. Bronfman's opinion shall prevail) to make all the decisions with regard to the investment in the Bank, save for matters of replacement of the power attorney (subject to the Bank of Israel's prior approval), making further investments in Treetops and/or the Bank and a sale, entering into and agreement for a merger agreement or any transfer of the interests of the Trusts, in Treetops and/or the Bank.

- PLM/IDB Investment LLC, a company fully owned by Philp Millstein, holds approx. 6.424% in Treetops;
- Rubinoff IDB Holdings LP, a limited partnership fully owned by Michael Rubinoff, holds approx. 3.207% in Treetops.

In addition to the Bronfman Group members the limited partnership Treetops Special Limited Partner LP (hereinafter: "SLP"), incorporated in the Cayman Islands, holds approx. 0.2% of Treetops, as limited partner. The limited partners in SLP are Matthew Bronfman (approx. 65%) and Michael Rubinoff, through Rubinoff IDB Holdings LP (approx. 35%). The SLP's general partner, is Treetops SLP Ltd., (a company fully owned by Matthew Bronfman, incorporated in the Cayman Islands) holds approx. 0.2% of SLP).

Treetops' general partner, that holds approx. 0.2% of Treetops, is Treetops Acquisition Group Ltd (hereinafter: "Treetops Ltd."), a company incorporated in the Cayman Islands. The means of control in Treetops Ltd. are held by the Bronfman Group members, in accordance with the ratio of their holdings in Treetops.

Treetops II is a limited partnership incorporated in the Cayman Islands. The limited partner of Treetops II is Cam Discount Ltd. (hereinafter: "Cam Discount"), that holds approx. 99.8% of Treetops II. Cam Discount is a company incorporated in the Cayman Islands, all the means of control wherein are held by Rubin Schron.

Treetops II's general partner, that holds approx. 0.2% of Treetops II, is Treetops Acquisition Group II Ltd (hereinafter: "Treetops II Ltd."), a company incorporated in the Cayman Islands, all the means of control wherein are held by Cam Discount.

For details regarding the transaction for the sale of a controlling interest in the Bank, and the arrangements between the buyers and the government and arrangements among the buyers, see this chapter hereunder.

SALE OF A CONTROLLING INTEREST IN THE BANK

According to the information provided to the Bank, on January 31, 2006, the transaction for the sale of a controlling interest in the Bank, entered into on February 1, 2005 by M.I. Holdings Ltd. and the Government of Israel (hereinafter - "the Government") on the one hand, and the Bronfman-Schroon Group (hereinafter- "the Buyers") on the other hand, (hereinafter - "the Agreement for the sale of a controlling interest in the Bank"), was completed.

In the Agreement the Bronfman-Schroon Group had purchased shares in the Bank comprising 26% of its issued share capital (hereinafter "the control nucleus") and was granted an option for a period of three years from date of the closing of the transaction, to purchase further shares comprising up to an additional 25% of the issued share capital of the Bank, all for the consideration of approximately NIS 1.3 billion (that was approximately NIS 5.1 per share), together with interest accrued until the closing date. Regarding the effective price per share, see "The effective price of the transaction for the sale of the controlling interest of the Bank" below.

On the closing date the Buyers paid the sum of US\$241,649,508, together with interest of US\$7,925,895, totalling US\$249,575,403. the balance of the consideration in the sum of US\$55,765,271 (hereinafter - "the balance of the consideration") together with the interest accrued thereon until the closing date, in the sum of US\$1,829,053, totalling US\$57,594,324, was translated into new shekels in accordance with the representative exchange rate of the dollar on the closing date.

On the closing date the undischarged balance of the consideration shall be linked to the index and bear annual interest of 4%. The balance of the consideration shall be paid by the Buyers by the first business day that shall occur after the end of 36 Gregorian months from 31 December 2005 (hereinafter referred to as "the first period"), save for the interest amounts that shall be paid by the Buyers in annual payments.

For details regarding the credit terms see "Credit agreement" hereinafter.

In light of the above, the price per share, according to which the sale transaction was carried out, calculated as to the closing date, according to the sum of the first installment, together with the interest accrued thereon until the date of the closing, in addition to the sum of the balance of the consideration, together with the interest accrued thereon until the date of the closing, divided by the number of the sold shares - is approx. US\$1.2047 for one share (the option to purchase shares comprising 25% of the Bank's outstanding capital, was not taken into account, within the above calculation; the above calculation does not include also the additional consideration, which is conditional, as detailed below).

For details about the calculation of the effective price per share in the Agreement for the sale of a controlling interest in the Bank, as was done for M.I. Holdings Ltd. shortly after entering the agreement, see “the effective price per share in the Agreement for the sale of a controlling interest in the Bank” below.

In the event that the option to purchase a further 245,159,802 shares will be exercised, the Buyers will pay an exercise price that might reach an additional sum of approximately NIS 1.25 billion (in the event of the full exercise of the option).

The exercise price for each of the option shares is NIS 5.0824 per share, linked to the increase of the index as of the index published on December 15, 2004 with adjustment provisions that were prescribed in the agreement. The option is exercisable by the Buyers or either of them in accordance with the ratio of their holdings of the control nucleus.

An additional consideration of up to NIS 156 million might be paid by the Buyers to the State according to the return on equity of the Bank during the period from October 1, 2004 to September 30, 2008. If the terms and conditions for the payment of the additional consideration are fulfilled, the Buyers shall pay it as follows: 50% out of sums received as dividend as from December 31, 2008 or 100% of monies that shall be received, as from the said date, in respect of a sale of the control nucleus shares or the option shares that shall be charged to the Government (if they shall be charged and for so long as they shall be subject to a charge), and all at the rates and upon the terms and conditions prescribed for such purpose in the agreement (see “Credit agreement” hereunder). In the event that a dividend is not distributed, although no legal or statutory constraint exists for such distribution, half of the additional consideration in the year in which no such constraint for non-distribution exists and half in the following year.

Concurrently with signing the Agreement for the Sale of a Controlling Interest in the Bank, the Buyers and the Government entered into an agreement providing interim financing for the State Grant to employees in respect of that part of the option, which may not be exercised by the Buyers (see hereunder for details of the “State Grant to Employees” provided in “the Employees Agreement”). According to the said agreement, in the event that the Buyers would not exercise the option in full, they are committed to finance that part of the State’s grant due nis 45 million to the employees in respect of the unexercised shares, and the Government shall refund this amount to them out of the consideration to be received by it from future sales of the shares of the Bank. The State will repay the interim financing as follows: At any date on which the State will sell shares of the Bank, the State will pay to the purchasers a proportionate part of the consideration receivable, based on the ratio of the number of shares sold to the number of the options not exercised. The balance will be payable within eight years.

For arrangements that have been made between the Government and the Buyers as to the coordination of their voting and of their exercise of control of the Bank see “Arrangements with Regard to Cooperation Between the Buyers and the Government, in Respect of Holding Shares of the Bank and Exercising the Control in the Bank”, below.

**THE GOVERNOR OF
THE BANK OF
ISRAEL'S PERMIT FOR
THE CONTROL AND
HOLDING OF MEANS
OF CONTROL IN THE
BANK**

The Governor of the Bank of Israel, after consultation with the licensing committee, granted on January 29, 2006, a permit to Edgar M. Bronfman, Mathew Bronfman, Adam R. Bronfman, Holly B. Lev, Michael Rubinoff, Philip Milstein and Rubin Schron (hereinafter: "the Group"), to jointly control and hold means of control in the Bank in a percentage of 26% of any type of means of control in the Bank. In addition the Governor permitted the Group's members to hold additional means of control in the Bank, in a percentage not exceeding 40% of any type of means of control, all subject to the percentage determined in such regard in respect of each of the Group's members in the annex to the permit. The annex to the permit details the holding of each member of the Group in the Bank and in Treetops and Treetops II partnerships, as detailed in "Entities in possession of Bank shares" above. The corporations and trusts details as aforementioned are prohibited from engaging in any business other than holding the means of control in the Bank. Further detailed in the annex to the permit are the additional percentages of means of control that any one of the members of the Group is permitted to hold beyond his or her share in the controlling interest. It is further determined that additional percentages of means of control will be held in the same manner as that of the controlling interest.

The said permit also includes a permit to control and hold means of control, through the Bank, in banking corporations controlled by the Bank, and in which it duly holds the means of control, all as shall be from time to time.

Following are the main conditions of the permit:

1. "Controlling interest" or "minimum percentage" means at least 26% of any type of means of control in the Bank, divided amongst the Group's members in the manner and ratio detailed in the annex to the permit.
2. If the Bank issues, after the grant of the permit, rights to shares or any other security convertible into shares, the Group shall maintain the minimum percentage holdings, computed on the basis of full dilution.
3. (a) For a period of five years subsequent to the date of the grant of this permit, the Group shall not directly or indirectly sell or transfer means of control in the Bank, if as a result thereof it is left with means of control of any type in a percentage lower than the minimum percentage. Any one of the Group's members may sell means of control from the additional percentage exceeding his or her share in the controlling interest, provided that a minimum of six months have elapsed since the last purchase affected by such Group member (in such regard, the exercise of the option from the government shall not be deemed a purchase act).
- (b) Five years from the date of the grant of this permit, the Group may sell or transfer its means of control, provided that it sells or transfers the entire means of control constituting the minimum percentage, to an individual or a Group that has duly received a permit for the control and holding of the aforesaid means of control.

In the Supervisor of Bank's letter annexed to the permit (hereinafter: "the letter annexed to the permit") it was stated that in the event that after five years from the date of the grant of the permit a decision is made by the Buyers to sell means of control in the Bank from the controlling interest such that after the sale none of the Group's members or the buyers require a permit for

the control or holding of the means of control in the Bank, pursuant to the law, the following provisions shall apply:

- The two Buyers shall approach the Governor of the Bank of Israel, notify him of their decision and detail the manner of the sale planned by them;
 - Before the sale of the means of control, as aforesaid, the Buyers shall make a preliminary with the Governor of the Bank of Israel, regarding the arrangements that shall be made, including the modification of the permit and the trust instrument, in order to allow them to effect the sale of the shares within a reasonable period of time (hereinafter: "the transitional period"), taking into account, inter alia, the implications on the Bank's management and transfer thereof, business relations with the Bank, the market conditions and the quantity of shares being sold, and the format of holding and voting in respect of the Bank's shares constituting a holding of more than 5% of the means of control in the Bank during the transitional period (without such derogating from the Buyers' fundamental right to effect the sale, as aforesaid).
- (c) Notwithstanding the abovesaid, an additional member may be added to the Group and each of the Group's members may, at the end of five years as aforesaid, transfer or sell the means of control held by him and constituting his share of the minimum percentage, or part thereof, provided that the transferee or buyer cooperate on a regular basis with the rest of the Group pursuant to the Summary of Principal Terms entered upon by the Group as aforementioned, or another agreement approved by the Supervisor of Banks, and that a permit was duly granted for the control and holding of the aforesaid means of control. Notwithstanding the above, an additional member may be added to the Group and a Group member may transfer or sell means of control as aforementioned also during the five year period from the grant of the permit, provided that the conditions set forth above had been fulfilled, and provided that the Group will continue being the leading factor both in regard to the percentage holdings as well as with regard to the cooperation between them.
4. (a) The Group's members and the entities through which the means of control are held shall act in accordance with the Summary of Principal Terms approved in advance and in writing by the Supervisor. The beneficiaries of the trusts from the Bronfman Group shall act in accordance with their undertakings to the Bank of Israel, which were approved in advance and in writing by the Supervisor.
- (b) The Group's members shall at all times hold the control and means of control in the Bank in the percentages and manner set forth and specified in paragraph 4 and in the addendum in respect of each of them, and shall not sell or otherwise transfer to another, including to corporations or other entities controlled by them, directly or indirectly, means of control in the Bank or in any of the entities detailed in these paragraphs, even if such sale or transfer does not require a permit pursuant to section 34 to the Law, unless otherwise provided in this permit or unless the Supervisor grants his prior written consent thereto.



In this regard, "sale" - includes a charge, save for certain charges within the Group specified in the permit.

- (c) Notwithstanding the aforesaid, for a period not exceeding three years from the date of the grant of this permit, the provisions of sub-paragraph (b) regarding a charge shall not apply to 6% of the means of control in the Bank that will be charged to the Government of Israel to secure the debt of Treetops and Treetops II to the Government.
 - 5.(a) The Group's member shall not expressly or impliedly agree to the imposition of an attachment on the means of control in the Bank or any of the entities detailed in the addendum; the Group's members shall not act in any manner that is such as to actually alter the ownership rights in these means of control or the rights embodied therein and detailed in the definition of "means of control" in section 1 of the Law.
 - (b) Should an attachment be imposed despite the aforesaid, over means of control as aforesaid held by a member of the Group, the said member shall act in a way available to him for the immediate removal of the attachment.
 - 6. The means of control in the Bank which are held directly shall be deposited by the Group, for the Group's members or for the Group's members and the government, as the case may be, with one or more Israeli resident trustees whose identity, trust instruments and the instructions given to them within the trust instruments shall be subject to the Supervisor's prior written approval.
 - 7. The Group's members, their relatives or corporations under the control of any one of them shall not receive management fees or any other consideration neither from the Bank nor from corporations under the Bank's control; however, they may provide services ordinarily provided by the providers thereof, at market prices, provided that prior written notice has been given to the Supervisor regarding the nature of the service and the consideration, at least 14 business days prior to providing of the service; if the Supervisor has given notice that the service is not of the type ordinarily provided to others or that the consideration for the service is unreasonable, the service shall not be provided.
- The provisions of this paragraph shall not apply to directors' remuneration that is paid in an indential amount to all the Bank's directors.
- 8.(a) No dividend shall be distributed from the Bank's profits that accrued prior to September 30, 2004. If losses accrued after this date, no dividend shall be distributed until after these losses have been covered; in addition, no dividend shall be distributed from profits from the sale of material assets of the Bank for five years from the date of the grant of this permit. Thereafter, dividend may be distributed from the sale of assets as aforesaid, subject to the Supervisor's prior written approval (The profits that accrued in the Bank prior to September 30, 2004, which are not available for distribution as aforesaid, amounts to NIS 2,704 million).
 - (b) Notwithstanding the aforesaid, dividend may be distributed from profits from a sale of material assets of the Bank in the five years following the date of the grand of the permit, on the fulfillment of all the following conditions:
 - (1) The sale derives from legal requirements governing the Bank;

- (2) The distribution of dividend from profits from a sale of such assets does not result in a reduction in the minimum capital ratio of the Bank existing prior to the sale of the said assets;
 - (3) The Bank's board of directors approves the distribution after examining the Bank's needs and its business plans;
 - (4) The Supervisor gives his prior written approval to an aforesaid distribution, after examining the Bank's capital adequacy and the board of directors' decision and the basis thereof.
9. (a) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not engage in any business, in Israel or abroad, of receiving deposits - even from less than 30 people, or granting credit, or any other financial business in Israel that is such as to compete with the Bank's business.
- (b) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not be interested parties, directors or senior managers in corporations engaging in business of the type mentioned in sub-paragraph (a) above; in such regard, "interested party" means someone holding 5% or more of any type of the means of control.
10. 100% of the total balance sheet assets of each of the purchasers is to be financed from capital. Notwithstanding, the purchasers will be entitled to finance the acquisition of the controlling interest by way of a debt to the Government of Israel. Financing of the purchase of the means of control in the Bank, including the grant of guarantees for financing as aforesaid, shall not be provided, directly or indirectly, by the Bank or by banking corporations under its control.
11. The Bronfman and Schron Group shall reduce their liability to the Bank in order to comply with Proper Banking Management Directive No. 312 concerning a banking corporation's business with related persons, unless otherwise approved by the Supervisor, in advance and in writing.
12. The Group shall do the utmost to ensure that the memorandum, articles of association and all the procedures of the Bank will match and conform with, insofar as required and at any time, with the provision of the permit.

**ARRANGEMENTS
WITH REGARD TO
COOPERATION
BETWEEN THE
BUYERS AND THE
GOVERNMENT, IN
RESPECT OF HOLDING
SHARES OF THE BANK
AND EXERCISING THE
CONTROL IN
THE BANK**

In the Agreement for the sale of a controlling interest in the Bank arrangements and various undertakings have been prescribed with regard to cooperation between the Government and the Buyers, in respect of their holdings of shares of the Bank, and with regard to the exercise of control in the Bank by the Buyers. Furthermore, contingencies were determined regarding the provisions of the Bank Shares Arrangement Law (see below) the principal aspects whereof are as follows:

- Provisions were prescribed that will apply for as long as the period for the exercise of the Option shall not have ended (meaning until the end of 2008 or before that due to the Full Exercise of the Option) (hereinafter "the Support Period") with regard to coordinating the manner of voting, by virtue of the Buyers' holding of the Bank's shares and by virtue of the holding of the Government of the option shares, at the Bank's general meetings and also with regard to the appointment of directors to the Bank's board of directors, pursuant whereof four directors who were proposed for election by the Government and nine directors who were proposed for election by the Buyers shall be appointed (and if the Government's holdings in the Bank fall below 10%,

two directors proposed by the Government for election and 11 directors proposed by the Buyers for election shall be appointed). It was also prescribed with regard to determining the identities of the candidates to serve as external directors of the Bank, that the first will be proposed by the purchasers and the second by the Government and all for the period and on the terms and conditions prescribed for such purpose in the and all for the period and on the terms and conditions prescribed for such purpose in the agreement.

- It was prescribed that during the Support Period, the Parties will employ their best efforts to cause that on all of the key committees of the board of directors of the Bank there will serve. At least one Director proposed by the Government will be appointed; in addition, for as long as the Bank remains the controlling shareholder of material companies, and directors of the Bank are appointed as directors of the aforesaid companies, and as long as the Bank has the right to appoint more than one director. At least one Director proposed by the Government will be appointed as a director on behalf of the Bank in each one of the aforesaid companies, and all on the terms and conditions prescribed for such purpose in the agreement.
- It was prescribed that during the Support Period, and on condition that the Buyers and those participating with the Buyers in the control nucleus shall hold at least 26% of the Shares of the Bank, shall fulfill their undertakings pursuant to the Agreement, and cause the Bank to comply with all of the provisions which the Buyers are required to cause the Bank to comply with the Government Representatives will refrain at the general meetings of the Bank, from exercising the voting rights pertaining to the Option Shares held by the Government, up to such portion that the Shares being held by the Buyers and by anyone participating with the Buyers in the control nucleus will confer 50.1% of the voting rights of the totality of Shares voting, for or against, at such meeting. It was agreed that representatives of the Government are entitled to vote in accordance with their own judgment, in respect of transactions with interested parties. Also, it was determined that, at the request of the purchasers, the representatives of the Government will be entitled to vote together with representatives of the purchasers instead of abstaining, all according to the conditions set in the agreement. During the Support Period the Government shall refrain from giving an instruction in accordance with Section 28(a)(3) of the Bank Shares in Arrangement Law. (Regarding the provisions of this law, see the "Bank Shares Arrangement Law" below).

- **In this clause -**

"The restriction period" means the period commencing on the closing date and continuing: (1) for so long as the Government and any party on its behalf jointly hold no less than 10% of the Bank's issued share capital or (2) until the end of four years from 31st December 2005 in an event in which the Buyers have not fully exercised the option, or (3) until the end of three years from 31st December 2005 in an event in which the Buyers fully exercised the option, whichever is the shortest period.

"The additional period" means the period commencing at the end of the restriction period and continuing: (1) for so long as the Government and any party on its behalf jointly hold no less than 5% of the Bank's issued share capital; (2) until the end of three years from the end of the restriction period; or (3) until after the full exercise of the option, whichever is the shortest period.

- During the restriction period the Buyers shall not carry out any of the following actions and they shall use their best endeavors to ensure that the Bank refrains from executing them, unless the action has been given the Government's prior written consent: (a) the voluntary winding up of the Bank; (b) a split of the Bank, merger of the Bank with companies that are not fully owned subsidiaries, a settlement or arrangement, within the meaning thereof in the Companies Law, 5759-1999, to which the Bank is a party, and any similar operation that affects the Bank's issued share capital; (c) an allotment of shares, change of the rights attached to shares, increase of capital (authorised or issued) and the distribution of bonus shares or the issue of rights by the Bank; (d) payment of management fees or the grant of another benefit by the Bank or corporations of the IDB Group (within the definition thereof in the sale agreement) to interested parties in the Bank, save for determining the terms and conditions of the chief executive officer's employment, and every exceptional transaction in which an interested party at the Bank has a personal interest; (e) a change in the Bank's documents of incorporation.
- Pursuant to the provisions of the agreement, the Government shall not refrain from granting its consent to the actions as set forth in sub-clause (b) above and to the actions as set forth in sub-clause (c) above, that are required for such purpose, save on reasonable grounds, relating to a material change of the Government's rights pursuant to the Agreement for the sale of a controlling interest in the Bank or an impairment to the value of the Bank's shares that the Government holds or an impairment to its ability to sell them.
- The Buyers have undertaken to use their best endeavors, subject to every law, in order to ensure that during the restriction period the Bank shall refrain from issuing shares and securities convertible into shares, save with the prior written consent of Holdings and the Government, and subject to the matters set forth below: (a) the Government and Holdings shall not refrain from agreeing to the issue of shares of the Bank in accordance with a written initiated demand of the Supervisor of Banks of the Bank of Israel, in accordance with his authority at law; (b) any issue as aforesaid to which the Government or Holdings have given their consent and also any issue of shares by the Bank, during the additional period, shall be effected in coordination with the Government, and the Bank shall enable the Government to join the sale with shares of the Bank out of the shares that it holds, at a rate of up to one half of the total number being sold in any offer, and all subject to the terms and conditions prescribed for such purpose in the sale contract.
- It has been prescribed that in the event of a sale of the control of Discount Bank New York, all the consideration in cash received in respect of the sale shall be transferred to the Bank and it shall not be possible to draw a dividend from the monies of such consideration until five years from the date of signing the Agreement for the sale of a controlling interest in the Bank have elapsed, unless otherwise agreed upon with the Bank's workers' committee.
- Restrictions as to a transfer of the holdings of the parties to the agreement in the Bank during the course of the restriction period and/or during the course of the additional period were prescribed. The Buyers are entitled to transfer Shares or to issue shares to whom ever shall be a Participant in the control nucleus, only after the Buyers shall purchase from the

Government at least 35% of the Issued Share Capital of the Bank. Any sale by the Buyers to a transferee which shall not be a Participant in the control nucleus, including sale offer of Shares of the Bank by means of a prospectus, provided that the Government shall be afforded the right to join in the sale and exercise its tag-along right, to sell Shares from the Bank's Shares held by the Government, and all on the terms and conditions prescribed for such purpose in the agreement.

- The Buyers have undertaken to cooperate with the Government and Holdings and to use their best endeavors such that the Bank and its officers and the other corporations in the IDB Group (as defined in the agreement) and the officers thereof shall cooperate with the Government and Holdings, at the Bank's expense (save with regard to the payment of underwriting and distribution commissions that shall apply to the Government), with the intention of assisting the Government and Holdings to sell the balance of the Bank's shares and such being in accordance with their duties pursuant to the Bank Shares in Arrangement Law, and pursuant to the existing cooperation agreement between the Bank and Holdings and subject to every law, and also in accordance with the provisions prescribed for such purpose in the agreement.
- It was prescribed that for as long as the Buyers control the Bank, the Buyers undertake to act so that the directors and officers who served in the Bank prior to the Closing Date will be afforded exemption, indemnification and insurance terms identical, inasmuch as possible, to the terms which shall be adopted by the Bank in relation to directors and officers who shall be appointed in commencing from the Closing Date in such manner as shall secure them insurance coverage, exemption and indemnification as aforesaid also with respect to their actions during the period preceding the Closing Date. The Buyers agreed that the aforesaid will also apply to the officers of the subsidiaries of the Bank.
- It was prescribed in the Agreement for the sale of a controlling interest in the Bank with regard to Section 41 of the Bank Shares in Arrangement Law, that the provisions contained in the Agreement will prevail over any provisions to the contrary in the Law. Without derogating from the generality of the foregoing it is agreed that the provisions of the Agreement will prevail over the provisions contained in Sections 18, 19(e), 23 and 24 of the Bank Shares in Arrangement Law with regard to the manner of appointment of the directors of the Bank and will prevail over the provisions contained in Section 21(b) with regard to the term of office of external directors. The provisions of the Agreement supplement the provisions contained in Section 33 of the Law with regard to cooperation with the Government and delivery of any information to the Government for the purpose of sell of the balance of the Bank's shares that the Government holds. The provisions contained in Section 22 of the Law with regard to the consent of the committee to the appointment of the chairman of the board of directors will not apply. The provisions contained in the Agreement will prevail over the provisions contained in Chapter F of the Bank Shares in Arrangement Law, with regard to the restriction of the exercise of the voting rights of the Government.

**ARRANGEMENTS
BETWEEN THE
MEMBERS OF THE
BRONFMAN-SCHRON
GROUP**

According to information provided to the Bank, Treetops and Treetops II (hereinafter - "the Buyers") as well as the members of the Bronfman Group and Rubin Schron (hereinafter - the members of the Bronfman Group and Rubin Schron are named together: "the Investors") entered into an agreement with respect to their investment in the Bank, which includes a Summary of Principal Terms detailing the manner of the cooperation between the Investors, which was approved by the Bank of Israel (hereinafter - "the Cooperation Agreement"). Furthermore, the investors signed a Clarification Letter, which clarifies and/or adds to the terms of the Cooperation Agreement (hereinafter - "the Clarification Letter"). On January 24, 2006, Bank of Israel informed the investors that the sale of shares constituting part of the controlling interest without the prior coordination with the Governor of Bank of Israel, even if effected more than five years after the date of receipt of the permit, would most probably breach the conditions of the permit. Notwithstanding, the Bank of Israel advised that it has no objection to the Clarification Letter being signed for the purpose of determining certain accords between the Investors, provided that the Clarification Letter would be amended or replaced after the Bank of Israel had examined it. To the best of the Bank's knowledge, the Bank of Israel has not raised the issue matter again and, as of date of publication of this report, the letter of clarification has not been amended or replaced. The Cooperation Agreement determines, among other things, that of the number of directors that the Buyers are entitled to appoint to the Bank's board of directors, the Bronfman Group and Rubin Schron (hereinafter named: "the Schron Group" and together with the Bronfman Group - "the Groups") are entitled to appoint directors in proportion to the relative percentage of each group in the total ownership rights of all the Investors being limited partners in the two Buyers together (the overall ownership rights as above, in the two Buyers together are hereinafter: "the Interests"). To date, according to the Agreement for the Sale of the Controlling Interest, the Bronfman Group is entitled to appoint five members to the board of directors and the Schron Group is entitled to appoint four. In addition, the Bronfman Group is entitled to appoint the first outside director that the two groups would be entitled to appoint, when such office becomes vacant, whereas the Schron Group would be entitled to appoint the second outside director (as to the subject of agreements between the Buyers and the Government regarding the appointment of outside directors, see above). The identity of the members of the board of directors recommended by each Group is to be determined by the majority of shareholders in the general partner of each of the Buyers. The Buyers would vote by power of their shares in the Bank for the appointment to the board of directors, as aforesaid.

The Cooperation Agreement further stipulates that the Buyers would vote jointly on all issues brought before a General Meeting of shareholders of the Bank. For this purpose, prior to every such general meeting, each Buyer shall hold a meeting of shareholders in its general partner, during which each shareholder would state how, in his opinion, the Buyers are to vote with respect to the issue in question. Excluding decisions regarding specific matters that require a special majority vote of over 67%, as stated below, and with respect to the appointment of members of the board of directors, as stated above, the Buyers shall not vote in favor of any issue brought before a

General Meeting of shareholders of the Bank, unless such vote is supported by shareholders holding together over 50% of the Interests.

It has been stipulated that with regard to the following resolutions, a special majority of over 67% of the Interests would be required: sale of Bank shares by the Buyers; a significant raising of capital in which the Bank is involved; mergers, splits, significant acquisitions or sales in which the Bank or the Buyers are involved; issuance of capital or debt securities by the Buyers; any amendment to the rights attaching to the Interests; liquidation (including voluntary) of any of the Buyers; appointment of the chairman of the board of directors of the Bank.

The Cooperation Agreement further stipulates that the net consideration, which each of the Buyers would receive for the sale of shares in the Bank or dividends and other payments that would be received from the Bank, would be distributed by each Buyer as follows: (1) firstly, each Buyer would distribute to each of its Investors a proportion of the said amounts according to the relative share of its investor Interests in that Buyer, until the recovery in full of the amounts invested by him in that Buyer; (2) secondly, each Buyer would distribute to each of the investors in it an amount equal to 8% per annum (cumulative) on his investment in that Buyer; (3) after having made the payments as described in (1) and (2) above, Treetops (and not Treetops II) would distribute 15% plus as additional amounts to SLP, and the balance (85% excluding the additional amounts) would be distributed to the investors in Treetops, pro-rata to their share, all as detailed in the Cooperation Agreement. Certain amounts paid to SLP by Treetops would be distributed to Mr. Matthew Bronfman, to a corporation owned by Mr. Michael Rubinoff as well as to Cam Discount, all according to the distribution and terms stipulated for this purpose in the Cooperation Agreement.

The Cooperation Agreement stipulates that, at the request of shareholders of the general partners in the Buyers who hold not less than 67% of the Interests, the Buyers would exercise the option granted to them according to the Agreement for the Sale of the Controlling Interest. In as much as it would be decided by the shareholders, as above, that the exercise of the option would be effected by means of additional capital investment of the Investors in the Buyers, then each investor would be entitled not to exercise his right, and in such a case other members of his Group would be entitled to exercise his proportionate share in the option. If all the Investors in any Group elect not to exercise their share in the option, then members of the other Group may do so in their stead. If the option is not exercised in full up to 180 days prior to the expiration of the option, then any Investor may cause the exercise of the option by giving notice, and, in such a case, if Investors holding less than 67% of the Interests would agree to finance the exercise of the option, then the Buyers shall divide, pro-rata, the rights to exercise the option to the Investors interested in exercising it or to entities under their control.

The Cooperation Agreement further stipulates that the Investors in each Buyer will have the right to participate in future allotments of shares by the Buyer in which it has an interest. It is also stipulated in the Cooperation Agreement, that during the first five years from date of acquisition of the controlling interest (or any shorter period that the Agreement for the Sale of the Controlling Interest allows), no sale, exchange, pledge or transfer (hereinafter together - "transfer") of any of

the interests in any Buyer (excluding transfers to family members or family entities) would be permitted without the consent of the general partner of that Buyer. In the event that permission for the transfer has been granted, or subsequent to the said period, any transfer would be subject to the right of first refusal granted to Treetops or Treetops II, as the case may be, and to any other investor, as well as subject to a Tag Along right. In addition, members of the Bronfman Family will continue to hold, at all times, at least 50.1% of the Interests held by members of the Bronfman Group, and Rubin Schron will continue to hold, at all times, at least 50.1% of the Interests held by the Schron Group. It is further stipulated in the Cooperation Agreement that if those who hold over 55% of the Interests would decide to sell over 55% of the Interests, they would be entitled to force the other Investors to sell, under the same conditions, the balance of the Interests held by them. It was decided that the unanimous approval of Mr. Mathew Bronfman, Mr. Leonard Grunstein on behalf of Mr. Rubin Schron and Mr. Michael Rubinoff, is required to change the controlling shareholders' agreement. The Clarification Letter stipulates that as from the end of five and one half years from date of closing of the transaction, each Buyer would be entitled to decide to surrender the Bank of Israel permit, for the purpose of the sale of the controlling interest shares, according to the letter attached to the permit (as described above). A Buyer choosing to do so is to inform the other Buyer accordingly, and in such a case the other Buyer would have the right of first refusal or the Tag Along right in respect of all the shares held by him, all subject to and in accordance with the terms to be agreed upon (in the future) between the Buyers regarding this matter. The sale of shares in accordance with this paragraph will not require a majority of 67% of the Investors (as required for the sale of shares according to the Cooperation Agreement).

The Clarification Letter further stipulates that the Cooperation Agreement would be valid so long as anyone of the Buyers holds, directly or indirectly, over 5% of the share capital of the Bank. It is further stipulated that the provisions of the Cooperation Agreement which apply to the controlling interest shares, shall apply also to shares acquired, directly or indirectly, by the Buyers or the Investors through the exercise of the option, including together with others. The voting rights attached to the shares so acquired as well as to other shares held by the Buyers or Investors, including together with others, shall be used in accordance with the manner in which the Buyers of the controlling interest shares vote, as detailed above.

CREDIT AGREEMENT

According to the information provided to the Bank, the Buyers shall be entitled to pay the balance of the consideration on dates and under terms detailed below, subject to the signing at date of closing of an Annex to the Sale Agreement, which will include provisions for assuring the payment of the balance (hereinafter - "the Credit Agreement"):

- Subject to that stated hereunder, the balance of the consideration shall be paid by the end of 36 months from date of closing of the transaction (hereinafter - "the First Period").
- The exercise price of the option or any part thereof shall be paid upon the exercise of the option, unless a part of the payment has been deferred in terms of circumstances determined for this purpose in the credit agreement.



- As collateral for fulfillment of the buyers' liabilities for repayment of the debt to the government, the buyers will record a first level contingent charge/fixed lien, in favor of the government, in an unlimited amount, on ordinary shares of the Bank constituting a total of 6% of its issued share capital and the yield thereon ("the subordinate shares"). At the end of the first period, and in circumstances defined in the credit agreement, shares included in the subordinate shares will be released, in such a way that the lien will be applicable to a total of 5% of the Bank's issued share capital.
- In addition, the Buyers shall provide the Government and M.I. Holdings on the closing date, personal letters of guarantee in an agreed text and in a total amount of US\$10,800,000. The right of recourse to the Buyers, over and above the collateral mentioned above, is subject to a permit from the Bank of Israel.
- Under certain conditions, the Buyers shall be entitled to make an early repayment of the outstanding balance of the consideration, in whole or in part. Furthermore, in the event that the Bank would distribute dividends, the Buyers will have to make an early repayment up to certain determined amounts.
- In the event that an early repayment has been made following the distribution of dividends by the Bank as above, then, under certain conditions, the Buyers may request the granting of new credit in the amount of the early repayments made by them.
- The Buyers shall be entitled to defer the last date for the payment of the balance of the consideration until the end of 36 months from the end of the first period, subject to certain conditions, including:
- The option has been partly or fully exercised by the end of the exercise period. If only a part of the option is exercised then the last date for the payment of the balance of the consideration will be deferred only as regards a proportion of the outstanding balance of the consideration in accordance with the ratio of the number of shares exercised to the total number of shares covered by the option.
- Until the end of the first period, the shares comprising the controlling interest in the Bank that are not pledged has to reach a rate of 26% of the outstanding capital of the Bank.
- On the date on which the Buyers request a deferment of the last date for the payment of the consideration, the collateral, as stated above, has to meet with the determined ratio of collateral to debt.
- So long as a debt, as detailed above, exists, the Buyers shall be subject to certain limitations, including limitations on transactions in the pledged shares, on the distribution of dividends, on the registration of an additional pledge on the shares acquired through the exercise of the option, and limitations on various actions regarding the Bank, which may affect the value of the collateral, without the prior consent of the Government. In addition, the Buyers will have to abide by a certain ratio of collateral to outstanding debt (a ratio of the amount of the personal guarantees plus the market value of the pledged shares, according to a determined calculation, or the value of other collateral provided by the Buyers, to the balance of the debt).
- In addition, the Credit Agreement includes events of default and other circumstances in which the debt will become immediately payable.

THE BANK SHARES ARRANGEMENT LAW

As stated above, the Bank Shares Arrangement Law was enacted in order to regularize the holdings of the State in the shares of the banks and the voting rights attached thereto as well as other related matters, this in order to enable the Government to sell the bank shares transferred to its ownership, in a manner deemed appropriate to it, and to avoid involvement in the current management of the business of the banks in the period until these shares are sold, while preserving the proprietary interest of the State in the shares and to allow structural changes in the banking industry according to Government policy and any law. The Law stated that the use of the voting rights attached to the shares in the name of the State and on its behalf shall be made by a committee for the bank shares (hereinafter - "the Committee"), which shall be appointed separately in respect of each bank, by a public body to be appointed by the Government. On December 22, 2005, the Bank Share Arrangement Instruction (Temporary Provision)(Appointment of other committees and the period of their tenure), 2005, was published in the Official Gazette, which determined that where the State has transferred control of a bank to another entity, the appointment of the Committee shall terminate. Notwithstanding, in response to an approach by the representative of the purchasers, the representative of the State informed on April 10, 2006, that the Committee for the shares of the Bank shall continue to act on behalf of the State for the purpose of voting by power of the Bank shares in its possession.

PRINCIPAL PROVISIONS OF THE LAW

Section 41 of the Law states that upon sale of shares by the Government in a transaction designed to lawfully transfer of control over a bank, the provisions of Sections 3 and 5, Chapters E and F and Sections 33 to 36 will apply, subject to provisions specifically determined for this purpose in the sale agreement. Described hereunder are the said provisions of the Law that are still relevant, and the amendments thereto according to the sale agreement, which is the agreement for the transfer of the control core of the Bank.

The agreement for the transfer of the control core of the Bank states that the provisions of the Bank Shares Arrangement Law with respect to the appointment of Directors (Chapter E of the Law) shall not apply. As to the provisions of Chapter F regarding General Meeting of shareholders, the agreement states that the provisions relating to the Committee shall apply to representatives of the Government even though they do not constitute the Committee. The provisions of Chapter F state that the Committee is bound to participate in general meetings of shareholders of the Bank, and to vote by power of the shares held by the Government in the manner decided upon by the Committee.

In the event that a proposal was tabled at a General Meeting to change the documents of incorporation of the Bank, the Committee shall vote in accordance with its good judgment, provided only that it should vote against any change that might be detrimental, directly or indirectly, to the rights attached to the shares or the ability to sell them, or to the Government policy relating to the sale of the shares, or to anything relating to structural changes in the banking system, and in the case of doubt, the Committee has the right to consult with the Minister of Finance or with whoever he appoints for this purpose.

As to the matter of approval of Directors' remuneration, the Committee is not permitted to vote for an increase in the remuneration in excess of the increase in the average wage in the economy, unless the results of the Bank justify such an increase.

Section 28 of the Bank Shares Arrangement Law states that the Minister of Finance, with the approval of the Government or of a Ministerial Committee authorized by the Government, shall be permitted to instruct the Committee to request the calling of a General Meeting of shareholders of the Bank, to participate therein and to vote in accordance with his instructions on any matter, including the amendment of the documents of incorporation, if, in his opinion, this is required for the achievement of any of the following objects:

- (1) Effecting the sale of the shares, including the fulfillment of obligations and realization of the rights determined in the sale agreements, and including the passing of resolutions as to changes in the share capital required to facilitate the trading in the shares as well as other related actions;
- (2) The avoidance or minimizing of an actual impairment, direct or indirect, of the rights attached to the shares, of the ability to sell them or of the proceeds of their sale;
- (3) Effecting structural changes, including the sale of material assets of the Bank or a reorganization of the Bank and companies under its control, required by law or which the Government has decided upon before October 31, 1993, however if shares of the Bank were sold to the public in accordance with a Prospectus, this authority shall be acted on only if the proposed structural changes are required by law or were specifically stated in the Prospectus, or if these matters shall not be detrimental to the Bank. This Section shall not apply during the support period;
- (4) Adoption of a policy for the distribution of dividends out of the earnings of the Bank, subject to limitations set by the Supervisor of Banks regarding the preservation of the stability of the Bank;
- (5) The assignment of authority as regards matters mentioned in (1) to (4) above, to the General Meeting of shareholders.

Section 33 of the Bank Shares Arrangement Law states that the Bank and every officer thereof, as well as any company controlled by the Bank and any officer thereof, shall cooperate with whoever is engaged with the sale of the shares of the Bank. It is further stated that the manner of the cooperation of the Bank would be in accordance with the provisions of the agreements signed between the Government and the M. I. Holdings and the Bank, and everything as detailed in the said Section.

Section 34 determines provisions regarding responsibility and indemnification relating to implementation of transactions according to Sections 28 - 33 of the Law.

**THE EFFECTIVE PRICE
OF THE TRANSACTION
FOR THE SALE _OF A
CONTROLLING
INTEREST OF THE
BANK**

On May 17, 2005, M.I. Holdings Ltd. provided the Bank with an opinion given the Goren Capital Group Ltd. which was prepared for M.I. Holdings Ltd. and the Finance Ministry in the matter of "The estimated economic value of the package of shares and options which constitute the controlling interest in the Israel Discount Bank".

In the summary of the Opinion, it is stated that:

- The consideration in the amount of NIS 1,300 million, received by the sellers from the Buyers

for the package of shares and options, reflects an effective price for the transaction of between 74% and 81% of the equity of the Bank at date of the sale, and an effective price for the transaction of between NIS 4.67 and NIS 5.20 per share.

- The estimated effective consideration took into account the weighted value of the options granted to the Buyers, these being based on an estimate of 50% of their value according to the B & S model, which reflects, according to the Goren Capital Group Ltd. estimate, a fair economic value, considering the many restrictions imposed on the options, their exercise and the receipt of the potential benefit inherent in them following their exercise.

This Opinion was attached, with the consent of the authors thereof, to an immediate report issued by the Bank in the above matter on May 23, 2005.

It should be mentioned that the Bank was not a party to the process of the sale and that it was neither involved in commissioning the valuation nor in the formation of the Opinion.

THE PRICE IN THE TRANSACTION FOR THE SALE OF THE BALANCE OF THE STATE'S SHARES IN THE BANK

Pursuant to a notice received by the Bank from the State of Israel on May 11, and May 15, 2006, the State sold shares comprising 6.09% of the issued share capital of the Bank in consideration of approximately NIS 553.7 million. (As abovementioned, the said parcel of shares constitutes the balance of the State's holdings in the shares of the Bank, i.e. the shares held by the State over and above the number of shares in respect of which the State granted the option to the Bronfman-Schron Group). The price of the transaction was determined at NIS 9.268 per share.

EMPLOYEES AGREEMENT

On February 1, 2005, concurrently with the signing of the Agreement for the Sale of a Controlling Interest in the Bank, an agreement was signed between the New Histadrut Federation of Labor (hereinafter: "the Histadrut"), the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance (hereinafter - "the Employees Agreement"), which, among other things, is subject to the approval of the Bank (see hereunder). The Employees Agreement is intended to settle several demands raised on behalf of the employees of the Bank in connection with their rights in light of the sale of the controlling interest in the Bank by the State. Set out below are the provisions of this Agreement:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of the Bank which are held by the State, at a 25% discount, and to a subsidized loan by the Bank to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees. In the Employees Agreement it was declared that the value of the benefit for conceding the purchase of the shares as aforesaid is NIS 120 million (hereinafter - "the State Grant to Employees").
- The employees would be entitled to receive from the Bank a bonus on account of 2004, of one salary to each employee (hereinafter - "the Bonus for 2004"), as well as a special grant with

regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter - "the Special Grant").

- The total value of the Special Grant and the Bonus for 2004 is approximately NIS 130 million (hereinafter together: "the Bank Grant to Employees").

It should be clarified that in a conversation held between the President & CEO of the Bank and the Deputy Accountant General at the Ministry of Finance, it was made clear to the Bank that the amount of the Bank Grant to Employees (amounting as stated above to NIS 130 million) reflects the total cost to the Bank as the employer of these employees. The content of this discussion has been put in writing in a letter sent by the Bank to the Deputy Accountant General.

Amounts in excess of the said NIS 130 million, will be paid by the Government.

- The State Grant to Employees and the Bank Grant to Employees (hereinafter - "the Total Grant") amount to NIS 250 million. The Total Grant shall be paid to the employees subject to the closing of the Agreement for the Sale of the Controlling Interest in the Bank, and on the following dates; (1) an amount of NIS 205 million payable in September 2005 or immediately following the closing, according to the later date; (2) an amount of NIS 45 million payable not later than the end of three years from date of closing, or close to the date of exercise of the option by the purchasers, in the event that the purchasers will exercise their right to exercise the option, in whole or in part, according to the earlier date (in practice, as stated below, the total bonus was paid in full immediately following the closing date).
- The employees entitled to the Total Grant are those who at date of closing are employees of the Bank, of Mercantile Discount Bank and of the wholly owned subsidiaries in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which, at the closing date have been with the Bank for at least one year. The Employees Agreement clarifies that the share in the total bonus relating to the employees of Mercantile Discount Bank shall be paid by the Government and the Bank subject to the signing of a separate agreement with these employees (see "Mercantile Employees Agreement" hereunder).
- The power of the Labor Charter as a collective labor agreement at Discount Bank, shall be extended for a period of five years, namely until December 31, 2009. At the end of this period, the parties shall act with regards to the power of the Labor Charter, in accordance with section 3 thereto.
- The Agreement for the Sale of a Controlling Interest in the Bank is to include a provision that in the event that the control of Israel Discount Bank of New York is sold, then the full cash proceeds of such sale will be transferred to the Bank, and that no dividend shall be distributed out of such proceeds for a period of five years from date of signing the Agreement for the Sale of a Controlling Interest in the Bank, unless otherwise agreed with the Representative Committee of the Employees.
- The labor dispute announced on March 11, 2004, with regard to the privatization of the Bank, shall be terminated immediately upon the approval of the Employees Agreement.

- Immediately following the approval of the Employees Agreement, the employees will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in the Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all. (In this respect, it has been clarified that that the term “employees” in relation to the above, excludes the employees of Mercantile Discount Bank).
- Subject to the approval of the Employees Agreement, the parties to the Employees Agreement have mutually committed that for the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain “industrial peace”. No one-sided actions will be taken or one-sided organizational changes be made by any of the parties that are not compatible with the Labor Charter. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair Labor Relations and orderly work procedures be brought into effect.

The Employees Agreement was subjected to the approval of the authorized institutions of the Bank. On February 7, 2005, the Audit Committee of the Bank and the Board of Directors of the Bank approved the Bank joining the Agreement. The resolution emphasized that the total cost to the Bank (employer’s cost) will be NIS 130 million (and shall not exceed that amount). On April 5, 2005, the General Meeting of Shareholders of the Bank approved the Bank joining the Employees Agreement. Within the approval, it was stated that the total cost to the Bank (employer’s cost) will be NIS 130 million (and shall not exceed that amount).

The Employees Agreement was also subject to the approval of the Finance Committee of the Knesset. The Finance Committee approved the Employee Agreement.

Soon after the closing of the agreement for the sale of a controlling interest in the Bank, which occurred in the first quarter of 2006, the Bank and its relevant subsidiaries paid the overall bonus agreed upon in the Employees Agreement. The total cost of this bonus, including related expenses (payroll VAT and National Insurance contributions) amounted to NIS 305 million. Accordingly, the bonus that is to be paid by the State will amount to NIS 175 million, of which NIS 120 was paid in March 2006, and the balance will be paid upon the exercise of the option by the Bronfman-Schron Group.

Mercantile Employees Agreement. On May 22, 2005, the Histadrut, The Representative Committee of Mercantile Discount Bank Employees and the Accountant General at the Ministry of Finance signed an agreement, which, inter-alia, is subject to Mercantile Discount Bank’s approval (see hereunder). The Mercantile Employees Agreement is intended to settle several demands raised by employees of this bank regarding their rights in light of the sale of the controlling interest in the Bank by the State.

The terms of the Mercantile Employees Agreement are as follows:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of Discount Bank which are held by the State, at a 25% discount, and to a subsidized loan to finance this purchase, as is customary in privatization of banks being part of the “Share Arrangement”.
- In exchange for the above-mentioned concession, the employees will receive from the

Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees.

- The employees would be entitled to receive from Mercantile Discount Bank a bonus on account of 2004, of one salary to each employee (hereinafter - "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter - "the Special Grant").
- The total amount of the bonus payable to the employees of Mercantile Discount Bank will be the proportional amount applicable to the Mercantile Discount Bank out of the total amount of the bonus (NIS 250 million) as defined in the said Employee Agreement. The said bonus will be paid to the employees subject to the closing of the agreement for the sale of a controlling interest in the Bank, and at dates specified in the Agreement (regarding acceleration of part of the bonus payment, see details of the conditions of the Employee Agreement, above).
- The employees entitled to the Total Grant are those who, at date of closing, are employees of Mercantile Discount Bank and of the wholly owned subsidiaries of Mercantile Discount Bank in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which, at the closing date have been with the Bank for at least one year.
- The validity of the collective agreements at Mercantile Discount Bank (as the term is defined in the collective agreement dated December 21, 2004 and all its Annexes) will be extended for a specified period until December 31, 2009. At the end of this period, the parties shall act as regards to the validity of the collective agreements, in accordance with the terms of Section 5 of the labor agreement dated May 17, 1968.
- The labor dispute announced at Mercantile Discount Bank on March 29, 2004, with regard to the privatization of Discount Bank, shall be terminated immediately upon the approval of the Mercantile Employees Agreement.
- Immediately following the approval of the Mercantile Employees Agreement, the employees of Mercantile Discount Bank will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in Discount Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all.
- Subject to the approval of the Mercantile Employees Agreement, the parties to the Mercantile Employees Agreement have mutually committed that in the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes made by any of the parties that are not compatible with the collective labor agreements. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair Labor Relations and orderly work procedures be brought into effect.

- The validity of the Mercantile Discount Bank Employees' Agreement was subject to approval of the authorized institutions of this bank, approval of Mercantile Discount Bank Employees' Council and the approval of the Finance Committee of the Knesset. On May 30, 2005, the Representative Committee of Mercantile Discount Bank Employees approved the Mercantile Employee Agreement. The Board of Directors of Mercantile Discount Bank approved the agreement on June 9, 2005, and the General Meeting of shareholders of Mercantile Discount Bank approved the agreement on June 20, 2005. The Finance Committee of the Knesset approved the Agreement.

In an Annex to the Mercantile Discount Bank Employees Agreement, which the signatories thereto (the New Histadrut Federation of Labor, Mercantile Discount Bank Employees' Committee and Mercantile Discount Bank) agreed to be an integral part of the said agreement, it has been agreed that despite the time schedule determined in the Mercantile Discount Bank Employees' Agreement, the date of payment of one month salary shall be advanced, and that following the approvals by the Mercantile Discount Bank institutions and by the Employees' Council of Mercantile Discount Bank, it will be payable to whomever at date of payment will comply with the entitlement terms prescribed in the Mercantile Discount Bank Employee Agreement. With this, all the claims of the employees of the Mercantile Discount Bank as regards to the bonus in respect of 2004 have been exhausted. The said payment will be deducted from the payment that will be carried out according to the Mercantile Discount Bank Employees' Agreement.

As stated above, the award to the employees of Mercantile Discount Bank was paid in the first quarter of 2006, soon after the closing date of the agreement for the sale of controlling interest in the Bank.

THE ACCOUNTING TREATMENT OF THE EMPLOYEE AGREEMENT

The financial statements for 2004 included a provision in respect of the bonus for 2004, to the amount of one salary, based on the assessment that in view of the results for the year 2004, the Bank and its other relevant subsidiaries in the Group would have, in any case, paid such a bonus to their employees. The amount of the said bonus is NIS 73 million.

The provision in respect of the balance of the Bank Grant to Employees in the amount of NIS 57 million, comprising the said special bonus, will be reflected in the financial statements for the first quarter of 2006, in which the conditions precedent in the Employees Agreement were fulfilled, and in particular the closing of the transaction for the sale of a Controlling Interest in the Bank.

As to the State Grant to Employees, the Bank was informed by the Supervisor of Banks that the Grant to be paid by the State (an amount of NIS 175 million, including employer related costs) is considered "a transaction with a controlling party". Therefore the grant paid by the State is to be recorded as part of payroll expenses against a capital reserve.

The expense regarding the State Grant to Employees will be recorded in the financial statements of the Bank, in accordance with the said directive of the Supervisor of Banks, in the first quarter of 2006, along with recording the provision for the special bonus.

LEGISLATION AND SUPERVISION

GENERAL

The Bank operates within the framework of Laws, Regulations and Directives, certain of which are exclusive for 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 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 and on its own behalf (for example: investment consulting and customer portfolio management, pension consulting, 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, purchasers of residential units, the agricultural sector) and various tax laws.

The operations of the Bank are subject to supervision and audit by the Supervisor of Banks as well as by other supervisory authorities regarding specific fields of operations, such as the Securities Authority and the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance. These entities perform, from time to time, audits at the Bank relating to various fields of operation.

Within the framework of the legislation passed in the wake of the Bechar Commission (see below), a monetary sanction has been prescribed by most of the laws applying to the operations of the Bank, in respect of violations of the provisions of the laws and secondary legislation (including guidelines and circulars) issued or to be issued under them.

Following is a summary of legislation changes and relevant legislation initiatives during the reported period, which have a significant effect or might have a significant effect on the operations of the Bank.

**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 General Director of the Ministry of Finance (the Bachar Committee) and during the year 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: The Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Capital Markets in Israel (Legislation amendments), 2005; The Supervision of Financial Services Law (Provident Funds), 2005; The Supervision of Financial Services Law (Consulting and Marketing of Pension Schemes), 2005. In the course of 2005 and also in 2006 and 2007, Rules and Regulations were published in order to complete the arrangements through secondary legislation.

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 form of activity which existed until then 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 field 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.

Also passed in the course of 2007 and at the beginning of 2008, legislation and regulatory amendments designed to change the arrangements in the field of pension savings and an Expansion Order according to which the agreement between the New Federation of Labor and the Economic Organizations Coordination Bureau is to apply to all employees and employers. The said agreement relates to the institution of compulsory pension payment for every employee starting January 1, 2008.

For a condensed review of the principle changes in legislation and their implications, see Note 33 to the financial statements. For details regarding the Bank's preparations in respect of the Israeli capital market reform and changes in legislation, see "Non-financial companies sub-segment" under "Activity of the Group according to Principal Segments of Operation" and "Operations in the Capital Market" under "Further details regarding activity in certain products".

The Ariav Committee. On November 20, 2007, the Governor of the Bank of Israel and the Minister of Finance appointed a Committee for developing and increasing competition in the banking industry and in the capital market in Israel, to be headed by Mr. Yarom Ariav, Director General of the Ministry of Finance. The Committee was requested to examine and recommend the steps required to develop the capital market and to increase its appeal to foreign investors in order to position it as a significant global player and to increase competition and efficiency therein. The Committee was requested to submit its recommendations by August 31, 2008.

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.

During 2004, the Antitrust Commissioner informed that he is considering using his authority under the Restrictive Trade Practices Law (Antitrust Law) in order to determine that five banks, among which the Bank is included, form a "concentrated group", and following this even published a proposal for the amendment of the Restrictive Trade Practices Law (Antitrust Law) in the matter of regulating his authority with respect to "concentrated groups".

In July 2005, the Supervisor of Banks and the banks reached an arrangement, with respect to commissions charged from household accounts. The Supervisor informed the Knesset Economics Committee of this arrangement, and on July 14, 2005, issued to the banks a letter detailing the principles for the implementation of the "package deal" in the matter of commissions pertaining to current accounts of private customers.

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 the competition 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 small 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.

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 was extended by three additional months (with the approval of the Knesset Economics Committee). Following the enactment of the Law, the Governor of the Bank of Israel published on January 8, 2008, the Banking Rules (Customer Service)(Commissions), 2008.

In addition to the Rules, the full commission tariff (applying to customers receiving full banking service) and the shortened tariffs (applying to customers receiving partial banking services, such as: current account services, housing loan services and credit card services only) were published. The customers to which these tariffs apply include two segments of customers: individuals and corporations the annual income turnover of which does not exceed NIS 1 million (hereinafter: "small businesses") Alongside the publication of the said rules, the Supervisor of Banks announced the withdrawal of Proper Banking Management Directive No. 414 regarding "The schedule of commissions of a bank", which has in fact been replaced by the said rules. Certain Sections of Proper Banking Management Directive No. 415 regarding "Commission procedures" have also been withdrawn.

Banking corporations must inform their customers by April 5, 2008, of the service charges included in the tariffs. The Governor of the Bank of Israel, with the approval of the Knesset Economics Committee, may defer by Order the effective date for a period not exceeding three additional months. Upon the request of the banking corporations, the Governor of the Bank of Israel has applied to the Economic Committee of the Knesset asking its approval for a deferment of the effective date for a period of three months, until July 5, 2008. The Economic Committee consented to a deferment until June 5, 2008, only.

The Bank has begun preparing for the establishment of a tariff in accordance with the format determined in the said directives. Within the framework of the preparation of banks for determining tariffs as above, various questions were raised at the bank and at other banks regarding the interpretation of the tariff determined in the directives. In view of the questions referred to the Supervisor of Banks by the various banking corporations, a circular letter was published on March 4, 2008, which included clarifications regarding the new commissions circular. For further details regarding the implications of the new Law and tariffs to be determined under it on commission income see "Activities of the Group according to principal segments of operation" under "Retails sector – Household segment".

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 Constitution, Law and Justice Committee.

Law proposals in respect of securing alternative housing. In October 2006, the "Arrangements in the Economy" law for 2007 was published, which included an extensive amendment of the Execution Law. The Bill passed its first reading together with the Budget Law. Following this the amendment of the execution law was detached from the "Arrangements in the Economy" law, and the discussion thereof was continued under separate legislation proceedings in the Knesset Constitution, Law and Justice Committee.

Within the framework of the law proposal, the matter of securing alternative housing in the case of foreclosure of a residential unit has also been discussed. According to the Bill, the Minister of Justice shall be authorized, in consultation with the Minister of Finance and the Minister of Construction and Housing, to formulate provisions in the matter of securing alternative housing, so that the borrower and members of family residing with him are not left homeless, including by way of committing the bank winning the case to pay rent in an amount and for a period to be determined. This also in cases where the mortgage and pledge documents determine that securing alternative housing will not apply.

At this stage it is not possible to predict what the final version of the law amendment would be, if indeed approved, and what the directives to be formulated by the Minister of Justice in accordance therewith, as to the duty to pay rent to borrowers evicted from their houses would be.

PROHIBITION OF MONEY LAUNDERING AND PROHIBITION OF THE FINANCING OF TERROR ACTIVITIES

Prohibition of money laundering. The Prohibition of Money Laundering Law, 2000 (hereinafter: "The Prohibition of Money Laundering Law") came into force on August 17, 2000. The Law, inter alia, provides that a person knowingly effecting an operation with prohibited property (i.e., an asset resulting, directly or indirectly, from the commitment of a transgression, an asset that was utilized for the commitment of a transgression and an asset that enabled commitment of a transgression), knowing that it is prohibited property, or with the object that there will be no report or to procure an incorrect report, commits a criminal offence. The Law provides, inter alia, that a person reporting actions as aforesaid shall be exempt from liability. Monetary sanctions may be imposed on a banking corporation in respect of violations of the provisions of the Law, the Regulations and Orders.

Following the legislation, regulations were enacted, orders were issued and proper banking management directives were determined (directive no. 411), applying to banking corporations and other entities, including subsidiaries of the Bank. In this respect, principles have, among other

things, been determined, regarding the identification, reporting and recording management, determination of policy, monitoring certain accounts and the treatment thereof, and more. The Proper Banking Management Directive instructs banks to prepare, among other things, for the forming of a group policy regarding these issues and for the supervision of its implementation, and for the installation of a computerized system to assist in the monitoring and discovery of unusual activities in customers' accounts.

The Bank and certain of its subsidiaries have appointed officers responsible for the compliance with the requirements of the Law, and they prepared and are preparing for the implementation of the said provisions, including the updating of customer data, verification of customer identity, determining procedures and installing appropriate computer programs.

Prohibition of the financing of terror activities. In December 29, 2004, the Knesset passed the Prohibition of the Financing of Terror Activities Act, 2004 (hereinafter: "the Prohibition of the Financing of Terror Activities Act"), which came into force at the beginning of August 2005. According to this Law, anyone who takes action as regards assets of a person knowingly that such a person is active in terror activities or has been declared as such (according to a procedure determined in the Law) is committing a felony. It is also determined that a bank is obligated to report any attempt to act as above and/or or any such action actually taken, and that the non-reporting also constitutes a felony.

The implementation of this Law required the Bank additional EDP preparations, training of staff as to everything connected with this subject (which is not similar to money laundering activities) and for the promulgation of additional operating procedures.

Banks within the Palestinian Authority. The Law evoked many ambiguities as to what is required from the banks, in particular, as to the ability of a Bank to locate and prevent transactions of terrorists, whose names do not appear on lists published by law, and the capability of the Bank to monitor and prevent the transfer of funds to and from residents of the Palestinian Authority, which might be used for the encouragement of terror activities. In May 2006 the Bank informed the banks operating in the Palestinian Authority, to which it provides clearing services, that these services would be terminated within periods of three and six months.

Following the announcements by the Bank and by other banks (hereinafter – "the representative banks"), the Governor of the Bank of Israel has asked the representative banks to reconsider their position. Concurrently, the Bank of Israel together with the Prevention of Money Laundering Authority, the Ministry of Justice and the Ministry of Finance, initiated the amendment of the existing provisions and regulations with a view of reducing the uncertainty and risk to which the representative banks are exposed while providing clearing services to the banks operating in the area of the Palestinian Authority and to regularize the duties and operations in this area.

In view of the above, the Bank informed the Palestinian banks that the engagement with them would be extended until December 31, 2006.

In December 2006, a special permit was granted concerning the activity of correspondent banks including the Bank and Mercantile Discount Bank, with the banks of the Palestinian Authority

and their customers, via a correspondent account conducted by them. An amendment to the Prohibition of Money Laundering Law (Obligations of identification, reporting and maintenance of records by banking corporations for the prevention of money laundering and the financing of terror), 2001, and the Prohibition of the Financing of Terror Regulations (Permission for transactions in assets), 2006 was published. In view of the forthcoming amendments, the Board of Directors had authorized the Management to continue the engagement with the banks of the Palestinian Authority for the granting of clearing representation services, subject to Management's business discretion.

The said amendments to the order and to the regulations include, inter alia, the following:

- Expansion of identification, examination and reporting requirements, following enactment of the Prohibition of Terror Financing Law, including the requirement to ascertain the identity of parties to a transaction against identifying details of terror organizations and persons declared as terror activists; changes in reporting requirements based on the amount of the transaction (a reporting threshold of NIS 5,000 was determined with respect to transactions with high risk countries and territories); addition of relevant terror financing indicators for the purpose of reporting an unusual transaction; restriction on exemptions with respect to transactions for import and export of goods, in order to exclude such transactions between a high risk country or territory;
- Application of the order to credit card companies;
- Extensions/relief in accordance with accrued experience, including the requirement to maintain documentary evidence of examinations to verify identity; determination of verification procedures and details and obtaining alternative documentation; extension of exemption relating to a beneficiary declaration.

The order provides for gradual implementation dates for the various provisions, according to the required preparation period.

Part of the instructions were implemented concurrently with publication of the order. Instructions requiring extensive preparation will be implemented within six or nine months, and the Supervisor of Banks is authorized, in certain circumstances, to extend these periods for additional similar periods.

The Supervisor of Banks has granted the Bank an extension until April 2008, for the implementation of part of the provisions of the Order. On August 27, 2007, the Bank of Israel issued instructions with respect to regularizing the money transfer operation system between banks in Israel and banks operating in the areas of the Palestinian Authority, this in order to act, to the extent possible, in identifying and monitoring transactions suspected as financing terror activities. The said instructions came into effect in February 2008.

In view of the decision of the Security Cabinet to declare the Hamas in the Gaza Strip a hostile entity, the Bank's Board of Directors decided on October 10, 2007, to terminate all activities with banks incorporated in the Gaza Strip and with branches of other banks located therein. The Board of the Bank also instructed to examine the termination of activities with all banks operating within the Palestinian Authority. On October 15, 2007, the Bank applied to the Chairman of the Clearing Committee at the Bank of Israel, as is the practice, requesting him to inform the banks as to the

termination of the representation as abovesaid. On October 25, 2007, the Bank of Israel notified that the request is being examined and that at this stage it would not be carried out. No reasons had been given for this notice nor any date given for the fulfillment of the request. Concurrently, and in continuation, the Bank was requested by the Bank of Israel to continue the said representation. As a result of the above, the Bank continues to transact operations with banks operating in Gaza, excluding the supply of cash that had been stopped immediately.

On November 21, 2007, the Supervisor of Banks informed that the Bank of Israel is acting in a concerted effort with the Ministry of Finance and additional relevant Government offices to establish correspondent banking relations between the banks operating within the Palestinian Authority and the Postal Bank. The Bank has been requested to continue correspondent relations with banks operating in the Palestinian Authority until completion of the process.

The Bank's preparations. The Bank is preparing for the implementation of that which is required from it in accordance with the Law for the Prohibition of Money Laundering and the Law for the Prevention of Financing of Terror and the related secondary legislation. The Bank is acting to acquaint all relevant employees with the procedures relating to money laundering prohibition and the prevention of terror financing. In this respect, systems for the identification and location of customers and activities and reporting them to the Authorities are being developed and currently improved, work procedures are being brought up to date, and new procedures determined, where necessary, and study and training means are provided to managers and employees. Considering the many changes that are taking place in the primary and secondary legislation regarding the prohibition of money laundering and regarding the prevention of financing of terror, the preparations and assimilation is a continuous activity, both by the Bank and its relevant subsidiaries.

The extensions of the Bank abroad have completed in 2006 the performance of an audit performed by independent auditors, with respect to the compliance of the extensions of the Bank with regulations relating to the prohibition of money laundering and of the finance of terror activities, applying in each of the extensions' location, as well as with the Group's policy on these matters. The audit reports that were issued do not disclose material findings. The audit reports were tabled for discussion at the foreign extensions committee of the Board.

Proposal for the 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 authorities of the Prohibition of Money Laundering Authority.

Audit regarding the implementation of the Prohibition of Money Laundering Law. During the second half of 2005 and in the first months of 2006 the Audit Department of the Bank of Israel conducted an extensive audit at the Bank regarding the Bank's handling of the prohibition on money laundering. The audit report in the matter was submitted to the Bank in July 2007. In

September 2007, the Bank submitted to the Bank of Israel its response to the audit report. 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.

A notice, as stated above, was forwarded to the Bank on February 6, 2008, which detailed the deficiencies found in the course of the audit, which prima facie constitute a violation of the Prohibition of Money Laundering Order (obligations of identification, reporting and maintenance of records of banking corporations for the prevention of money laundering and the financing of terror), 2001, and of the Prohibition of Money Laundering Order (The manner and dates for reporting to the data base by banks and by the entities detailed in the third Addendum to the Law), 2002. The Bank was requested to submit in writing its response to the above and its request to appear before the Committee for the Imposition of Monetary Sanctions. The Bank has not yet submit its response and a date for discussion by the Committee has not yet been fixed. The Bank believes that to the extent that sanctions would be imposed on it, these would not be in material amounts.

For details regarding violations of the Prohibition of Money Laundering Law in Mercantile Discount Bank, see "Mercantile Discount Bank" under "Main Investee Companies". For details regarding an investigation conducted at IDB New York in matters related to the prohibition of money laundering laws, see "Discount BankCorp Inc." under "Principal investee companies" hereunder.

CANCELLATION OF THE "ADJUSTMENTS LAW"

The tax liability of corporations in Israel is computed, inter-alia, in accordance with the provisions of the "Adjustments Law" (enacted following previous tax laws in the matter), that was passed in the period where very high inflation rates prevailed in Israel and was intended to avoid the payment of tax on inflationary profits. In view of the continued reduction in inflation rates to rates acceptable in the western world and the expectation for the continued stability trend, the Ministry of Finance initiated the cancellation of the Adjustments Law.

On March 6, 2008, the Income Tax Law (Adjustments for Inflation)(Amendment No. 20), 2008 (hereinafter: "the Amendment") was published. According to the Amendment, the Inflationary Adjustments Law will no longer be applicable subsequent to the 2007 tax year, except for certain transitional provisions the objective of which is to prevent distortions in the tax calculation.

Further, according to the Amendment, commencing with the 2008 tax year, the adjustment of income for the effects of inflation for tax purposes will no longer be calculated. Additionally, depreciation on fixed assets and tax loss carryforwards will no longer be linked to future changes in the CPI, such that these amounts will continue to be linked only to the CPI as of the end of the 2007 tax year and will not be linked to CPI changes after this date.

PAYMENT SYSTEMS LAW, 2008

In February 2008, the above Law was enacted, which is intended to regularize the subject of the payments system and inter-bank transfers, in which very high amounts are being settled daily, to define the roll of the central bank ("the operator") with respect to the said system in contrast to the banks ("the participants"), and to determine directives that would secure that payment orders passed through the system are final and definite and in line with standards accepted around the

world in this respect. Soon after the passing of the Law, the Official Gazette published a declaration regarding the Continuous Linked Settlement CLS system operated by CLS Bank and the RTGS system operated by the Bank of Israel as controlled and designated systems. For additional details, see hereunder "Reform of bank payment and clearing system" under "Miscellaneous").

**LEGISLATION AND
REGULATION IN THE
MATTER OF
PROTECTION OF
INVESTORS IN
RESIDENTIAL UNITS**

Following the collapse of a large construction company, various legislation proposals, both private and Governmental, were initiated in the matter of protecting investments in residential units.

On February 4, 2008, the Supervisor of Banks published Proper Banking Management Directive No. 326 in the matter of "Project financing", applying to project financing agreements signed as from June 1, 2008. The Directive applies to the financing of construction contractors by the method known as "closed project financing", with respect to assets, transactions and rights subject to the Sales Law (Residential units)(Securing investments of residential units purchasers), 1974 (hereinafter: "the Sales Law").

The Directive is intended to ensure that payments by purchasers of residential units would only be deposited in project's bank account, and that either a bank guarantee under the Sales Law would be granted in respect of such deposits or the purchaser will receive other security as prescribed by the Law. Accordingly, banking corporations are required to obligate contractors in financing agreements to include in the sale contracts made with the contractor's customers various provisions including the obligation to effect payments for the purchased property only by payment coupons issued by the lending bank. These payment coupons are to include, inter-alia, unequivocal identification of the project financing account into which the payments are to be made, as well as identification of the specific residential unit in respect of which payment is effected. The Bank, Mercantile Discount Bank and Discount Mortgage Bank are preparing for the implementation of this Directive.

Concurrently, the Official Gazette published on February 4, 2008, a private Bill of Members of Knesset on behalf of the Knesset Finance Committee, which includes proposed amendments to the Sales Law, including establishing by law the method of payment through payment coupons. The Bill, which was preceded by a Preliminary Bill of November 2007, was tabled before the Knesset for approval in second and third readings. The Bill imposes a duty on a bank financing a construction project by way of a project financing account, to provide a purchaser with a bank guarantee, according to the Sales Law, with respect to each payment made using the particular payment coupon or to verify that another security in accordance with the Law has been given to the purchaser.

A bank (or another corporation) providing a purchaser of a residential unit with a loan to finance such purchase, must acquaint the borrower with the Law and with his rights under it, and to forward the loan monies to the seller of the unit only after verifying that proper security under the Law had been provided to the purchaser. The limit determined in the Sales Law, in excess of which a seller has the duty to provide a bank guarantee or another security and the bank financing the seller or the purchaser has the duty to verify that such security has in fact been provided, has

been lowered from 15% of the price of residential unit being sold to 7%. The Construction and Housing Minister shall determine, with the consent of the Supervisor of Banks, the wording of the guarantee to be issued to purchasers by banking corporations.

Violation of the duties imposed on banks by the said Amendment will be considered a criminal offence in respect of which a fine may be imposed. In addition, the Supervisor of Bank has been authorized to impose a monetary sanction on a bank violating the duties imposed by the Amendment to the Law. The Supervisor is also authorized to instruct a bank violating such provisions to correct the violation and to dictate the manner for correcting it.

Furthermore, following a memorandum issued by the Ministry of Construction and Housing as early as in August 2007, a Government Bill for the amendment of the Sales Law was published in the Official Gazette on February 13, 2008. The Bill was also passed for second and third readings by the Knesset, and presumably both Bills would be tabled for approval at the same time.

At the present time, the Supervisor of Banks is formulating a uniform version of the guarantee and he intends issuing a binding directive in the matter to all banking corporations. According to the proposed version the bank guarantee may be acted upon in case the construction contractor is utterly unable to deliver the property even if he is not insolvent. It will also be possible to act upon the guarantee in cases where the agreement for the sale of the unit is legally annulled but the contractor is unable to refund the amounts received from the purchaser.

MUTUAL INVESTMENT TRUST REGULATIONS

In November 2007 a series of Regulations under the Mutual Investment Trust Law, 1994, was published in which came into effective on December 31, 2007.

The new Regulations are intended to increase competition, to broaden the offer of mutual fund related financial products and to remove obstacles complicating operations in this market. Among other things, the new Regulations regulate the operations of mutual funds of the "cluster funds" and the "monetary funds" types. In his address to the Knesset Finance Committee, the Minister of Finance noted that the "monetary funds" are of great importance in increasing competition in the market and they may constitute a competitive alternative to short-term bank deposits, as well as opening an additional channel for raising credit by way of debt notes (non-marketable commercial papers) as a source for the financing of working capital.

Within the framework of the amendment, an exemption from distribution commission has been prescribed for fund units held by another fund (a cluster of funds), for units of an imitating fund type 2 (the maximum level of exposure to shares of which, according to criteria determined by the new Regulations, is higher than 3), and fund units held by personally managed provident funds. A further lower grade of distribution commission at the rate of 0.125%, has been prescribed, which banks could charge customers acquiring units in "monetary funds".

**DIRECTIVE OF THE
SECURITIES
AUTHORITY
REGARDING
OBTAINING
INFORMATION ON
REQUIREMENTS AND
INSTRUCTIONS OF A
CUSTOMER SEEKING
INVESTMENT
CONSULTING**

In January 2007, the Israel Securities Authority published directives for obtaining information on requirements and instructions of a customer seeking investment consulting. The directives detail and expand the responsibilities of an investment consultant in respect of obtaining information on requirements and instructions of a customer seeking consulting and advice. The directive requires, inter alia, adoption of an investment policy for the customer by determining several possible risk levels, in accordance with the customer's requirements and needs, and coordination of several potential investments channels for each risk level. The directives relate to customers applying for investment consulting as from January 1, 2008, and to customers already receiving consulting services during 18 additional months.

The Bank and Mercantile Discount Bank prepared for the implementation of the requirements according to the directive. As part of the above, a computer system has been installed at the Bank and at Mercantile Discount Bank, which supports carrying out the requirements of the Directive, which will enable providing improved service to customers in the field of investment consulting.

**REGULATIONS
REGARDING
DOCUMENTATION OF
INVESTMENT
CONSULTING
CONVERSATIONS**

In December 2007, Regulations were published with respect to documenting an investment consulting conversations. The regulations will come into effect on January 1, 2009. The Regulations broaden and detail the requirements from license holders in the matter of documenting an investment consult conversations as well as the recording of portfolio management activities. The Bank and its relevant subsidiaries are preparing the implementation of the requirements pursuant to the Regulations.

**"PRINCIPLES OF
CONDUCT"
DOCUMENT**

In 1985, the Bank voluntarily agreed to an arrangement with the Attorney General of the Government and with the Antitrust Commissioner ("the Commissioner") regarding principles of conduct. This arrangement determined the areas in which banks are not permitted to act jointly on the one hand, and the areas in which banks have a legitimate interest to act among themselves on the other hand.

The arrangement also included provisions for the recording and reporting of certain meetings between representatives of various banks.

In 2001, the Commissioner informed the banks that the principles of conduct do not constitute a law, they are not enforceable, and the Commissioner is no longer bound by them.

The Bank together with the three other banks applied to the Commissioner for an exemption from a binding arrangement as regards agreements to which the Bank is a party, concerning the companies Automatic Bank Services Ltd. and Bank Clearing Center Ltd. In addition, the Bank, similarly to other banks, has applied for exemption from a binding arrangement as regards the authorization for debiting accounts. For further details see hereunder.

Continued holding and joint activity of Automatic Bank Services Ltd. (ABS). On June 19, 2002 the Commissioner informed the banks that he authorizes them to operate within the framework of ABS subject to the provisions determined by him, which include a limitation on the areas of activity of ABS; the non-distribution of profits in any form or manner to the shareholders of ABS

(five banks including the Bank); imposing an obligation on ABS to allow any person (and not only a bank) to connect to the access services both as an operator of automatic teller machines and as an issuer; charging identical commissions to all users; the obligation of providing full information to whoever connects to the service; a limitation on the information to be transmitted to or passed between the shareholders of ABS.

The Bank has submitted to the Commissioner a computation providing the basis for the commission collected in respect of the withdrawal of cash using automatic teller machines. On September 17, 2002, the Commissioner informed the Bank that he was convinced of the reasonableness of the commission, and approved its amount for a period of two years from the date of the exemption granted under the ABS agreement. On June 17, 2004, the Commissioner extended the validity of the said exemption, under the same terms, for an additional period of three years.

On June 19, 2002 the Antitrust Commissioner 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, following which, the exemption was extended for a further three months, during which the examination would be intensified. For additional details, see below.

The continued holding and joint activity of the Bank Clearing Center (BCC). On June 19, 2002, the Commissioner 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, including limitation on the areas of operation of BCC; an obligation to allow access for any bank to the said clearing services; the non-distribution of profit or of any other payments to the shareholders; identical commissions to all users of the clearing services; the possibility of charging “access fee” for a new connection (if no agreement will be reached between the said newly connected bank and BCC, an arbitrator will be appointed, with the approval of the Commissioner, who shall determine the amount of the access fee and the parameters to be considered in determining such fee; the obligation to present full information to the bank being connected; a limitation on the information to be passed between the shareholders of BCC.

On June 17, 2004, the Commissioner extended the validity of the said exemption, under the same terms, for an additional period of three years.

On June 19, 2002, the Antitrust Commissioner 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, following which, the exemption was extended for a further three months, during which the examination would be intensified.

As part of the examination by the Commissioner, the Antitrust Authority sent the Bank a letter dated September 23, 2007, in which the Bank was required to provide the Commissioner with details and data regarding the present structure of ownership of ABS and BCC, as well as details regarding the importance of this structure of ownership to the current operations of the Bank and the efficiency stemming from the joint management of ABS and BCC by the banks. The Bank was also required to submit to the Commissioner details and data regarding the importance and volume of the services provided by ABS and BCC to the Bank. To the Bank's best knowledge, a similar letter was sent to the other partner banks in ABS and BCC. The Bank has submitted the requested data to the Commissioner. On December 18, 2007, the Commissioner informed verbally that an exemption from approval of a binding arrangement with respect to the operations of Automatic Bank Services and Bank Clearing Center shall be granted for an additional period of three years. On January 6, 2008, the draft of the terms attached to the exemption from approval of a binding arrangement was forwarded for comments to the banks that jointly own the above two operations. The Bank has forwarded to the Antitrust Authority its objections to these terms, and to the best of its knowledge other banks which participate in ABS and in BCC, have done the same. The material changes to the original terms of exemption, in respect of which the Bank has filed its objections, are the prohibition on the appointment of senior officers of a banking corporation as directors of the said companies, and the requirement that the CEO of the banking corporation as well as the Director acting on behalf of that corporation sign a declaration in respect of their responsibility for the banking corporation's compliance with the terms of the exemption.

Consortium agreements. On August 18, 2002, the Commissioner informed Bank Leumi, Bank Hapoalim and the Bank that at this stage he is not able to determine the terms for a "class exemption" regarding consortium agreements. Therefore, he does not intend to enforce the terms of the exemption for six months or until the establishment of a "class exemption", whichever is earlier, subject to the fulfilment of the following provisions: the joining of a consortium is vital in the sense that otherwise it would not be possible to grant credit to the customer at reasonable terms; the customer agrees to the consortium; the customer shall be entitled to negotiate separately with the member banks of the consortium; and where both Bank Leumi and Bank Hapoalim are members of the consortium – the minimum amount of credit to be granted is to be greater than NIS 150 million.

On March 5, 2003, the Commissioner extended the period of effect of his said notice until December 31, 2006, determining that the said limitation on the Consortium in which Bank Hapoalim and Leumi participate, will not apply to an arrangement regarding the repayment of loans granted by them to the same customer prior to August 18, 2002.

Since then the Commissioner has extended from time to time the validity of his notice.

During the period, banks were asked to address the possibility that the said terms would be regularized by a class exemption, and to submit to the Commissioner various details regarding the consortium arrangements made. The exemption was further extended in March 2007, until March 8, 2008, and the minimum amount for a consortium, in which both Bank Hapoalim and Bank Leumi

participate, was raised to NIS 300 million. To the best knowledge of the Bank, the Commissioner intends to extend the exemption.

In addition, on March 2, 2008 the Commissioner published the terms under which she would refrain from taking action against a consortium for credit between banks and insurance companies and between insurance companies themselves. These terms are substantially similar to the terms applying to the consortium arrangements between the banks, though the Commissioner does not specify the minimum amount required for participating in such a consortium as above said. The Commissioner's notice will be effective for three years, and it was clarified that it is intended to add to the terms determined with respect to a consortium for the granting of credit in which banks are the sole participants.

**REGULATION
PROPOSALS WITH
RESPECT TO THE
PROTECTION OF THE
ENVIRONMENT**

During the past year there was an increase in the voices calling for the reinforcement of the protection of the environment, including by way of imposing various duties on banks as the financiers of corporations and operations polluting the environment. The banking corporations in Israel have decided to face the challenge, and on December 17, 2007, it was published that the Bankers Union and the Supervisor of Banks decided to cooperate in a process aimed at increasing the banks' awareness of environmental risks to which they might be exposed as a result of financing (directly or by way of investment) entities the operation of which might cause environmental harm. The joint initiative is intended to find the way by which banks would take into consideration environmental values, as part of their social contribution, alongside a prudent risk management.

In continuation, the Supervisor of Banks published in January 2008, a draft Proper Banking Management Instruction in the matter of management of environmental risks by banking corporations. Concurrently, various legislative and regulatory initiatives were started during the year, including a private Bill on the subject of rehabilitation of polluted ground, in the framework of which it is proposed to include also the financing entity among the entities that might be considered responsible for a piece of ground being polluted and/or its rehabilitation.

**ABUNDANCE OF
LEGISLATION
INITIATIVES**

The year 2007, as its preceding years, was typified by an abundance of private law proposals (part of which supported by the Government) regarding the imposition of restrictions on banks (by law or by regulations under it) applying to various fields of activity, including: restrictions on the granting of credit, restrictions on the charging of commissions, restrictions on the payment and/or collection of interest, etc. These law proposals and other similar ones, if passed, might have a material adverse effect on the activities of the Bank and its subsidiaries and on their results of operations in the future. The Bank is not able to evaluate which of these law proposals will in fact be passed and what would be the scope of their effect.

The year 2007 was also characterized by an abundance of regulatory directives, both Proper Banking Management Directives and various instructions regarding reporting to the public the issued by the Supervisor of Banks. To these were added instructions by the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance and by the Securities Authority,

as to issues under their control. The implementation of the various instructions requires, on more than one occasion, preparations involving the investment of resources, and sometimes it has a possible adverse impact on the income of banking corporations from various sources.

**CRITICAL
ACCOUNTING
POLICIES AND
CRITICAL
ACCOUNTING
ESTIMATES**

**INSTRUCTIONS OF THE
SUPERVISOR OF BANKS**

On January 7, 2004, the Supervisor of Banks issued a Temporary Instruction in the matter of disclosure of accounting policies on critical issues, which will apply to financial statements of banking corporations for 2003 and thereafter. This Instruction follows an Instruction by the SEC dated December 12, 2001, regarding the same issues. The Instruction relates to two layers: the one – adoption of an accounting policy on critical matters and its application; and the other – the disclosure of such policies.

The Provisional Instruction was amended in January 2008 to include also reference to critical accounting assessments.

GENERAL

The financial statements of the Bank are prepared according to generally accepted accounting principles (summarized in Note 1 to the 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 sometimes 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 preparation of the financial statements.

Application by Management of the accounting principles and the instructions and guidelines of the Supervisor of Banks, requires sometime 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 information and professional judgment. Following is a summary review of evaluations and assessments made as regards “critical” matters:

**PROVISIONS FOR
DOUBTFUL DEBTS**

The provisions for doubtful debts include specific provisions for doubtful debts, a general provision and a supplementary provision.

The specific provision for doubtful debts reflects the evaluation of Management as to the loss

inherent in the credit portfolio, based on rules set by the Supervisor of Banks and on evaluations and assessments. The specific provision in respect of housing loans is made according to a scale (rates of provision and periods in arrears) specified by the Supervisor of Banks. The general provision for doubtful debts comprises 1% of the outstanding debts at December 31, 1990, in inflation adjusted terms. The supplementary provision for doubtful debts is based on various risk characteristics as determined in the instructions of the Supervisor of Banks and according to rates set by him.

Once in every quarter, Management of the Bank examines the credit portfolio with the aim of evaluating the possible loss inherent therein. The process of the loss evaluation includes two stages:

- Identifying customers, the ability of whom to honor their obligation to the Bank has changed, and their resulting classification as “problematic debtors”, in accordance with the classes of debts specified in the instructions of Bank of Israel and the criteria determined therein: “doubtful debts”, “non-performing debts”, “debts that have been restructured”, “debts temporarily in arrears”, “debts under special supervision”.
- Creating provisions that reflect the anticipated loss in respect of “doubtful debts”. In determining the provisions Management relies on information at hand regarding the debtor: his credit rating, history of honoring obligations to the Bank, [Insert E-124] quality of the collateral given by him and the risk level of the economic sector in which he operates. In addition Management takes into account when making the provision, additional factors, such as: The quality of the debtor’s management, his repayment ability and financial flexibility.

The process of assessing the loss inherent in the credit portfolio, as described above, is based on significant assessments that involve extensive uncertainties (such as: the quality of the collateral, repayment ability of the debtor, etc.), and on subjective evaluations, both as regards the category to which the problematic debt was classified (such as: the differentiation between “debt in arrears” and “debt temporarily in arrears”) and as regards the factors used in computing the provision (such as the quality of management of the debtor and the risk level of the sector in which he operates). A change in the assessments or evaluations as stated above, might have a significant effect on the provision for doubtful debts included in the financial statements of the Bank.

In addition to the above, part of the assessments mentioned above relies on economic or market variables and part thereof is updated in as much as the cumulative experience gathered in dealing with the debtor increases. Accordingly, the Bank’s Management examines once every quarter the assessments used in determining the provisions in respect of problematic debts and updates them where necessary.

See the above section “Development of Assets and Liabilities” for details of the overall credit risk of the Group with respect to problematic debts. See the above section “Exposure to Risks and Risk Management” for details regarding the credit risk management at the Bank.

For details regarding the instruction in the matter of “Measurement and disclosure of delinquent debts, credit risk and provision for credit losses”, effective as from the financial statements for January 1, 2010 and thereafter, the principles of which constitute a far reaching change compared to the existing instructions in the matter of classification of problematic debts and the

measurement of provisions for credit losses, see under “Development of assets and liabilities” and below in Note 1 Y to the financial statements.

CONTINGENT LIABILITIES

Against the Bank and against other banks and companies in the Group are pending legal actions on various issues, including class action suits and requests for approval of actions as class action suits. The accounting treatment of contingencies is implemented in accordance with the US Standard FAS 5 – “Accounting for Contingencies” and its related guidelines, and in accordance with the guidelines and clarifications of the Supervisor of Banks, including public reporting directives in the matter of “Accounting for Contingencies”.

In assessing the required provision, it is necessary to examine the probability of a loss and to assess its amount. These evaluations affect both the duty itself of creating a provision in respect of the claim and the mode and scope of the disclosure in the financial statements.

According to FAS 5 there are three levels for evaluating the loss: (1) Remote; (2) Reasonably possible; (3) Probable. The US Standard also rules that if the loss cannot be assessed, no provision should be created in respect thereof, but the matter should be disclosed if it might be significant. For the purpose of assessing possible losses as a result of actions filed against the Bank, Management of the Bank and the managements of other banks and companies in the Group rely on opinions of Counsels representing them in these matters.

In the nature of things, such opinions are subjective and face objective evaluation difficulties. Such difficulties grow immensely in cases of class action suits, due to the following reasons.

According to Israeli law, a plea for the approval of a class action constitutes in fact a preliminary procedure in which the Court examines several prerequisites in order to decide the plea. Inter-alia the Court examines whether the claimant is appropriate and fitting, whether he is in good faith, whether a class action is the fair and appropriate way of dealing with the matter, whether the action reveals joint questions of fact and law, and the Court assesses also the prospects of the action. The Court further determines in the same decision the nature of the group that the claimant would be entitled to represent and on grounds of what cause the action will be filed.

It is understood from the above that most of the parameters are exogenous to the prospects of the action itself, and they are generally clarified in the course of the proceedings (which may continue over several years).

Furthermore, both the manner in which the Court interprets the said prerequisites and the weight that is given to each of them as well as the level of proof required (in view of the little experience and legal precedents), at this early stage, lack uniformity in the legal system, and accordingly it is most difficult to evaluate the prospects of such pleas.

When the Court’s decision in the matter is given, a request for permission to appeal is usually submitted, which is also dealt with over a long period. Only afterwards, if the request for appeal is dismissed, the class action begins to be heard subject to limitations determined in the preliminary procedure.

It should be also mentioned that until 2006, class actions related to specific laws, to specific causes and to various effective dates (the date on which the relevant law adopted the option of a class action suit). Also as to the interpretation of these issues contradicting judgments had been given. The new Law regarding class actions, passed by the Knesset in 2006, regularized all the arrangements made in the matter of class actions in the framework of one law, and extended the causes in respect of which a class action may be brought against banks, over and above those that were included in legislation in the past.

The law also applies to class actions and motions for approval of class actions pending at the Courts at date of its publication. The new provisions determined by the law and the fact that these have recently been tested in Court rulings, add a new dimension of uncertainty to everything concerning the assessment of the prospects and results of class actions and motions for approval of class actions.

The accounting principle adopted by the banking corporations in Israel is indeed the US principle, however it is vital to bring into account in this respect the difference in the characteristics of the US reality in comparison to Israeli reality, and the difficulties that arise as a result.

The US has experience of many years (several decades) regarding the issue of class action suits and there is recognized and tested data, including the rate of compromise agreements and the amounts paid in compromise settlements. Such an experience is completely lacking as regards the law and practice in Israel.

Also the legal procedures in the US are different than those in Israel, allowing each party to interrogate the witnesses of the other party before the case is heard in Court, thus making it possible to evaluate the prospects of the action at an earlier stage.

The issues discussed above create special difficulties in everything related to class action suits and motions for approval of class actions.

As stated, the Management of the Bank and the managements of other banks and companies in the Group rely on opinions of Counsels. Such opinions are subjective and face objective evaluation difficulties.

Accordingly, it is possible that the actual results of certain of the actions would be different from those estimated based on the opinions of Counsels. In view of the volume of actions pending against the Bank, other banks and companies in the Group, it may transpire that the non-materialization of such estimates would have a material effect on the financial results of the Discount Group.

The Management of the Bank and its Counsels, as well as the managements and counsels of other banks and companies in the Group, examine once every quarter the pending actions and update, where necessary, the provisions created therewith in the light of developments.

On January 10, 2006, the Supervisor of Banks distributed a public reporting directive in the matter of "The accounting treatment of contingent claims".

It has been determined in the directive that in evaluating the outstanding legal actions, the management of a banking corporation is to rely upon legal opinions of Counsel, which should determine the probability of the exposure to the risk involved in such actions materializing.

Claims have been classified according to the probability range for a risk exposure materializing, as follows:

- 1) Probable – probability of over 70%;
- 2) Reasonably possible – probability of over 20% and up to and including 70%;
- 3) Remote – probability of 20% or below.

The financial statements include appropriate provisions for claims in respect of which realization of the related risk exposure is probable.

According to the Directive only in rare cases a banking corporation is entitled to state in its financial statements that in its Management's opinion, based on Counsel's opinion, it is not possible to assess the prospects that a risk exposure would materialize in respect of an ordinary legal action and an action approved as a class action. As to a motion for approval of a class action, the banking corporation is entitled to determine that it is not possible to assess the prospects of realization of the exposure to risk in four financial statements (including one annual report) to be published subsequently to the filing of an action together with a plea to have it approved as a class action suit. Such period is not to include the period in which the Court has stayed the proceedings in the matter. Note 19 to the financial statements states separately the outstanding claims, in respect of which a reasonable assessment of the exposure is not possible.

The banking corporations have been asked to determine for themselves a graded disclosure level relating to the classification of the proceedings according to the assessment of the risk involved therein. Accordingly, the financial statements include disclosure of material legal proceedings conducted against the Bank and Group companies, based on the following criteria: as a general rule, a material legal proceeding is one where the amount claimed is in excess of 0.5% of the equity capital of the Bank, and if it is not possible to assess the prospects of the risk materializing; and of 1% of the equity capital if the prospects of the risk materializing are reasonably possible or remote.

The banking corporations have also been asked to provide disclosure regarding the total exposure in respect of claims that have been assessed, in whole or in part (in respect of the relevant part), as "reasonably possible". Disclosure as above is given in Note 19 to the financial statements.

It should be further mentioned that where the Bank is one of the defendants in an action, and the claimants have not attributed an amount to each of the defendants, the evaluation of the claim amount relevant to the Bank has been made to the best of ability, taking into account that consideration of the total amount might mislead and is incorrect in the circumstances, and that the evaluation does not necessarily represent the allocation as finally determined by the Court.

See Note 19 C to the financial statements for details of material legal actions pending against the Bank and against other companies in the Group. For details as to additional proceedings and claims settled during the year, see Section "Legal proceedings" hereunder.

ASSESSMENT OF THE FAIR VALUE OF DERIVATIVE FINANCIAL INSTRUMENTS

The Bank is active to a considerable extent in the derivative financial instruments field, which are presented in the financial statements on a fair value basis as different from the accrual basis. The calculation of the fair value of derivative financial instruments in respect of their foreign currency component is based on interest rates and prices prevailing in the international money markets, and

with respect to their Israel currency component on non-linked interest rates and linked interest rates, determined by the asset and liability management department of the Bank, taking into consideration market prices, liquidity and the existing trading level in the local market. The margin between the sales interest rate and the purchase interest rate comprises a subjective factor, which affects the computation of the fair value of derivative financial instruments.

The fair value of options is based mainly upon the Black and Scholes Model, and is influenced by the inherent fluctuations and interest rates of the base assets. The data regarding the fluctuations in exchange rates of the Israel currency against foreign currencies are determined by the dealing room of the Bank and are controlled by the Middle Office, while comparing them with several sources of information and fluctuation data of one foreign currency against another determined according to the international money markets.

The interest rates in foreign currency and in Israeli currency for the various time periods, constitute also the basis according to which the fair value of the balance sheet items is computed, as well as the cash flows deriving from assets and liabilities of the Bank, as detailed in Notes 18 and 21 to the financial statements.

These interest rates serve also for the computation of the fair value of assets and liabilities hedged against derivative financial instruments, to the extent that they comply with the hedging criteria, as required in the guidelines of the Supervisor of Banks.

EMPLOYEE RIGHTS

Employees of the Bank and of its consolidated Banking subsidiaries in Israel are entitled to long-service bonuses ("Jubilee Bonuses") comprising several monthly salaries and additional paid vacation days, at the end of 20, 30 and 40 years of employment with the Bank. For details as to a new agreement allowing employees the choice of redeeming in cash such vacation days, see "Developments in labor relations" in the Chapter "Human resources" above. Bank employees are also entitled to certain benefits subsequent to their retirement from the Bank. These liabilities depend on several conditions that have to materialize in the future.

The Supervisor of Bank requires the Bank to base the provision for Jubilee bonus on an actuarial computation and to present it at discounted value. The Bank engages the services of an independent actuary in preparing the said provision.

The actuarial computation is based on several parameters, including the probability that all conditions for the payment of the bonus will materialize: life expectancy, retirement age, the rate of employee retirement prior to the prescribed retirement date, the rate of increase in salary anticipated until date of payment of the bonus and the discount rate. These parameters were determined, inter-alia, in a temporary instruction of the Bank of Israel, regarding the discount rate to be used in the computations based on forecasts prepared by the actuary and the experience accumulated in the Bank.

The calculation of the provision for Jubilee bonus is sensitive to each of the values and parameters mentioned above.

An increase of 1% in the discount rate would result in a reduction in liabilities in the amount of

approximately NIS 20 million, while a decrease of 1% in the discount rate would result in an increase in liabilities in the amount of approximately NIS 21 million.

DEFERRED TAXES

Deferred taxes are recorded in respect of temporary differences between the value of assets and liabilities in the balance sheet and their value for tax purposes.

Deferred tax assets in respect of timing differences are recorded only if it is probable that a tax savings will accrue upon reversal of the difference and deferred tax assets in respect of carry forward losses for tax purposes are recorded only if the realization of the tax asset in the foreseeable future is not in doubt.

Accordingly, when deferred tax assets are being recorded, the Bank is required to perform assessments and estimates as to the probability of realization of these assets in the future. For further details see Note 1 P and Note 29 to the financial statements.

LEGAL PROCEEDINGS OUTSTANDING CLAIMS AGAINST THE BANK

Various actions are pending against the Bank and its consolidated subsidiaries, including class action suits and pleas to approve actions as class action, brought against them by customers of the Bank and of its consolidated subsidiaries, past customers as well as allegations with regard to various third parties, who consider themselves harmed or damaged by the actions of the Bank and its consolidated subsidiaries in the ordinary course of their business. Among other things, these actions raise allegations with regard to the unlawful debiting of interest and/or not in accordance with agreements, subjecting one service to another, the failure to execute instructions, applications for the confirmation of attachment orders in respect of attachments served by third parties as regards assets of debtors held, as alleged by them, with the bank, the unlawful debiting of accounts, mistakes in value dates, the invalidity of collateral security and the realization thereof, requests for injunction orders instructing the Bank to refrain from paying out of bank guarantees or documentary credit, as well as to provident funds, securities, construction loans, and applications for the removal of restrictions on an account pursuant to the Dishonored Checks Law, 1981. Management of the Bank believes, based inter-alia on Counsel's opinion and on the opinions of the managements of the consolidated subsidiaries of the Bank, which are also based on counsel's opinion, as the case may be, respectively, that adequate provisions have been included in the financial statements, if required.

Material actions outstanding against the Bank and its consolidated subsidiaries are described in Note 19 to the financial statements.

DEBT COLLECTION PROCEDURES

As part of the debt collection policy of the Bank and its consolidated subsidiaries, legal procedures are instituted in the ordinary course of business for the collection of debts from the borrowers or from guarantors for such debts, including the realization of collateral provided by the borrowers or by any third parties. Included in such procedures are procedures for receiverships, liquidations, the foreclosure of pledged assets, etc.

ADDITIONAL LEGAL PROCEEDINGS TO WHICH THE BANK IS A PARTY

On July 24, 2006, a criminal charge was filed against the Bank and against several of its officers, including one member of the Bank's management and the Bank's Internal Auditor. According to the charge, in 2003 the accused disclosed confidential information regarding the plaintiff's account, taken from the data base of the Bank, without the plaintiff's consent. As alleged, the information was passed on to third parties, which utilized this confidential information willfully and maliciously, for the purpose of ex parte foreclosure, in contradiction to the protection of privacy law and in violation of the Bank's confidentiality commitments towards the plaintiff. On November 19, 2006, the public prosecutor announced that he would not join the proceedings due to lack of public interest. The accused responded to the charges and denied their content and substance. The file will be heard on April 10, 2008.

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN 2007

1. The former President and CEO of IDB New York filed a claim on May 31, 2006 against IDB New York for the payment of damages alleging that the termination of his employment is in violation of the law against discrimination, as well as demanding severance payment in accordance with his employment agreement. In its defense brief and the counter claim filed, IDB New York argued that the former President is not entitled to damages and severance pay as he had violated his employment agreement as well as the duty of trust.

In September 2007, IDB New York reached a settlement with the former President, according to which he will be paid an amount of US\$1.9 million in full and final settlement of all his claims and arguments against that bank. As part of the settlement agreement, the former President and CEO is committed to cooperate with IDB New York and to provide it with information and details as required by it.

2. 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.

3. For details regarding the motion submitted by Yahav Bank to the Supreme Court against the Minister of Finance, the Accountant General at the Ministry of Finance, the Supervisor of Banks and the bank, which has been dismissed, see the Section (Retail banking – the household segment" in the Chapter "activity of the Group according to Principal segments of operations" above.

PROCEEDINGS REGARDING AUTHORITIES

1. For details regarding various proceedings conducted by the Antitrust Commissioner and concerning the Groups activities in the credit card field, see Note 34 to the financial statements and "Credit card operations" under "Further details as to activity in certain products".
2. For details regarding various proceedings conducted by the Antitrust Commissioner concerning the "Principles of Conduct Document", see the chapter "Legislation and supervision" above.
3. On December 1 and 2, 2004, investigators of the Antitrust Authority arrived at units at the Bank and seized a large number of documents and computer material. The search order presented by the investigators was a very wide one and indicated an investigation concerning "binding arrangements". On several occasions in July 2005, investigators of the Antitrust Authority revisited several of the Bank's units and seized documents and computer material. In addition, Bank employees, including a member of Management, were summoned for interrogation at the Antitrust Authority on several dates in July and August 2005.

Additional Bank employees have been summoned for interrogation by the Authority in March 2008. Furthermore, investigators of the Authority visited the bank's premises and requested the commission tariffs of the Bank published for the years 1998-2004.

On March 19, 2008, the Bank received from the Antitrust Authority a summons for a hearing. The summons stated that in view of the findings of the investigation performed by the Authority, the Antitrust Commissioner considers the possibility of applying her authority according to law and determine that binding arrangements had existed between Bank Hapoalim, Bank Leumi, Mizrahi Bank, the First International Bank and the Bank, in the matter of passing information with respect to commissions. The summons detailed matters to which the Commissioner considers, inter-alia, addressing herself with regards to the said determination, and the Bank has been given the opportunity of presenting its position in the matter before she applies her authority as stated above. The bank has not yet submitted its position in the matter.

4. 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 6 D to the financial statements.
5. For details of an investigation regarding suspected violations by employees of the Prohibition of

Money Laundering Law, see "Mercantile Discount Bank Ltd." above under "Main investee companies".

6. Following audits conducted at the Bank on August 12, 2006 and September 8, 2006, the enforcement of labor laws division at the Ministry of Industry, Trade and Labor initiated an investigation in the matter of illegal employment during weekly hours rest, suspicion of prima facie commitment of an offence in respect of the Hours of Work and Rest Law, 1951, i.e. employment of Bank personnel during the weekly resting day on the said dates. 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.

The Bank is applying for a permit for employment of required personnel on the weekly resting day.

7. 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 February 17, 2008. The parties are conducted negotiations out of Court to settle the dispute between them regarding the alleged deviation from the terms of the permit and as a result thereof an amended indictment was presented to the Court on February 17, 2008, in which the name of the Bank was removed from the indictment.
8. For details regarding a Bank of Israel audit in the matter of the implementation of the Prohibition of Money Laundering Law and the summons to appear before the monetary sanctions committee, see above "Prohibition of Money Laundering and the Financing of Terror" in the Chapter "Legislation and supervision".

MATERIAL AGREEMENTS

Hereunder is presented a summary description of agreements, entered into outside the ordinary course of business, that might be considered material, to which the Bank is a party, or which according to its best knowledge, the Bank is a beneficiary in terms thereof, including agreements that were valid in the period covered by this annual report, or which affected the Bank's operations during such period.

AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN THE FIRST INTERNATIONAL BANK ("FIBI")

According to an agreement dated July 31, 1983, between the Bank and FIBI Holdings Ltd. and one of its subsidiaries, in terms thereof the Bank acquired ordinary shares of a par value of NIS 5 each in FIBI, which granted the Bank approximately 26% share in the equity and 11% share in the voting rights of FIBI, it was agreed, among other things, that the Bank shall not be involved in the management of FIBI.

The agreement provided that so long as the Bank is in possession of at least 80% of the shares in FIBI acquired by it under this agreement (including bonus shares and rights in respect of these shares), FIBI Holdings will see to it that one quarter of the members of the board of directors and of board of directors' committees of FIBI will be members recommended by the Bank, on condition that the Bank will not recommend persons the appointment of whom might, in the opinion of the

Governor of the Bank of Israel, create a conflict of interests. In addition, the said agreement provided that each of the parties thereto shall have the right of first refusal in respect of the acquisition of shares in FIBI held by the other party, whether such sale shall be made on or off the market. The right of first refusal does not apply to sales of up to 20% of the total holdings of each party effected on the Tel-Aviv Stock Exchange in the ordinary course of business. Furthermore, the right of first refusal does not apply in the case of a sale of FIBI shares by any of the parties to its parent company or to a company controlled by such party.

The acquisition of the said shares was made in terms of a permit for the acquisition of means of control, under Section 34 of the Banking Law (Licensing), 1981, granted by the Governor of the Bank of Israel on July 20, 1983, in the framework of which the Bank was permitted to acquire up to 30% of the issued and paid share capital of FIBI. As part of the process of obtaining the permit to acquire means of control, the Bank has made a commitment to the Bank of Israel that FIBI will be managed in an independent manner, and that all members of the Board of Directors of FIBI shall be appointed by FIBI Holdings Ltd., 25% thereof to be appointed in accordance with the recommendation of the Bank as approved by the Governor of the Bank of Israel. It was further agreed that the Governor would not withhold his approval of the recommendation of the Bank as above, unless based on reasonable grounds and considering the possibility that such appointments might create a conflict of interests.

**OBLIGATIONS OF THE
BANK WITH RESPECT
TO CAPITAL MARKET
OPERATIONS**

In October 1983, within the framework of the “bank shares arrangement”, the Bank informed the Minister of Finance and the Governor of the Bank of Israel that, among other things, it would not initiate, either directly or indirectly, orders for the purchase or sale of securities within the orders submitted to the Stock Exchange prior to the beginning of trading (“Leaders”), or as part of the setoff of purchase or sale orders prior to the beginning of trading.

The Bank further confirmed that it would prevent, either directly or indirectly, any transaction in securities issued or which would be issued by banks or bank holding corporations, unless such transactions are on behalf of its customers, including provident and mutual funds. However, the Bank noted that nothing in the above would avoid transactions effected in the ordinary course of business.

**EXEMPTIONS OF
INDEMNIFICATION TO
DIRECTORS OR
FORMER DIRECTORS
IN THE BANK OR
INVESTEE COMPANIES
OF THE BANK**

The previous version of the Articles of Association of the Bank, which was amended in March 2002, included provisions regarding the indemnification of whoever acts or has acted, at the request of the Bank, as director in another company, in which the Bank has an interest, as detailed in Note 19 C 10 a to the financial statements. Accordingly the Bank had issued at that time letters of indemnification, unlimited in amount, to the acting directors or who have acted at the request of the Bank in other companies owned by it. For details regarding exemption in advance and indemnification of Directors and other Officers of the Bank, see Note 19 C 10 J to the financial statements.

**COMMITMENT FOR
COOPERATION
DURING THE PROCESS
OF SALE OF THE
BANK'S SHARES**

In an Annex to the agreement dated August 29, 1991, between the Government of Israel, in the name of the State of Israel, M.I. Holdings Ltd.(hereinafter – “M.I. Holdings”), Israel Financial Holdings and IDB Holding Company Ltd., the parties thereof are M.I. Holdings and the Bank, the Bank committed to cooperate with M.I. Holdings and assist in the process of sale of the Bank's shares, this, subject to adherence to any law and the guidelines of the Supervisor of Banks, and subject to the matters detailed in the Annex. Among other things, the Annex determined that the Bank will provide information to assessors acting on behalf of M.I. Holdings and on behalf of potential buyers, everything subject to the limitations and confidentiality arrangements detailed in the Annex.

As determined in the Annex, M.I. Holdings has agreed to indemnify and/or compensate the Bank and/or any member of the Board of Directors of the Bank and/or any employee of the employees of the Bank in respect of any damage suffered by the Bank and/or any of the above, as applies, and /or any of the customers of the Bank (on condition that the Bank or any of the above would be charged in respect of any damage determined by a Court's verdict) as a result of the performance of the Annex and everything related to it; however, the commitment to indemnify and/or compensate as above, shall not apply to responsibility for or in respect of a violation of the Securities Law, 1968. It shall also not apply to damage resulting from error, misrepresentation or omission in the information, documents or presentations made by the Bank in accordance with the Annex, if it is proved that the error, misrepresentation or the omission were caused intentionally or not in good faith.

The form of the cooperation in accordance with the said agreement was later formalized in the The Bank Shares in Arrangement (Temporary Provision) Law, 1993. The said agreement has been amended several time with the consent of the parties.

**AGREEMENT FOR THE
ACQUISITION OF
ADDITIONAL MEANS OF
CONTROL IN ICC**

On December 10, 2006, the Bank and the First International Bank signed an agreement with Fishman for the purchase of his holdings in ICC. On March 1, 2007, the Bank and the First International Bank signed an agreement with Harel for the purchase of its holdings in ICC. For additional details see “Credit card operations” under “Further details as to activity in certain products” and Note 34 A to the financial statements.

**AGREEMENTS WITH THE
FIRST INTERNATIONAL
BANK AS TO THE
HOLDING OF MEANS OF
CONTROL IN ICC**

On December 10, 2006, alongside the consummation of the agreement for the purchase of the shares in ICC held by Fishman, the Bank and the First International Bank signed an agreement securing the understandings between them and regularizing the rights and obligations towards one another as shareholders of ICC. The said agreement amends a previous agreement between the parties dated September 29, 2000. The arrangements determined in the agreement apply, respectively, also to the shares purchased from Harel. For additional details see also Note 34 A to the financial statements.

AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN ILANOT DISCOUNT	An agreement was signed on September 21, 1999, between the Bank, Ilanot Batucha Investment House Ltd. (hereinafter – “Ilanot Batucha”) and Ilanot Discount Ltd. (hereinafter – “Ilanot Discount”), according to which, it was agreed, among other things, on the acquisition of control by the Bank in Ilanot Discount. The agreement granted each of the parties the right of first refusal and the right of participation, which would apply in the case of the sale of holdings in the company by the other party. For details as to the exercise of the right of first refusal, in September 2005, see above, under “Capital market activity” under “Further details as to activity in certain products”, and Note 6 E to the financial statements. This agreement is not valid any longer, and the rights of the Bank under it as regards management fees, have been assigned to Clal Finance Batucha Investment Management Ltd., within the terms of an agreement whereby all the rights of Ilanot Discount were sold to it stated below.
AN AGREEMENT IN PRINCIPLE FOR THE SALE OF ILANOT DISCOUNT LTD. AND THE PROVIDENT FUND ACTIVITY	For details as to the agreement in principle for the sale of the shares in Ilanot Discount Ltd. and the provident fund activity, see above “Capital market activity” under “Further details as to activity in certain products” and Note 6 E to the financial statements.
AGREEMENT FOR SALE OF ALL MEANS OF CONTROL IN ILANOT DISCOUNT	For details regarding the agreement dated April 11, 2006, according to which all the shares in Ilanot Discount Ltd. were sold to Clal Finance Batucha Investment Management Ltd., see Note 6 E to the financial statements.
AGREEMENT FOR THE SALE OF THE OPERATIONS OF THE BANK IN THE PROVIDENT FUND MANAGEMENT FIELD.	For details regarding the agreement dated January 29, 2007, amended June 19, 2007, between the Bank and Discount Provident Fund Management and Clal Insurance Company Ltd., for the sale of the operations of the Bank in the provident fund management field, see “Capital market activity” above, under “Additional details regarding the activity in certain products” and Note 6 E to the financial statements.
AGREEMENT FOR THE SALE OF MEANS OF CONTROL IN HAREL	On November 1, 2006, the transaction was consummated for the sale of 10.1% of the share capital of Harel and the receipt of an option (that was not exercised) for the sale of the remaining shares that the Bank holds in Harel (5.79% of the share capital). For additional details see “The non-financial companies sub segment” under “Activities of the Group according to principal segments of operation”.
AGREEMENT WITH THE EMPLOYEES	An agreement dated February 1, 2005, signed concurrently with the agreement for the sale of a controlling interest in the Bank, between the New Histadrut Federation of Labor, the

Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance, which was later joined by the Bank, following approval by the Bank's authorized organs, and which is intended to regularize certain demands raised on behalf of the Bank employees in the matter of their rights on the background of the sale of a controlling interest in the Bank by the State, everything as described in "Employees Agreement" under "Control of the Bank" above.

**AN AGREEMENT FOR
THE GRANTING OF
LOANS AND SERVICES
TO STATE EMPLOYEES**

On May 10, 2007, the Bank signed an agreement for the granting of loans, overdraft and banking services to State employees following its success in the tender issued by the Accountant General. For further details see "Retails banking sector – household segment" in the Chapter "Activity of the Group according to principal segments of operating".

**AGREEMENT FOR THE
PURCHASE OF A BANK
IN SWITZERLAND**

For details regarding the agreement for the purchase of Arzi Bank in Switzerland, see above under "International operations".

**THE INTERNAL
AUDIT IN THE
GROUP
GENERAL**

Details of the internal auditor. The Bank's internal auditor is Mr. Shlomo Pitchon, acting in this position since September 1, 1994.

The internal auditor is not an interested party in the Bank⁽¹⁾, is not an officer of the Bank, is not related to any of these persons and is not the Bank's external auditor or acting on his behalf.

The internal auditor complies with the provisions of Section 146(B) of the Companies Law and of Section 8 of the Banking Rules (Internal Audit), the staff of the internal audit department comply with the provisions of Section 8 of the Banking Rules (Internal Audit).

In addition, as from February 1, 1994, Mr. Pitchon serves also as the internal auditor of certain subsidiaries of the Bank, including: Discount Mortgage Bank Ltd. and its subsidiaries, Discount Gemel Ltd., Israel Discount Capital Market and Investments Ltd. and its subsidiaries, Tachlit Investment House Ltd., Discount Trust Ltd., Discount Leasing Ltd., BDL Computer and Administration Services Ltd. He serves as internal auditor of Discount Manpikim Ltd. since April 1, 1999, and of Manpikim Financial Operations Ltd. since December 8, 2004 and of ICC since March 1, 2008. (the appointment has been approved by ICC's Board of Directors, but requires also approval by the Bank of Israel).

The manner of appointment. The appointment of the internal auditor was approved by the Board of Directors as a permanent appointment in its meeting of August 29, 1994. Approval of the appointment was based upon the qualifications, experience and education of Mr. Shlomo Pitchon. Mr. Pitchon is a Certified Public Accountant and an economist and prior to his appointment served for ten years as the deputy internal auditor and for six months as acting internal auditor.

The organ in charge of the internal auditor. The Chairman of the Board of Directors is the organizational entity in charge of the internal auditor.

(1) The internal auditor holds a negligible number of shares in Discount Bank in the par value of NIS 21,583, and in the opinion of the Board such holdings have no effect on the quality of his performance.

Work plan. The internal audit operates according to the annual work plan derived from a multi-annual work plan (the multi-annual work plan covers a period of three years not including the current year). The annual and multi-annual work plans (hereinafter: “the work plan”) are prepared in accordance with the Internal Audit Law, 1992, according to the Banking Rules (Internal Audit) 1993 and according to Proper Bank Management Directives.

The work plan was designed on the basis of an overall risk survey, conducted according to new and accepted methodologies, and was influenced by local and international guidelines (including Basel II, COSO, SOX and by the draft internal audit guidelines published by the Supervisor of Banks).

The senior management of the internal audit layout and an external consulting company that has proven experience and know-how of international methodologies in this field are involved in the preparation of the work plan.

Prior to the work plan being submitted for approval, it is forwarded to the Bank’s independent auditors, to the chairman of the Board of Directors, to the Chairman of the Board’s Audit Committee and to the Bank’s President and CEO for comments.

The Board of Directors’ Audit Committee discusses the work plan and on the basis of its recommendations the plan is brought before the Board for approval.

The work plan allows the internal auditor discretion for a 15% deviation as regards the use of human resources. A higher deviation requires prior approval of the Audit Committee.

The planned work programs for the material subsidiaries, at which the Bank’s internal auditor serves also as their internal auditor, are combined with the annual work program for the internal audit of the Bank, while addressing each subsidiary separately. The scope of the work program for each subsidiary as above, is discussed by the audit committee of each subsidiary, and/or by the Board of Directors.

Each audit report is submitted by the internal auditor to the chairman of the board, to the President and CEO of the Bank and to the Bank’s auditors. Each report with respect to head office units and a management summary of audit report regarding the Bank’s branch offices is submitted to the chairman of the audit committee of the Board.

During the reported period, material transactions (within the meaning of Proper Banking Management Directives) were effected, and these have been examined by the internal auditor on a sample basis, including the procedures for their approval.

Audit performed abroad or audit of investee companies. The internal audit work plan also relates to the Bank’s investee companies in Israel and abroad.

Where the internal auditor of the Bank does not perform audits of investee companies, control of such companies is performed as required by Section 1(A)(3) of Banking Rules.

The Bank’s internal auditor coordinates in advance with the internal auditor of the investee company as to the matters which would be audited by the internal auditor of the investee.

Scope of employment. The internal auditor is engaged in a full time position and the average number of staff working under him in the reported period numbered 77.8 positions (including outsourcing and overheads).

The number of positions in the internal audit layout is derived from the requirements of the work plan as approved by the Board of Directors.

Following are details of the number of positions engaged in internal audit at the Bank and in investee companies in Israel and abroad:

The Bank itself, including outsourcing and overhead	72.8
Investee companies in Israel audited by the internal auditor of the Bank	5.0
Investee companies in Israel where the audit (including outsourcing and overhead) is performed by an independent internal auditor	26.0
Investee companies abroad where the audit (including outsourcing and overhead) is performed by an independent internal auditor	20.2
Total	124.0

Performance of the audit. The internal audit is carried out according to the provisions of the Internal Audit Law, 1981, according to the Banking Rules (Internal Audit), 1993 and according to the professional standards of the Institute of Internal Auditors in Israel.

The internal auditor also acts in accordance with the instructions and guidelines of the Supervisor of Banks as reflected in Proper Banking Management Directives and in audit reports performed by the Supervisor of Banks.

In discussions regarding the work plan and audit reports of the Supervisor of Banks, members of the Audit Committee and of the Board of Directors received information as to the mode of performance of the internal auditor and they were satisfied that he acts in accordance with the requirements of the instructions mentioned above.

Access to information. All information and documentation required by the internal auditor is handed over to him and is granted permanent and direct access to the information systems of the Bank, including financial data.

Access to information as stated above, in investee companies and foreign operations, is secured by the internal audit procedures of these entities and by guidelines of their boards of directors.

Reports by the internal auditor. All reports of the internal auditor are submitted in writing.

With respect to each quarter, about 45 days following the end of the quarter, the internal auditor submits a comprehensive report regarding all activities of the internal audit in Israel and abroad, for that quarter. The quarterly report discusses the material findings included in audit reports submitted in the course of the reported quarter, a concise response to the findings by the audited entities, as well as follow-ups of previous quarterly reports and prior issues that had not yet been resolved. It should be noted that all detailed audit reports are submitted to the Chairman of the Board, the Chairman of the Audit Committee, the President and CEO and the Bank's independent auditors.

The quarterly report is submitted to the Chairman of the Board, to the President and CEO and to all Board members, so that at each quarter they have a very detailed picture as to the findings of all audits performed by the internal auditor, the response to these findings and the manner in which audit findings had been treated. The audit committee of the board discusses the quarterly report.

In addition, the audit committee of the board discusses specific audit reports regarding the Bank's units, in cases where the chairman of the board, the chairman of the audit committee and/or the internal auditor consider that the findings in these reports or the significant issues which they raise require special attention.

Once a year, the internal auditor submits to the Chairman of the Board, to the President and CEO and to all Board members an annual report (in addition to the four quarterly reports). This report details the principal matters that were audited during the year, the manner in which the findings and recommendations were treated. The annual report is being submitted within 75 days from the end of the year to which it relates, and is being discussed by the board and by the audit committee of the board.

The quarterly and the annual reports were submitted and discussed as follows:

- Report on the activities of the internal audit in the last quarter of 2006, submitted on January 24, 2007, and discussed by the Audit Committee on March 20, 2007.
- Annual report on the activities of the internal audit in 2006, submitted on March 8, 2007, and discussed by the Audit Committee on April 24, 2007 and by the Board of Directors on June 11, 2007.
- Report on the activities of the internal audit in the first quarter of 2007, submitted on May 2, 2007, and discussed by the Audit Committee on June 26, 2007.
- Report on the activities of the internal audit in the second quarter of 2007, submitted on August 8, 2007, and discussed by the Audit Committee on November 5, 2007.
- Report on the activities of the internal audit in the third quarter of 2007, submitted on November 8, 2007, and discussed by the Audit Committee on December 18, 2007.
- Report on the activities of the internal audit in the fourth quarter of 2007, submitted on February 26, 2008, and discussed by the Audit Committee on March 24, 2008.

Valuation by the Board of Directors of the internal auditor's performance. In the opinion of the Board of Directors and of the Audit Committee, the scope, nature and continuity of the operations of the internal auditor and his work plan are reasonable under the circumstances and attain the goals set out for internal audit at the Bank.

Remuneration. Details of the payments to the internal auditor and of the components thereof are given hereunder under "Remuneration of the Chairman of the Board of Directors and Senior Executive Officers".

In the opinion of the Board of Directors, such payments have no effect upon the internal auditor's professional judgment.

INVOLVEMENT AND CONTRIBUTION TO THE COMMUNITY

Since its formation, Israel Discount Bank has been active in community affairs, having an overall management conception, according to which, activities beneficial to the community form part of a business, social and cultural obligation.

The volunteer activity of the "Lema'an" Project – Discount Employees for the Community continued and was even expanded during 2007, in this context, volunteer Bank employees act out the Bank's vision of humane banking contributing their time and compassion.

The volunteer activity is varied and provides assistance and support to a wide range of components of the population in Israel: children and youth, students, servicemen, disadvantaged sectors, old elderly, handicapped and such like.

In addition to the activities of "Lema'an – Discount Employees for the Community" project, described hereunder, the following activities were also conducted in 2007 in the culture and arts field, providing sponsorship, "Tzalah" activities in the branches and donations.

The total volume of activities of Discount group in 2007, including the Lema'an Project, amounted to NIS 7,286 thousand, compared with NIS 5,454 thousand in 2006.

In 2007, the Bank continued the trend of supporting children and youth in various states of distress, and Art seeking youth.

The social activity and involvement in the community was carried out by the Bank in the following areas:

DONATIONS

Donations are directed mainly to associations, clubs, education establishments, health organizations and others, that focus on children and personal welfare. Among the donations granted in 2007, the following are noteworthy: "Discount Start-up", "Ashalim", "Ezrah Lemarpeh", "Yad Ezer Le'Chaver", "Variety", "A warm house for children on respirators", the Anti AT and ALS diseases Association, and more.

THE "LEMA'AN" PROJECT – DISCOUNT EMPLOYEES FOR THE COMMUNITY

This project was launched at the end of March 2002. The project constitutes the joint effort of management and the employees' committee, whereby Bank employees volunteered for activities for the community. In 2007, the effort was focused on voluntary activities through associations for youth in distress, children clubs and various associations that support the needy.

Presented below is a selection of examples of the projects and activities within the framework of the "Lema'an" Project:

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.

"Adopt a combat soldier" Project. Discount Bank has decided to join the enterprise established by the Friends of the IDF and take part in this project. Within this framework the Bank elected to adopt "Squadron 916" of the Israel Navy, which is entrusted with Israel's southern coastline.

The bank supports the Squadron with a monetary contribution as well as with voluntary work. The contribution is a yearly amount of NIS 100 thousand intended for financing activities for the welfare of the soldiers. In addition to a monetary contribution, the Bank incorporates volunteer activity of the Ashdod Branch employees. Furthermore, naval servicemen participate in various events of the Bank.

Support of social projects. The Bank granted scholarships to two youth of Upper Nazareth, who participated in the Israeli Management Center's summer camp for the development of a young business leadership. This project trains youth from all over the country for entrepreneurship,



contribution to the community and social commitment and responsibility. The youth participating in the project are expected to develop a new social project in the areas they live in. Employees of the Bank's Upper Nazareth branch and of the Migdal Ha'Emeq branch will support the new projects in these towns, providing professional marketing guidance and entrepreneurship advice.

Assistance for the Passover Holiday. According to the tradition established at the Bank, this year the Bank also rallied to help needy families in the preparations for the Passover Holiday. The assistance this year consisted of the purchase of food packages which were distributed to the needy through associations all over the country. At the same time, employees of the Bank rallied in aid of the "Chag Save'a" campaign – a campaign for the collection of foodstuffs, small electrical and other household appliances, in conjunction with the "Meir Panim - Hacoach Latet" Association.

Assistance to needy families for the New Jewish Year. The Bank purchased charged food cards in the amount of NIS 250 each for distribution to 1,100 needy families all over the country. Distribution of the cards was done by Bank employees at some 120 branches, who in coordination with the social services departments in the towns where the branches are located distributed the cards to the families.

Tu Be'Shvat fruit. Packages of Tu Be'Shvat fruit were distributed at the voluntary activity centers of Discount Bank employees.

Surplus sandwiches. Surplus sandwiches are distributed on a daily basis by Bank employees to the "Latet" and Lasova" Associations.

"Discount Fund" at the "Ezra LeMarpe" Association. The Fund was established in August 2007, with the object of providing financial assistance in exceptional and difficult cases. The Fund is a collaboration between the Bank and the "Ezra LeMarpe" Association. Applications with respect to difficult cases will be referred to the Association for examination of the case and its various aspects and for determination of the amount of assistance to be provided where the case is found deserving of assistance.

Setting-up a computer room at the "Neveh Opher" children's club. Besides the volunteer activities on the part of Israel Discount Bank employees at the "Neveh Opher" club of the Association for the Advancement of Education in Jaffa, it was decided to set-up a computer room at the club. Fifteen new personal computer, of the most advanced version have been donated to the club, for use by children of distressed families and their parents. The computer room was inaugurated in March 2007, at a ceremony attended by representatives of the Bank.

Assistance in the setting-up of a bazaar at the IDF Disabled Rehabilitation Center. Towards the Passover Holiday, the Bank assisted in setting-up a Bazaar in which products made by disabled IDF soldiers belonging to the Rehabilitation Center of the Ministry of Defense were sold. The revenues earned in the Bazaar are designated to finance extra mural activities of inmates of the Center.

Adoption of a children club in Rishon Le'Zion. The Bank's investment center of South Tel Aviv and Shfela Region has begun volunteer activity in the framework of which the Rishon Le'Zion

children club was adopted. This club numbers some 22 children of distressed families aged between 6 and 10.

Adoption of the 'Children's Home' in Beer Sheva. The City Center Branch of the Bank in Beer Sheva has, among other things, adopted the "Children's Home" in the city. This is a place where children who have been subjected to family violence aged 4 to 8 and who were extricated from their homes find refuge. The branch maintains relations with this Home and its staff conduct various activities at holiday time, such as purchasing new clothing for the holidays out of prize money of the branch, organizing parties for the holidays and purchasing refreshments.

The warm House Association. The cooperation with this Association continues, including volunteer work by Bank employees and a contribution to the Association, which serves as a center for children requiring special services, children suffering from various types of muscular atrophy and children with a low life expectancy. The assistance of the Bank is expressed in several areas: providing medication, financing special medical treatment as well as participation in the purchase of special foodstuff.

Promotion of Education in Yaffo Association. The cooperation with this Association continues, including volunteer work by Bank employees at the clubs of the Association and a financial contribution by the Bank. The Association provides a variety of education programs, welfare and enrichment to thousand of children in risk situations. The assistance is provided to families of a low socio-economic background giving them higher prospects of success in life.

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 art with community activity.

Within the framework of this Project, the Bank offers its branch facilities all over the country to serve as a platform where artists would be able to exhibit their works to the public. The Bank is committed to purchasing one work from each exhibition, and, concurrently, the exhibiting artist will also donate one item. At the conclusion of the Project, which lasted for about one year, an exhibition would be held in which all the works purchased by the Bank and donated by the artists would be offered for sale. All the proceeds from the sale would be used for financing projects in aid of children and youth with special needs.

The following exhibitions were held in in the course of 2007: "Eight in the wake of One" by the artist Eliaz Slonim, at the Afeka Branch. "Bronze Statues" by the artist Hanna Shachar, at the International Private Banking Center in Netanya, "Drawings and Sculpture" by the artists Dan Reisner and Rinat Podisok Reiser, at the "Jaffa Court" branch and the exhibition "Painting and

Sculpture” of the artists Nurit Levav, Anita Arba Bokovza, Limor Peleg and Matti Orlov, was held at the Nataniya Branch.

Stage for the Artist Project. The project is intended to assist artist artist to present their work to the public at large, and with the support of the Bank provide exposure outside confines of the Bank. With the assistance of the Bank, the artist Lily Bahari exhibited her works “Rimonim” at the Bible Museum in Tel Aviv, while the artist Eva Lavie, with the assistance of the Bank, presented an exhibition at the Ashkelon branch, combining painting with ceramics.

“The Circles of Life” exhibition. The exhibition of the works of the artist Robi Matzkin was on show at the Chamber Theatre to customers of Maniv House and of the Bank. The works of the artist, which had been known as masterpieces of the Soviet Union, have been lent to the exhibition by collectors and family members of the artist.

The Discount Album of Art. The project of The Discount Album of Art began in 1978 as part of the Bank’s commitment to act in favor of the community and to promote the support of cultural and artistic activities. Since then and up to now 14 Albums have been published including 105 reproductions and artist folios.

Discount Album No. 14. Published in 2007 and included works of the artists Phillip Tantzler, Nelly Agassi and Erez Israeli.

Lending works from the discount art collection. The Bank attributes importance to the exposure of the collection to the public and during 2007, several works of art were lent to exhibitions. 12 works of “second look” artists were lent to an exhibition at the Tel Aviv Museum of Art. A retrospective exhibition of works of the artist Moshe Givati was held at the Tel Aviv Museum of Art.

Donations made out of the Collection. As is usual in every year, also this year the Bank donated reproductions from its collection to culture club-rooms at military bases, at the community centers, boarding schools and schools having art education activities.

The Discount Museum website. The art collection of the bank is considered one of the quality collections of Israeli art. The Bank attributes great importance to the maintenance and cultivation of its art collection and is proud to exhibit a selection of the works included therein to the public at large through the Discount Museum website. The works selected for presentation are arranged according to themes in a manner that enables the public to learn about the structure of the collection and the contribution of the Bank to cultural and community life in Israel.

The address of the site is: <http://www.discountbank.co.il/museum>

Dis-Cover. As part of the activities of the Mifalot Discount Fund for Culture and Art, a new enterprise has been launched for the enhancement of youth studying within the framework of youth boarding schools in the field of art product design. The enterprise took part in conjunction with the Ministry of Education, the Holon Technological Institute and other business enterprises, such as the Israel Electric Corporation and the Society for the Protection of Nature in Israel, in which students studying industrial design at the Holon Technological Institute tutored pupils of Youth Boarding Schools, with the objective of exposing them to the field of industrial design and

to its link to corporations and business. Income from these sales is designated for higher education scholarships for pupils of youth boarding schools.

SPONSORSHIPS

During 2007, the Bank granted sponsorship to entities and activities promoting social, health, sporting, cultural, artistic and educational and business goals.

SOCIAL SPONSORSHIP

WIZO Germany. The Bank granted patronage to an event organized by WIZO in Frankfurt in September 2007, in which representatives of the international banking division of the Bank participated.

The Moroccan Immigrants Union in Israel. Sponsorship was provided to a seminar conducted by this Association.

The Institute for the Advancement of Education in Jaffa. The Bank has granted sponsorship to this Institute, which supports the advancement of children coming from a low socio-economic background.

CULTURAL, ARTISTIC AND EDUCATIONAL SPONSORSHIPS

“Edut” Theatre. A theatre engaged in the commemoration of the Holocaust through the dramatization of the testimonies of Holocaust survivors with participation of students. The project is managed by Ezra and Irit Dagan, with the participation of local authorities and high schools under the heading “Telling in order to live”.

Music. Sponsorship for an evening in memory of Moshe Wilensky, who died ten years ago, held at the “Tzavta” club at the end of January 2007.

The amateur stage theatre. sponsorship for the production of “Lysistrata”, a comedy by Anat Gov. **Sponsorship for a fund raising evening for the benefit of “Yeladim – Fair Chance for Children” Association.** The Council held on January 18, 2007.

Habimah Theatre. Patronage has been granted to the Habimah Theatre, in the framework of which benefits in purchasing tickets were granted to Discount customers under special drives.

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.

The Israel Ornithological Center. Sponsorship has been granted to a seminar on the subject of bird-watching, within the framework of which a preliminary vote was taken in electing the national bird of Israel.

Council of the Recanatti Business School Graduates. Sponsorship has been granted to the graduates’ convention.



SPORTS SPONSORSHIPS **The triathlon competition** which took place in Eilat in February 2007. This is the most challenging competition of its type held in Israel.

The Magnes Race. Sponsorship has been granted to the race organized by the Cossel Center for Physical Education, Leisure and Health at the Hebrew University in Jerusalem.

The Israeli Handicapped Organization. Sponsorship has been granted to the Israeli wheelchair tennis championship.

HEALTH SPONSORSHIPS **Evening with the friends of the Tel-Hashomer Medical Center** for the purpose of recruiting donors for the establishment of a national unit for the treatment of burns at the hospital.
Sponsorship for an international convention held at the French Hospital in Nazareth.

BUSINESS SPONSORSHIPS **Herzliya Convention – On The Balance of Israel’s National Strength and Security** held in January 2007 by the Inter-disciplinary Center in Herzliya.
An open day on the subject of research and development in the Arava Valley – presentation of developments and research in agriculture in the Arava Valley was held.

“SPRINT FOR THE FUTURE” - DISCOUNT BANK’S FLAG SHIP PROJECT

In 2005 Israel Discount Bank joined forces with “Sprint for the Future” Association adopting the program focused on school age children from peripheral regions with difficulties in their studies. The program’s objective is to provide assistance to school children so that they will be able to graduate high school, attaining a full matriculation certificate, enabling them to continue with higher education. The name of the program is “Discount Start Up”.

The Bank is a party to both the financial support of the Association as well as to promoting and advancing its activities. Representatives of the Bank’s management are members of the executive board of the Association and employees of the Bank have started voluntary activity in the framework of the Association’s programs, among other things, in the form of the adoption by nearby Bank branches and Banks units of schools participating in the project.

The Bank also supports the excellence class of the School of Communication of the Natanya Academic College, and during the past year representatives of the Bank escorted students in their acquaintance with the world of advertising and marketing. Enrichment to students was provided with respect to professional and practical contents and students were acquainted with the “Discount Hezek” Project. At the practical experience stage, the Bank presented a challenge to the students: the production of an advertising campaign for the “Discount Hezek” Project, which includes clips to be shown on plasma screens at the Bank’s branches, radio advertising jingles, advertising notices and vocal answering service at the branches.

The late Nissim Alagem Fund. In January 2007 the Bank inaugurated a scholarship fund for academic studies. The Fund is named after the late Nissim Alagem, who passed away in 2006. Mr. Aladgem worked at the Bank for 40 years his last post being Vice President in charge of the Commercial Banking Division. Within the framework of the Fund, the Bank will grant an annual contribution to finance the academic studies of young persons, graduates of the “Discount Start-up”

Project, who successfully completed their matriculation studies. The Fund will enable graduates of the "Discount Start-up" Project to continue their academic studies at higher education institutions. 10 scholarships were granted in 2007.

EMPLOYMENT OF HANDICAPPED PERSONNEL

As part of its personnel recruitment policy, the Bank offers disabled persons, who generally are not accepted by employers, the opportunity of being integrated into positions at the Bank suitable to their ability and according to the requirements of the Bank. This offers such persons the opportunity to function as regular citizens who provide for themselves with self respect.

"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.

SOCIAL RESPONSIBILITY MANAGEMENT UNIT

The Bank's management decided in 2007 to establish a social responsibility unit. This move was intended to strengthen the management of the social responsibility field at the Bank and reflects the importance attributed by the Bank to this subject.

The unit's task is to intensify the awareness of Bank employees as well as of those having an interest in the Bank generally, regarding social responsibility, and to form action plans for the attainment of goals set in this respect.

The main project undertaken in 2007, was the "mapping of gaps" project, intended at diagnosing the gaps both between the existing situation and the targets which the Bank strives to reach, as reflected among other things in the first CSR (Corporate Social Responsibility) report issued by the Bank, and in relation to targets to which the Bank committed by signing the "Ma'aleh" code. The mapping of the gaps was carried out with the assistance of external consultants, and it is used both for the designing of work plans of the unit and for the preparation of Bank's second CSR report.

"MA'ALEH" RATING

The "Ma'aleh" rating for social responsibility covers companies included in the Tel Aviv 100 share index, which engage in industry, trade, construction, infrastructures and services. The "Ma'aleh" index includes the twenty leading companies in the "Ma'aleh" rating for social responsibility, which comply with the entry terms of the TA 100 Index, and provides indication to investors who wish to invest their money in Israeli companies committed to and implementing social responsibility. Discount Bank is rated among the first ten companies included in the "Ma'aleh" rating for social responsibility.

"THE MARCH OF THE LIVING"

In April 2007, a delegation of Discount Bank employees participated for the fifth time in the "March of the Living" from Auschwitz to Birkenau that takes place every year on the memorial day for the Holocaust and Heroism. The delegation numbered 40 of the Bank's staff. This continued a tradition started on 2003, of participation of a Discount Group delegation in the "March of the Living", the Bank and the Employee Union participating in the cost thereof. A delegation numbering 90 of the Bank's staff is expected to participate in 2008 in the "March of the Living".

AUDITORS' REMUNERATION⁽¹⁾⁽²⁾

The Bank's auditors are Ziv Haft and Somekh Chaikin - joint auditors. Below are particulars of the remuneration that was paid to the auditors (in NIS thousands):

	Consolidated		The Bank	
	For the year ended December 31,			
	2007	2006	2007	2006
For Auditing⁽³⁾:				
To the joint auditors	14,195	12,620	4,482	4,502
For Other Services:				
Audit related services ⁽⁴⁾ :				
To the joint auditors	3,404	3,592	2,867	2,779
Taxation Services ⁽⁵⁾ :				
To the joint auditors	3,763	2,550	921	848
Other Services:				
To the joint auditors	2,080	⁽⁶⁾ 29,305	1,045	273
Total	9,247	35,447	4,833	3,400
Total Auditors' Remuneration	23,442	48,067	9,315	7,902

Footnotes:

- (1) The auditors' remuneration includes payments to partnerships and corporations under their control and also includes payments pursuant to the VAT law.
- (2) Includes remuneration that has been paid and remuneration that has been accrued.
- (3) Auditing annual financial statements and reviewing interim financial statements.
- (4) Includes mainly audit work and special examinations.
- (5) Including mainly annual tax reconciliation statements paid for as part of the audit fees and attributed to tax services based on estimate, tax assessments and tax consultations.
- (6) Of which, an amount of NIS 29,032 thousand, paid by IDB New York within the framework of preparing a comprehensive compliance program and conducting examinations as required by the letters of instruction (see Note 6 D to the financial statements)

REPORT OF THE BOARD OF DIRECTORS
TO THE GENERAL MEETING OF THE SHAREHOLDERS ANNUAL REPORT 2007

REMUNERATION OF
THE CHAIRMAN OF
THE BOARD OF
DIRECTORS AND
SENIOR EXECUTIVE
OFFICERS

	Salary and bonuses*	Employer's provisions ⁽¹⁾	Supplemental reserves ⁽²⁾	Total salary, bonuses and related expenses	Share based compensation transactions	Total salary and related expenses
2007	In NIS thousands					
Shlomo Zohar	(4)6,582	(4)1,353	-	7,935	(3)(5)9,915	17,850
Giora Offer	(6)6,564	(4)(5)1,085	(4)(6)27	7,676	(5)(6)9,915	17,951
Eli Hoter	2,122	338	7	2,467	1,543	4,010
Shlomo Pitchon	2,079	279	34	2,392	1,285	2,677
Noam Hanegbi	2,145	230	8	2,383	1,543	3,926
Israel David	2,106	307	9	2,422	1,543	3,965
2006						
Shlomo Zohar	(3)3,845	(4)1,117	-	4,962	(5)-	4,962
Giora Offer	4,039	634	2,683	7,356	(5)-	7,356
Eli Hoter	1,688	197	8	1,893	1,196	3,089
Shlomo Pitchon	1,697	150	6	1,853	997	2,850
Noam Hanegbi	1,758	124	9	1,891	1,196	3,087
Israel David	1,685	236	10	1,931	1,196	3,127

* Excluding VAT on salary.

Not including information regarding loans granted under similar terms to those granted to Bank employees in general, which amounts have been determined on the basis of uniform criteria.

(1) Including severance, emoluments, vocational studies fund, leave and National Insurance.

(2) Supplemental reserves for related expenses in consequence of salary changes.

(3) The remuneration and employment conditions were approved by a general meeting of shareholders on August 26, 2008.

(4) Including adjustment grant.

(5) The issue of the option warrants is made in five equal annual tranches for each of the years 2006-2010. Whereas the option plan was only approved in 2007, the expense recognized in that year also includes the expense in respect of 2006. The total benefit to be recognized in respect of the years 2006-2010 amounts to NIS 15.65 million.

(6) The remuneration and employment conditions, including the options plan, were approved by the audit committee and the Bank's Board of Directors. The increase in the capital required for the option plan was approved by a general meeting of shareholders held on August 26, 2007.

The terms of engagement of executive officers are determined in personal employment contracts. In determining payments included in the report, the Board of Directors took into account the contribution of the executive to the activities of the Bank and its profitability, and the position he holds at the Bank.

For details as to an option plan and an award plan to senior officers of the Bank, including the Chairman of the board of directors and the President and CEO, see Notes 13, 16 and 22 to the financial statements.

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, and absorbed in the work processes.

Based on the findings of the said detailed examination, the Bank's Management in conjunction with its President and CEO and its Chief Accounting Officer have evaluated, on the basis of the said evaluation, 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.

During the quarter ended December 31, 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 (see above) is not supposed to cover the extensive aspects of evaluating the effectiveness of the internal control over the financial reporting determined in section 404. 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 efficiency 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 on the assessment made by the management of the banking corporation, in the preparation of which they will be required to implement the relevant standards to be adopted or published by the Public Company Accounting 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.

Summary of the preparations by the Bank for compliance with the guidelines of SOX Act 404, as adopted by the Supervisor of Banks. In the course of 2006, the Bank completed the planning and preparation stage for the implementation of the project. As part of this stage, the execution methodology has been defined, the COSO Model has been adopted as a model for assessing the internal control over financial reporting, and the project management and a guiding committee have been established. The planning stage included the conduct of a pilot project, in the course of which the work methodology and the structure of products have been tested. Furthermore, during the year, the Bank completed the mapping of the overall principal procedures that affect financial reporting, and has started the documentation and verification stage of a part of these procedures.

The Bank and its principle subsidiaries carried out, in the course of 2007, the documentation stage of the material procedures that affect financial reporting, the mapping of financial reporting and the controls applied to these procedures. In this respect proposals are being examined for improvement of existing controls, if required, and for addition of new controls. The examination stage of control effectiveness is expected to begin in the second quarter of 2008.

The Bank in conjunction with its banking subsidiaries in Israel purchased at the end of 2007 a designated information system that will contain all the accumulated information with respect to the documented processes. This system is intended to serve in the future as a central tool for the management and ongoing operation of the project and the formation of a plan to reduce exposure, if same materializes.

The review and documentation of about 65% of the processes affecting financial reporting at the Bank have been completed by the end of 2007.

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 calculation of the return on equity in 2007 was done according to the said amendment.

Following is a calculation of the return on equity for 2006 as reported in the past and as recalculated in accordance with the new requirement (in %):

As reported in the past	12.2
As recalculated	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 be compatible to the Bank of International Settlements (BIS) in accordance with accepted standards of other central banks in the world.

According to the model that has been proposed by the 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 includes money transfers between customers and between dealing rooms, was launched at the beginning of September 2007.

In a circular letter dated September 25, 2007, the Supervisor of Banks notified that the determination of a particular amount, above which each transfer of funds from an account of a customer to another bank would be effected by means of the ZAHAV system only, is considered proper banking procedure regarding the liquidity risks of the banking corporation

Further to the above, the Bank of Israel published on October 30, 2007, a guideline according to which, as from November 4, 2007, banks are no longer permitted to effect money transfers in amounts exceeding NIS 3 million, unless by means of the new system.

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 15 B 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 quarter 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.

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 those decisions requiring its approval 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.

It should be noted that the Chairman of the Board has been engaged by the Bank since the beginning of 2006, though he has not been paid any compensation in respect of this engagement pending receipt of the said approvals. The Bank has currently created full provisions in respect of remuneration and awards in accordance with the plan approved by the Audit Committee. A provision in respect of the stock option component was included for the first time in the financial statements as of September 30, 2007, following receipt of the said approvals.

For further details, see Notes 13 and 22 to the financial statements.

BOARD OF DIRECTORS AND MANAGEMENT GENERAL

A list of the members of the Board of Directors and their occupation and a list of the Bank's executive officers and their areas of responsibility appear on page 4 of this report. These lists are correct as at the date hereof.

DETAILS REGARDING MEMBERS OF THE BOARD OF DIRECTORS

Shlomo Zohar - Serves as Director of the Bank since January 31, 2006. Mr. Zohar serves as Chairman of the Board, Chairman of the Credit Committee, Chairman of the Manpower Committee, Chairman of the Foreign Operations Committee, Chairman of the Insurance and Assets Committee, and as member of the Financial Statements Committee, the computer committee and the Risk Management Committee. Has financial and accounting expertise as well as professional qualification.

Mr. Zohar is a Certified Public Accountant having academic education – Bachelor in Economics and Accounting from the Bar-Ilan University and Master in Business Administration (specializing in accounting and finance) from McGill University, Montreal, Canada.

Serves as Chairman of the Boards of Mercantile Discount Bank Ltd., Discount Israel Capital Markets & Investments Ltd., Israel Credit Cards Ltd., and as Director of Discount Bancorp Inc., S. Zohar Consulting & Management Ltd. and Director and deputy chairman of Israel Discount Bank of New York. Served as Chairman of the Board of The Provident Fund of the Staff of Israel Discount Bank (until March 26, 2008), Chen Project 1990 Ltd. (until February 2006), Pazit Properties and Investments Ltd. (until January 2006), Blue Square Furniture Ltd. (until January 2006), acted as business consultant (until January 2006), partner in Zohar & Zohar CPA's (until December 2005), and acted as Director of Zohar & Zohar Accounting Company Ltd. (until December 2005), Zohar & Zohar and Co. Management Ltd. (until December 2005), Shelron Management and Trusteeship Ltd. (until December 2005), Blue Square Israel Ltd (until September 2005), Blue square Chain Properties and Investments Ltd. (until September 2005), Maple Canada-Israel Teal Estate Ltd. (until May 2004), Mitzpeh Kinneret Hotel Ltd. (until March 2004).



Betzalel Eiger - Serves as Director of the Bank since January 31, 2006. Member of the Credit Committee. Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has financial and accounting expertise as well as professional qualification. Has academic education – Bachelor and Master Degrees in Business Administration (specializing in finance) from the Bar Ilan University.

Serves as Chairman of the Board and CEO of Dorea Investments & Development Ltd. and Liberty Properties Ltd. and as Director of Comsec Ltd. and Ortam Sahar Engineering Ltd. Served as outside Director in Adanim Mortgage bank Ltd. (until January 2006), as CEO of Giron Development and Building Ltd. (until March 2005) and as Director in Neot Aviv Ltd. (until September 2003).

Ittamar Givton - Serves as Director of the Bank since October 31, 2002. Chairman of the Computer Committee, and member of the Credit Committee and the Human Resources Committee. Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has financial and accounting expertise as well as professional qualification.

Mr. Givton has an academic education – Bachelor in Economics from the Tel Aviv University and Bachelor of Law from the Hebrew University in Jerusalem.

Serves as Managing Director of Automotive Equipment Group, as Director of Automotive Equipment Ltd., Moto Parts Ltd., The Israel Automobile Corporation Ltd., Metive Ltd., Metropolitan Public Transport Ltd., Automotive Industries Ltd, Advanced Vehicles C.R.M. Ltd., Metrodan Beer Sheva Ltd., Automotive Equipment & Vehicles (2004) Ltd., M.S.Y. Sports Cars Israel Ltd., Member of the Managing Committee of Buxenbaum-Neta Fund (private fund) and member of Management, Sheba Fund (endowment). Served as Director of M.C.T. Autorent Ltd. (until August 2003) and of I.D. Vehicles and Transportation Ltd. (until August 2003).

Ben-Zion Granit - Serves as Director of the Bank since January 31, 2006. Member of the Audit Committee, the Financial Statements Committee and the Computer Committee. Served as a member of the ad-hoc committee in the matter of Discount Bancorp Inc. and Israel Discount Bank of New York (the committee acted between April 2007 and December 2007). Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has financial and accounting expertise as well as professional qualification.

Mr. Granit has an academic education – BSc. Degree in Agriculture from the Hebrew University in Jerusalem, Faculty of Agriculture, Rehovot, and a professional Diploma from the Business School of the Hebrew University, Jerusalem.

Serves as management consultant, member of management of Ilan – Israeli Association for Handicapped Children and is a voluntary consultant of Nitzan Association. Served as a voluntary consultant of the Rehovot Community center Company (until 2006). Served as Executive Vice President (until December 2004), market and credit risk Controller (in 2004), member of management and Head of Operations Division (2000-2004) of Union Bank of Israel Ltd.. Served as Director of Carmel Igud Mortgages and Investments Ltd. (until December 2003) and Igudim Ltd. (until December 2003) and served as CEO of Igud Systems Ltd. (until December 2003).

Prof. Ben-Zion Zilberfarb - Serves as Director of the Bank since January 31, 2006. Chairman of the Risk Management Committee and member of the Credit Committee, Financial Statements Committee and the Insurance and Assets Committee. Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has financial and accounting expertise as well as professional qualification.

Prof. Zilberfarb has an academic education – Bachelor in Economics and Business Administration and Master in Economics from the Bar-Ilan University, PhD in Economics from the University of Pennsylvania (1978), appointed Professor (1988) and serves as Professor of Economics at the Bar-Ilan University. Serves as outside Director of Brimag Digital Age Ltd., Delek Group Ltd., Direct capital Investments Ltd., Perrigo Company (a US corporation) and Director of Prof. Ben-Zion Zilberfarb Economic and Management Consultant Ltd. Holds the Edmond de Rothschild Chair for Global Asset Management at the School of Banking and Capital Market at the Netanya Academic College. Served as outside Director of Fundtech Ltd. (until end of December 2007), of Clal Finance provident and Education Fund Ltd. (until April 2006) and of Partner Communications Ltd. (until February 2006).

Joseph Singer - Serves as Director of the Bank since September 25, 2002. Was reappointed to the office on September 25, 2005. Member of the Audit Committee, Credit Committee, Financial Statements Committee and Computer Committee. Serves as an outside Director according to the Companies Law, 1999, and has financial and accounting expertise as well as professional qualification. Mr. Singer has an academic education – Bachelor in Economics and Business Administration and Master in Business Administration (specializing in finance) from the Bar Ilan University.

Serves as Director and Managing Partner of Giza Singer & Even Ltd., Director of Singer & Even Ltd., Midroog Ltd., Midrug Holdings Ltd., Giza Singer & Even Finance Ltd., Singer Even & Kraizberg Holdings Ltd., an Independent Director of Poalim IBI – Underwriting & Issuing Ltd. (since July 4, 2007), Giza Singer Even Real Estate Ltd. (since October 11, 2007), Giza Singer Even Investments 2007 Ltd. (since September 25, 2007). Served as outside Director of Edmond de Rothschild Mutual Funds Management Ltd. and Chairman of its Investment Committee (until August 2006), and as CEO of Singer & Even Ltd. (until 2004).

Tsippi Samet - Serves as Director of the Bank since February 24, 2003. Was reappointed to the office on February 24, 2006. Chairman of the Audit Committee (since February 25, 2008). Member of the Human Resources committee, Foreign Operations Committee, risk Management Committee and the Insurance and Assets Committee. Served as a member of the ad-hoc committee in the matter of Discount Bancorp Inc. and Israel Discount Bank of New York (the committee acted between April 2007 and December 2007). Serves as an outside Director according to the Companies Law, 1999, and has financial and accounting expertise as well as professional qualification.

Ms. Samet has an academic education – Bachelor in Economics and Mathematics, Master in Economics from the Hebrew University, Jerusalem. Research student (PhD) at the Hebrew University Jerusalem. Serves as outside Director of Menorah Mivtachim Pension Ltd., Menorah Mivtachim Gemel Ltd., Sinai Insurance Holdings (1993) Ltd., Ophir Optronics Ltd. (since January 16, 2007), Meirav-Yaniv Financial Consultants Ltd., Chairperson of the Investments Committee of Avner – Motor Vehicle



Accident Victims Insurance Ltd., President of Adif College for Insurance, Pension and Finance Studies. Served as outside Director of Hazera Genetics Ltd. (until February 2007), Menorah Gaon Capital Markets Ltd. (until February 2004), Hachsharat Hayishuv Insurance Company Ltd. (until September 2003) and as Project Manager – Rothschild Caesarea Center (until September 2003).

Jorge Zafran - Serves as Director of the Bank since January 31, 2006. Member of the Audit Committee and the Foreign Operations Committee. Has professional qualification

Mr. Zafran has an academic education – Master in Business Administration and Certified Public Accountant from the National University of Buenos Aires, Argentina, Faculty of Economic Science (specialized in accounting and marketing). Serves as Joint Managing Director of T.M. Intertrom Ltd., and serves as Director and CEO of Power Phone Marketing Ltd., Power dialing Ltd., Inter American Marketing services Ltd., Cadillac Properties and Building Company Ltd. and Israel learning systems Ltd. Served as director (as well as in certain periods Chairman of the Audit Committee and Credit Committee) at Eurotrade Bank (until July 2005).

Itshak Forer - Serves as Director of the Bank since December 18, 2007. Chairman of the Financial Statements Committee, member of the Risk Management Committee and the Human Resources Committee. Has financial and accounting expertise as well as professional qualification.

Mr. Forer is a certified Public accountant having an academic education – BSc Economics from the Tel Aviv University.

Serves as chairman of the Board of K&G Properties Inc., Shir Tal Holdings and Management Ltd., P.H.Y. Holdings Ltd., Y.F.S.R. Management Services Ltd. and Director of Biomass Ltd. and of Conference on Jewish Material Claims against Germany Inc. Member of the advisory Committee of Tamir Fishman Investments Ltd. Until March 31, 2007, Mr. Forer served as Chairman of the accounting firm of Ernst & Young Israel (Cost Forer Gabbai and Kassierer) and Managing Partner of the accounting firm of Ernst & Young Israel (Cost Forer Gabbai and Kassierer) in the years 1979-2000. Fulfilled various duties in this Firm since 1959.

Dr. Dafna Schwartz - Serves as Director of the Bank since December 27, 2007. Member of the Credit Committee, Risk Management Committee and the Foreign Operations Committee. Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has financial and accounting expertise as well as professional qualification.

Dr. Schwartz has an academic education – Bachelor in Economics (Statistics) from the Tel Aviv University, Master in Agricultural Economics and Management, and PhD in Economics from the Hebrew University, Jerusalem.

Serves as an economic and business consultant and is Senior Lecturer Department of Business Administration, Head, MBA Specialization (Megama) in Entrepreneurship and High-Tech Management and Director, Bengis Center For Entrepreneurship and High-Tech Management, Ben Gurion University of the Negev.

Serves as an outside director of Oil Refineries Ltd. and Giron Development and Building Ltd. and Director of Rotem Industries Ltd. Served as Director of Phoenix Holdings Ltd. (until December 26, 2007), Phoenix Insurance Company Ltd. (until December 26, 2007), and Leumi Securities and Investments Ltd.

(until August 2007) and as outside Director in Orda Print Industries Ltd. (until July 2007), Al-Bad Massuot Itzhak Ltd. (until May 2004), and Hadar Insurance Company Ltd. (until August 2003).

Zvi Streigold - Serves as Director of the Bank since January 31, 2006. Member of the Credit committee, Human resources Committee, Financial Statements Committee and the Computer Committee. Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has professional qualification.

Mr. Streigold is a lawyer with a LL.B. Degree from the Tel Aviv University. He also studied economics there without graduating.

Works as a lawyer and serves as Director of Zvi Streigold-Law Company Ltd., Clal Finance Trust 2007 Ltd. (since March 24, 2008). Served as chairman of the Board of UBank Trust company Ltd. (until January 2006), Director of UBank Underwriting and Consulting Ltd. (until June 2005) and Chief Legal Counsel, head of Specialized Finance Division and member of senior Management of UBank Ltd. (until June 2005).

Tida Shamir - Serves as director of the Bank since September 23, 2002. Member of the Audit Committee, Foreign Operations Committee and the Insurance and Assets committee. Served as a member of the ad-hoc committee in the matter of Discount Bancorp Inc. and Israel Discount Bank of New York (the committee acted between April 2007 and December 2007). Serves as an outside Director according to Instruction 301 of the proper banking Management Instructions and has professional qualification.

Ms. Shamir is a lawyer having an academic education – LL.B Degree from the Hebrew University, Jerusalem and Master in Business Administration from the European Institute for Business administration INSEAD in France. Serves as Attorney at law and Director and Partner in the Firm of Tida Shamir & Co. Advocates, outside Director of Gazit-Globe Ltd. and Elron Electronic Industry Ltd. (since May 28, 2007) and director of Dikla Insurance Company Ltd. and of G.M.S.L. Ltd. (inactive company).

Dr. Yitzhak Sharir - Serves as director of the Bank since December 24, 2006. member of the Computer Committee, Human Resources Committee and Foreign Operations Committee. Has professional qualification. Dr. Sharir has an academic education – BSc Mechanical Engineering from the Haifa Technion, MSc Materials Engineering from the Negev Ben Gurion University, Beer Sheva, and PhD Materials Engineering from the Illinois Institute of technology, Chicago, USA. Has a non-academic diploma in Business Administration from the Israel Institute of Productivity in Tel Aviv.

Is engaged privately in business and investments. Serves as outside Director of Tzur Shamir Holdings Ltd. and chairman of the Board of Revolutionaire Ltd. (since September 2007). Served as President and CEO of Sapiens International Corporation NV (November 2000 to November 2005)

Prof. Eytan Sheshinski - Serves as Director of the Bank since January 31, 2006. Member of the risk management Committee and the Human resources Committee. Has professional qualification. Prof. Sheshinsky has an academic education – BA Degree in Economics and MA Degree in Economics and Statistics from the Hebrew University, Jerusalem, PhD degree in Economics from the Massachusetts Institute of Technology, USA.

Serves as Professor of Public Finance at the Hebrew University in Jerusalem and as Director of Pssagot Mutual Funds Ltd. Served as Director and chairman of the Investments Committee of Atudot Pension Fund (1996) Ltd. (until December 2004).



DETAILS REGARDING MEMBERS OF MANAGEMENT

Giora Offer - Serves as president and CEO of the Bank since March 2, 2001. serves as Chairman (temporary) of Discount Bancorp Inc. (Director since April 18, 2001, Chairman since April 13, 2007), Chairman of the Board of Israel discount Bank (Switzerland) SA, director of Israel discount Bank of New York. Mr. Offer has an academic education – Bachelor in Economics and Master in Industrial Management from the Negev Ben Gurion University, Beer Sheva. Served as Chairman of the Board of Israel credit cards Ltd. (until March 2006).

Ehud Arnon - Serving since May 13, 2007, as Executive Vice President Head of the Corporate banking Division of the Bank. Mr. Arnon has an academic education - Bachelor in Social Sciences – Economics and International Relations and Master in Business Administration from the Hebrew University, Jerusalem. Serves on the Management Board of the Israeli association of the san Francisco Federation (since 1995), as Director in Korat Fund (since 2005), member of Management of the International Chamber of Commerce (since 1995), member of Management of the Israel Britain Chamber of Commerce (since 2002), and a Director of Beyachad Fund (since 2006). Served as manager of the business wing and member of management of the Israeli branch of HSBC Bank Plc (2001 until May 12, 2007).

Dorit Bensimon - Serves since April 2, 2006, as Executive Vice President Head of Financial Division and as the Bank's Risk Manager. Serves also as Chairperson of the Board of Discount Manpikim Ltd. (since April 10, 2006), of Bet Lamed Dalit Ltd. (since January 23, 2007) and Direcotr of Manpikim Financial Operations Ltd. (in voluntary liquidation).

Ms. Bensimon has an academic education – Bachelor in Social Sciences – economics and general studies and Master in Business Administration (specializing in finance) from the Hebrew University, Jerusalem. Served as Director of Discount Reinsurance International Limited, Guernsey (since 2006 and until March 12, 2008), Director of Maalot - The Israel Rating Company Ltd. (April 17, 2006 to November 15, 2007) and General manager of Gmulot and Head of the provident funds asset management unit at Bank Hapoalim (February 2001 to January 2006).

Joseph Beressi - Serves as Senior Executive Vice President, Comptroller – Chief Accounting Officer and Head of the accounting layout of the Bank. Serves as Chief Accounting Officer since April 1, 2000, Executive Vice President since March 15, 2001, Comptroller and Senior Executive Vice President since May 14, 2007. Acts as Chairman of the Board of Discount Gemel Ltd. and Director of Israel Discount Capital Markets & Investments Ltd., Badal Computer and Management Services Ltd., Nidbach Real Estate and Investments Ltd. and Discount Reinsurance International Limited, Guernsey (since March 12, 2008). Mr Beressi is a certified Public Accountant and has an academic education – Bachelor in Accounting and Economics from the Tel Aviv University.

Amnon Gideon - Serves as from March 1, 2006, as Executive Vice President Head of the Human Resources layout of the Bank. Mr. Gideon has an academic education – Bachelor in Political Science and Psychology from Bar-Ilan University, and MA-HRM studies in Human Resources Management (has not graduated) at Derby University. He has also taken professional courses: Business administration and general Management (Bar-Ilan University), Export Import Management (Berkley University,

California), Human Resources Management (Berkley University, California). Served as Director of Discount Gemel (from March 15, 2006 to January 30, 2008) (until July 29, 2007 the company's name was Discount Provident Funds Management Ltd.) and as VP Human Resources at Partner Communications Ltd. (from 2001 to the beginning of 2006).

Israel David - Serves as Senior Executive Vice President, Head of the Retail Banking Division at the Bank. Serves as Vice President as from February 1, 2002, and as Head of the Retail Banking Division as from March 1, 2006 and as Serves as Senior Executive Vice President since May 14, 2007. Serves as Chairman of the Board of Discount Mortgage Bank Ltd. and as Director of Israel Credit Cards Ltd., Israel Credit Cards (assets) Ltd. (since February 3, 2008), and Bayit Meniv for Israel Ltd. (since May 16, 2005). Mr. David has an academic education – Bachelor in Economics from the Negev Ben Gurion University, Beer Sheva and Master in Business Administration from the Bar-Ilan University. He has also taken a course in management and guidance at the Bar-Ilan University. Served as Director of Diners Club Israel Ltd. (until December 2006), Director of Israel Discount Bank (Switzerland) SA (until March 2006), and acted as Head of the Marketing and Strategic Planning at the Bank (February 2002 – March 2006).

Esther Deutsch - Serves as Legal Adviser and Head of the Legal Advisory layout of the Bank as from June 1, 2006. Serves as member of management (since October 31, 2006) and as Executive Vice President (since May 14, 2007). Acts as Chairperson of the board of Discount Trust Ltd. (Chairperson since February 26, 2008 and Director since January 27, 2008). Serves as director of the Tel Aviv stock Exchange Ltd. (since July 2007).

Ms. Deutsch is a lawyer having an academic education – LL.B. from the Hebrew University, Jerusalem. Served as manager of the Legal department of the Bank (2000 to June 2006).

Noam Hanegbi - Serves as Senior Executive Vice President, Head of the Operations and Information Systems Division of the bank. Serves as Executive Vice President since November 15, 2000 and as Senior Executive Vice President since May 14, 2007. Acts as chairman of the Board of Banking clearing Center Ltd. and of Automatic bank services Ltd. (since July 1, 2007) and director (since November 2000), Chairman of the Board and CEO of Badal Computer and Management Services Ltd., and director of Mercantile Discount Bank Ltd., Nidbach Real Estate and Investments Ltd. and Israel Credit cards Ltd. Acts as member of the computer committee of the tel Aviv Stock exchange (since December 2001).

Mr Hanegbi has an academic education – Bachelor in Economics and Computer Sciences from the Bar-Ilan University. Served as Director of Diners Club Israel Ltd. (until December 2006).

Eli Hoter - Serves as Senior Executive Vice President, Head of the Marketing and Strategic Planning Division of the Bank. Serves as Executive Vice President since March 15, 2001, and in his present position since March 1, 2006, and as a Senior Executive Vice President since May 14, 2007. Serves as Director of Israel Discount Bank (Switzerland) SA, of Mercantile Discount Bank Ltd., of Israel Credit cards Ltd., and as Chairman of the Board of Nidbach Real Estate and Investments Ltd., Tzir Trading Company Ltd., and Har Levi Properties Ltd.



Mr. Hoter has an academic education – Bachelor in Psychology from the Haifa University and Executive MBA from the Tel Aviv University. Serves on the Management Board of the Society for the Protection of nature in Israel (since January 1, 2001). Served in the past as Head of the Human Resources layout at the Bank (March 2001 to February 28, 2006), Director of Diners Club Israel Ltd. (until December 2006), and director of Discount Gemel Ltd. (December 2002 to March 2006) (until July 29, 2007 the company's name was Discount Provident Funds Management Ltd.).

Shlomo Pitchon - Serves as Senior Executive Vice President and Internal Auditor of the bank as from September 1, 1994. Serves also as internal auditor of certain of the subsidiaries of the Bank. Mr. Pitchon is a Certified Public Accountant having an academic education - Bachelor in Economics and Accounting from the Tel Aviv University.

REPORT ON DIRECTORS HAVING ACCOUNTING AND FINANCIAL EXPERTISE

According to Section 92 (12) of the Companies Law, the board of directors must determine the required minimum number of directors having accounting and financial expertise, as this term is defined in Section 240 of the Companies Law.

In accordance with regulations enacted under the said Section 240, the evaluation of the accounting and financial expertise of a director shall be made by the board of directors, and, among other things, the following should be taken into account as part of the overall considerations: the director's education, experience and knowledge of the matters detailed in the Companies Regulations (terms and tests for a director having accounting and financial expertise and a director having professional qualifications), 2005.

In March 2004, the board of directors determined the minimum number of directors that should have accounting and financial expertise, in accordance with guidelines issued by the Securities Authority in October 2003, which was adopted by the Supervisor of Banks in December 2003.

In February 2006, the newly comprised board of directors, adopted, once again, the said resolution. Accordingly, the minimum number of such directors to serve on the board is three.

According to the directives of the Supervisor of Banks, a banking corporation must determine the minimum number of directors having accounting and financial expertise, who could properly serve as members of the audit committee of the board or of any other committee of the board which is empowered to discuss the financial statements of banking corporations.

In February 2006, the board determined that the minimum number of directors as abovementioned, who would serve on the audit committee of the board and on the financial statements committee of the board, is one.

The Directors having "accounting and financial expertise", and the factual background providing the basis for attributing these qualifications to them, are as follows. It should be mentioned that according to the reporting requirements of the Bank of Israel, against each name of a director it is stated whether he is a member of the financial statements committee of the board dealing with the Bank's financial statements and/or a member of the audit committee of the board.

Shlomo Zohar - Certified Public Accountant, Bachelor in Economics and Accounting and Master in Business Administration (specializing in accounting and finance).

From 1980 to the end of December 2005 was a partner in the accounting firm of Zohar, Zohar & Co., CPA (Isr). Also served as director in various companies.

As from 2006, Mr. Zohar serves as active chairman of the Bank's board of directors, as chairman of the boards of directors of Mercantile Discount Bank Ltd., Israel Credit Cards Ltd., Israel Discount Capital Market & Investment Ltd., as vice chairman of the board of directors of IDB New York, and as director, Discount Bancorp Inc..

Mr. Zohar serves as a member of the financial statements committee.

Betzalel Eiger - Bachelor in business administration, Masters in business administration (specializing in finance).

Chairman of the Board of Directors and CEO of Dorea Investments and Development Ltd., a company traded on the Tel-Aviv Stock Exchange, engaged in real estate mainly in income property segment in Israel and abroad. Chairman of the Board of Directors and CEO of Liberty Properties Ltd., a public company traded on the Tel-Aviv Stock Exchange, engaged in real estate. Serves as Director in Comsec Ltd, a public company engaged in data security and in Ortam Sahar Engineering Ltd.

In the period from December 2001 until January 2006, served as outside Director in Adanim Mortgage Bank Ltd. In the period from 1987 to September 2003 served as Director in Neot Aviv Ltd. From May 2002 to March 2005 served as CEO of Giron- Development and Building Ltd. From 1979 to 1994 held various positions in Bank Leumi, including as a member of various credit committees of the bank. His experience includes analysis of financial statements.

Ittamar Givton - Bachelor in economics and law.

Serves as Managing Director of the Automotive Equipment Group (since 1993) and as Director in Automotive Equipment Ltd and in Automotive Equipment & Vehicles (2004) Ltd, and their affiliated companies. He also serves as member of the Management Committee of Buxenbaum-Neta Fund (private fund), a member of management of Sheba Fund (endowment) and as chairman of the finance and investments committees of these funds.

Served as Director of the Tel-Aviv Stock Exchange Ltd. (1993-1995), Deputy General Manager and CFO of Automotive Equipment Group (1991-1993), Vice President and Acting Managing Director of Dor Energy Ltd. (1988-1990) and Assistant General Manager Economics and Business Development of Dankner Investments Ltd. (1987-1991).

From 1979 to 1987 held several positions at the Ministry of Finance including Deputy Budget Director (1984-1987) and a member of the small team that prepared the program for the 1985 economic arrangement.

He also served as a member of the Board of Directors of various Government corporations including the Israel Electric Corporation Ltd. (1982-1989) and Israel Chemicals Ltd. (1985-1987)



Ben-Zion Granit - BSc. in Agriculture from Hebrew University with a minor in agricultural economics. Studied senior business management at the Business School of the Hebrew University and took courses in a wide range of financial subjects.

Served as chief internal auditor of Union Bank of Israel Ltd. and its subsidiaries (1993-2000), as executive vice president, member of management and head of the operations division at Union Bank (2000-2004), as risk manager (market and credit risks) of Union Bank (2004). He also served as CEO of Union - Systems Ltd. (2000-2004) and as director of Carmel Igud Mortgages and Investments, Ltd. and of Igudim Ltd. (2000-2004).

Mr. Granit serves as member of the audit committee and the financial statements committee.

Prof. Ben-Zion Zilberfarb - Bachelor in Economics and Business Administration, Master in Economics, Ph.D. in Economics from the University of Pennsylvania. Serves as Professor of Economics at Bar-Ilan University and holds the Edmond de Rothschild Chair for Global Asset Management at the School of Banking and Capital Markets at the Netanya Academic College.

Serves as outside director and member of the audit committees of Brimag Digital Age Ltd., Direct Capital Investments Ltd. and of Delek Group Ltd. Serves as an outside director of Perrigo Company (an American company). Served as outside director and member of the audit committee of Fundtech Ltd. and Clal Provident Fund and Education Fund Financing Ltd.

Served as outside director in Partner Communications (including a tenure as chairman of the audit committee). Served as Chairman of the Board of Directors of Karnit (1998-2000) and of Eurotrade Bank Ltd. (2000-2001). In the years 1982-1985, he served as director of the Economic Planning Authority, and 1988-1989 as Director General of the Ministry of Finance.

Partner Communications Ltd. reported him as having financial expertise under the US Securities Regulations. As a member of the audit committees of Fundtech and of Partner Communications Ltd., accompanied the process implementing requirements under the Sarbanes-Oxley Act. Is proficient in accounting matters pertaining to GAAP and to the recognition of earnings and other subjects relating to the communications sector.

Prof. Zilberfarb serves as member of the financial statements committee.

Joseph Singer - Bachelor in Economics and Business Administration, Master in Business Administration. Serves as director and managing partner of Giza Singer & Even Ltd., an economics and business consulting company specializing in two central areas: one, analysis and valuation of companies and the other, company and project financing. In addition, is a member of the boards of directors of various companies, including Singer & Even Ltd., Midroog Ltd., a rating company, Midroog Holdings Ltd., Giza Singer & Even Finance Ltd. and Singer, Even & Kreizberg Holdings Ltd., Giza Singer Even Real Estate Ltd. and Giza Singer Even Investments 2007 Ltd. Also serves as an independent director of Poalim I.B.I. – Underwriting & Issuance Ltd. Served as outside director of Edmond de Rothschild Mutual Funds Management Ltd. and as Chairman of its investments committee. Served as outside director of Otzarit Mutual Funds Management Co. Ltd.

For over a decade served as President and CEO of Singer and Even Ltd. – Economics and Business Consulting Company.

Mr. Singer is a member of the financial statements and audit committees.

Tsippi Samet - Bachelor in Economics and Mathematics, Masters in Economics from the Hebrew University, Jerusalem.

Serves as President of Adif College for Insurance, Pension and Finance Studies, and as outside director in Sinai Insurance Holdings (1993) Ltd., Menora Mivtachim Pensions Ltd., Menora Mivtachim Gemel Ltd. and Ophir Optronics Ltd., as well as Chairperson of the Investment Committee of Avner –Motor Vehicle Accident Victims Insurance Ltd.

She served as outside director of Hazera Genetics Ltd. (2003 – February 2007).

In the period 1998-2002, served as Commissioner of Capital Markets, Insurance and Savings and at the same time served as director of M.I. Holdings Ltd. Between 1996-1998, served as a member of the Israel Securities Authority. Between 1983-1995, held the office of senior economist in the research unit of the Supervisor of Banks.

Ms. Samet serves as chairwoman of the audit committee.

Itshak Forer, B.A.(Econ.) Certified Public Accountant

Since 1959 to March 31, 2007, served in various positions with the accounting firm of Ernst & Young Israel (Kost Forer Gabbay & Kassierer): since 1959 to 1962 - auditor; 1962 to 1979 – partner; 1979 to end of December 1999 – managing partner; beginning of 2000 to end March 2007 – chairman. He also served as director and chairman of the audit committee of Oil Refineries Ltd. and as director and chairman of the finance committee of Tadiran Ltd.

Mr. Forer acts as chairman of the financial statements committee.

Dr. Dafna Schwartz, B.A. (Econ.)(Statistics), M.Sc. (Agriculture Econ. and Administration), PH.D. (Hebrew University, Jerusalem).

Serves as Senior Lecturer, Department of Business Administration, Head, MBA Specialization (Magama) in Entrepreneurship and High-Tech Management, and Director, Bengis Center for Entrepreneurship and High-Tech Management Ben Gurion University of the Negev and as economic and business consultant in Israel and abroad.

Serves as an outside director of the following companies: Oil Refineries Ltd., Giron Development and Buildings Ltd. In addition serves as director of Rotem Industries Ltd.

Also served in the past as director of The Phoenix Holdings Ltd. (August 2003 – December 2007), The Phoenix Insurance Company Ltd. (May 2006 – December 2007), Israel Discount Bank Ltd. (1995–2002) and Bezeq the Israel Telecommunication Corp. (1997–2000).

CHANGES IN THE BOARD OF DIRECTORS

Mr. Zeev Vurembrand and Mr. Gene Kleinhendler retired from the Board on December 18, 2007, while Mr. Gad Arbel retired from the Board on December 27, 2007.

The Chairman and members of the Board wish to thank the retired members for their effort and contribution to the Bank during their period of service.

The general meeting of shareholders held on December 18, 2007, resolved to appoint as Directors to the Bank Mr. Itshak Forer CPA, effective from December 18, 2007, and Dr. Dafna Schwartz effective from December 27, 2007.



MEETINGS OF THE BOARD AND ITS COMMITTEES

In 2007, the Board of Directors held 32 meetings. In addition, 77 meetings of committees of the Board of Directors were held.

The Board of Directors wishes to thank the President & Chief Executive Officer, the members of Management, the Bank's employees and employees of the Group's companies and their management for their work towards the advancement of the Bank and the Group.

March 31, 2008

Shlomo Zohar
Chairman of
the Board of Directors

Giora Offer
President and
Chief Executive Officer

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SCHEDULE A - CONSOLIDATED BALANCE SHEET - MULTI-PERIOD DATA

As at December 31					
	2007	2006	2005	2004	2003
	Reported amounts ⁽¹⁾				Adjusted amounts ⁽¹⁾
	In NIS millions				
Assets					
Cash and deposits with banks	19,850	*25,100	20,586	17,751	16,888
Securities	37,278	*38,977	*42,226	*40,099	38,774
Securities borrowed or purchased under resale agreements	346	-	-	-	-
Credit granted to the public	101,899	*90,097	*87,778	*81,254	79,671
Credit granted to the Government	374	*324	92	271	367
Investments in affiliated companies	2,008	*1,367	*1,478	*1,258	*1,218
Buildings and equipment	2,780	2,614	2,268	1,978	2,102
Other assets	4,275	*4,044	*4,292	*3,666	*3,462
Total assets	168,810	162,523	158,720	146,277	142,482
Liabilities and Shareholders' Equity					
Deposits from the public	130,518	130,517	130,285	121,982	120,104
Deposits from banks	5,072	8,099	6,518	4,806	4,948
Deposits from the Government	125	119	136	127	140
Securities loaned or sold under buy-back arrangements	5,895	-	-	-	-
Debentures and subordinated capital notes	7,437	6,302	5,342	4,809	4,223
Other liabilities	10,412	*9,119	9,254	7,718	6,628
Total liabilities	159,459	154,156	151,535	139,442	136,043
Minority interest	147	402	467	449	484
Shareholders' equity	9,204	7,965	6,718	6,386	5,955
Total liabilities and shareholders' equity	168,810	162,523	158,720	146,277	142,482

* Reclassified.

Footnotes:

(1) See Note 1 B.

SCHEDULE B - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

	As at December 31				
	2007	2006	2005	2004	2003
	Reported amounts ⁽¹⁾				
	in NIS millions				
Financing Income					
Income from financing activities before provision for doubtful debts	4,225	3,790	3,697	3,473	2,970
Provision for doubtful debts	447	570	691	880	845
Income from financing activities after provision for doubtful debts	3,778	3,220	3,006	2,593	2,125
Non-Financing Income					
Operating commissions	2,216	1,911	1,863	1,776	1,666
Net income on investment in shares	58	65	3	103	9
Other income	298	383	540	352	434
Total non-financing income	2,572	2,359	2,406	2,231	2,109
Non-Financing Expenses					
Salaries and related expenses	3,030	*3,202	*2,967	2,564	2,303
Maintenance and depreciation of buildings and equipment	819	679	670	634	638
Other expenses	1,217	*1,139	*1,092	830	669
Total non-financing expenses	5,066	5,020	4,729	4,028	3,610
Operating income before taxes in reported amounts	1,284	559	683	796	624
Erosions and adjustments ⁽¹⁾	-	-	-	-	30
Operating income before taxes	1,284	559	683	796	654
Provision for taxes on operating income	566	350	324	342	371
Operating income after taxes	718	209	359	454	283
Bank's share in operating income of affiliated companies, net of tax effect	45	188	174	135	117
Net operating income before minority interest	763	397	533	589	400
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(56)	(82)	(75)	(56)	(60)
Net operating income	707	315	458	533	340
Net cumulative effect as of the beginning of the year of change in accounting	-	-	(4)	(1)	10
Net income, before extraordinary income (loss) after taxes	707	315	454	532	350
Cancellation of provision (provision) for impairment in value of investment in affiliated companies	-	173	-	-	(173)
Net income (loss) from extraordinary items, net of taxes	558	348	4	24	(23)
Net income	1,265	836	458	556	154

* Reclassified.
For footnotes see next page.

SCHEDULE B - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA (CONTINUED)

As at December 31					
	2007	2006	2005	2004	2003
Reported amounts ⁽¹⁾					
in NIS millions					
Earnings per share of NIS 0.1 (in NIS)⁽¹⁾:					
Net operating income	0.72	0.32	0.47	0.54	0.35
Net income (loss) from extraordinary items, net of taxes ⁽²⁾	0.57	0.53	-	0.03	(0.19)
Net income	1.29	0.85	0.47	0.57	0.16
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639	980,639

Footnotes:

(1) See Note 1B of the financial statements.

(2) December 31, 2006: Including a cancellation of provision for impairment in value of investment in an affiliated company.

December 31, 2005 and December 31, 2004: Including net cumulative effect as of the beginning of the year of change in accounting.

December 31, 2003: Including a provision for impairment in value of investment in an affiliated company and the net cumulative effect as of the beginning of the year of change in accounting.

SCHEDULE C - INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾

REPORTED AMOUNTS

	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⁾	60,249	3,660	6.07		*53,588	3,586	6.69	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	65	2			-	-		
Embedded derivatives and ALM	29,566	910			9,708	57		
Total assets	89,880	4,572		5.09	63,296	3,643		5.76
Liabilities ⁽⁵⁾	(57,918)	(1,693)	(2.92)		*(53,020)	(1,969)	(3.71)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(66)	-			-	-		
Embedded derivatives and ALM	(28,146)	(884)			(8,386)	18		
Total liabilities	(86,130)	(2,577)		(2.99)	(61,406)	(1,951)		(3.18)
Interest margin			3.15	2.10			2.98	2.58
Israeli Currency Linked to the CPI:								
Assets ⁽⁴⁾⁽⁵⁾	21,544	1,715	7.96		21,434	1,111	5.18	
Effect of derivatives: ⁽³⁾								
Embedded derivatives and ALM	655	30			51	3		
Total assets	22,199	1,745		7.86	21,485	1,114		5.19
Liabilities ⁽⁵⁾	(18,727)	(1,274)	(6.80)		(18,841)	(742)	(3.94)	
Effect of derivatives: ⁽³⁾								
Embedded derivatives and ALM	(1,574)	(109)			(964)	(25)		
Total liabilities	(20,301)	(1,383)		(6.81)	(19,805)	(767)		(3.87)
Interest margin			1.16	1.05			1.24	1.32
Foreign Currency:⁽⁶⁾								
Assets ⁽⁴⁾⁽⁵⁾	73,352	(1,033)	(1.41)		76,132	(832)	(1.09)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	755	(110)			**890	**12		
Embedded derivatives and ALM	40,365	(848)			**31,502	**550		
Total assets	114,472	(1,991)		(1.74)	108,524	(1,370)		(1.26)
Liabilities ⁽⁵⁾	(73,529)	2,724	3.70		(75,471)	2,375	3.15	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(753)	114			**906	**2		
Embedded derivatives and ALM	(40,818)	672			**29,244	**453		
Total liabilities	(115,100)	3,510		3.05	(105,621)	2,826		2.68
Interest margin			2.29	1.31			2.06	1.42

* The comparative data have been reclassified in order to include debt balances and liabilities in respect of open credit card transactions.

** Reclassified.

For footnotes see page 318.

SCHEDULE C - INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾**(CONTINUED)****REPORTED AMOUNTS**

	2007				2006			
			Ratio of income (expense)				Ratio of income (expense)	
			Excluding the effect of derivatives	Including the effect of derivatives ⁽³⁾			Excluding the effect of derivatives	Including the effect of derivatives ⁽³⁾
	Average balance ⁽²⁾	Financing income (expense)			Average balance ⁽²⁾	Financing income (expense)		
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated financing income ⁽⁴⁾⁽⁵⁾	155,145	4,342	2.80		151,154	3,865	2.56	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	820	(108)			890	12		
Embedded derivatives and ALM	70,586	92			41,261	(490)		
Total assets	226,551	4,326		1.91	193,305	3,387		1.75
Monetary liabilities which generated financing expenses ⁽⁵⁾	(150,174)	(243)	(0.16)		(147,332)	(336)	(0.23)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(819)	114			(906)	(2)		
Embedded derivatives and ALM	(70,538)	(321)			(38,594)	446		
Total liabilities	(221,531)	(450)		(0.20)	(186,832)	108		0.06
Interest margin			2.64	1.71			2.33	1.81
In respect of options		(75)				108		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives) ⁽³⁾		89				(4)		
Commissions on financing operations and other financing income ⁽⁷⁾		363				305		
Other financing expenses		(28)				(114)		
Income from financing activities before provision for doubtful debts		4,225				3,790		
Provision for doubtful debts (including general and supplemental provisions)		(447)				(570)		
Income from financing activities after provision for doubtful debts		3,778				3,220		

For footnotes see page 318.

SCHEDULE C - INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾

(CONTINUED)

REPORTED AMOUNTS

	2007	2006
	Average balance ⁽²⁾	
	in NIS millions	
Total:		
Monetary assets which generated financing income ⁽⁴⁾⁽⁵⁾	155,145	151,154
Assets related to derivative instruments ⁽⁸⁾	1,325	-
Other monetary assets ⁽⁵⁾	3,405	3,355
General and supplemental provisions for doubtful debts	(609)	(721)
Total monetary assets	159,266	153,788
Total:		
Monetary liabilities which generated financing expenses ⁽⁵⁾	(150,174)	(147,332)
Liabilities related to derivative instruments ⁽⁸⁾	(1,384)	(200)
Other monetary liabilities ⁽⁵⁾	(4,552)	(3,420)
Total monetary liabilities	(156,110)	(150,952)
Surplus of monetary assets over monetary liabilities	3,156	2,836
Non-monetary assets	5,898	4,827
Non-monetary liabilities	(192)	(61)
Total capital resources	8,862	7,602

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 (192) million in the non-linked segment, NIS (14) million in the CPI linked segment and NIS 84 million in the foreign currency segment; 2006 – NIS (73) million in the non-linked segment, NIS (2) million in the CPI linked segment and NIS 132 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).

SCHEDULE C - INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾ (CONTINUED)

	2007				2006			
	Ratio of income (expense)				Ratio of income (expense)			
	Average	Financing	Excluding	Including	Average	Financing	Excluding	Including
	balance ⁽²⁾	income	the	the	balance ⁽²⁾	income	the	the
		(expense)	effect of	effect of		(expense)	effect of	effect of
	in US\$ millions		derivatives	derivatives ⁽³⁾	in US\$ millions		derivatives	derivatives ⁽³⁾
Foreign Currency –								
Nominal in US\$^{(6)*}								
Assets ⁽⁴⁾⁽⁵⁾	17,839	1,021	5.72		16,974	931	5.48	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	187	(17)			**200	**15		
Embedded derivatives and ALM	10,003	400			**7,063	**248		
Total Assets	28,029	1,404		5.01	24,237	1,194		4.93
Liabilities ⁽⁵⁾	(17,938)	(721)	(4.02)		(16,916)	(630)	(3.72)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(187)	18			**(203)	**(17)		
Embedded derivatives and ALM	(10,069)	(386)			**(7,208)	**(218)		
Total liabilities	(28,194)	(1,089)		(3.86)	(24,327)	(865)		(3.56)
Interest margin		315	1.70	1.15		329	1.76	1.37

* Nominal Israeli Shekel amounts translated to US\$ Dollars at the representative rate of exchange.

** 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 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\$ 20 million 2006 - in the amount of US\$ 29 millions.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.



SCHEDULE D - BANK'S EXPOSURE TO FLUCTUATIONS IN INTEREST RATES AS OF DECEMBER 31, 2007

REPORTED AMOUNTS (IN NIS MILLIONS)

	On demand to 1 month	Over 1 month to 3 months	Over 3 months to 1 year	Over 1 to 3 years
Non-linked Israeli Currency				
Total assets	46,034	6,156	2,723	4,251
Total liabilities	48,645	3,078	6,260	1,709
Difference	(2,611)	3,078	(3,537)	2,542
Effect of forward transactions and special commitments	24,005	(493)	(2,979)	(10,673)
Options	(25)	(41)	153	(56)
Exposure to changes in interest rates in the segment	21,369	2,544	(6,363)	(8,187)
Cumulative exposure in the segment	21,369	23,913	17,550	9,363
Israeli Currency Linked to the CPI				
Total assets	858	621	2,937	6,295
Total liabilities	511	1,135	3,295	4,430
Difference	347	(514)	(358)	1,865
Effect of forward transactions and special commitments	62	(23)	(198)	(290)
Options	-	-	-	-
Exposure to changes in interest rates in the segment	409	(537)	(556)	1,575
Cumulative exposure in the segment	409	(128)	(684)	891
Foreign Currency**				
Total assets	33,965	16,394	7,839	3,529
Total liabilities	39,725	24,597	8,907	1,075
Difference	(5,760)	(8,203)	(1,068)	2,454
Effect of forward transactions and special commitments	817	718	(2,467)	5
Options	25	41	(153)	55
Exposure to changes in interest rates in the segment	(4,918)	(7,444)	(3,688)	2,514
Cumulative exposure in the segment	(4,918)	(12,362)	(16,050)	(13,536)
Overall Exposure to Changes in Interest Rates				
Total assets***	80,857	23,171	13,499	14,075
Outstanding debt deriving from credit card transactions****				
Total balance sheet assets	80,857	23,171	13,499	14,075
Total liabilities***	88,881	28,810	18,462	7,214
Creditors in respect of credit card activity****				
Total balance sheet liabilities	88,881	28,810	18,462	7,214
Difference	(8,024)	(5,639)	(4,963)	6,861
Effect of forward transactions and special commitments	24,884	202	(5,644)	(10,959)
Exposure to changes in interest rates in the segment	16,860	(5,437)	(10,607)	(4,098)
Cumulative exposure in the segment	16,860	11,423	816	(3,282)

General notes:

- (1) Full data as the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.
 - (2) In this table, the data according to periods present the present value of future cash flows discounted at the internal yield rate of the particular balance sheet item. Future cash flows discounted as above include interest which will accrue at maturity date or at the date of change in the interest rate, the earlier of the two.
 - (3) The effect of hedge transactions is included in total assets or total liabilities, as the case may be.
- * The column "No fixed maturity" shows the amount stated in the balance sheet.
- ** Including Israeli currency linked to foreign currency.
- *** Including non-monetary assets and liabilities which are presented in the "No fixed maturity" column.
- **** Assets and liabilities deriving from the use of credit cards, to which customers are already committed.

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	Over 3 to 5 years	Over 5 to 10 years	Over 10 to 20 years	Over 20 years	No fixed maturity*	Total	Rate of return %	Average duration in years	31.12.2006	
									Rate of return %	Average duration in years
	1,084	2,632	457	2	1,351	64,690	6.00	0.71	5.20	0.62
	420	704	406	117	115	61,454	3.01	0.41	2.23	0.30
	664	1,928	51	(115)	1,236	3,236	2.99	0.30	2.97	0.32
	(2,853)	(6,749)	26	-	-	284				
	(186)	120	363	1	-	329				
	(2,375)	(4,701)	440	(114)	1,236	3,849				
	6,988	2,287	2,727	2,613	3,849	-				
	4,267	5,151	2,374	171	179	22,853	5.08	4.61	5.32	4.16
	3,259	4,625	1,538	-	89	18,882	4.30	4.11	4.39	4.03
	1,008	526	836	171	90	3,971	0.78	0.50	0.93	0.13
	(37)	(2,343)	(237)	-	-	(3,066)	-	-	-	-
	-	2	-	-	-	2	-	-	-	-
	971	(1,815)	599	171	90	907	-	-	-	-
	1,862	47	646	817	907	-	-	-	-	-
	1,964	2,761	2,273	984	344	70,053	5.08	1.35	4.62	1.26
	159	86	42	-	27	74,618	3.34	0.23	3.63	0.51
	1,805	2,675	2,231	984	317	(4,565)	1.74	1.12	0.99	0.75
	402	3,360	(53)	-	-	2,782	-	-	-	-
	186	(121)	(363)	(1)	-	(331)	-	-	-	-
	2,393	5,914	1,815	983	317	(2,114)	-	-	-	-
	(11,143)	(5,229)	(3,414)	(2,431)	(2,114)	-	-	-	-	-
	7,315	10,544	5,104	1,157	8,799	164,521	-	1.56	-	1.43
						4,289				
	7,315	10,544	5,104	1,157	8,799	168,810				
	3,838	5,415	1,986	117	447	155,170	-	0.77	-	0.88
						4,289				
	3,838	5,415	1,986	117	447	159,459				
	3,477	5,129	3,118	1,040	8,352	9,351	-	0.79	-	0.55
	(2,488)	(5,731)	(264)	-	-	-	-	-	-	-
	989	(602)	2,854	1,040	8,352	9,351	-	-	-	-
	(2,293)	(2,895)	(41)	999	9,351	-	-	-	-	-

SCHEDULE E - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS
REPORTED AMOUNTS (IN NIS MILLIONS)

December 31, 2007					
	Balance sheet credit risk ⁽¹⁾	Off-balance sheet credit risk ⁽²⁾	Total credit risk	Annual expense on specific provision for doubtful debts	Balance of problematic debt ⁽³⁾
1. Lending Activity in Israel					
Agriculture	797	392	1,189	(3)	41
Industry	12,581	13,517	26,098	76	925
Construction and real estate	12,853	11,096	23,949	92	2,576
Electricity and water	1,003	329	1,332	-	2
Commerce	8,138	6,798	14,936	52	382
Hotels, hotel services and food	2,111	627	2,738	28	896
Transportation and storage	3,453	1,513	4,966	10	89
Communications and computer services	2,334	2,128	4,462	8	424
Financial services	8,048	14,286	22,334	5	41
Other business services	6,094	3,525	9,619	22	311
Public and community services	1,595	1,098	2,693	9	181
Individuals - housing loans	11,149	649	11,798	10	425
Individuals - other loans	13,216	10,646	23,862	123	590
Total	83,372	66,604	149,976	432	6,883
Less a deposit abroad linked to the credit risk of the borrower	(59)	-	(59)	-	-
Total	83,313	66,604	149,917	432	6,883
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements ⁽⁴⁾	409	141	550	3	113
Local authorities ⁽⁵⁾	216	138	354	-	11
2. Lending Activity Outside of Israel					
Agriculture	28	-	28	-	-
Industry	4,049	2,963	7,012	12	149
Construction and real estate	6,606	2,280	8,886	4	107
Electricity and water	79	125	204	-	-
Commerce	4,176	3,722	7,898	(11)	130
Hotels, hotel services and food	724	130	854	-	-
Transportation and storage	113	21	134	-	-
Communications and computer services	154	17	171	-	25
Financial services	3,815	1,267	5,082	10	64
Other business services	1,943	1,698	3,641	12	84
Public and community services	79	39	118	-	-
Individuals - housing loans	35	-	35	-	-
Individuals - other loans	1,019	439	1,458	-	7
Total	22,820	12,701	35,521	27	566

Footnotes:

(1) Credit to the public of NIS 102,487 million, investments in bonds of NIS 3,199 million, and assets relating to derivative instruments created with the public of NIS 447 million.

(2) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation.

Due to lack of data, only partial information regarding unutilized credit lines is included in respect of a consolidated subsidiary.

(3) The balance of problematic debts net of credit covered by collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability limitation.

Includes the components of off-balance sheet risk.

(4) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the agricultural settlement movements.

(5) Including corporations under their control.

Credit risk and the balance of problematic debts are presented after deducting specific provisions for doubtful debts.

SCHEDULE E - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS (CONTINUED)

ADJUSTED AMOUNTS* (IN NIS MILLIONS)

December 31, 2006					
	Balance sheet credit risk ⁽¹⁾	Off-balance sheet credit risk ⁽²⁾	Total credit risk	Annual expense on specific provision for doubtful debts	Balance of problematic debt ⁽³⁾
1. Lending Activity in Israel					
Agriculture	718	395	1,113	8	41
Industry	11,499	11,172	22,671	122	876
Construction and real estate	11,210	10,292	21,502	153	3,036
Electricity and water	1,381	331	1,712	(2)	2
Commerce	7,942	5,321	13,263	42	447
Hotels, hotel services and food	2,128	554	2,682	6	1,053
Transportation and storage	2,917	1,097	4,014	16	100
Communications and computer services	2,431	1,269	3,700	9	635
Financial services	*6,107	7,401	13,508	40	145
Other business services	5,040	2,815	7,855	48	266
Public and community services	1,560	859	2,419	5	187
Individuals - housing loans	*9,615	*881	10,496	19	*462
Individuals - other loans	*12,088	*10,531	22,619	77	*485
Total	74,636	52,918	127,554	543	7,735
Less a deposit abroad linked to the credit risk of the borrower	(63)	-	(63)	-	-
Total	74,573	52,918	127,491	543	7,735
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements ⁽⁴⁾	*348	*11	359	8	*142
Local authorities ⁽⁵⁾	244	*182	426	-	16
2. Lending Activity Outside of Israel					
Agriculture	25	-	25	-	-
Industry	3,609	2,677	6,286	58	99
Construction and real estate	4,911	1,648	6,559	-	42
Electricity and water	75	127	202	-	-
Commerce	4,214	3,623	7,837	42	111
Hotels, hotel services and food	490	31	521	-	-
Transportation and storage	67	62	129	-	-
Communications and computer services	118	11	129	-	-
Financial services	3,132	877	4,009	-	4
Other business services	1,406	1,303	2,709	-	-
Public and community services	60	3	63	-	-
Individuals - housing loans	11	-	11	-	-
Individuals - other loans	1,179	332	1,511	-	4
Total	19,297	10,694	29,991	100	260

* Restated.

Footnotes:

(1) Credit to the public of NIS 90,691 million, investments in bonds of NIS 2,678 million, and assets relating to derivative instruments created with the public of NIS 501 million.

(2) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation.

Due to lack of data, only partial information regarding unutilized credit lines is included in respect of a consolidated subsidiary.

(3) The balance of problematic debts net of credit covered by collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability limitation. Includes the components of off-balance sheet risk.

(4) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the agricultural settlement movements.

(5) Including corporations under their control.

Credit risk and the balance of problematic debts are presented after deducting specific provisions for doubtful debts.



**SCHEDULE F - CREDIT RISK ON A CONSOLIDATED BASIS BY GEOGRAPHIC REGION - ULTIMATE RISK
IN DEVELOPING COUNTRIES (LDC)
REPORTED AMAUNTS (IN NIS MILLIONS)**

	December 31	
	2007	*2006
Credit ⁽¹⁾⁽²⁾	1,284	1,155
Off-balance sheet credit risk ⁽³⁾	130	82
Total	1,414	1,237

* Reclassified.

Footnotes:

(1) After deducting specific provisions for doubtful debts.

(2) The amount of expense in respect of the specific provision for doubtful debts totals NIS 2.2 million (2006: NIS 0.1 million).

(3) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation.

SCHEDULE C - CONDENSED CONSOLIDATED BALANCE SHEET FOR END OF EACH QUARTER REPORTED AMOUNTS

Quarter	2007				2006			
	4	3	2	1	4	3	2	1
In NIS millions								
Assets								
Cash and deposits with banks	19,850	23,238	26,135	24,021	*25,100	*23,075	22,084	21,134
Securities	37,278	*40,343	*39,825	*39,627	*38,977	*39,034	*40,688	*42,924
Securities borrowed or purchased under resale agreements	346	375	*488	149	-	-	-	-
Credit granted to the public	101,899	*96,911	*95,000	*90,789	*90,097	*89,707	*88,410	*87,917
Credit granted to the Government	374	12	*25	17	*324	*128	81	101
Investments in affiliated companies	2,008	1,527	1,450	*1,464	*1,367	*1,786	*1,732	*1,699
Buildings and equipment	2,780	2,715	2,678	2,645	2,614	2,567	2,412	2,369
Other assets	4,275	4,620	4,421	*3,897	*4,044	*4,167	*4,170	*4,041
Total assets	168,810	169,741	170,022	162,609	162,523	160,464	159,577	160,185
Liabilities and Shareholders' Equity								
Equity								
Deposits from the public	130,518	*129,555	*133,189	*126,852	130,517	130,872	129,435	131,882
Deposits from banks	5,072	7,530	8,157	9,548	8,099	6,817	7,732	6,428
Deposits from the Government	125	124	123	96	119	130	120	107
Securities loaned or sold under buy-back arrangements	5,895	*6,273	*2,768	*1,953	-	-	-	-
Subordinated capital notes	7,437	6,730	6,614	6,432	6,302	5,856	5,561	5,560
Other liabilities	10,412	*10,225	*10,183	*9,072	*9,119	*8,808	9,118	8,898
Total liabilities	159,459	160,437	161,034	153,953	154,156	152,483	151,966	152,875
Minority' interest	147	136	120	418	402	444	463	487
Shareholders' equity	9,204	9,168	8,868	8,238	7,965	7,537	7,148	6,823
Total liabilities and shareholders' equity	168,810	169,741	170,022	162,609	162,523	160,464	159,577	160,185

* Reclassified.

**SCHEDULE H - CONDENSED CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER -
MULTI QUARTER DATA
REPORTED AMOUNTS**

Quarter	2007			
	4	3	2	1
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	1,075	1,212	916	1,022
Provision for doubtful debts	85	108	158	96
Profit from financing activities after provision for doubtful debts	990	1,104	758	926
Non-Financing Income				
Operating commissions	585	560	540	531
Net income (loss) from investment in shares	(16)	20	4	50
Other income	57	42	131	68
Total non-financing income	626	622	675	649
Non-Financing Expenses				
Salaries and related expenses	834	768	641	787
Maintenance and depreciation of buildings and equipment	223	212	194	190
Other expenses	357	279	328	253
Total non-financing expenses	1,414	1,259	1,163	1,230
Operating income before taxes	202	467	270	345
Provision for taxes on operating income	135	195	69	167
Operating income after taxes	67	272	201	178
Bank's share in operating income of affiliated companies net of tax effect	(99)	56	47	41
Net operating income (loss) before minority interest	(32)	328	248	219
Minority interest in the operating income after taxes of consolidated companies	(10)	(16)	(13)	(17)
Net operating income (loss)	(42)	312	235	202
Net income from extraordinary items, net of taxes	83	80	392	3
Net income	41	392	627	205
Earnings per share of NIS 0.1 (in NIS):				
Net operating income (loss)	(0.05)	0.32	0.24	0.21
Net income from extraordinary items, net of taxes	0.09	0.08	0.40	-
Net income	0.04	0.40	0.64	0.21
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639

**SCHEDULE H - CONDENSED CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER -
MULTI QUARTER DATA (CONTINUED)
REPORTED AMOUNTS**

Quarter	2006			
	4	3	2	1
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	1,004	961	933	892
Provision for doubtful debts	177	142	109	142
Income from financing activities after provision for doubtful debts	827	819	824	750
Non-Financing Income				
Operating commissions	502	471	465	473
Net income on investment in shares	14	1	42	8
Other income	113	66	95	109
Total non-financing income	629	538	602	590
Non-Financing Expenses				
Salaries and related expenses	834	*623	749	996
Maintenance and depreciation of buildings and equipment	179	175	159	166
Other expenses	334	*245	289	271
Total non-financing expenses	1,347	1,043	1,197	1,433
Operating income (loss) before taxes	109	314	229	(93)
Provision for taxes on operating income	70	112	90	78
Operating income (loss) after taxes	39	202	139	(171)
Bank's share in operating income of affiliated companies, net of tax effect	29	61	49	49
Net operating income (loss) before minority interest	68	263	188	(122)
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(16)	(18)	(25)	(23)
Net operating income (loss)	52	245	163	(145)
Cumulative effect of change in accounting	-	-	-	173
Net income (loss) from extraordinary items, net of taxes	96	(1)	254	(1)
Net income	148	244	417	27
Earnings (losses) per share of NIS 0.1 (in NIS):				
Net operating income (loss)	0.05	0.25	0.17	(0.15)
Net income from extraordinary items, net of taxes ⁽¹⁾	0.10	-	0.26	0.18
Net income	0.15	0.25	0.43	0.03
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639

* Reclassified.

Footnote:

(1) Including cancellation of provision for impairment in value of investment in an affiliated company.

CERTIFICATION

I, Giora Offer, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 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 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

March 31, 2008

CERTIFICATION

I, Joseph Beressi, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 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 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

March 31, 2008



STATEMENT OF THE BOARD OF DIRECTORS AND MANAGEMENT'S RESPONSIBILITY FOR THE ANNUAL REPORT

The annual report was prepared by the Management of the Bank, which is responsible for its propriety. This report includes financial statements prepared in accordance with generally accepted accounting principles and the reporting requirements and directives of the Supervisor of Banks, related supplementary data similarly prepared, as well as other information. The preparation of periodic financial statements also requires the preparation of estimates determining certain amounts and items in the financial statements. Such estimates were prepared by the Bank's Management using its best judgment.

In order to ensure that the Bank's financial statements are presented fairly, the Bank's Management maintains a comprehensive system of internal control for the purpose of ensuring that the transactions effected by the Bank are properly authorized, that the Bank's assets are properly protected and that the accounting records are a reliable basis for the preparation of the financial statements. The system of internal control is, by nature, limited in that the certainty of its ability to uncover and prevent errors and irregularities is reasonable rather than absolute. The principle of reasonable certainty is based on the recognition that the decision as to the amount of resources to be invested in operating the control procedures must take into account the benefit to be derived from such procedures.

The Bank's Board of Directors, which is responsible for drawing up the financial statements and their approval pursuant to section 92 of the Companies Law, determines the accounting policy, controls its application and the structure of the internal control system, and supervises its implementation. The President and Chief Executive Officer is responsible for the routine management of the Bank's affairs within the context of the policy determined by the Board of Directors, and he is subject to its directions. The Bank's Management operates in accordance with the policy established by the Board of Directors. The Board of Directors, through its committees, holds meetings on a regular basis with Management, the internal auditor, and the Bank's auditors for the purpose of reviewing the scope of their work and the results thereof. The Bank's auditors, Messrs. Ziv Haft., Certified Public Accountants (Isr.), and Messrs. Somekh Chaikin, Certified Public Accountants (Isr.), audited the Bank's annual financial statements in accordance with generally accepted auditing standards including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973 and certain auditing standards published by the American Institution of Certified Public Accountants and whose application was enforced by the Supervisor of Banks. The purpose of the audits is to enable the auditors to express an opinion as to the extent to which the financial statements reflect, in accordance with generally accepted accounting principles and the reporting requirements and directives of the Supervisor of Banks, the Bank's financial position, the result of its operations, the changes in shareholders' equity and its cash flows. Pursuant to section 170 of the Companies Law, the auditors are responsible to the Bank and its shareholders for the matters stated in their report on the financial statements. The auditors' report is appended to the annual financial statements.

In addition, the data included in the Report of the Board of Directors to Shareholders and Management Review (hereinafter "the annexed data") was submitted to the auditors so that they could advise whether there were any material differences between the data contained in the financial statements and the annexed data, or whether the annexed data included details which were in substantial disagreement with evidence or information which came to their attention during the course of their audit. No such advice was received from the auditors. The auditors did not undertake any auditing procedures for this purpose in addition to those they were required to employ in their examination of the financial statements.

	Shlomo Zohar	Giora Offer	Joseph Beressi
	Chairman of the	President and	Senior Executive Vice President,
March 31, 2008	Board of Directors	Chief Executive Officer	Chief Accountant

2007 FINANCIAL STATEMENT

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Somekh Chaikin



AUDITORS' REPORT TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD.

We have audited the financial statements of Israel Discount Bank Limited (hereinafter - "the Bank") and the consolidated financial statements of the Bank and its consolidated subsidiaries: Balance sheets as at December 31, 2007 and December 31, 2006, statements of income, statement of changes in shareholders' equity and statements of cash flows for the three years, the last of which ended December 31, 2007. These financial statements are the responsibility of the Bank's Board of Directors and Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We did not audit the financial statements of certain affiliated companies, the investment in which amounted to NIS 424 million and NIS 65 million at December 31, 2007 and 2006, respectively, and the share of the Bank in their net operating income is NIS 25 million, NIS 5 million and NIS 1 million, for the three years, the last of which ended December 31, 2007. The financial statements of those companies were audited by other auditors, whose reports were furnished to us, and our opinion, insofar as it relates to amounts included in respect of those companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including those prescribed under the Israeli Auditors' Regulations (Auditor's Mode of Performance), 1973 and auditing standards applied in the audit of banking corporations as determined by guidelines of the Supervisor of Banks. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's Board of Directors and Management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors, the financial statements referred to above present fairly, in conformity with generally accepted accounting principles, in all material respects, the financial position - of the Bank and consolidated - as at December 31, 2007 and 2006, and the results of operations, the changes in shareholders' equity and cash flows - of the Bank and consolidated - for the three years the last of which ended December 31, 2007. Furthermore, in our opinion, the abovementioned financial statements were prepared in accordance with the directives and guidelines of the Supervisor of Banks.

As explained in Note 1 B, these financial statements are presented in reported amounts, in accordance with accounting standards of the Israel Accounting Standard Board and Directives of the Supervisor of Banks.

Without qualifying our opinion, we draw attention to the following Notes to the financial statements:

- (a) Note 6 D concerning 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 company).
- (b) Note 19 C item 15.1 concerning a motion to approve a certain lawsuit as a class action suit and to item 15.7 as regards a third party notice served against the Bank and some of its subsidiary companies.

Somekh Chaikin
Certified Public Accountants (Isr.)

Ziv Haft
Certified Public Accountants (Isr.)

March 31, 2008

BALANCE SHEET AS AT DECEMBER 31

REPORTED AMOUNTS

		Consolidated		The Bank	
	Notes	2007	2006	2007	2006
in NIS millions					
Assets					
Cash and deposits with banks	2	19,850	*25,100	24,234	*27,625
Securities	3	37,278	*38,977	17,545	16,937
Securities borrowed or purchased under resale agreements		346	-	346	-
Credit granted to the public	4	101,899	*90,097	59,574	51,467
Credit granted to Governments	5	374	*324	363	*313
Investment in investee companies (consolidated - affiliated companies)	6	2,008	*1,367	7,980	6,618
Buildings and equipment	7	2,780	2,614	2,141	2,032
Other assets	8	4,275	*4,044	2,533	1,963
Total assets		168,810	162,523	114,716	106,955
Liabilities and Shareholders' Equity					
Deposits from the public	9	130,518	130,517	92,630	84,710
Deposits from banks	10	5,072	8,099	3,041	5,526
Deposits from the Government		125	119	37	5
Securities loaned or sold under buy-back arrangements		5,895	-	-	-
Debentures and subordinated capital notes	11	7,437	6,302	3,837	3,880
Other liabilities	12	10,412	*9,119	5,967	4,869
Total liabilities		159,459	154,156	105,512	98,990
Minority interest		147	402	-	-
Shareholders' equity	13	9,204	7,965	9,204	7,965
Total liabilities and shareholders' equity		168,810	162,523	114,716	106,955

* Reclassified.

The notes to the financial statements are an integral part thereof.

Shlomo Zohar
Chairman of the Board
of Directors

Giora Offer
President &
Chief Executive Officer

Joseph Beressi
Executive Vice President
Chief Accountant

March 31, 2008

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

		Consolidated		
	Notes	2007	2006	2005
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	23	4,225	3,790	3,697
Provision for doubtful debts	1i,4c	447	570	691
Income from financing activities after provision for doubtful debts		3,778	3,220	3,006
Non-Financing Income				
Operating commissions	24	2,216	1,911	1,863
Net income on investment in shares	25	58	65	3
Other income	26	298	383	540
Total non-financing income		2,572	2,359	2,406
Non-Financing Expenses				
Salaries and related expenses	27	3,030	*3,202	*2,967
Maintenance and depreciation of buildings and equipment		819	679	670
Other expenses	28	1,217	*1,139	*1,092
Total non-financing expenses		5,066	5,020	4,729
Operating income before taxes		1,284	559	683
Provision for taxes on operating income	29	566	350	324
Operating income after taxes		718	209	359
Bank's share in operating income of affiliated companies, net of tax effect	6b	45	188	174
Net operating income before minority interest		763	397	533
Minority interest, after taxes, in the operating income of consolidated subsidiaries		(56)	(82)	(75)
Net operating income		707	315	458
Net cumulative effect as of the beginning of the year of change in accounting principles		-	-	(4)
Net income, before extraordinary income after tax		707	315	454
Cancellation of provision for impairment in value of investment in affiliated company	6f	-	173	-
Net income from extraordinary items, net of taxes	30	558	348	4
Net income		1,265	836	458
Earnings per share of NIS 0.1 (in NIS)	1s,13,37			
Net operating income		0.72	0.32	0.47
Net income from extraordinary items, net of taxes ⁽¹⁾		0.57	0.53	-
Net income		1.29	0.85	0.47
Total number of shares used for the above computation (in thousands)		980,639	980,639	980,639

* Reclassified.

Footnote:

(1) December 31, 2006: Including a cancellation of provision for impairment in value of investment in an affiliated company.

December 31, 2005: Including net cumulative effect as of the beginning of the year of change in accounting.

The notes to the financial statements are an integral part thereof.

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

The Bank				
	Notes	2007	2006	2005
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	23	2,692	2,423	1,848
Provision for doubtful debts	1i,4c	245	377	441
Income from financing activities after provision for doubtful debts		2,447	2,046	1,407
Non-Financing Income				
Operating commissions	24	1,054	903	922
Net income on investment in shares	25	13	44	-
Other income	26	260	279	378
Total non-financing income		1,327	1,226	1,300
Non-Financing Expenses				
Salaries and related expenses	27	1,975	2,082	2,032
Maintenance and depreciation of buildings and equipment		557	452	429
Other expenses	28	586	540	448
Total non-financing expenses		3,118	3,074	2,909
Operating income (loss) before taxes		656	198	(202)
Provision for taxes on operating income	29	241	103	26
Operating income (loss) after taxes		415	95	(228)
Bank's share in operating income of investee companies, net of tax effect	6b	292	220	686
Net operating income		707	315	458
Net cumulative effect as of the beginning of the year of change in accounting principles		-	-	(4)
Net income, before extraordinary income (loss) after tax	6f	707	315	454
Cancellation of provision for impairment in value of investment in affiliated company		-	173	-
Net income from extraordinary items, net of taxes	30	558	348	4
Net income		1,265	836	458

The notes to the financial statements are an integral part thereof.



STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

REPORTED AMOUNTS

	Capital reserves		
	Share capita	Share premium reserve	Other capital reserves
	in NIS millions		
Balance at December 31, 2004	658	2,939	37
Changes in 2005:			
Income for the year	-	-	-
Net adjustments for the presentation of available-for-sale securities at fair value	-	-	-
Net adjustments for the presentation of available-for-sale securities reclassified to the income statement	-	-	-
Related tax effect	-	-	-
Financial statements translation adjustments	-	-	-
Net loss on the hedging of cash flows	-	-	-
Net loss on the hedging of cash flows reclassified to the income statement	-	-	-
Balance at December 31, 2005	658	2,939	37
Changes in 2006:			
Initial application of an accounting standard by an affiliated company	-	-	-
Income for the year	-	-	-
The State's bonus to the employees (privatization)	-	-	175
Benefit in respect of equity based compensation transactions	-	-	8
Net adjustments for the presentation of available-for-sale securities at fair value	-	-	-
Net adjustments for the presentation of available-for-sale securities reclassified to the income statement	-	-	-
Related tax effect	-	-	-
Financial statements translation adjustments	-	-	-
Balance at December 31, 2006	658	2,939	220
Changes in 2007:			
Income for the year	-	-	-
Benefit in respect of equity based compensation transactions	-	-	27
Net adjustments for the presentation of available-for-sale securities at fair value	-	-	-
Net adjustments for the presentation of available-for-sale securities reclassified to the income statement	-	-	-
Related tax effect	-	-	-
Financial statements translation adjustments	-	-	-
Balance at December 31, 2007	658	2,939	247

* Reclassified.

Footnotes:

(1) Translation adjustments of foreign autonomous units. The consolidated subsidiary Israel Discount Bank of New York was treated until December 31, 1994, in the financial statements of the Bank as autonomous units. Accordingly this item included the financing sources of this investment and the related tax effect until that date (see also Note 1 G).

(2) Including an amount of NIS 2,704 million that is not available for distribution (See Note 32).

The notes to the financial statements are an integral part thereof.

FINANCIAL STATEMENT

ANNUAL REPORT 2007

Other cumulative comprehensive income (loss)					
Total share capital and reserves	Adjustment for presentation of available for sale securities at fair value	Translation adjustments ⁽¹⁾	Net gains (losses) on cash flow hedging	Retained earnings ⁽²⁾	Total shareholders' equity
in NIS millions					
3,634	152	(232)	(6)	2,838	6,386
-	-	-	-	458	458
-	*(230)	-	-	-	(230)
-	*(40)	-	-	-	(40)
-	136	-	-	-	136
-	-	3	-	-	3
-	-	-	(3)	-	(3)
-	-	-	8	-	8
3,634	18	(229)	(1)	3,296	6,718
-	-	-	-	1	1
-	-	-	-	836	836
175	-	-	-	-	175
8	-	-	-	-	8
-	*420	-	-	-	420
-	*6	-	-	-	6
-	(195)	-	-	-	(195)
-	-	(4)	-	-	(4)
3,817	249	(233)	(1)	4,133	7,965
-	-	-	-	1,265	1,265
27	-	-	-	-	27
-	10	-	-	-	10
-	(92)	-	-	-	(92)
-	30	-	-	-	30
-	-	(1)	-	-	(1)
3,844	197	(234)	(1)	5,398	9,204

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Cash Flows from Operating Activities						
Net income for the year	1,265	836	458	1,265	836	458
Adjustments necessary to present cash flows from operations:						
Bank's share in undistributed loss of investee companies (consolidated - affiliated companies)	(79)	*(319)	*(179)	(415)	(322)	(719)
Minority interest in income of consolidated subsidiaries	56	82	75	-	-	-
Depreciation of buildings and equipment	350	275	286	254	190	193
Amortization of goodwill	32	*11	*12	-	-	-
Provision for decline in value of securities held for investment	46	7	9	44	-	-
Provision for doubtful debts	553	642	763	348	447	510
Loss (gain) on sale of available-for-sale	(67)	-	(29)	(33)	(35)	(22)
Realized and non realized loss (gain) from adjustment to fair value of trading securities	47	*(33)	(4)	40	(25)	(3)
Gain on realization of investments	-	(376)	-	-	(417)	-
Benefit with respect to the allotment of options	27	-	-	27	8	-
Provision for impairment in value of buildings	10	4	10	8	4	10
Gain (loss) on sale of buildings and equipment	9	(2)	(7)	4	(2)	(6)
Net deferred taxes	281	106	121	240	86	10
Severance pay - decrease (increase) in excess of deposits over the provision	(18)	43	(123)	(5)	9	(86)
Inflation adjustment component of investing and financing activities	2,581	*1,376	*(851)	263	254	330
Changes in Balance Sheet Items:						
Other assets, net	(473)	315	(612)	(792)	355	(21)
Other liabilities, net	1,201	*(331)	1,622	1,006	(452)	983
Net Cash Flows from Operating Activities	5,821	2,644	1,551	2,254	936	1,637

* Reclassified.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

REPORTED AMOUNTS

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(834)	(2,134)	(2,289)	-	-	-
Proceeds from redemption of held-to-maturity bonds	1,823	2,722	2,370	-	-	-
Acquisition of available-for-sale securities	(19,120)	*(17,313)	*(18,016)	(5,659)	(4,679)	(7,067)
Proceeds from sale of available-for-sale securities	13,482	15,298	12,021	1,530	1,684	2,031
Proceeds from redemption of available-for-sale securities	3,989	4,334	4,786	3,207	4,093	4,504
Net deposits with banks	756	(805)	270	(1,188)	(36)	(584)
Trading securities, net	(20)	*(362)	(297)	43	(541)	(370)
Net credit granted to the public	(11,975)	*(3,132)	*(7,104)	(8,039)	(2,871)	(3,609)
Net credit granted to the Government	(50)	*(232)	180	(51)	*(224)	179
Net on securities borrowed or purchased under resale agreements	(346)	-	-	(346)	* -	-
Additional investment in investee companies	(738)	153	(34)	(756)	757	16
Decrease in cash due to initially consolidated companies (annex A)	-	-	(2)	-	-	-
Proceeds, net, from sale of investments in previously consolidated subsidiaries (annex B)	-	508	-	-	-	-
Acquisition of buildings and equipment	(565)	(644)	*(581)	(403)	*(548)	*(470)
Proceeds from sale of buildings and equipment	18	14	31	18	10	28
Net Cash Flows from Asset Transactions	(13,581)	(1,593)	(8,665)	(11,643)	(2,355)	(5,342)
Cash Flows From Liability and Capital Transactions:						
Net deposits from the public	(317)	281	8,364	7,603	4,477	3,597
Net deposits from banks	(3,028)	1,581	1,711	(2,485)	2,556	990
Net deposits from the Government	6	(17)	10	32	(5)	(9)
Net securities loaned or sold under buy-back arrangements	5,895	-	-	-	-	-
Payment for fixed assets purchased on credit	-	(13)	(4)	-	(13)	(4)
Issuance of subordinated capital notes	1,446	1,485	644	297	807	100
Redemption of bonds and subordinated capital notes	(737)	(729)	(449)	(637)	(639)	(447)
The State's bonus to the employees (privatization)	-	128	-	-	98	-
Dividend paid to shareholders	-	(58)	(56)	-	-	-
Net cash flows from liability and capital transactions	3,265	2,658	10,220	4,810	7,281	4,227
Increase in cash	(4,495)	3,709	3,106	(4,579)	5,862	522
Cash balance at beginning of year (see Note 2)	21,808	18,099	14,993	19,015	13,153	12,631
Cash balance at end of year (see Note 2)	17,313	21,808	18,099	14,436	19,015	13,153

* Reclassified.

The notes to the financial statements are an integral part thereof.



STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

REPORTED AMOUNTS

Annex A – Decrease in cash due to initially consolidated subsidiaries

	2007	2006	2005
	in NIS millions		
Assets and liabilities at acquisition date of consolidated subsidiaries:			
Long-term assets	-	-	(2)
Total decrease in cash due to initially consolidated companies	-	-	(2)

Annex B - Proceeds from sale of investments in previously consolidated subsidiaries

	2007	2006	2005
	in NIS millions		
Assets and liabilities of previously consolidated subsidiaries, at date of sale:			
Assets	-	14	-
Liabilities	-	19	-
Shares available for sale	-	231	-
Minority shareholder's interest	-	(23)	-
Goodwill	-	11	-
Capital gain	-	256	-
Net cash flows on sale of investments in previously consolidated subsidiaries	-	508	-

Annex C - Non-cash asset and liability activity during the reported year

	2007	2006	2005
	in NIS millions		
The Bank:			
Purchase of fixed assets	3	15	41
Lending of securities	(416)	132	41
The State's bonus to the employees (privatization)	-	45	-
Additional purchase of shares in a consolidated subsidiary	-	21	-
Sale of securities to a subsidiary	53	-	-
Consolidated:			
Purchase of fixed assets	4	16	50
Lending of securities	(381)	156	184
The State's bonus to the employees (privatization)	-	47	-

The notes to the financial statements are an integral part thereof.

NOTES TO THE FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

A. GENERAL

- 1) The financial statements are prepared in accordance with the directives and guidelines of the Supervisor of Banks in Israel.
- 2) The Notes to the financial statements relate to the Bank's financial statements and to the consolidated financial statements of the Bank and its subsidiaries, except where it states that the note relates to the Bank only, or to the consolidated statements only.
- 3) In these financial statements -

Consolidated subsidiaries - companies in which the Bank holds voting rights, either directly or indirectly, exceeding fifty percent, and/or is entitled to appoint over one half of the members of their boards of directors, and whose financial statements are consolidated with those of the Bank.

Affiliated companies – companies, other than consolidated subsidiaries, the investment in which is included on the equity basis.

Investee companies – consolidated subsidiaries or affiliated companies.

Extensions abroad – consolidated subsidiaries and branches abroad.

B. DISCONTINUATION OF THE ADJUSTMENT OF FINANCIAL STATEMENTS TO THE EFFECT OF INFLATION – FINANCIAL STATEMENTS IN REPORTED AMOUNTS

Standard No. 12 of the Israel Accounting Standard Board, dealing with the discontinuation of the adjustment of financial statements ("Standard 12") came into effect in October 2001. According to Standard 12 and according to Standard No. 17 of December 2002, as from January 1, 2004, the adjustment of financial statements was discontinued and they are presented in reported amounts (namely, amounts adjusted on the basis of the CPI for the month of the transition, together with nominal amounts which were added subsequent to date of transition, and less amounts which were deducted after that date). Until December 31, 2003, the Bank prepared financial statement on an inflation adjusted basis in accordance with instructions of the Supervisor of Banks, based on the principles determined in Opinion No. 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements for December 31, 2003, served as a starting point for the nominal financial reporting in accordance with the Standard as from January 1, 2004.

In these financial statements, "cost" – cost in reported amounts.

The data included in these financial statements is presented, in accordance with the Standards and the instructions of the Supervisor of Banks, in "reported amounts" as follows:

(1) Balance sheet

- Monetary items are stated in nominal amounts.
- Non-monetary items are stated in reported amounts. The amounts of non-monetary assets do not necessarily represent their realizable value or updated economic value, but rather the reported amounts of such assets.

(2) Statement of income

- Income and expenses relating to non-monetary items or to provisions included in the balance sheet are derived from the movement between the reported amount of the opening balance and the reported amount of the closing balance. The remaining components of the income statement are stated in nominal historical values.
- The Bank's share in the results of operations of investee companies and the minority shareholders' interest in the results of consolidated companies, are determined on the basis of the financial statements of these companies.



1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. COMPARATIVE FIGURES

Several items have been reclassified, as stated in the financial statements.

D. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Bank and those of its consolidated subsidiaries. Inter-company balances and transactions between the consolidated companies are annulled in the consolidated financial statements. Financial statements of provident funds managed by the Bank or by a consolidated subsidiary have not been consolidated.

The Bank's financial statements only, include the financial statements of the property company "Nidbach Real Estate and Investments Ltd." and "Badal Computer and Management Services Ltd.", which are wholly owned by the Bank.

E. INVESTMENTS IN INVESTEE COMPANIES

Investments in the shares of investee companies (in the consolidated statements - investments in shares of affiliated companies) are presented on the equity basis, based on the financial statements of these investees as of the balance sheet date.

The Bank's share in the financial results of such investees is stated net, after amortization of the excess of cost arising on the acquisition of the investment. Excess of cost attributed to assets and liabilities is being amortized over the life of the related asset or the acquired company. Excess of cost not attributed as above (goodwill) is amortized at an annual rate of 10%.

Accounting Standard No. 20 (Amended). In March 2006, the Israel Accounting Standards Board published Accounting Standard No. 20 (Amended) - "Accounting Treatment of Goodwill and Intangible Assets on Acquisition of Investee companies". The standard determines the Accounting treatment with regard to goodwill and intangible assets on acquisition of a subsidiary or an investee company, which is not a subsidiary.

The main changes determined in the standard as compared with accounting standards applying until January 1, 2006: the allocation of the excess of the cost of the acquisition in an investee company to identifiable intangible assets of the acquired company; the distinguishing between intangible assets with defined use of life and intangible assets with undefined use of life; immediate recognition as of acquisition date, of a negative goodwill that was formed during the acquisition, as a gain in the financial statements after it's deduction from intangible assets and from non-monitory assets of the investee company; the discontinuation of the amortization of positive goodwill and intangible assets with undefined use of life; the distinction between the goodwill of a subsidiary and an investee company which is not a subsidiary while evaluating the impairment in value of an investment.

The Supervisor of Banks notified that standard 20 will apply to financial statements of banking institutions except the sections relating to the cancellation of goodwill amortization and the recognition of negative goodwill in the income statement. The accounting treatment of goodwill will remain in its present form, thus the amortization of goodwill shall not exceed a period of 10 years, unless the Supervisor of Banks has approved otherwise, and negative goodwill will not be recognized immediately on the statements of income. In the future with the full embracing of the IFRS the Supervisor of Banks will reconsider his position.

Should the Supervisor fully embrace the standard, the future application of the standard will influence the goodwill recorded in the acquisition of Fishman and of Harel's shares in ICC (see Note 34 hereunder).

F. FOREIGN CURRENCY AND LINKAGE

1) Assets (except for investments in investee companies, buildings and equipment) and liabilities are stated in the balance sheet as follows:

- Those in foreign currency or linked thereto, are presented at representative exchange rates published by the Bank of Israel at the balance sheet date, or at a different date, in accordance with the terms of the relevant transactions.
- Those linked to the CPI or to other indices, are presented in the balance sheet according to the latest known index on the balance sheet date.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Those optionally linked, are stated in accordance with their related terms ruling on the balance sheet date.
- 2) Revenues and expenses in foreign currency or linked thereto, are presented in the statement of income at representative rates prevailing at the time of the transactions, with the addition of exchange rate differences on assets and liabilities from which these revenues or expenses resulted.
- 3) The following are the representative rates of exchange and the CPI and their annual rates of change:

	Annual rate of change					
	2007	2006	2005	2007	2006	2005
				%	%	%
CPI (in points):						
Balance sheet month (December index)	106.4	102.9	103.0	3.4	(0.1)	2.4
Known at balance sheet month (November index)	105.8	102.9	103.2	2.8	(0.3)	2.7
Representative exchange rate at the balance sheet date of the:						
U.S. Dollar (in NIS)	3.846	4.225	4.603	(9.0)	(8.2)	6.8
Euro	5.6592	5.564	5.446	1.7	2.2	(7.3)

G. CONVERSION OF FINANCIAL STATEMENTS OF EXTENSIONS ABROAD

Up to the year 1994, foreign subsidiaries were considered autonomous units, and the conversion differences with respect to the investment therein were included as a separate item in Shareholders' Equity.

Following guidelines of the Supervisor of Banks, foreign subsidiaries are considered, as from 1995, "extensions" of the Bank. Concurrently with the publication of Standard 12, the Israel Accounting Standard Institute issued Standard No.13 dealing with the effect of changes in foreign currency exchange rates ("Standard 13"). The Bank implements that Standard as from January 1, 2004. Standard 13 deals with the conversion of transactions in foreign currency and overseas operations into the reporting currency of the company, for the purpose of including the same in its financial statements. Furthermore, the Standard determines rules for the classification of foreign operations as an "autonomous foreign entity" or as an "extension", based on the relevant characteristics stated therein. In the framework of the interim provisions for quarterly reporting in reported amounts in 2004, the Supervisor of Banks determined that foreign extensions of banking corporations should continue to be classified by the banking corporations an "extension", and that classification of a new foreign banking extension as an autonomous unit would be subject to prior approval by the Supervisor.

H. SECURITIES

- 1) In accordance with directives of the Supervisor of Banks, the securities portfolio is categorized into three groups:
 - (a) "Held to maturity bonds" - bonds which the Bank intends and has the ability to hold until maturity. The bonds are presented at their adjusted cost at the reporting date, not of a provision for impairment in value net of a temporary nature.
 - (b) "Trading securities" - securities which are held, in principle, with the intention of selling them in the short term. The securities are presented at their fair value at the reporting date. Gains or losses due to adjustments to fair value are recorded in the statement of income.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- (c) "Available for sale securities" - securities not classified under the two previous categories. Securities available for sale are stated at their fair value on the balance sheet date, except for shares the fair value of which is not readily available, which are stated at cost. Unrealized gains or losses resulting from the adjustment to fair value, net of the related tax effect, are recorded as a separate line item in Shareholders' Equity, and forwarded to statement of income upon sale or redemption of the securities. A provision for impairment in value not of a temporary nature is recorded in the statement of income.
- 2) The cost of realized securities is recognized in the statement of income on a "moving average" basis.
- 3) Swap transactions, in which the Bank acquired short-term bills issued by the Bank of Israel in exchange for other Government bonds, in a tender from the Bank of Israel, were recorded as two separate transactions as follows:
- The sale of Government bonds - according to prices set in advance by the Bank of Israel.
 - Purchase of short-term bills - at prices the Bank obtained in the tender.
- 4) The lending of securities by the Bank as cover for the short selling of securities by the borrower, is presented as part of credit to the public as long as these securities are outstanding.
- 5) A foreign subsidiary enters into transactions of sale and purchase of securities, which include "buy back" terms. These transactions are classified as secured loans or secured deposits, respectively.
- 6) The Bank's securities portfolio as of December 31, 2007, includes investments primarily in asset backed securities, mortgage backed securities (MBS), which are held for the most part by a consolidated subsidiary abroad (see Note 3 below). The said subsidiary is currently reviewing the securities (including MBS) to determine whether other than temporary impairments have occurred. In the event that the overseas subsidiaries' management will deem the decrease in value other than temporary, then the loss will be recognized in the statement of income.

The review is based on the following considerations:

- The duration in which the fair value of the security has been less than the cost;
- The financial position of the issuer;
- Adverse changes in ratings announced by the rating agencies;
- Whether the issuer of the debt securities continues to make principal and interest payments on their due dates;
- Whether the decrease in fair value appears to be specific to the issuer or reflects general market conditions;
- The intent and ability of the subsidiary to retain the securities for a period of time sufficient to allow for the recovery of the value of the securities to their original cost.

I. PROVISION FOR DOUBTFUL DEBTS

- 1) The provision for doubtful debts includes a specific provision, a general provision and a supplemental provision. The provision for doubtful debts of the Bank and the consolidated subsidiaries in Israel was made according to the directives of the Supervisor of Banks. The provisions for doubtful debts in the consolidated banking subsidiaries abroad, are determined according to generally accepted principles in those countries.
- 2) The specific provision for doubtful debts has been recorded on the basis of the Bank's estimate of expected losses in credit portfolios, including off-balance sheet debt items, by examining and monitoring the financial condition of the debtors and their business activities, an assessment of collateral held, and an evaluation of the risks related to their financial condition, performed on a quarterly basis.

The specific provisions regarding housing loans granted by banking subsidiaries in Israel, have been calculated according to the directives of the Supervisor of Banks, on an increasing scale in accordance with the extent of the arrears.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 3) The supplemental provision for doubtful debts is calculated based on the quality of the portfolio of debts according to the characteristics of risk as stated in the directives of the Supervisor of Banks.
- 4) The ratios of the general provision and the supplemental provision (including the provision for off-balance sheet items), to credit granted to the public for the Bank and its consolidated subsidiaries in Israel are:

	Consolidated		The Bank	
	December 31			
	2007	2006	2007	2006
General provision	0.20%	0.20%	0.20%	0.20%
Supplemental provision	0.18%	0.20%	0.15%	0.15%

The directives of the Supervisor of Banks stipulate that the balance of the general provision for doubtful debts, at adjusted values, accumulated under the previous directives, at a rate of 1% of total indebtedness as of December 31, 1991, should be maintained.

The adjustment of the general provision was discontinued on January 1, 2005, according to directives of the Supervisor of Banks.

- 5) The supplemental provision and the general provision are not deductible for tax purposes, and in accordance with the directives of the Supervisor of Banks, a deferred tax asset has not been recorded.
- 6) A foreign subsidiary creates a general provision for doubtful debts based on past experience and management's estimate of business and economic conditions, the concentration of the credit portfolio, quality of the borrowers and trend of arrears in repayments.
- 7) Bad debts are written off when the Bank reaches the conclusion that the debt is uncollectible, either after taking legal proceedings, or as a result of agreements and arrangements made, most of which were in cases where legal proceedings were not taken, and the debts are not collectable, or for other reasons rendering them unrecoverable.

For details regarding the instruction in the matter of "Measurement and disclosure of delinquent debts, credit risk and provisions for credit losses" to be implemented in financial statements of banking corporations and credit card companies as from the statements for January 1, 2010 onwards, see section Y below.

J. BUILDINGS AND EQUIPMENT

Buildings and equipment are presented at cost after the deduction of accumulated depreciation and impairment in value if such was made. Adjusted depreciation is calculated by the straight-line method based on the estimated useful life of the assets. The cost of buildings includes interest capitalized during the construction period. Buildings and realty designated for sale have been presented at their market price in those cases where it is lower than their adjusted cost.

Certain costs relating to in-house development of computer software are capitalized to investment in equipment. Up to December 31, 2006 these were presented in accordance with the accounting treatment prescribed in the US Accounting Publication (Statement of Position 98-1). As of January 1, 2007 these costs are presented in accordance with Standard No. 30 of the Israel Accounting Standard Board.

Software development costs for own use, which were incurred as from the end of the preliminary development stage, were capitalized. Costs of preliminary research and development as well as costs relating to the post application development stage (end of acceptance tests) were recorded in the income statement as incurred. These expenses are amortized as from the date of completion of the development, over the useful economic lives of these assets.

The core systems ("Ophek Project") development costs are being amortized over a period of seven years.



1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

K. AMORTIZATION OF DEFERRED EXPENSES

Bond and subordinated capital notes issue costs are amortized proportionally to the outstanding principal amount of the bonds.

The inventory of credit cards purchased by a consolidated subsidiary, is stated at cost and is being amortized over the expected period of benefit therefrom of six years, having regards to the number of clients.

L. THE BASIS OF RECOGNITION OF INCOME AND EXPENSES

Income and expenses are recognized on an accrual basis, except for financing income on non-performing loans and except for interest in arrears on housing loans of a mortgage bank which are recognized when collected.

With respect to securities - see (h) above; with respect to the provision for doubtful debts - see (i) above; with respect to derivative financial instruments - see (m) below.

Sale and leaseback transactions are presented in the financial statements in accordance with International Accounting Standard (IAS) 17.

M. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE TRANSACTIONS

The Bank recognizes all derivatives as assets or liabilities on the balance sheet and measures them at fair value.

The fair value of derivatives as abovementioned is stated, net, in the items "Other assets" or "Other liabilities".

Changes in the fair value of a derivative instrument shall be reflected in the statement of income, or shall be included in shareholders equity as an "other comprehensive income" component, in accordance with the designation of the derivative instrument.

The change in the fair value of derivatives hedging exposure to the change in the fair value of an asset, a liability or a firm commitment, shall be recognized in the statement of income on a current basis, as well as the change in value of the hedged item, which may be related to the hedged risk.

The accounting treatment of changes in the fair value of derivatives that hedge exposure to changes in the cash flow generated by an asset, a liability or an anticipated transaction, depends on the effectiveness of the hedging relationships.

- The effective part of the change in the fair value of a derivative designated to hedge a cash flow risk, is initially reported in shareholders equity (outside the statement of income) as a component of "other comprehensive income", following which, when the anticipated transaction affects the income statement, it is reclassified to the statement of income.
- The non-effective part of the change in the fair value of a derivative designated as above is recognized immediately in the statement of income.

For further details see Note 20 hereunder.

N. SET-OFF OF FINANCIAL INSTRUMENTS

Assets and liabilities are set-off against one another where an enforceable legal right of set-off and the intention to set-off the transactions at maturity date exist. Accordingly, designated deposits, the repayment of which to the depositor is conditional upon the extent of collection of the loans granted out of such deposits, and where the Bank has no risk of loss from such loans, are stated in the balance sheet net of the loans granted therefrom. The margin earned on this activity is included in the item "Operating commissions".

O. EMPLOYEE BENEFITS

Liabilities in respect of employee rights are covered by appropriate provisions. For further details see note 16 hereunder.

P. TAXES ON INCOME

(1) The Bank and its consolidated subsidiaries use the tax allocation method with respect to timing differences in the recognition for tax purposes of certain income and expenses.

Deferred taxes have been calculated according to the "liability" method, at tax rates expected to be applicable during the period

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

in which the deferred taxes are realized, based on laws in force at the balance sheet date. The realization of deferred taxes receivable is contingent upon the future existence of taxable income. Management believes that such deferred tax assets will be realizable in the future.

- (2) A provision for deferred taxes is included in the financial statements for that part of the adjustment of depreciable non-monetary assets (excluding buildings - see Note 29 J) which will not be deductible for tax purposes.
- (3) Retained earnings of certain investee companies may be subject to additional taxes if and when distributed as cash dividends. With respect to consolidated subsidiaries - when a dividend distribution is not expected in the foreseeable future - no provision for taxes has been recorded. With respect to affiliated companies - a provision for taxes on income was recorded if an additional tax liability is likely to arise due to the distribution of dividend.
- (4) Profits from the future sale of investments in shares of investee companies may attract additional taxes. The provision for deferred taxes does not include taxes relating to the sale of investments in investee companies as long as the supposition of the ongoing holding of the investment exists.
- (5) The provision for taxes on income of the Bank and its consolidated subsidiaries which are financial institutions, for the purposes of Value Added Tax, includes profit tax levied on income as stipulated in the Value Added Tax Law. Value Added Tax levied on payroll of financial institutions is included in the statement of income under the item "Salaries and related expenses".
- (6) Beginning with January 1, 2005, the Bank implements Accounting Standard No. 19 - "Taxes on income", subject to instructions of the Supervisor of Banks. The Standard determines that deferred tax liabilities are to be recognized in respect of all temporary differences subject to tax, excluding a small number of exceptions. Furthermore, deferred tax assets are to be recognized in respect of all temporary differences that are tax deductible, tax losses and unutilized tax benefits, to the extent that taxable income is expected in the future against which these could be utilized, excluding a small number of exceptions.

On certain matters relating to the accounting treatment of taxes on income, including the terms for recognizing a deferred tax asset in respect of carry forward losses and timing differences, the instructions of the Supervisor of Banks include additional limitations to those included in Standard No.19. The said additional limitations as determined in the instruction of the Supervisor of Banks, apply to the Bank with regards to the said matters. Thus, for instance, pursuant to the instructions of the Supervisor, a deferred tax asset may be recognized in respect of carry forward losses and in respect of a transferred right in cases where the realization of such tax asset in the foreseeable future is beyond any reasonable doubt, while according to Accounting Standard No. 19 it is sufficient that the said realization is expected.

Q. CONTINGENT LIABILITIES

The accounting treatment of outstanding legal actions is in accordance with the provisions of the US Accounting Standard SFAS-5 "Accounting for Contingencies" and its related guidelines, and in accordance with the guidelines and clarifications of the Supervisor of Banks, including public reporting directives in the matter of the "Accounting for Contingencies".

In assessing the outstanding legal actions, Managements of the Bank and of its subsidiaries base themselves on opinions of their legal Counsels, which determine the probability of the exposure to the risk involved in these claims materializing.

Claims have been classified according to the probability range for a risk exposure materializing, as follows:

- 1) Probable - probability of over 70%.
- 2) Reasonably possible - probability of over 20% and up to and including 70%.
- 3) Remote - probability of 20% or less.



1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The financial statements include appropriate provisions regarding claims the realization of the exposure in respect thereof was considered probable.

According to the guidelines, only in rare cases may a banking corporation state in its financial statements that it is not possible to assess the prospects of a risk exposure materializing in respect of an ordinary legal action and an action approved as a class action, this in four financial statements (including one annual financial statements) to be published subsequently to the filing of an action together with a petition to have it approved as a class action suit, such period is not to include a period in which the Court has decided to stay the proceedings. Note 19 states separately the outstanding claims, in respect of which a reasonable assessment of the exposure to risk is not possible.

The Bank has described material legal proceedings being conducted against the Bank and Group companies. In this respect, the Bank has determined that as a general rule, a legal proceeding shall be disclosed where the amount claimed exceeds 0.5% of the equity capital of the Bank and it is not possible to assess the prospects of the risk exposure materializing and exceeds 1% of the equity capital where there are reasonably possible prospects of the risk exposure materializing or where the prospects of the risk exposure materializing are remote.

It should further be noted, that in cases where the Bank is one of the defendants in the action, and the claimants have not allocated the amount claimed to each of the defendants, the amount estimated as relevant to the Bank is computed to the best of ability, considering the fact that taking the full amount into account might be misleading and is not correct under the circumstances, and that the estimate made does not necessarily represent the allocation which at the end of the day would be decided by the Court.

The financial statements include appropriate provisions in accordance with generally accepted accounting principles and the estimates of the Managements of the Bank and of its subsidiaries, based on opinions of their legal Counsels.

R. STATEMENT OF CASH FLOWS

Cash flows from transactions in assets and liabilities are presented net, apart from cash flows resulting from non-monetary items, from held-to-maturity bonds, and from available-for-sale securities. Cash for this purpose includes balances of cash on-hand and deposits with banks where the initial period of deposit was up to three months.

S. EARNINGS PER SHARE

The Bank has been implementing Accounting Standard No.21 – “Income per share”, subject to instructions of the Supervisor of Banks. The Standard determines the principles for computing and presenting the basic and the diluted income per share. This Standard replaces the provisions of Opinion 55 of the Institute of Certified Public Accountants in Israel regarding income per share.

Following the application of the Standard, the Bank presents the earnings per share in relation to one share unit of NIS 0.1 par value each, while in the past the earnings per share were presented in relation to a unit of NIS 1 par value.

T. USE OF ESTIMATES

The preparation of financial statements in accordance with generally accepted accounting principles requires the Management to make use of estimates and assessments which affect the reported amounts of assets and liabilities, the disclosure relating to assets and contingent liabilities as well as amounts of income and expenses for the reported period. It should be clarified that actual results may differ from such estimates.

U. IMPAIRMENT IN THE VALUE OF ASSETS

The Bank implements Accounting Standard No. 15, which deals with the impairment in the value of assets. The Standard sets out procedures which a corporation has to adopt in order to secure that assets are not stated in amounts which exceed their recoverable

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

value, being the higher of the net selling price or the present value of the estimated amount of anticipated future cash flows to be generated by the use of the asset and its realization. The Standard applies to all assets included in the consolidated balance sheet, excluding tax assets and monetary assets (except for monetary assets comprising investments in investee companies that are not subsidiaries). The Standard also determines the principles of presentation and disclosure in respect of assets, the value of which has been impaired.

V. FINANCIAL INSTRUMENTS - DISCLOSURE AND PRESENTATION

Beginning with January 1, 2006, the Bank implements Accounting Standard No. 22 - "Financial products: disclosure and presentation", subject to instructions of the Supervisor of Banks. This Standard determines rules for the presentation of financial instruments in financial statements and specifies the disclosure required in respect thereof. Furthermore, the Standard determines the mode by which financial instruments are to be classified as financial liabilities and as equity, the classification of interest, dividends, losses and profits related thereto and the circumstances in which financial assets and financial liabilities may be offset.

There are some directives of the Supervisor of Banks with respect to certain issues to which the above Standard relates. In such cases, the directives of the Supervisor will apply to banking corporations.

W. SHARE BASED COMPENSATION

The Bank implements Accounting Standard No. 24 - "Share based compensation". This Standard requires that transactions involving compensation paid by way of shares should be recognized in the financial statements, including transactions with employees or other parties involving payment in capital instruments, cash or other assets. According to the Standard, transactions involving goods or services received in consideration for payment in shares are to be stated at their fair value.

The Standard requires, among other things, that as regards share based payment transactions that are settled by capital instruments, the goods or services received thereby and the parallel increase in the share capital, should be measured according to the fair value of the goods or services that had been received, unless it is not possible to assess the fair value in a reliable manner.

As to transactions with employees, it is required to measure the fair value of the capital instruments granted, as generally, it is not possible to reliably assess the fair value of the services that had been received from the employees.

The fair value of the capital instruments granted is to be measured on the grant date.

The payroll expenses in the case of options granted to employees, is to be recorded over the vesting period against a credit to a capital reserve.

Moreover, the Standard states the various disclosure requirements regarding the substance and scope of share-based payment arrangements that existed during the reported period and the manner in which the fair value of these arrangements has been determined. (For details regarding a stock option plan for officers of the Bank see Note 13 hereunder).

X. INITIAL APPLICATION OF ACCOUNTING PRINCIPLES

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



1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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. The initial application of the standard had no material effect on the financial statements.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 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. The initial application of the standard had no material effect on the financial statements.

Y. 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 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 Israel Securities Authority has initiated amendments to the Securities Regulations, which would enable the application of the provisions of Accounting Standard No. 29. Concurrently, the Authority issued in September 2006, a draft guideline in the matter of the disclosure that will be required regarding the adoption of the International Financial Reporting Standards (IFRS) for public comments.

The Supervisor of Banks informed banking corporation as follows regarding the method of implementation of the Standard:

- The Supervisor will currently issue 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. 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 (Presentation in the financial statements of transactions between an entity and the controlling shareholder therein) Regulations, 1996 which were adopted in the public reporting instructions of the Supervisor of Banks. 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.



1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Supervisor of Banks informed that it is his intention to apply the Standard to banking corporations as from January 1, 2008. However, 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.

Directive in the matter of “measurement and disclosure of delinquent debts, credit risk and provision for credit losses”. On December 31, 2007, the Supervisor of Banks issued a Directive in the matter of “Measurement and disclosure of delinquent debts, credit risk and the provision for credit losses (hereinafter: “the Directive”). The Directive aligns the reporting principles applying to banking corporations in Israel with those applying to banks in the United States, and among other things, it is based on US accounting principles and on the directives of the bank regulatory authorities in the US as well as on the SEC. The principles on which the 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 directive, compared to the existing directives, are as follows:

- Banking corporations are required to create a provision to cover anticipated losses on their credit portfolio to be estimated by one of two ways: “specific provision” or “class provision”, as detailed below:
- “The specific provision for credit losses” – shall be applied in respect of a debt the contractual balance thereof (without deduction of accounting write-offs not involving a legal waiver, interest not recognized, provisions for credit losses and collateral) amounts to NIS 1 million or over, as well as in respect of other debts identified by the banking corporation for the purpose of a specific evaluation and the provision for impairment in respect thereof is not included in the “class provision”. The specific provision for loan losses will be based on the present value of anticipated future cash flows, discounted at the effective interest rate pertaining to the debt, or, where the debt is subject to collateral or the banking corporation determines that the foreclosure of an asset is expected, according to the fair value of the security pledged with respect to that loan.
- “Class provision” – shall be applied in the case of provisions for impairment of loans of large groupings of small homogeneous loans (such as: outstanding balances of credit card transactions, housing loans and consumer loans repayable in installments), as well as in respect of loans evaluated specifically and found not to be delinquent. 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 full in a timely manner, and for which the provision for credit loss will be determined as a “specific provision”.

According to the directive, 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.

According to the directive, 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 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 debt, 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 the following was determined:
 1. Debts in arrears secured by collateral other than a residential unit, or unsecured debts, shall be written off accounting wise, if in default for over 180 days.
 2. In the case of debts secured by a mortgage on a residential unit, the amount of the debt exceeding the value of the collateral is to be written off if in default for over 180 days.
 3. Debts of bankrupt individuals or of companies under a liquidation order are to be written off accounting wise within 60 days from the date of the liquidation or receivership order, as the case may be.
 - 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 debts 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 by the banking corporations for determination of provision for credit losses utilizing a consistently-applied methodological procedure. The method will be documented in writing, including explanations and analyses.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2. Periodic review by management of the banking corporations 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 losses, 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 in the banking corporation involved in determination of the provision for credit losses.
5. Documentation of all existing systems in the banking corporation, 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.

The directive does not refer to the tax implications stemming from its implementation. According to clarifications provided at the discussions with the banks on the draft instruction, prior to its publication the Supervisor of Banks will discuss a settlement for the matter with the Tax Authorities.

The directive will apply to the financial statements of banking corporations and of credit card companies starting with the statements as of January 1, 2010 onwards.

Upon the initial implementation of the Directive, banking corporations will be required to write off accounting wise, the balance of problematic debts that qualify the criteria specified in the Directive for an accounting write-off and to reverse all interest income accrued until January 1, 2010, if not actually collected by this date, in respect of defective debts as defined in the Directive.

The instruction is not to be applied retroactively in financial statements for prior periods. Adjustments of the balance of the provision for loan losses in respect of credit to the public and in respect of off-balance sheet credit instruments as of January 1, 2010, according to the requirements of the directive, will be reflected directly in the retained earnings item of shareholders' equity.

The application of the directive requires preparation and material changes to the existing information systems, which, at this stage, are not compatible with reporting according to the new regulations. Further more, the new rules require each bank to formulate a methodology regarding various matters, including for example, the evaluation of the effect on the outstanding loan balance in the case of the "class provision" that cannot be performed without identification and determination of the models and parameters leading to the formation of homogenous classes having similar risk characteristics and the gathering of adequate information for the purpose of assessing the rate of past losses for each class of loans.

In view of the above, it is not possible at this stage to quantify the anticipated effect of the implementation of the Directive on the financial statements for 2010 and thereafter, on the results of operations of the Bank, including the effect of the initial implementation of the Directive of the Bank's equity as at January 1, 2010. Notwithstanding, it is expected that the implementation of the Directive will have an adverse effect on the results of operations of the Bank and on its financial position.

2. CASH AND DEPOSITS WITH BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
Cash and deposits with central banks	3,428	*3,711	2,649	*2,937
Deposits with commercial banks	15,320	*20,139	12,560	*17,050
Deposits with specialized banking institutions	1,102	1,250	9,025	7,638
Total	19,850	25,100	24,234	27,625
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	17,313	*21,808	14,436	*19,015

* Reclassified.



3. SECURITIES⁽¹⁾

A. CONSOLIDATED

December 31, 2007					
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value ⁽²⁾
In NIS millions					
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	678	678	-	2	676
Government Sponsored Enterprises (GSE) Agencies	2,360	2,360	14	7	2,367
Others	307	307	9	5	311
Total held-to-maturity bonds	3,345	3,345	23	14	3,354
(2) Available for sale securities:					
Bonds and bills:					
Government	13,819	13,764	92	37	13,819
Government Sponsored Enterprises (GSE) Agencies	10,465	10,491	52	78	10,465
Others	4,850	4,967	20	137	4,850
Total	29,134	⁽³⁾ 29,222	164	⁽⁴⁾ 252	29,134
Shares:					
Fund of Hedge Funds	363	⁽⁷⁾ 363	-	-	363
Others	1,397	1,113	285	⁽⁴⁾ 1	1,397
Total shares	1,760	1,476	285	1	1,760
Total available-for-sale securities	30,894	30,698	⁽⁴⁾ 449	253	⁽⁵⁾ 30,894
(3) Trading Securities:					
Bonds and bills:					
Government	2,408	2,397	35	24	2,408
Government Sponsored Enterprises (GSE) Agencies	10	10	-	-	10
Others	608	614	7	13	608
Total	3,026	3,021	42	37	3,026
Shares:					
Others	13	13	1	1	13
Total trading securities	3,039	3,034	⁽⁶⁾ 43	⁽⁶⁾ 38	3,039
Total securities	37,278	37,077	515	305	37,287

General footnote: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Including securities sold under repurchase terms by a foreign consolidated subsidiary amounting to NIS 5,895 million (US\$ 1,533 million).

(4) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(5) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 909 millions.

(6) Recorded in the statement of income.

(7) The original amount of the investment in the hedge fund was NIS 407 million. Since the acquisition of the hedge fund, its fair value has declined in a manner that is not of temporary nature, by NIS 44 million, which amount has been recognized in the statement of income.

3. SECURITIES⁽¹⁾ (CONTINUED)**A. CONSOLIDATED (CONTINUED)**

December 31, 2006					
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value ⁽²⁾
In NIS millions					
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	*799	*799	*21	*1	*819
Government Sponsored Enterprises (GSE) Agencies	*3,984	*3,984	*16	*69	*3,931
Others	41	41	-	1	40
Total held-to-maturity bonds	4,824	4,824	37	71	4,790
(2) Available for sale securities:					
Bonds and bills:					
Government	*14,465	*14,233	*252	*20	*14,465
Government Sponsored Enterprises (GSE) Agencies	*11,114	*11,318	*8	*212	*11,114
Others ⁽⁷⁾	4,316	4,321	19	24	4,316
Total	29,895	⁽³⁾ 29,872	279	256	29,895
Shares:					
Others	1,193	941	253	1	1,193
Total available-for-sale securities	31,088	30,813	⁽⁴⁾ 532	⁽⁴⁾ 257	⁽⁵⁾ 31,088
(3) Trading Securities:					
Bonds and bills:					
Government	*2,521	*2,476	*50	*5	*2,521
Government Sponsored Enterprises (GSE) Agencies	*59	*57	*2	-	*59
Others	471	384	95	8	471
Total	3,051	2,917	147	13	3,051
Shares:					
Others	14	13	2	1	14
Total trading securities	3,065	2,930	⁽⁶⁾ 149	⁽⁶⁾ 14	3,065
Total securities	38,977	38,567	718	342	38,943

General footnote: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Including securities sold under repurchase terms by a foreign consolidated subsidiary amounting to NIS 2,074 million (US\$ 491 million).

(4) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(5) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 371 millions.

(6) Recorded in the statement of income.



3. SECURITIES⁽¹⁾ (CONTINUED)

B. THE BANK

December 31, 2007					
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value ⁽²⁾
In NIS millions					
(1) Available for sale securities:					
Bonds and bills:					
Government	11,700	11,640	89	29	11,700
Others	2,302	2,319	11	28	2,302
Total	14,002	13,959	100	⁽³⁾ 57	14,002
Shares:					
Fund of Hedge Funds	363	⁽⁶⁾ 363	-	-	363
Others	716	464	252	-	716
Total Shares	1,079	827	252	-	1,079
Total available-for-sale securities	15,081	14,786	⁽³⁾ 352	57	⁽⁴⁾ 15,081
(2) Trading Securities:					
Bonds and bills:					
Government	2,076	2,099	1	24	2,076
Others	386	388	1	3	386
Total	2,462	2,487	2	27	2,462
Shares:					
Others	2	3	-	1	2
Total trading securities	2,464	2,490	⁽⁵⁾ 2	⁽⁵⁾ 28	2,464
Total securities	17,545	17,276	354	85	17,545

General footnote: See note 23E for details of results of bond investment activity. For results of investments in shares, see note 25.

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(4) Including shares, the fair value of which is not readily available, stated at cost of NIS 370 million.

(5) Recorded in the statement of income.

(6) The original amount of the investment in the hedge fund was NIS 407 million. Since the acquisition of the hedge fund, its fair value has declined in a manner that is not of temporary nature, by NIS 44 million, which amount has been recognized in the statement of income.

3. SECURITIES⁽¹⁾ (CONTINUED)**B. THE BANK (CONTINUED)**

December 31, 2006					
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value ⁽²⁾
In NIS millions					
(1) Available for sale securities:					
Bonds and bills:					
Government	12,273	12,089	202	18	12,273
Others	1,397	1,399	3	5	1,397
Total	13,670	13,488	205	23	13,670
Shares:					
Others ⁽⁶⁾	719	503	216	-	719
Total available-for-sale securities	14,389	13,991	⁽³⁾ 421	⁽³⁾ 23	⁽⁴⁾ 14,389
(2) Trading Securities:					
Bonds and bills:					
Government	2,410	2,404	11	5	2,410
Others	133	131	2	-	133
Total	2,543	2,535	13	5	2,543
Shares:					
Others	5	3	3	1	5
Total trading securities	2,548	2,538	⁽⁵⁾ 16	⁽⁵⁾ 6	2,548
Total securities	16,937	16,529	437	29	16,937

General footnote: See note 23 E for details of results of bond investment activity. For results of investments in shares, see note 25.

Footnotes::

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(4) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 46 million.

(5) Recorded in the statement of income.

3. SECURITIES (CONTINUED)

C. The item includes a balance of: consolidated – NIS 439 million; the Bank – NIS 314 million, representing the proportionate share of the Bank and of Mercantile Discount Bank in the collateral received from a certain borrower, as detailed hereunder.

The Bank and Mercantile Discount Bank have granted a loan as part of a Consortium of banks. As the borrower did not abide by the terms of the loan and did not settle the periodic interest payments, the Court, at the request of the Consortium, appointed a Receiver to realize shares of “Bezeq” pledged as collateral for the loan.

On July 15, 2003 the Supervisor of Banks issued a guideline stating that the balance of the said loan as of June 30, 2003, should be treated as an “investment in shares” classified as “available-for-sale securities”, based on the market value of the proportionate share of the Bank and Mercantile Discount Bank in the said collateral.

The Bank and Mercantile Bank have made the classification according to the guideline, based on the market value of their share in the collateral as of June 30, 2003, which amounted to NIS 326 million. As from that date, changes in market value are taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value, up to the amount of the debt.

As of December 31, 2007, the market value of the Bezeq shares exceeded the outstanding balance of the debt in respect of which they had been pledged, by an amount of NIS 21 million, which as stated was not recorded as a capital reserve.

In the course of 2007, the Bank and Mercantile Discount Bank received a dividend of approximately NIS 70 million in respect of the Bezeq shares. This income is presented in “Dividends on available-for-sale shares, net” (see Note 25).

D. The item includes the shares of “HOT” that were received as part of the creditor arrangement of a certain company, upon completion of the transaction for the merger of the TV cable companies on December 31, 2006, the fair value of which stood at NIS 73 million. As from that date, changes in market value are taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value.

Pursuant to a guideline issued by the Supervisor of Banks, the excess fair value of the shares received over the net balance of the debt (net of provisions for doubtful debts) as at December 31, 2007, in the amount of NIS 33 million, has been deferred and was classified as deferred income under “Other liabilities”.

E. For details regarding sale of holdings in Harel Insurance Investments Ltd., see Note 6 H below. The balance of the shares remaining in the Bank at this stage is included in the “Available for sale securities” item.

3. SECURITIES (CONTINUED)

F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES

December 31, 2007				
		Other cumulative income ⁽¹⁾		
	Written down value (for shares - cost)	Unrealized gains from adjustment	Unrealized losses from adjustment to fair value	fair value
in NIS million				
1. Mortgage backed securities (MBS):				
Available for sale trading bonds:				
A. Mortgage pass through securities:				
Securities guaranteed by GNMA	306	2	3	305
Issued by FNMA and FHLMC	7,796	40	73	7,763
Total mortgage backed pass through securities	8,102	42	76	8,068
B. Other mortgage backed securities (including CMOs):				
Issued or guaranteed by FNMA, FHLMC or GNMA	473	3	-	476
Collateralized by MBS issued or guaranteed by FNMA, FHLMC or BNMA	100	2	1	101
Total available for sale other MBS securities	573	5	1	577
Total available for sale MBS securities	8,675	47	77	8,645
Held to maturity bonds				
Securities issued by FNMA and FHLMC	11	-	-	11
Bonds for sale				
Securities issued by FNMA and FHLMC	7	-	-	7
Total mortgage backed securities (MBS)	8,693	47	77	8,663
2. Asset backed securities (ABS)				
Credit financing the purchase of motor vehicles	3	-	-	3
Credit to other than private individuals	3	-	-	3
Total asset backed securities (ABS)	6	-	-	6
Total mortgage and asset backed securities				

Note:

(1) Total other cumulative income - for available for sale securities.

3. SECURITIES (CONTINUED)

F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES (CONTINUED)

December 31, 2006				
		Other cumulative income ⁽¹⁾		
	Written down value (for shares - cost)	Unrealized gains from adjustment	Unrealized losses from adjustment to fair value	fair value
in NIS million				
1. Mortgage backed securities (MBS):				
Available for sale trading bonds:				
A. Mortgage pass through securities:				
securities guaranteed by GNMA	318	-	7	311
Issued by FNMA and FHLMC	8,522	32	188	8,366
Total mortgage backed pass through securities	8,840	32	195	8,677
B. Other mortgage backed securities (including CMOs):				
Issued or guaranteed by FNAM, FHLMC or GNMA	469	2	6	465
Total available for sale other MBS securities	469	2	6	465
Total available for sale MBS securities	9,309	34	201	9,142
Held to maturity bonds				
Securities issued by FNMA and FHLMC	8	-	-	8
Bonds for sale				
Securities issued by FNMA and FHLMC	9	-	-	9
Total mortgage backed securities (MBS)	9,326	34	201	9,159
2. Asset backed securities (ABS)				
Credit financing the purchase of motor vehicles	4	-	-	4
Credit to other than private individuals	4	-	-	4
Total asset backed securities (ABS)	8	-	-	8
Total mortgage and asset backed securities	9,334	34	201	9,167

Note:

(1) Total other cumulative income - for available for sale securities.

3. SECURITIES (CONTINUED)

F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES (CONTINUED)

The Bank's securities portfolio as of December 31, 2007, includes investments in asset backed securities, primarily investment in mortgage backed securities (MBS) which are held for the most part by a consolidated subsidiary abroad.

Mortgage-backed Securities – MBS. A type of asset-backed security (ABS) that is secured by a mortgage or a collection of mortgages. These securities must also be grouped in one of the top two ratings as determined by an accredited credit rating agency, in respect of which periodic payments similar to coupon payments are paid. Furthermore, the mortgage must have originated from a regulated and authorized financial institution.

These securities are also known as mortgage related or mortgage pass-through securities.

Mortgage Pass – Through. A security issued by a financial institution which constitutes holdings of a proportionate share of the mortgage loan portfolio of private borrowers. When the issue is performed by Fannie Mae, Freddie Mac or Gennie Mae (hereinafter: “the agencies”), the issuer provides guarantee for any loss on the loan portfolio backing the bond. Where the issue is performed by other financial institutions, the security is backed by the mortgages alone. The large issuers of securitized assets are the agencies who have a high credit rating.

In securitized mortgage loans, of the type abovementioned, it is customary to grant the private borrower the right of early repayment at any given time.

As a result, the investor's exposure to changes in the rate of early repayments, linked to the interest rate, to the real estate market and the economy and others.

Collateralized Mortgage Obligation – CMO. A type of structured bond, backed by a portfolio of mortgage loans of private borrowers in the United States. The CMO is divided into tranches. Each tranche represents a bond security entitled to receive interest and repayment of principal before or after other bonds in the CMO, so that each bond reflects a different maturity period and interest risk. Where the CMO is issued by an agency, the issuer provides guarantee for any loss on the loan portfolio backing the bond. Where the CMO is issued by other financial institutions, the bond is backed by the mortgages alone and preference is given to bonds rated AAA in respect of payments of principal and interest over the other tranches given a lower rating.

Securities of the CMO type usually offer a relatively lower return as they are very low risk securities and are sometimes also backed by Government securities.

Securities of the CMO type held by IDB New York belong to the top tranche, the most qualitative, having a relatively low risk level.

Securitized Loan Portfolio – CDO. A structured obligation product, backed by a portfolio of credit derivatives, bonds, preferred or subordinate, of corporate issuers, governments or municipalities, either secured or non secured loans, that were granted to commercial and industrial entities by one or more banks, etc.

The CDO is divided into tranches, each representing a bond security entitled to receive interest and repayment of principal before all other bonds rated lower than itself, by international rating companies, such that each bond represents a different risk level, and accordingly offers a different level of return to the investor.



3. SECURITIES (CONTINUED)

F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES (CONTINUED)

Additional details regarding available for sale mortgage and asset backed securities in unrealized loss position:

	Less than 12 months		12 months and over	
	Fair value	Unrealized losses	Fair value	Unrealized losses
In NIS millions				
December 31, 2007				
Mortgage pass through securities	203	1	4,280	75
Other mortgage backed securities	49	1	153	-
Total	252	2	4,433	75
December 31, 2007				
Mortgage pass through securities	1,291	9	6,545	186
Other mortgage backed securities	65	-	251	6
Total	1,356	9	6,796	192

In light of the decrease in interest rates in the United states, the mortgage backed securities (MBS) portfolio as of March 21, 2008, included unrealized gains of US\$20 million.

G. As of December 31, 2007, the available-for-sale securities portfolio of IDB New York included corporation bonds, including bank bonds, in a total amount of US\$530 million. The balance of the said bonds included at December 31, 2007, unrealized losses of some US\$25 million. As of March 21, 2008, the said balance included unrealized losses of some US\$48 million.

H. Substantially all of the unrealized losses at December 31, 2007 relate to investment grade securities and are attributable to changes in market interest rate changes subsequent to purchase. 179 securities were in a continuous state of unrealized loss for a period of under 12 months, whereas 188 securities were in such a position for a period of 12 months or over. For debt securities, there are no securities past due or securities for which IDB New York currently believes it is not probable that it will be able to collect all the amounts owed to it pursuant to the investment contracts. Since IDB New York has the ability and intent to hold on to securities with unrealized losses until a market price recovery (which for debt securities, may not be until maturity), IDB New York and the Bank do not consider these investments to be other than temporarily impaired at December 31, 2007.

IDB New York has determined that all unrealized losses on available-for-sale securities are temporary. IDB New York has used recent market prices and security ratings, where available. There were no declines in market prices, other than what would be attributable to changes in interest rates, or observed rating changes that would indicate an other than temporary impairment. Based upon IDB New York's analysis, no provisions for other than temporarily impaired available-for-sale securities were required in 2007 with the exception of one security in a value of US\$2 million, in respect of which a provision for impairment of US\$700 thousand has been recorded.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS)**A. CREDIT GRANTED TO THE PUBLIC**

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
Credit	102,203	*90,406	59,715	51,604
Customers' liabilities for acceptances	284	285	164	179
Total credit	102,487	90,691	59,879	51,783
General provision and supplemental provision for doubtful debts	(588)	(594)	(305)	(316)
Total	101,899	90,097	59,574	51,467

*Reclassified.

Footnote:

The specific provision for doubtful debts has been deducted from the relevant items (see Note 4 C).

B. CREDIT GRANTED TO THE PUBLIC INCLUDES:**1. Credit to problem borrowers excluding local authorities:**

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			

(a) Non-Income Bearing Loans to Problem Borrowers

Balance at balance sheet date:				
In Israeli currency, non-linked	1,646	*1,790	1,133	1,193
In Israeli currency, linked to CPI	231	318	115	200
In foreign currency (including linked to foreign currency)	352	417	308	343

(b) Restructured Credit to Borrowers**(1) Credit restructured during the current year, with waiver of income:**

In Israeli currency, non-linked:				
Balance at balance sheet date	-	1	-	-
Average repayment period, in years	-	6	-	-
Effective rate of income:				
Included in the anticipated repayment flow	-	6.3%	-	-
Included in the repayment flow according to original contracts	-	8.5%	-	-
In Israeli currency, linked to CPI:				
Balance at balance sheet date	73	-	70	-
Average repayment period, in years	12.5	-	12.5	-
Effective rate of income:				
Included in the anticipated repayment flow	6.4%	-	6.5%	-
Included in the repayment flow according to original contracts	6.6%	-	6.6%	-

* Reclassified.



4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED)

1. Credit to problem borrowers excluding local authorities (continued)

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			

(2) Credit restructured in prior years, with waiver of income:

Balance at balance sheet date:				
In Israeli currency, non-linked	5	*5	-	-
In Israeli currency linked to CPI	6	7	-	-

(3) Credit restructured during the current year - without waiver of income:

Balance at balance sheet date:				
In Israeli currency, non-linked	137	66	112	19
In Israeli currency, linked to CPI	49	107	23	33
In foreign currency (including linked to foreign currency)	8	104	7	78

(c) Restructured Credit Not Yet Executed

Balance at balance sheet date	33	143	33	135

(d) Credit in Temporary Arrears

Balance at balance sheet date	252	187	147	140
Interest in respect of such credit included in the statement of income	9	11	8	10

(e) Credit Under Special Supervision

Balance at balance sheet date	3,321	*3,542	2,411	2,714

* Reclassified.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)**B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED)****2. Credit to the local authorities sector:**

Credit to the local authorities sector:				
	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
(a) Credit to local authorities				
Balance at balance sheet date	216	244	180	214
(b) The Credit to local authorities included:				
(1) Credit under special supervision:				
Balance at balance sheet date	11	16	8	15
(2) Credit that is not included in credit granted to problematic borrowers:				
Balance at balance sheet date	205	228	172	199
Interest in respect of such credit included in the statement of income	21	24	17	20



4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

C. PROVISION FOR DOUBTFUL DEBTS

2007				
	Specific provision ⁽¹⁾			Total
	According to extent of delinquency	Other	Supplemental provision ⁽²⁾	
	In NIS millions			
Consolidated				
Balance of provision at beginning of year	161	5,278	675	6,114
Provision for current year	61	649	29	739
Reduction of provision	(56)	(185)	(41)	(282)
Collection of debts written-off in previous years	-	(10)	-	(10)
Provision charged to statement of Income	5	454	(12)	447
Write-offs	(3)	(575)	-	(578)
Inflationary erosion and adjustment of balances	-	(8)	-	(8)
Balance of provision at end of year	163	5,149	663	5,975
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	119	75	194
The Bank				
Balance of provision at beginning of year	-	4,271	360	4,631
Provision for current year	-	400	16	416
Reduction of provision	-	(143)	(27)	(170)
written-off in previous years	-	(1)	-	(1)
Provision charged to statement of Income	-	256	(11)	245
Write-offs	-	(496)	-	(496)
Inflationary erosion and adjustment of balances	-	-	-	-
Balance of provision at end of year	-	4,031	349	4,380
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	118	44	162

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: Consolidated - NIS 427 million; 2006 - NIS 423 million; 2005 - NIS 509 million. The bank - NIS 197 million; 2006 - NIS 197 million; 2005 - NIS 197 million (see Note I1).

(3) Including a special provision for doubtful debts of NIS 4 million.

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2006				2005			
Specific provision ⁽¹⁾			Total	Specific provision ⁽¹⁾			Total
According to extent of delinquency	Other	Supplemental provision ⁽²⁾⁽³⁾		According to extent of delinquency	Other	Supplemental provision ⁽²⁾⁽³⁾	
In NIS millions				In NIS millions			
150	5,005	748	5,903	130	4,838	695	5,663
68	735	46	849	63	742	72	877
(52)	(99)	(119)	(270)	(41)	(105)	(23)	(169)
-	(9)	-	(9)	-	(17)	-	(17)
16	627	(73)	570	22	620	49	691
(5)	(342)	-	(347)	(2)	(457)	4	(455)
-	(12)	-	(12)	-	4	-	4
161	5,278	675	6,114	150	5,005	748	5,903
-	54	81	135	-	65	68	133
-	4,167	352	4,519	-	4,093	340	4,433
-	451	24	475	-	506	30	536
	(81)	(16)	(97)	-	(76)	(18)	(94)
	(1)	-	(1)	-	(1)	-	(1)
-	369	8	377	-	429	12	441
-	(265)	-	(265)	-	(359)	-	(359)
-	-	-	-	-	4	-	4
-	4,271	360	4,631	-	4,167	352	4,519
-	51	44	95	-	63	44	107

**4. CREDIT GRANTED TO THE PUBLIC (CONTINUED):****D. HOUSING LOANS AND THE PROVISION FOR DOUTFUL DEBTS IN RESPECT THEREOF BASED ON THE DURATION OF DELINQUENCY****Consolidated**

	December 31, 2007						December 31, 2006					
	Duration of arrears											
	Over 3 and up to 6 months	Over 6 and up to 15 months	Over 15 and up to 33 months	Over 33 months	credit restructured	Total	Over 3 and up to 6 months	Over 6 and up to 15 months	Over 15 and up to 33 months	Over 33 months	credit restructured	Total
	In NIS millions											
Amount in arrears	7	13	18	71	-	109	7	16	19	62	-	104
Of which: Interest on the amount in arrears	1		1	19	-	21	-	-	1	15	-	16
Balance of provision for doubtful debts based on delinquency period ⁽¹⁾	-	20	39	104	-	163	1	23	46	91	-	161
Balance of loans net of provision for doubtful debts	135	117	44	27	1	324	140	137	51	24	1	353

Footnote:

(1) Not including a provision for interest in respect of the amount in arrears.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)**E. COMPOSITION OF CREDIT TO THE PUBLIC⁽¹⁾ AND OFF-BALANCE-SHEET CREDIT RISK⁽²⁾, BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS**

Consolidated

				December 31					
				2007			2006		
			Number of borrowers ⁽²⁾	Credit	Credit risk ⁽³⁾	Number of borrowers ^{*(2)}	Credit [*]	Credit risk ^{*(3)}	
in NIS millions									
Credit limit (in NIS thousand):									
		Up to	10	407,222	1,490	1,416	399,025	*1,548	1,861
Over	10	Up to	20	105,716	1,231	608	99,019	*1,172	768
Over	20	Up to	40	130,154	2,278	1,972	118,129	*2,041	2,280
Over	40	Up to	80	117,903	3,365	5,029	110,218	*2,959	3,961
Over	80	Up to	150	54,758	3,570	3,051	51,463	*3,297	2,413
Over	150	Up to	300	28,704	4,892	1,386	27,128	*4,636	1,554
Over	300	Up to	600	18,240	6,437	1,284	16,677	*5,816	1,625
Over	600	Up to	1,200	8,439	5,224	1,664	7,624	*4,521	1,775
Over	1,200	Up to	2,000	2,932	3,070	1,280	2,672	*2,642	1,130
Over	2,000	Up to	4,000	2,192	4,423	1,566	2,151	*4,238	1,637
Over	4,000	Up to	8,000	1,267	4,867	2,055	1,172	4,419	2,231
Over	8,000	Up to	20,000 ⁽⁴⁾	1,154	9,082	5,094	1,114	8,819	4,675
Over	20,000	Up to	40,000 ⁽⁴⁾	631	10,121	6,658	582	8,796	5,069
Over	40,000	Up to	200,000 ⁽⁴⁾	643	26,304	21,546	547	25,018	18,373
Over	200,000	Up to	400,000 ⁽⁴⁾	67	9,242	10,418	49	6,763	5,668
Over	400,000	Up to	800,000 ⁽⁴⁾	18	5,189	4,979	*15	3,581	4,190
Over	800,000	Up to	1,200,000 ⁽⁴⁾	5	1,522	3,368	6	1,628	4,402
Over	1,200,000	Up to	1,600,000 ⁽⁴⁾	2	2	2,555	-	-	-
Over	1,600,000	Up to	2,000,000 ⁽⁴⁾	-	-	-	-	-	-
Over	2,000,000	Up to	2,400,000 ⁽⁴⁾	1	1,126	1,261	-	-	-
Over	2,400,000	Up to	2,800,000 ⁽⁴⁾	1	494	2,115	-	-	-
Total				880,049	103,929	79,305	837,591	91,894	63,612
Income receivable and other debtors ⁽⁵⁾					2,204			1,976	
Total				-	106,133	79,305	-	93,870	63,612

* Restated.

Footnotes:

(1) Including investments in bonds of the public and assets related to derivative financial instruments created with the public, net of a specific provision for doubtful debts.

(2) Number of borrowers based on total credit and credit risk.

(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.

(4) Consolidated - by combining specific balances.

(5) The outstanding balance of ICC customers with respect to credit cards issued by it. The Supervisor of Banks exempted credit card companies, at this stage, from presenting these balances according to size of borrower.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

E. COMPOSITION OF CREDIT TO THE PUBLIC⁽¹⁾ AND OFF-BALANCE-SHEET CREDIT RISK⁽²⁾, BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS (CONTINUED)

The Bank

				December 31					
				2007		2006			
				Number of borrowers ⁽²⁾	Credit	Credit risk ⁽³⁾	Number of borrowers ^{*(2)}	Credit*	Credit risk ^{*3)}
in NIS millions									
Credit limit (in NIS thousand):									
		Up to	10	208,921	375	1,349	199,589	284	1,688
Over	10	Up to	20	56,694	567	565	56,768	559	532
Over	20	Up to	40	96,323	1,363	1,933	88,119	1,247	2,184
Over	40	Up to	80	95,766	2,234	4,899	92,019	1,986	3,887
Over	80	Up to	150	41,303	2,172	2,908	38,432	1,921	2,308
Over	150	Up to	300	13,544	1,750	1,254	12,112	1,528	1,391
Over	300	Up to	600	5,511	1,422	1,014	5,075	1,305	1,335
Over	600	Up to	1,200	3,579	1,804	1,179	3,419	1,690	1,117
Over	1,200	Up to	2,000	1,455	1,473	751	1,311	1,271	695
Over	2,000	Up to	4,000	1,192	2,378	1,002	1,155	2,124	999
Over	4,000	Up to	8,000	785	2,894	1,435	746	2,590	1,479
Over	8,000	Up to	20,000	643	4,821	3,236	604	4,516	2,932
Over	20,000	Up to	40,000	328	5,181	3,997	293	5,094	3,039
Over	40,000	Up to	200,000	390	16,802	14,838	340	16,125	12,128
Over	200,000	Up to	400,000	59	7,869	9,584	36	5,136	4,895
Over	400,000	Up to	800,000i	19	5,079	5,425	*15	3,973	4,505
Over	800,000	Up to	1,200,000	4	1,317	2,543	5	1,146	3,807
Over	1,200,000	Up to	1,600,000	3	46	3,955	1	-	1,305
Over	1,600,000	Up to	2,000,000	-	-	-	-	-	-
Over	2,000,000	Up to	2,400,000	1	1,126	1,261	-	-	-
Over	2,400,000	Up to	2,800,000	1	494	2,115	-	-	-
Total				526,521	61,167	65,243	500,039	52,495	50,226

* Restated.

Footnotes:

(1) Including investments in bonds of the public and assets related to derivative financial instruments created with the public, net of a specific provision for doubtful debts.

(2) Number of borrowers based on total credit and credit risk.

(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)
F. DETAILS AS TO THE MANNER OF COMPUTING THE SPECIFIC PROVISION FOR HOUSING LOANS – (CONSOLIDATED)

December 31, 2007						
	Problematic housing loans				Specific provision	
	Balance of credit	Balance of debt ⁽⁴⁾	Balance in arrears	According to extent of delinquency ⁽⁵⁾	Other	Total
	in NIS millions					
Housing loans ⁽¹⁾⁽⁶⁾	8,196	299	94	142	-	142
"Large loans" ⁽²⁾	2,173	66	30	5	30	35
Other loans ⁽³⁾	815	60	22	16	19	35
Total	11,184	425	146	163	49	212

December 31, 2006						
	Problematic housing loans				Specific provision	
	Balance of credit	Balance of debt ⁽⁴⁾	Balance in arrears	According to extent of delinquency ⁽⁵⁾	Other	Total
	in NIS millions					
Housing loans ⁽¹⁾⁽⁶⁾	7,205	314	88	141	-	141
"Large loans" ⁽²⁾	1,579	65	26	5	24	29
Other loans ⁽³⁾	842	83	27	15	19	34
Total	9,626	462	141	161	43	204

* Reclassified.

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 extent of delinquency.

(2) Housing loans, the outstanding balance of each exceeds NIS 805 thousand (2006: NIS 783 thousand).

(3) Loans secured by a mortgage of a residential unit - prepared according to a circular published by the Bank of Israel on January 1, 2006, stating that housing loans for purposes of financial statements presentation are to include multi purpose loans secured by a mortgage on a residential unit.

(4) Balance of problematic loans (over 3 months in arrears) and net of the balance of provisions.

(5) Includes interest on arrears without deduction of the balance of provisions in the amount of NIS 15.3 million (2006: NIS 8.8 million).

(6) Including balance of credit at the Bank in the amount of NIS 91 million (December 31, 2006: NIS 105 million).



5. CREDIT GRANTED TO GOVERNMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
Deposit of the Accountant General - tender for teaching employees	362	-	362	-
Other credit ⁽¹⁾	12	^{(2)*} 324	1	^{(2)*} 313
Total credit granted to Governments	374	324	363	313

* Reclassified.

Footnotes:

(1) Including credit to foreign governments: Consolidated - NIS 2 million (2006: NIS 6 million), the Bank - no balance (2006: NIS 4 million).

(2) An amount of NIS 306 million is in respect of borrowings from the Treasury, reflected this year as part of securities borrowed or purchased under buy-back agreements.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES

A. CONSOLIDATED

	December 31, 2007			December 31, 2006		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
In NIS millions						
Investments						
Shares stated on equity basis ⁽¹⁾	1,931	-	1,931	1,353	-	1,353
Other investments:						
Capital notes	3	-	3	2	-	2
Shareholders' loans	74	-	74	12	-	12
Total other investments	77	-	77	14	-	14
Total investments	2,008	-	2,008	1,367	-	1,367
Includes:						
Earnings accumulated since January 1, 1992	891	-	891	678	-	678
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	32	-	32	31	-	31
Adjustment for translation of foreign currency financial statements	(3)	-	(3)	(2)	-	(2)
Details Regarding Goodwill:						
Period of amortization	10 years			10 years		
Original amount	8	292	300	10	246	256
Unamortized balance	6	240	246	7	224	231
Book and Market Values of Marketable Investments:						
Book value	1,451	-	1,451	1,254	-	1,254
Market value	1,387	-	1,387	1,477	-	1,477

* Reclassified.

Footnote:

(1) Includes earnings and translation adjustments in autonomous units accumulated from the acquisition date up to December 31, 1991.



6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

B. THE BANK

	December 31, 2007			December 31, 2006		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	In NIS millions					
Investments						
Shares stated on equity basis ⁽¹⁾	1,513	5,778	7,291	1,322	5,083	6,405
Other investments:						
Subordinated debt note and Capital notes	3	107	110	2	140	142
Shareholders' loans	3	576	579	3	68	71
Total other investments	6	683	689	5	208	213
Total investments	1,519	6,461	7,980	1,327	5,291	6,618
Includes:						
Retained earnings since January 1, 1992	903	2,677	3,580	684	2,353	3,037
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	30	(41)	(11)	31	(53)	(22)
Adjustment for translation of foreign currency financial statements	(1)	34	33	(2)	35	33
The state's bonus to the employees (privatization)	-	32	32	-	32	32
Details Regarding Goodwill:						
Period of amortization	10 years			10 years		
Original amount	8	292	300	8	242	250
Unamortized balance	6	240	246	7	223	230
Book and Market Values of Marketable Investments:						
Book value	1,451	-	1,451	1,254	550	1,804
Market value	1,387	-	1,387	1,477	408	1,885

Footnote:

(1) Includes earnings and translation adjustments in autonomous units accumulated from the acquisition date up to December 31, 1991.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

THE BANK'S SHARE OF INCOME OR LOSS OF INVESTEE COMPANIES

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	In NIS millions					
The Bank's share of operating income of investee companies (consolidated - affiliated companies)	175	190	196	457	248	770
Provision for taxes:						
Current taxes	-	-	-	22	25	58
Deferred taxes	⁽¹⁾ 130	2	22	⁽¹⁾ 143	3	26
Total provision for taxes	130	2	22	165	28	84
The Bank's share of operating income of investee companies (consolidated - affiliated companies), after tax	45	188	174	292	220	686

Note:

(1) Including a provision for taxes in the amount of NIS 130 million in the respect of the Bank's share in earnings of the First International Bank (see Section F below).



6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

C. INFORMATION ON PRINCIPAL INVESTEE COMPANIES

Name of Company	Details of company	Share in capital conferring rights to profits		Share in voting rights	
		2007	2006	2007	2006
		As a percentage		As a percentage	
1. Consolidated Subsidiaries:					
Discount Bancorp, Inc. ⁽¹⁾	Holding company, U.S.A.	100.00	100.00	100.00	100.00
Israel Discount Bank of New York ⁽²⁾	Commercial bank, U.S.A	100.00	100.00	100.00	100.00
Mercantile Discount Bank Ltd.	Commercial bank	100.00	100.00	100.00	100.00
Discount Mortgage Bank Ltd. ⁽³⁾	Mortgage bank	100.00	65.07	100.00	65.07
Israel Credit Cards Ltd.	Credit card service	71.83	68.24	79.00	76.00
Discount Leasing Ltd.	Equipment leasing	100.00	100.00	100.00	100.00
Discount Israel Capital Markets and Investments Ltd.	Underwriting and investments	100.00	100.00	100.00	100.00
Discount Manpikim Ltd.	Securities issue	100.00	100.00	100.00	100.00
Ilanot-Discount Ltd. ⁽⁴⁾	Mutual fund management	-	-	-	-
Israel Discount Bank (Switzerland) SA	Commercial bank, Switzerland	100.00	100.00	100.00	100.00
Companies held by Israel Discount Bank of New York:					
Discount Bank (Latin America) ⁽⁵⁾	Commercial bank, Uruguay	100.00	100.00	100.00	100.00
IDBNY Realty (Delaware), Inc. ⁽⁵⁾	Holding company, USA	100.00	100.00	100.00	100.00
IDBNY Realty Inc. ⁽⁶⁾	REIT, US	100.00	100.00	100.00	100.00
Company held by Discount Israel Capital Markets and Investments Ltd.:					
Freenet A.K. Communications Ltd.	Holding company	100.00	100.00	100.00	100.00
2. Affiliated Companies:					
First International Bank of Israel Ltd. ⁽⁷⁾	Commercial bank	26.45	26.45	11.09	11.09
Harel Insurance Investments Ltd. ⁽⁸⁾	Holding company	-	-	-	-
Company held by Discount Israel capital markets and Investments Ltd:					
Kardan Financial Services N.V. ⁽⁹⁾	Financial Investment, the Netherlands	11.00	-	20.00	-

* Reclassified.

Footnotes:

(1) A holding company, wholly-owned by the Bank, which fully owns and controls Israel Discount Bank of New York.

For details as to an investigation with respect to matters related to the Prohibition of Money Laundering Law, see section D. hereunder.

(2) The company is owned by Discount Bancorp, Inc.

(3) For details regarding a full purchase offer for the shares of Discount Mortgage Bank, see section I. hereunder.

(4) For details regarding the sale of all the holdings in Ilanot Discount, see section E. hereunder.

(5) Included in the financial statements of Israel Discount Bank of New York.

(6) Included in the financial statements of IDBNY Realty (Delaware), Inc.

(7) For details regarding the provision for impairment in value and its reversal, and atax provision in respect of the investment see section F. hereunder.

(8) For details regarding the sale of holdings in Harel, see section H. hereunder.

(9) The investment was made at the end of 2007. Israel Discount Capital Markets and Investments is considering the allocation of the excess of cost of

(10) Including adjustments from translation of financial statements of foreign autonomous units and adjustments concerning the presentation of certain securities of investee companies at fair value.

(11) Goodwill

(12) Including a provision for taxes in the amount of NIS 130 million in respect of the Bank's share in earnings of the First International Bank (see Section F below).

[illegible]

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

D. AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS

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

6. INVESTMENTS IN investee COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 proceedings to which the Bank is a party" in the annual report for 2006, pp. 205-207; for details regarding a compromise agreement with Mr. Sheer, see under "Additional legal proceedings to which the Bank is a party" in the section "Legal proceedings").

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

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

addressing all the recommendations will be completed by the end 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 95% 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. In September 2007, KPMG completed the preparation of an assessment report summarizing the findings of an examination performed by KPMG in order to evaluate the effectiveness of the efforts undertaken by IDB New York to reduce the gaps identified by them in the past. Out of 352 previously identified gap issues, the Bank's effort with respect to 95% of these has been rated as "highly" responsive; 5% have been rated as "moderately" responsive and no measure has been rated as having a "low" level of responsiveness.

"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 was carried out which as of the date of preparation of the financial statements has been completed. A report that includes the findings of a "backward review" has been relayed to the authorities.

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\$13.3 million in 2007. According to IDB New York, additional costs will be incurred during 2007 for implementation of improvements and examinations in an amount between US\$2 million – US\$3 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.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 hereunder.

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.

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. Mr. Grunstein raised certain criticisms regarding the draft examination report, including arguments regarding the unfair influence of IDB New York’s management on the draft examination report’s preparers. These arguments were passed on by the Bank to an American legal firm for examination, as detailed hereunder (see item 5 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 (hereinafter: “the 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



6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 Bancorp, 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. 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 discussed 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) At the beginning of September 2007 a report of the examination of a U.S. legal firm, which had been engaged by the Bank to examine the transactions regarding which the committee was appointed, inter alia, from the standpoint of United States legislation, was submitted. The report indicates deficiencies in the procedures for approval of the transactions examined, deficiencies stemming from the presence on the Board of IDB New York of representatives of shareholders, as detailed above, and the non-compliance with proper corporate governance principles at IDB New York. The writers of the report concluded that the major part of the deficiencies had been corrected with the termination of office of the controlling shareholders and their representatives as Directors of Discount Bancorp and IDB New York. The writers of the report also determine that the Parent Company should take action to develop supervisory mechanisms over Discount Bancorp and IDB New York and to consider the adoption of corporate

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

governance principles designed to comply with the provisions of the law in Israel, with respect to everything related to the approval of transactions with interested parties to them. No recommendations were made in this respect.

- (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 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).

- (8) As stated in Section 5 above, in July 2007 the findings of the examination in the matter of the arguments of the former Chairman of IDB New York, Mr. Grunstein, against the draft examination report of January 2007, according to which there was no basis whatsoever to Mr. Grunstein's claims, were submitted. The draft examination report was brought to completion and at the beginning of November 2007, the final report was submitted to the Board of Directors of IDB New York.

In the opinion of the writers of the report, the final report indicated deficiencies in the approval process of several transactions made by controlling shareholders with IDB New York and Discount Bancorp.

The deficiencies relating to the granting of a loan to a company controlled by one of the controlling shareholders, for the purpose of renovating the 12th floor, sub-leased to that company, and the non-payment of rent in respect of the said property for a period of nine months may constitute a breach of various regulatory provisions. The conclusions of the report and its implications have not yet been discussed by the committee and by the Board of Directors. The report was relayed to the authorities in September 2007.

- (9) In view of the recommendations of the examination report, the company paid IDB New York interest in respect of the delay in the payment of rent.

Furthermore, according to the recommendations of the report, an opinion of an independent appraiser was sought out and received with respect to the appropriate amount of rent as of the date of the examination report. In view of the opinion of the assessor, IDB New York negotiated to change the rental fees and it has been agreed to increase such fees by US\$4 per square foot.

The amendment of the agreement regarding the amount of rental fees has been approved by the authorized organs of IDB New York and will be submitted for approval by the authorized organs at the Bank as an entitled transaction. At the present stage, the transaction is being discussed by the Audit Committee of the Bank and the discussion has not yet been completed.

- (10) In February 2008, the recommendations of the ad-hoc committee on the new York issues were presented to the Board of Directors.

The committee recommended that part of the transactions that had been examined by it should be examined according to the rules approved within the framework of Discount Group's "Corporate Governance" code (see item 7 above). The committee further recommended, among other things, that rules be determined for the treatment of material transactions at IDB New York; for the composition of the Board of Directors of IDB New York and for the selection and approval of nominees to this Board, and all with a view of strengthening the independence of IDB New York's Board as against the controlling shareholders and strengthening the control of the Bank over IDB New York; to determine reporting principles to the Bank's Board regarding IDB New York.

The Bank's Board of Directors has adopted the committee's recommendations.



6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

E. THE SALE OF SHARES OF ILANOT DISCOUNT LTD. AND THE OPERATIONS OF THE PROVIDENT FUNDS

1. Agreement in Principle for the sale of shares of Ilanot Discount Ltd. and the operations of provident funds

On November 9, 2005, an agreement in principle was signed between the Bank and Clal Insurance Enterprises Holdings Ltd., whether itself or by way of a company under its control (hereinafter – “the Purchaser”) for the sale of all shares of Ilanot Discount Ltd. and for the sale of the provident funds operations as one package, in consideration for NIS 1,310 million, subject to adjustments. The consideration for the sale of the shares of Ilanot Discount Ltd. was set in the Agreement in Principle at NIS 600 million, subject to adjustments, and the consideration for the sale of the operations of the Provident Funds was set at NIS 710 million, subject to adjustments. The Agreement in Principle determined, among other things, that following the consummation of the transaction, the Bank shall provide Ilanot Discount and the Provident Funds with distribution services in consideration for a distribution fee equal to the rate of fees stated in the draft regulations known at the time regarding distribution commissions payable by mutual funds and provident funds, respectively, as well as operating services and additional services.

2. An agreement for the sale of the shares of Ilanot Discount

On April 11, 2006, the Bank, Clal Finance Batucha Management and Investments Ltd. (hereinafter – “the Purchaser”) and Clal Insurance Enterprises Holdings Ltd. (both of the IDB Group), signed an agreement for the sale by the Bank to the Purchaser of all the shares of Ilanot Discount (hereinafter – “the Sales Agreement”). In addition the Bank is to assign to the Purchaser the right to receive management fees from Ilanot Discount and will also sell to the Purchaser the goodwill it acquired in the field of mutual fund management. In consideration for the above, the Purchaser will pay the Bank NIS 580 million, subject to adjustments that may arise from the difference between the expenses of Ilanot Discount and the actual payments made to the Bank in the period from January 1, 2006 until date of closing of the transaction, in comparison to the amount of expenses determined in the Sale Agreement.

The Sale Agreement includes, inter-alia, provisions as to additional services that the Bank may provide to Ilanot Discount. The Sales Agreement also stipulates indemnification arrangements between the Bank and the Purchaser under certain circumstances.

The sale agreement came into effect on June 18, 2006, after the completion of all conditional terms for its execution. As part of the completion of the sale, the following agreements were signed between the Bank and Ilanot Discount: an operational agreement, according to which the mutual funds managed by Ilanot Discount would gradually be transferred for operation by the Bank, and a distribution agreement (replacing a previous agreement) according to which the Bank would distribute the mutual funds managed by Ilanot Discount.

45% of the shares of Ilanot Discount that were sold to the Purchaser were acquired by the Bank on September 29, 2005, from IDB Development Ltd. (hereinafter: “IDB”) and Discount Investment Company Ltd. (hereinafter: “DIC”) in consideration for NIS 229.7 million, after the Bank claimed the right of first refusal, replacing a third party, with whom IDB and DIC signed an agreement for the sale of these shares.

The said shares were acquired and held from the start with the intention of selling them. Accordingly, as of December 31, 2005 the said shares were presented, until that sale, in the financial statements as available-for-sale securities, and the rights of the outside shareholders have been computed at 45%.

Correspondingly with the completion of the sale, the Bank paid IDB and DIC a sum of NIS 12.5 million, as additional consideration for the shares that it acquired from them.

The profit from the sale transaction amounted approximately NIS 256 million, net after tax, and had been recorded in the financial statements as net gain from extraordinary items.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

3. On January 29, 2007, the Bank and its subsidiary Discount Management of Provident Fund Ltd. (hereinafter: "Discount Provident") signed an agreement with Clal Insurance Company Ltd. (hereinafter: "Clal Insurance") according to which Clal Insurance would acquire from the Bank and from Discount Provident 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, 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.

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 ownership 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 Provident. 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.

6. INVESTMENTS IN investee COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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".

F. PROVISION FOR THE IMPAIRMENT IN VALUE OF THE BANK'S INVESTMENT IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI")

1. Provision for impairment in value

Towards the publication of the financial statements of the Bank as of March 31, 2003, the Supervisor of Banks instructed the Bank to include a provision for impairment in value of FIBI of 20% of the equity value of the investment as of March 31, 2003. Accordingly, the Bank included in the financial statements for March 31, 2003, a provision of NIS 173 million.

2. Reversal of the provision for impairment in value

(a) The Bank applied to the Supervisor of Banks for permission to reverse the said provision. This, among other things in view of the fact that since the issue of the Supervisor's directive in this respect, a significant improvement has taken place in the results of FIBI, as reflected in its published financial statements, as well as a significant increase in the market price of its shares. Furthermore, the Bank has independent opinions according to which the recoverable value of the Bank's investment in FIBI does not fall below its share in the equity of the First International Bank.

(b) On May 22, 2006, the Supervisor of Banks informed the Bank that he had reached the conclusion that his involvement in the matter of the provision for impairment in value of the investment in FIBI is no longer required, and accordingly, starting with the financial statements of the Bank as of March 31, 2006 onwards, the Bank will decide in accordance with generally accepted accounting principles in Israel, the accounting treatment and the provision for impairment in value, if required, in respect of the investment of the Bank in FIBI.

In accordance with the above, the Bank reversed the said provision in its financial statements as of March 31, 2006.

G. PUBLIC ISSUANCE BY FIBI

On May 9, 2007 the shares of Discount Mortgage Bank Ltd. were removed from trade on the Tel Aviv Stock Exchange.

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

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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, 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 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, 2007, 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.

Following the above, the parties conducted negotiations, which at this stage were not successful.

In continuation to the above and on the background of the disputes between the parties, FIBI informed on November 19, 2007, that it will

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

refrain from providing the Bank with certain data of its financial statements prior to their publication, as has been the custom in the past. FIBI based its notice on the claim that recently, following and on grounds of the said dispute, it has allegedly transpired that the use of the equity basis method by the Bank in presenting its investment in FIBI is improper. FIBI further informed that the Securities Authority had been approached in order to obtain its opinion thereon, but this has not yet been received.

On December 25, 2007, the Bank wrote to the Securities Authority informing it that it happened to hear, through a representative of FIBI, that the Securities Authority had taken a decision in the matter. The Bank requested information as to this decision, especially since the Securities Authority had not approached the Bank in this matter, had not informed it as to any proceedings existing in the matter and that prima facie it was an approach made by a party who was engaged in a commercial dispute with the Bank. In its reply, the Securities Authority stated that the Supervisor of Banks will be the one to decide on the issue, that the Authority had not formed its final opinion regarding this issue and that in any event the Bank is free to present its opinion in the matter. At this stage it has been agreed with the Securities Authority to wait until the Supervisor of Banks gives his ruling on this issue.

It should be noted that ever since the acquisition of the means of control in FIBI, no changes have occurred in the arrangements between the shareholders of FIBI, in the rate of holdings of means of control that the Bank has in FIBI or in the permit granted by the Governor of the Bank of Israel for the acquisition of the said means of control. Furthermore, in recent years no changes have occurred in the relevant accepted accounting principles applying to this matter.

The Bank's investment in the FIBI has been presented using the equity basis method since the acquisition of the means of control in FIBI over twenty years ago. The Bank's opinion has been and remains such that the proper accounting treatment of the investment in FIBI is the one using the equity basis method.

Approach by the Antitrust Commissioner. On January 22, 2008, the Antitrust Authority informed the Bank that the Antitrust Commissioner is examining certain aspect relating to the holdings of the Bank in the First International Bank. In this respect, the Bank has been asked to forward to the Commissioner various documents and data.

In an additional letter of the same date, the said Authority clarified that in view of the fact that the issue of the Bank's holdings in the First International Bank is being examined by it, "the parties are taking a legal and commercial risk with respect to any change in the existing situation, which may strengthen the affinity between the two banks". Following contacts in the matter held between the Bank and the Antitrust Authority, it has been decided to arrange a meeting between the parties, even prior to the Bank submitting its response to the subject at hand. The meeting has not yet taken place.

As stated above, the Bank has not as yet responded addressing the substance of the approach by the Antitrust Authority, however, according to the position taken by the Bank and its legal counsel, the Bank is lawful in protecting its rights as a minority shareholder in the First International Bank, and the Antitrust Authority has also been informed accordingly.

Under the circumstances the Bank considered 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.

Following negotiations between the parties, the Bank, with the knowledge of the Bank of Israel and pursuant to its request, has suspended the filing of proceedings at this stage.

Negotiations are being conducted lately with a view of reaching an arrangement between the parties. The arrangement has not yet been reached and presently differences of opinion exist between the parties.

6. INVESTMENTS IN investee COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

In this respect, the Board of Directors directed the Bank's Management to act so that in the event that an arrangement is established to include an outline, in the framework of which the Bank would reduce its holdings in FIBI, then such outline shall be subject to maintaining the terms under which the Bank may continue recording the investment in the said bank by the equity method of accounting, to the amendment of the shareholder agreement of 1983 and subject to additional terms to the extent required to preserve the rights of the Bank.

Any arrangement between the Bank and FIBI, if and so far as established, is subject to the approval of the Board of Directors.

It had been assumed in financial statements published hitherto that the investment in shares of FIBI would be a long-term one and therefore no provision for taxes had been recorded in the past in respect of the Bank's share in retained earnings of the investee bank.

In view of that stated above, it is no longer certain that the assumption of continuous holding is viable in its entirety and therefore the Bank decided to record a provision for taxes of NIS 130 million, in relation to that part of the investment in respect of which a continuous holding as above cannot be assumed.

H. THE SALE OF THE HOLDINGS IN HAREL INSURANCE INVESTMENTS LTD. (HEREINAFTER - "HAREL")

On November 1, 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, came into effect.

Following the sale, the Bank holds 5.79% of the share capital of Harel, which are stated in the item "Available for sale securities".

The profit from the sale of shares amounted approximately NIS 104 million, net after tax, and had been recorded in 2006 as net gain from extraordinary items.

I. PURCHASE OFFER FOR ALL SHARES OF DISCOUNT MORTGAGE BANK HELD BY THE PUBLIC

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 265 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 Antitrust Commissioner, 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.



6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

J. INVESTMENT IN "KFS"

On December 30, 2007, Israel Discount Capital Markets and Investments Ltd., (hereinafter: "DCMI") Kardan Financial Services BV ("KFS") and Kardan NA ("Kardan") entered into an agreement according to which DCMI will acquire by way of an issue of shares 11.01% of the issued and paid share capital of KFS at date of issue (and 11% of the issued and paid share capital of KFS fully diluted), in consideration of Euro 55.6 million.

KFS is a holding company incorporated in Holland engaged in financial services in central/eastern European countries, in former Soviet Union countries and in Turkey. Most of the operations of KFS are conducted through its holdings in TBIF Financial Services BV ("TBIF") and in TBIH Financial Services Group NV ("TBIH"). TBIF, in which KFS has a 90.4% equity interest, is active in the banking, financing services (retail credit, leasing and mortgages) as well as asset management, while TBIH, in which KFS has an equity interest of 40%, is engaged in the fields of insurance and pension savings.

Within the framework of the investment agreement, the parties have determined certain arrangements between them with respect to their rights and obligations as shareholders of KFS, among other things, it has been determined that as long as DCMI holds at least 7.50% of the issued share capital of KFS and the company has not been issued to the public, DCMI shall have the right to appoint 20% of the members of the Board of Directors (excluding in certain circumstances as prescribed in the agreement). DCMI has also been granted veto rights regarding certain resolutions of KFS, the right to participate in future share issues by KFS, "tag along" right in the event that Kardan sells its control in KFS and a right of "first offer" in the event that DCMI would wish to sell its shares in KFS to a third party, everything in accordance with the provisions of the investment agreement. The investment transaction was consummated on December 31, 2007. DCMI is considering the allocation of the excess of cost of this investment over its share in the equity value of KFS (amounting to NIS 203 million).

7. BUILDINGS AND EQUIPMENT

A. COMPOSITION

	Consolidated			The Bank		
	Buildings and land*	Equipment, furniture and vehicles	Total	Buildings and land*	Equipment, furniture and vehicles	Total
in NIS millions						
Cost						
Balance at beginning of the year	2,073	3,196	5,269	1,521	2,118	3,639
Additions	86	466	552	53	338	391
Disposals	(47)	(88)	(135)	(41)	(66)	(107)
Balance as at December 31, 2007	2,112	3,574	5,686	1,533	2,390	3,923
Depreciation						
Balance at beginning of the year	854	1,801	2,655	596	1,011	1,607
Depreciation for the year	47	303	350	28	226	254
Recognized impairment losses	10	-	10	8	-	8
Accumulated depreciation on disposals	(29)	(80)	(109)	(23)	(64)	(87)
Balance as at December 31, 2007	882	2,024	2,906	609	1,173	1,782
Depreciated balance as at December 31, 2007	1,230	1,550	2,780	924	1,217	2,141
Depreciated balance as at December 31, 2006	1,219	1,395	2,614	925	1,107	2,032
The average depreciation rate in 2007	3.0%	13.5%	9.2%	2.6%	15.7%	10.1%
The average depreciation rate in 2006	2.9%	14.1%	9.2%	2.6%	15.9%	9.6%

* Includes:

- Installations and leasehold improvements, the depreciated balance of which amounted to NIS 124 million - consolidated and to NIS 63 million in the Bank. (2006: NIS 100 million - consolidated; and NIS 52 million - in the Bank).
- Interest capitalized in prior years net of amortization, in the amount of NIS 2 millions (2006: NIS 3 millions).
- Including a provision for decline in value in the amount of NIS 34 million - consolidated and NIS 32 million - in the Bank (2006: NIS 28 million - in the Bank).

- B. The Bank and a consolidated subsidiary own leasehold rights for various periods ending in the years 2008 to 2056. The Bank and a consolidated subsidiary are the owners of non-capitalized leasehold rights: Consolidated - NIS 30 million (2006: NIS 31 million). The Bank, stand alone: NIS 28 million (2006: NIS 29 million). The Bank and a consolidated subsidiary are the owners of capitalized leasehold rights: Consolidated - NIS 85 million (2006: NIS 120 million). The Bank, stand alone - NIS 57 million (2006: NIS 90 million).
- C. The depreciated cost of buildings not yet registered in the names of the Bank or of its subsidiaries at the Land Registry Office, amounts to NIS 503 million (2006: NIS 511 million) on a consolidated basis, and NIS 454 million (2006: NIS 460 million) for the Bank.
- D. The depreciated cost of buildings not in use by the Bank, and which are mostly let to outside parties, amounts to NIS 26 million (2006: NIS 29 million) on a consolidated basis, and NIS 21 million (2006: NIS 24 million) for the Bank.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

E. THE COST OF IN-HOUSE DEVELOPMENT OF COMPUTER SOFTWARE:

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
The cost of software put into operation	1,112	863	1,047	809
Accumulated depreciation	(423)	(288)	(378)	(249)
Undepreciated balance	689	575	669	560
Cost of software not yet in operation	132	165	115	151
Total	821	740	784	711

8. OTHER ASSETS

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	In NIS millions			
Net deferred tax assets (see Note 29K)	335	602	91	318
Excess advance tax payments over current provisions	38	62	-	-
Excess deposits for severance pay and pensions, over provision (see Note 16DH)	491	482	475	470
Goodwill	240	*224	-	-
Issue costs and discount expenses of debentures and subordinated capital notes	13	11	12	9
Income receivable	174	190	51	52
Debit balances of derivative financial instruments	1,517	874	1,414	727
Surrender value of life assurance policies owned by the Bank and corporate owned life insurance	614	650	-	-
Other debtors and debit balances	853	949	490	387
Total other assets	4,275	4,044	2,533	1,963

* Reclassified.

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	In NIS millions			
Deposits on demand	13,335	11,836	9,706	8,601
Schedule and other deposit	111,218	*112,043	77,671	*70,247
Savings plan deposits	5,965	6,638	5,253	5,862
Total deposits from the public	130,518	130,517	92,630	84,710

* Reclassified.

10. DEPOSITS FROM BANKS

Total deposits from banks				
	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	In NIS millions			
Commercial banks:				
Deposits on demand	1,028	715	594	435
Schedule deposits	1,604	2,507	2,049	2,235
Acceptances	295	285	174	179
Central banks:				
Schedule deposits	2,038	2,300	-	2,300
Specialized banking institutions:				
Deposits on demand	24	19	67	107
Schedule deposits	83	2,273	157	270
Total deposits from banks	5,072	8,099	3,041	5,526

11. DEBENTURES AND SUBORDINATED CAPITAL NOTES

	Average maturity ⁽¹⁾	Internal rate of return ⁽¹⁾	Consolidated		The Bank	
	years	%	December 31		December 31	
			2007	2006	2007	2006
	in NIS millions					
Subordinated capital notes in Israeli currency, linked to CPI ⁽²⁾	5.42	5.32	6,570	6,174	3,656	3,667
Subordinated capital notes in non-linked Israeli currency	6.16	6.37	867	128	181	213
Total debentures and subordinated capital notes			7,437	6,302	3,837	3,880

Footnotes:

(1) Internal rate of return is the rate which discounts the projected payment flow of amounts presented in the balance sheet. Period to maturity is the average of the repayments periods weighted by the cash flows discounted at the internal rate of return. Data regarding the internal rate of return and the period to maturity relates to the consolidated statements as of December 31, 2007.

(2) 2007 - Including NIS 1,044 million subordinated capital notes regarded as "hybrid tier I capital" (2006: NIS 750 millions)(see Note 14 5 below).



12. OTHER LIABILITIES

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	In NIS millions			
Excess current tax provisions over advance payments	231	72	123	31
Net provision for deferred taxes (see Note 29K)	167	24	167	24
Income in advance	215	*182	61	88
Provision for doubtful debts in respect of guarantees	187	128	155	88
Accrued expenses	825	732	542	395
Provisions for vacation pay, seniority bonus and retirement benefits	969	1,007	829	831
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16DH)	5	15	-	-
Credit balances of derivative financial instruments	1,559	1,038	1,453	825
Credit cards activity creditors	5,314	4,847	2,106	2,001
Amounts received from realization of Other creditors and credit balances	940	1,074	531	586
Total other liabilities	10,412	9,119	5,967	4,869

* Reclassified.

13. SHAREHOLDERS' EQUITY

A. THE AUTHORIZED, ISSUED AND PAID-UP NOMINAL SHARE CAPITAL (IN NEW ISRAEL SHEKELS):

	December 31, 2007		December 31, 2006	
	Authorized	Issued and Fully Paid-Up	Authorized	Issued and Fully Paid-Up
Ordinary "A" Shares of NIS 0.1 par value each	143,000,000	98,063,921	140,000,000	98,063,921
6% Cumulative Preference Shares, of NIS 0.00504 par value each (equivalent to 10 pounds sterling each)	202	202	202	202
Total	143,000,202	98,064,123	140,000,202	98,064,123

Ordinary "A" Shares are registered and are listed for trade on the Tel Aviv Stock Exchange.

B. 6% CUMULATIVE PREFERRED REGISTERED SHARES:

The dividend and the rights of these shareholders are linked to the representative rate of exchange of the New Israel shekel to the pound sterling at the date of each payment.

At the balance sheet date, every holder of a preferred share, the par value of which is equivalent to 10 pounds sterling, is entitled to an annual dividend in an amount of NIS 4.63, and at the time of liquidation to a distribution in an amount of NIS 77.1. According to an Opinion issued by the Institute of Certified Public Accountants in Israel, non-participating preferred shares are not to be included as part of shareholders' equity, and accordingly they are presented under the item "other liabilities".

C. INCREASE IN THE REGISTERED SHARE CAPITAL

The special meeting of shareholders convened on December 26, 2006 resolved to increase the registered share capital of the Bank by 400 million ordinary A shares of NIS 0.1 par value each, and to amend the Memorandum and Articles accordingly.

13. SHAREHOLDERS' EQUITY (CONTINUED)

The shares derived from the said increase are intended to be issued to investors in subordinate capital notes (series "A") in a total amount of NIS 1 billion, in the event of a compulsory conversion of the principal amount and/or interest, in certain circumstances that have been determined by the Supervisor of Banks (hereinafter: "compulsory conversion events"; for additional details see Note 14 below). As of December 31, 2007, subordinate capital notes in the amount of NIS 1 billion were issued.

The Bank is committed towards the State of Israel, which holds 25% of the share capital of the Bank, that the shares constituting part of the registered share capital of the Bank, which were created as a result of the said increase in capital, will be utilized for the above purpose, only upon occurrence of a compulsory conversion event, and will not be used for any other purposes.

The special meeting of shareholders convened on August 26, 2007 resolved to increase the registered share capital of the Bank by 3 million ordinary A shares of NIS 0.1 par value each, and to amend the Memorandum and Articles accordingly.

D. EQUITY BASED COMPENSATION TRANSACTIONS - AN OPTION PLAN FOR OFFICERS OF THE BANK

(1) The original plan

The Board of Directors of the Bank resolved, on March 26, 2006, to approve a stock option plan for officers of the Bank, including the Chairman of the Board and the President and CEO of the Bank.

The purpose of this plan is to enhance the interests and goals of the Bank, by way of increasing the material interest of Bank officers in its success and results of operations. The plan is designed to add a layer of long-term remuneration that would induce officers to reach long-term growth targets, and would act towards the long-term preservation of the senior and qualitative management team of the Bank.

According to this plan, 9,806,392 stock option warrants would have been allotted to the Chairman of the Board, and 9,806,392 stock option warrants would be allotted to the President & CEO, as well as 10,787,031 stock option warrants would be allotted to ten other officers of the Bank, including the Internal Auditor (hereinafter - "the other officers"). The allotment of the stock option warrants to the Chairman of the Board as part of the plan, was to be brought for approval at a special general meeting of shareholders of the Bank, which had been summoned for April 26, 2006. (For details regarding the removal from the agenda of the general meeting of shareholders of the matters relating to the offer of option warrants to the Chairman of the Board and to the President and CEO, at their own request, and for details as to the ratification of the decisions made the offer of option warrants to the other officers, see sub-sections (2) and (3) hereunder, respectively).

Each stock option warrant is exercisable into one "A" ordinary share of NIS 0.1 par value each of the Bank (hereinafter - "the share"), subject to adjustments as detailed in the plan.

The exercise price of each option warrant offered to the Chairman or to the President & CEO according to the plan, would have been NIS 5.5 (subject to adjustments in terms of the plan), with the addition of linkage increments to the CPI, from the CPI last published prior to February 1, 2005, and up to the known CPI on the exercise date, with the addition of annual interest at the rate of 5%. The said exercise price had been determined according to a formula based principally on the price in the agreement for the acquisition of a controlling interest in the Bank. The exercise price of each of the option warrants offered according to the plan to eight of the other officers, would have been NIS 6.379 (subject to adjustments in terms of the plan), with the addition of linkage increments to the CPI, from the CPI last published prior to February 1, 2005, and up to the known CPI on the exercise date. The said exercise price had been determined on the basis of the closing market price of the Bank's shares on February 1, 2005.

The exercise price of each of the option warrants offered according to the plan to one of the other officers, who took office at the Bank on March 1, 2006, as well as to one other officer who took office at the Bank on April 2, 2006, is closing market price of the Bank's shares on the last trading day prior to the day on which such officer started his employment with the Bank, as the case may be (subject to adjustments in terms of the plan), with the addition of linkage increments to the CPI, from the CPI last published prior to the said trading date and up to the known CPI on the exercise date.

13. SHAREHOLDERS' EQUITY (CONTINUED)

The said exercise prices are subject to adjustments derived from the cash distribution of dividends and/or the distribution of bonus shares as well as rights issues by the Bank.

The exercise period of two thirds (2/3) of the warrants allotted under the plan will begin on January 5, 2009 and end on January 4, 2011, and the exercise period of the remaining one third (1/3) will begin on January 1, 2011 and end on December 31, 2012, all subject to the provisions specified in the plan as regards the termination of employment of the offerees with the Bank.

The theoretical value of the approved 30,399,815 option warrants, based on the provisions of Accounting Standard No. 24, is estimated at approximately NIS 112 million (of which an amount of NIS 68 million in respect of the Chairman of the Board and the President and CEO).

The value of the benefit to the officers, including payroll tax, as should have been recorded in the books of the Bank, is estimated, on March 23, 2006, at approximately NIS 122 million (of which an amount of NIS 74 million in respect of the Chairman of the Board and the President and CEO). The value of this benefit is to be recognized in the Bank's books from the first quarter in which the award has been made until the beginning of the exercise period of each part.

The estimated benefit to the officers is based on the Black & Scholes formula, considering known parameters and assessments or such that are assessable at the relevant date.

The fair value of each option warrant to be allotted to the Chairman of the Board and to the President and CEO as part of the plan is assessed at NIS 3.49. The fair value of each option warrant to be allotted as part of the plan to the eight other officers already employed by the Bank is assessed at NIS 4.29. The fair value of each option warrant to be allotted as part of the plan to the other officer who took office on March 1, 2006, is NIS 2.81. The fair value of each option warrant to be allotted as part of the plan to the other officer who took office on April 2, 2006, is NIS 2.53.

All data regarding the theoretical value of the benefit and its impact on the financial statements of the Bank as well as the fair value data as regards to each option warrant, have been computed based on the data available on March 23, 2006. It should be noted that the determining date for the fair value computation of the option warrants is the date on which such warrants are actually being allotted.

The actual date of the grant to the officers of the Bank (excluding the Chairman of the Board and the President & CEO) was the date of approval by the Board of Directors (with the exception of one officer in respect of whom the actual date of the grant was the date on which he took office at the Bank).

The parameters of the model for the computation of the theoretical value of the warrants are:

- Cost of the share on March 23, 2006 - NIS 9.5, higher than the average price in the month preceding this date by 5%;
- Exercise prices - as stated above;
- Period of expiration of the options - two thirds to expire after 4.8 years from date of allotment and one third to expire after 6.8 years from date of allotment;
- Non-risk interest rate - 3.7%;
- Dividend yield rate - "0", as the exercise price of the options is adjusted for the distribution of dividends;
- Standard deviation of the share yield - 19%.

In accordance with section 102 of the Income tax ordinance, all the option warrants under the plan are to be allotted in the name of a Trustee for and on behalf of the offerees, in accordance with the terms of the capital gains alternative by means of the Trustee.

Procedure for the exercise of the options - At each exercise date, the amount of the benefit to the offeree will be computed and the Bank would issue to the Trustee for the offeree a number of ordinary shares, the total market value of which, based on the closing market price of the shares of the Bank on the trading date preceding the exercise date, equals the amount of the monetary benefit.

The Bank will convert into share capital, that part of its earnings, within the meaning of section 302(b) of the Companies Law, 1999,

13. SHAREHOLDERS' EQUITY (CONTINUED)

("the Companies law"), from premium on shares or from any other source included in its shareholders' equity, as stated in Section 304(a) of the Companies Law, equal to the par value amount of the exercised shares to be allotted as stated.

Each option warrant not exercised in accordance with the terms of the plan until the end of the period determined for its exercise, shall become null and void and would not entitle to any rights whatever.

On March 26, 2006, the State notified its consent to the terms of the stock option plan to officers of the Bank and of its consent to vote together with the controlling shareholders of the Bank, by power of the option shares held by it. (For details regarding the notice of revocation of the said consent, delivered on June 20, 2006, see sub-section (2) hereunder).

The remuneration and terms of office of the Chairman of the Board were removed from the agenda of the said general meeting of shareholders at the request of the Chairman, and the matter was brought for a renewed discussion by the authorized organs of the Bank (for further details see sub-section (2) hereunder).

(2) Further developments

On March 26, 2006, the Bank issued a notice for a special meeting of the Ordinary "A" shareholders of the Bank to be convened on April 26, 2006. The agenda for the meeting included, inter-alia, the following items:

- Approval of a proposed allotment of option warrants to the Chairman of the Board of the Bank, in a stock option plan to officers of the Bank;
- Increase of the registered share capital of the Bank by NIS 4,000,000 par value, and a respective amendment to the Memorandum and Articles of Association of the Bank;
- Approval of the terms of office of the Chairman of the Board of the Bank.

On April 20, 2006, the Israel Securities Authority (ISA) requested the Bank to provide explanations and documents with regards to the general meeting of shareholders that was to be held in order to approve the matters stated above. The requested details related to the manner in which the remuneration plan for senior management had been formulated and to the procedure for its approval.

Requests for details and information were also made to members of the Board of Directors.

The said letter was received on the background of a public uproar with respect to the remuneration of senior bank executives in general and at the Bank in particular.

In view of the situation that has arisen, the Chairman of the Board and the President & CEO were of the opinion that the preoccupation at this time with the stock option plan that had been approved with respect to them, might divert attention from promoting the issues that are on the agenda of the Bank. Therefore, out of concern for the Bank, and wishing not to delay the approval of the remaining issues that were to be discussed at the general meeting, and in order to avoid any possible damage to the Bank - the Chairman and the President & CEO requested the removal of the items dealing with the granting of stock option warrants to them (including the increase of the registered share capital of the Bank) from the agenda of the general meeting. A notice to this respect was issued to the public on April 23, 2006.

The said notice did not create any change in the plan for the granting of stock options to the officers of the Bank (not including the Chairman and the President & CEO; hereinafter "the other Officers"), and which can be carried out within the existing registered share capital of the Bank (without requiring its increase), in accordance with the terms of the option plan determined in their respect.

At the same time, the Bank responded to the said request of the ISA, however, on April 25, 2006, an additional letter from the ISA was received by the Bank, which among other things, requested additional information and clarifications as well as further questions, which in the opinion of the ISA required further deliberations. In view of these requests and questions the ISA was of the opinion that it was not proper to hold the general meeting convened for April 26, 2006, as planned. Under these circumstances, the Bank advised of the postponement of the general meeting.



13. SHAREHOLDERS' EQUITY (CONTINUED)

At the request of the Chairman of the Board and to the President and CEO, their remuneration plan was brought for reconsideration by the authorized organs of the Bank. For additional details see Not 22 hereunder.

The Bank has provided the ISA with a legal opinion with respect to the procedure for the approval of the remuneration of the Chairman of the Board and has replied the questions asked.

In a letter dated June 20, 2006, the Accountant General at the Ministry of Finance informed that if and to the extent that the Bank would decide to renew the procedure for approval of a stock option plan and terms of remuneration for senior executives of the Bank or an alternative plan for options or remuneration that requires the State's consent, the controlling shareholders of the Bank would have to apply again for the prior consent of the State for the matter, in accordance with the provisions of the agreement dated February 1, 2005, and the State would reconsider its position on the matter, and any consent given in the past by the State in such matter is null and void.

On June 25, 2006, the Bank responded to the Accountant General at the Ministry of Finance, stating among other things that the remuneration plan for the other officers would be brought for renewed examination, discussion and ratification before the Audit Committee and to the Board of Directors of the Bank, and that the ratification procedure does not require by law the consent of any shareholder or the approval of the general meeting of shareholders.

On June 26, 2006, the representative of the controlling shareholders of the Bank replied to the Accountant General stating among other things that he rejects the contents of the letter of the Accountant General and that the ratification of the option plan to the other officers of the Bank is entrusted by law to the discretion of the Audit Committee and the Board of Directors of the Bank.

(3) Ratification of the remuneration plan to other officers

In view of the questions referred by the ISA, the Audit Committee and Board of Directors of the Bank reexamined the plan for the allotment of options to the other officers, including the Internal Auditor, as described in sub-section (1) above, and the award plan for members of management, including the Internal Auditor, as described in Note 16 H

In discussions held on July 6 and 25, 2006, the Audit Committee and Board of Directors of the Bank ratified their decisions from March 26, 2006 regarding the approval of the award plan and the option plan.

The resolutions of the Audit Committee and Board of Directors clarified that the offer of option warrants to the other officers in accordance with the option plan remains in effect, separately and disengaged from the offer of option warrants to the Chairman of the Board and to the President and CEO. The said resolutions also clarified that they remain in effect without any reliance or dependence on the standpoints of the Government or the controlling shareholders of the Bank.

On the Audit Committee and the Board of Directors meetings it was noted with deep sorrow that Mr. Nissim Alagem, an Executive Vice President at the Bank, who was one of the offerees under the option plan had passed away. According to the terms of the plan the option warrants that were designated for him would not now be allotted.

The main arguments of the Audit Committee and the Board of Directors in favor of ratifying their said decisions, taking into consideration the best interests of the Bank, were as follows:

- (a) The remuneration plan in general balances three components: salary, options and bonus, and is intended to promote the interests of the Bank and its goals by way of the long-term preservation of the senior and qualitative executive team, which has proven its ability, so that it would continue to lead the Bank in the coming years. This especially on the background of the competitive environment in the banking industry, in which the Bank operates, and in view of the competition of recruitment of qualitative and highly skilled personnel, such as the class of officers belonging to the senior management rank of the Bank, and the remuneration offered to such officers by large financial and other companies in general, and in the banking industry in particular.

13. SHAREHOLDERS' EQUITY (CONTINUED)

- (b) The remuneration plan does not change the basic salary terms (including retirement benefits) of members of management, but adds further layers of remuneration, dependent on performance and conditional upon the success of the Bank. The one: short term remuneration - the award plan - conditional upon the annual performance of the Bank and tightens the bond between the remuneration of members of management and the annual return on equity and also depends on the personal performance of each particular member of Management. The other layer comprises long-term remuneration - the option plan - which is intended to create a long-term economic incentive and an obligation of the senior management team to continue and act in the coming years towards increasing the Bank's profits and its value.
- (c) Furthermore, the option plan also tries to create an identity of interests between members of management and the shareholders of the Bank at large, regarding the increase in value of the Bank.
- (d) As a part of the award plan, rates of return on equity have been determined with a view of forming both a challenging though realistic plan, taking into consideration the rates of return on equity reached by the Bank in recent years and the goals for the future.
- (e) The award plan grants the Board of Directors of the Bank the authority to decide, at its sole discretion, that for the purpose of computing the annual rate of return on equity, exceptional gains or losses or those that are not derived from current operations and which affect the rate of return on equity, would be eliminated. The plan also authorizes the Board of Directors to change or cancel at any time and at its sole discretion, the award plan, in part or in whole, provided that such change or cancellation would come into effect in the calendar year beginning at the end of the calendar year in which such a decision is taken.
- (f) In accordance with the option plan, the exercise price of the option warrants offered to some of the other offerees, who acted as officers of the Bank on February 1, 2005 (date on which the agreement for the sale of the Bank was signed between the State of Israel and the controlling shareholders of the Bank), and who have contributed significantly to the business management of the Bank in the period prior to the transfer of control of the Bank, would allow the said offerees to benefit from the rise in the market price of the Bank's shares, starting with the said date and until the date of allotment of the option warrants, as well as from that date and until the exercise date of the option warrants, on condition that they would not resign from office at the Bank prior to the beginning of the exercise period determined in the option plan. The exercise price of the option warrants offered to two of the said other offerees, who took office at the Bank in March and April 2006, was determined on the basis of the closing market quotation on the trading date, one day prior to the date on which they took office at the Bank, as the case may be.

(4) Allotment of option warrants

On August 4, 2006, the Bank allotted to a Trustee on behalf of nine other officers 9,806,391 non-marketable option warrants, exercisable into ordinary "A" shares of the Bank of NIS 0.1 par value each, under terms and on dates determined in the plan (see sub-section (1) above).

The theoretical value of the benefit in respect of the option warrants, allotted as above, in accordance with the provisions of Accounting Standard No. 24, is estimated at NIS 39 million. The value of the benefit in respect of the option warrants, allotted as above, which includes payroll tax, considering the change that has taken place in the payroll tax rates and the actual profit component (in contrast to that estimated at the time), is assessed at NIS 40 million.

The value of the benefit on behalf of the said nine other officers will be allocated in the books of the Bank as from the date of grant of the options (March 26, 2006), and until the beginning of the exercise period of each portion (two thirds over a period of 2.8 years and the additional one third over a period of 4.8 years). One of the other Officers retired from the Bank at the end of 2006, and the options that had been allotted to him expired. Following the retirement of a member of management in the course of 2007, the options issued to her (1,176,767) expired. In the year ended on December 31, 2007, an amount of NIS 7.6 million were charged in respect of seven officers, as salary expenses as against a capital reserve. (2006: an amount of NIS 8 million in respect of eight Officers)



13. SHAREHOLDERS' EQUITY (CONTINUED)

(5) 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. A special shareholders meeting of the Bank held on August 26, 2007, approved the terms of office of the Chairman of the Board of the Bank as well as the issue of option warrants to the Chairman of the Board within the framework of the stock option plan for the Chairman of the Board and for the President & CEO.

Within the framework of the option plan, 8,090,275 option warrants were 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 is NIS 8.455 linked to the CPI. The price was 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 said condition was fulfilled in the years 2006 and 2007, and therefore the Chairman and the President and CEO become entitled to the right to the annual tranche in respect of the said years.

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, is 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 all 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, is calculated as of 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 31.3 million.

In 2007 an expense in the amount of NIS 19.8 million was recorded in respect of the said benefit. (out of a total benefit in the amount of NIS 31.3 million, with respect to the whole plan).

(6) 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 of them, 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 Remuneration Committee of the Board of Directors decided in December 2007 that the stock option plan for the said members of Management would be for a period of five years beginning with the date on which each of them took office as Executive Vice President,

13. SHAREHOLDERS' EQUITY (CONTINUED)

and that the option price shall be determined in accordance with the said date. The Committee determined to that the stock option plan approved for members of Management in March 2006 and ratified in July 2006 would be adjusted in accordance with the above. After the approval of the plan intended for the said Management members is approved by interested parties at the Bank, it will be brought for approval by the authorized organs at the Bank and interested parties therein, in accordance to the collaboration agreement between them.

(7) Share based payment of the share option type - quantitative detail summary

a. Share based payment for Officers of the Bank (Consolidated and Bank)

	2007		2006	
	Number of Options	Weighted average exercise price ⁽¹⁾	Number of Options	Weighted average exercise price ⁽¹⁾
Outstanding at beginning of the year	8,629,624	6.94	-	-
Granted during the year ⁽²⁾	-	-	9,806,391	6.88
Lapsed during the year	1,176,767	6.38	1,176,767	6.38
Outstanding at end of the year ⁽³⁾	7,452,857	7.03	8,629,624	6.94

Footnotes:

(1) The actual exercise price is subject to adjustments as detailed above, with the addition of linkage increments to the CPI, from the CPI last published prior to February 1, 2005, and up to the Known CPI on the exercise date.

(2) The weighted average fair value of each option granted during 2006, at the measurement date, was 3.97 NIS.

(3) Options outstanding at the end of the year divided by ranges:

	31 December 2007		31 December 2006	
	Range 1	Range 2	Range 1	Range 2
Exercise price range (in NIS)	6.38	8.84-8.90	6.38	8.84-8.90
Number of options	5,491,579	1,961,278	6,668,346	1,961,278
Weighted average exercise price (in NIS)	6.38	8.87	6.38	8.87
Weighted average contractual life (years)	3.667	3.667	4.667	4.667

b. Share based payment for the Chairmen of the Board and the President and CEO of the Bank (Consolidated and Bank)

	2007	
	Number	Weighted average exercise price ⁽¹⁾
Outstanding at beginning of the year	-	-
Granted during the year ⁽²⁾	16,180,550	8.45
Outstanding at end of the year	16,180,550	8.45

Footnotes:

(1) The actual exercise price is subject to adjustments and with the addition of linkage increments to the CPI, from the 07/08 CPI and up to the Known CPI on the exercise date.

(2) The weighted average fair value of each option granted during 2007, at the measurement date, was 1.93 NIS.

13. SHAREHOLDERS' EQUITY (CONTINUED)

E. Dividend

The distribution of dividends by the Bank is subject to the provisions of the law, including limitation deriving from Directives of the Supervisor of Banks.

For details as to a limitation on the distribution of dividends from funds from a future sale of control over IDB New York, if at all, see "Employee agreement" in Note 32 C hereunder. For details as to a limitation determined by the Governor of the Bank of Israel, included in the permit granted to the Bronfman-Schron Group for the acquisition and holding of means of control in the Bank, see Note 32 B hereunder.

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.

Distribution of dividend. Following the strategic plan and on background of the satisfactory progress that had been made in reaching its goals, including as regards the Bank's profitability and its capital adequacy, the Bank's Management decided as follows:

- a. To recommend to the Board of Directors a dividend distribution in 2008 in an amount comprising a dividend yield of approximately 3.0%. The recommendation would take its form proximate to its presentation to the Board during 2008, when the suggested dividend rate would be determined, among other things, taking into account the maintenance of capital adequacy at a suitable level and the Bank's ability to continue the accelerated development of its business, and prior to that, it would be brought to the attention of the Supervisor of Banks, as required.
- b. To bring before the Board, in the first quarter of 2009, a recommendation for a dividend policy for the following years.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

General - Proper Banking Management Directives Nos. 311 and 341 regarding "minimum capital ratio" and "allocation of capital in respect of exposure to market risk" require banking institutions to maintain a ratio of capital to risk components which shall not fall below a rate of 9% of the weighted total of the risk components in their balance sheet and off-balance sheet assets.

The measurement of capital for this purpose is based on its classification into two main components: Tier I capital and Tier II capital from which are deducted the banking institution's investments in non-banking affiliates and in subsidiaries which are not consolidated in its consolidated financial statements.

Tier I capital includes the shareholders equity, and the minority interest in the capital of consolidated subsidiaries, net of goodwill. The Tier I capital also includes the Hybrid Tier I Capital (For details regarding issuance of hybrid tier I capital and the conditions thereof, see Section 5 below).

Tier II capital includes certain subordinated notes, which comply with characteristics defined by the Supervisor of Banks, and which have been approved by him for this purpose, as well as the general provision for doubtful debts. The volume of subordinated notes is limited to 50% of the Tier 1 capital.

The Tier III capital includes subordinated capital notes, which comply with characteristics determined in Directives of the Supervisor and which were approved by him for this purpose. It was required, inter-alia, that these capital notes will include an explicit condition, according to which payment of the indebtedness shall not be made if such payment will result in the minimal capital ratio falling below the minimum requirements of the Supervisor.

The weighted total of risk components in the business of the Bank, includes the balances of all assets included in the balance sheet

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

and of off-balance sheet items (guarantees, derivative financial instruments etc.), which are weighted according to the degree of credit risk, as determined by the Directives.

Included in the weighted total of risk assets is the estimate of market risk relating to the marketable portfolio of the Bank and to its exposure to linkage base and interest risk. Such estimate was made based on principles determined by the Supervisor.

The policy regarding the ratio of capital to risk assets. On March 24, 2008, the Board of Directors resolved as a policy matter that the Bank should aim at reaching a ratio of capital to risk assets of no less than 12% by the end of 2009. Within the framework of the said policy an interim target has been determined whereby the Bank would work towards achieving a ratio of capital to risk assets of between 11.25% and 11.50% by the end of 2008.

The said policy, according to which the Bank will take action to broaden the safety margin of the capital adequacy ratio over and above the minimum capital ratio prescribed at present by regulation, has been determined as part of the general preparations for the implementation of the Basel II principles, taking into consideration the sensitivity of the Bank's capital to changes in exchange rates.

1. CAPITAL FOR CALCULATING RATIO OF CAPITAL

	December 31	
	2007	2006
	in NIS millions	
Tier I capital:		
Original tier I capital	8,908	7,887
Hybrid tier I capital	1,044	750
Tier II capital:		
Upper Tier II capital ⁽¹⁾	257	257
Other Tier II capital	4,562	3,779
Tier III capital ⁽²⁾	-	10
Deductions ⁽³⁾	(1,466)	(1,271)
Total capital	13,305	11,412

Footnotes:

(1) The balance of the general provision for doubtful debts in the amount of NIS 211 million (2006: NIS 211 million) constitutes a part of the upper Tier II and is not deducted from credit to the public.

(2) Held against market risk only.

(3) The balance of investments in shares and in subordinated capital notes of financial affiliated companies and non-consolidated subsidiaries. This balance is deducted from the amount of capital and therefore also from the balance of investments in affiliated companies.



14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

2. WEIGHTED CREDIT RISK BALANCE

	December 31			
	2007		2006	
	Balances ⁽⁴⁾	Weighted credit risk	Balances ⁽⁴⁾	Weighted credit risk
	in NIS millions			
Credit risk assets				
Cash and deposits with banks	19,850	3,493	*25,100	4,386
Securities	37,278	7,692	*38,977	7,872
On securities borrowed or purchased under buy-back agreements	346	-	-	-
Credit granted to the public ⁽¹⁾⁽⁵⁾	102,188	86,132	*90,323	76,711
Credit granted to the government	374	2	*324	2
Investment in affiliated companies ⁽³⁾⁽⁵⁾	1,930	457	*1,353	77
Buildings and equipment	2,780	2,780	2,614	2,614
Other assets	4,275	2,957	*4,044	*3,366
Total assets	169,021	103,513	162,735	95,028
Off-Balance Sheet Instruments				
Transaction whose balance represent credit risk	13,922	12,599	10,333	9,336
Derivative financial instruments ⁽⁶⁾	10,959	3,844	6,484	2,835
Other	56	56	316	316
Total off-balance sheet instruments	24,937	16,499	17,133	12,487
Total credit risk assets	193,958	120,012	179,868	107,515
Market risk		2,126		1,649
Total risk assets	193,958	122,138	179,868	109,164

* Reclassified.

Footnotes:

(1) The balance of the general provision for doubtful debts in the amount of NIS 211 million (2006: NIS 211 million) constitutes a part of the upper Tier II and is not deducted from credit to the public.

(2) Held against market risks only.

(3) The balance of investments in shares and in subordinated capital notes of financial affiliated companies and non-consolidated subsidiaries. This balance is deducted from the amount of capital and therefore also from the balance of investments in affiliated companies.

(4) Assets - year-end balances. Off balance sheet instruments-par value The weighted average balances of off balance sheet instruments, are computed taking into account their conversion factor into credit.

(5) Loans and capital notes presented in the balance sheet under investments in affiliated companies in the amount of NIS 77 million (2006: NIS 14 million) are included in credit to the public

(6) Including a NIS 86 million (2006: NIS 25 million) liability towards the Ma'of Clearing House.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED) 3. RATIO OF CAPITAL TO RISK ASSETS

	December 31	
	2007	2006
	Percent	
A. The bank		
Ratio of original tier I capital to credit risk assets	7.3	7.2
Ratio of tier I capital to credit risk assets	8.1	7.9
Ratio of total capital to credit risk assets	10.9	10.5
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
B. Significant subsidiaries		
1. Mercantile Discount Bank LTD. and its subsidiaries		
Ratio of tier I capital to credit risk assets	9.9	8.6
Ratio of total capital to credit risk assets	13.2	12.7
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
2. Discount Mortgage Bank LTD. and its subsidiaries		
Ratio of tier I capital to credit risk assets	8.5	9.5
Ratio of total capital to credit risk assets	10.6	12.2
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
3. Discount Bakcorp Inc.⁽¹⁾		
Ratio of tier I capital to credit risk assets	10.0	10.9
Ratio of total capital to credit risk assets	11.0	11.9
Ratio of total minimal capital required by the Supervisor of Banks	⁽²⁾ 8.0	⁽²⁾ 8.0
4. Israel Credit Cards LTD.		
Ratio of tier I capital to credit risk assets	13.9	10.2
Ratio of total capital to credit risk assets	14.6	11.3
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0

Footnotes:

(1) The data in this item was computed in accordance with the rules applicable in the U.S.A.

(2) IDB New York, a subsidiary of Discount Bankcorp Inc., was classified by the FDIC as "well capitalized". Maintaining the said classification requires the maintenance of a capital ratio, including the minimum ratio of 10%, and of a primary minimum capital ratio of 6%.



14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

4. The publication of a shelf prospectus (2006). On September 28, 2006, Manpikim published a shelf prospectus for the issuance of up to NIS 4 billion par value, subordinated capital notes (series "C" - "F"), and for the listing for trade of NIS 300 million par value, capital notes (series "B"), which were issued shortly prior to the publication of the prospectus.

At this stage, an issue of notes has been approved within the framework of the said shelf prospectus, in an amount not to exceed NIS 1.2 billion. At the beginning of March 2007, Manpikim issued NIS 350 million par value subordinate capital notes (Series "E") in accordance with a shelf offer report dated March 5, 2007.

On February 27, 2008, Discount Manpikim informed, further to the publication of a shelf Prospectus of that date (see hereunder), that according to a resolution of Discount Manpikim's Board of Directors, upon the publication of the above mentioned shelf Prospectus, it will no longer issue subordinate capital notes according to the shelf Prospectus of September 28, 2006.

The publication of a shelf Prospectus (2008). On February 27, 2008, Discount Manpikim published a shelf Prospectus for the issue of up to NIS 2 billion par value, of subordinate capital notes (for each series from G to R) and an issue by way of extension of up to NIS 2 billion par value, of the subordinate capital notes (for each series B, D and E).

At the beginning of March 2008, Discount Manpikim issued NIS 665 million par value, of subordinate debt notes (series G) and NIS 356 million par value, of subordinate capital notes (series H), in accordance with a shelf offer report dated March 5, 2008.

5. The issue of hybrid tier I capital. According to a resolution of the Bank's Board of Directors of December 10, 2006, on December 31, 2006 deferred capital notes, in its par value, were issued in the amount of NIS 750 million in a private placement, and on May 13, 2007 an additional NIS 250 million was issued to investors in a private placement. The Governor of the Bank of Israel approved that the abovementioned deferred capital notes will be deemed hybrid 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 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 the listing for trade of subordinate capital notes.

The subordinate capital notes will bear interest at the rate of 5.1%.

The subordinate capital notes were issued for a period of 99 years and the principal will be repayable on January 1, 2106. The principal and interest on the notes are linked to the CPI and will bear annual interest as stated. The interest on the subordinate capital notes is payable quarterly.

The Bank is entitled, at its own discretion, to redeem the subordinate capital notes prematurely, after a minimum of 15 years from the issuance date, subject to the conditions stated in the notes and to approval from the Supervisor of Banks. In the event that the notes are not redeemed prematurely after 15 years, the capital notes will bear step-up interest at the rate of 1% over the original margin determined for the first 15 years.

The subordinate capital notes include special provisions, as detailed below, mainly compulsory conversion of the principal amount and/or interest into ordinary "A" shares of NIS 0.1 par value each of the Bank, under certain circumstances determined by the Supervisor of Banks. In the event of conversion of the total principal amount of the capital notes and the allocation of shares in exchange for interest in respect of the full number of shares designated for such purpose in the authorized share capital of the Bank, 300 million ordinary "A" shares of the Bank, comprising 23.4% of the issued share capital of 1,280,639,209 ordinary "A" shares of the Bank, will be allocated in respect of the issued capital notes, as stated.

The subordinate capital notes are not secured by any pledge on the assets of the Bank or by any other collateral. The liability of the Bank for payment of the principal and interest on the capital notes is subordinate to all other liabilities of the Bank to creditors of any class,

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

including to holders of subordinate capital notes that were issued or will be issued in the future by the Bank and/or its subsidiaries, and will be superior only to rights of the shareholders to the distribution of the balance of the Bank's assets upon liquidation. The liability of the Bank for payment of the principal amount of the capital notes and the interest thereon will be equivalent, *pari passu*, to other liability notes and/or securities that will be issued by the Bank or by its subsidiaries, and which are approved by the Supervisor of Banks as primary capital instruments.

The Governor of the Bank of Israel approved the Bank's inclusion of the capital notes as preferred primary capital.

Following are the basic conditions for recognition of the capital notes as preferred primary capital:

1. The ratio of capital to risk assets of the Bank should not fall below 10% as of the date of issuance of a compound capital instrument.
2. Hybrid tier I capital is required to comply with the designated conditions for compound capital instruments, as defined in Proper Banking Management Directive No. 311, included in secondary capital.
3. Structure of the issuance - The issuance should be implemented directly only by the Bank itself.
4. Quantity restriction - The ratio of the hybrid tier I capital should not exceed 15% of the total tier I capital as defined in Proper Banking Management Directive No. 311, including the hybrid tier I capital (hereinafter: "overall tier I capital").
5. Repayments - Only capital notes fully paid up in cash will be deemed hybrid tier I capital.
6. Non-accrual interest - In "special circumstances", as defined below, on the due date for payment of interest, such interest will not be payable and the entitlement of holders of the capital notes to interest will expire. Interest not paid as a result of existence of the special circumstances will not accumulate and will be erased after the payment date. Following are the special circumstances:
 - (a) The Board of Directors of the Bank has determined that the Bank is unable to honor its obligations, which rank higher than the subordinate capital notes (series "A") or are equivalent thereto, or the independent auditors of the Bank drew attention in their audit report or review report attached to the Bank's annual or interim financial statements, respectively, to notes to the financial statements regarding the Bank's inability to fulfill its obligations, as stated above;
 - (b) The Board of Directors of the Bank has determined that probability exists that payment of the interest would create a situation in which the Bank will be unable to settle its existing and/or expected liabilities, or the independent auditors of the Bank drew attention in their audit report or review report attached to the Bank's annual or interim financial statements, respectively, to notes to the financial statements regarding the probability of such situation;
 - (c) During six consecutive quarters, the financial statements for the last of which were published prior to the date for payment of the interest, the Bank did not report on accrued net income (i.e. if the simple addition of the quarterly amounts of the net earning or losses reported in the Bank's financial statements, for six consecutive quarters, constituted a negative amount);
 - (d) The last financial statements of the Bank published prior to the date of the interest payment indicate that the Bank has no distributable profits.
7. Allotment of shares in respect of interest - In the case of erasure of interest, as described in 6 above, the Bank is empowered to issue shares to holders of the capital notes against the erased interest. Such shares may be issued only in respect of interest not paid in the same year, and shares may not be issued in respect of interest erased in prior years.
8. Sustaining of losses - The Bank is required to convert all outstanding balances of principal and interest in respect of the subordinate capital notes into ordinary "A" shares of the Bank, of the circumstances described below occur:
 - (a) If the ratio of the overall tier I capital to risk assets of the Bank, as stated in the annual financial statements or in the quarterly interim financial statements of the Bank for the reporting period, falls in a particular quarter below 6%, and does not recover within 90 days from the date of issue of the said financial statements, to a rate of at least 6% - conversion will be implemented immediately;



14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

- (b) If the ratio of the tier I capital to risk assets of the Bank, excluding the hybrid tier I capital (hereinafter - "the original tier I capital"), as stated in the annual financial statements or in the quarterly interim financial statements of the Bank for the reporting period, falls in a certain quarter below 5.5%, and does not recover until the date of publication of the financial statements for the following quarter to a rate of at least 5.5% (even if the ratio of the overall tier I capital exceeds 6% at that time) - conversion will be implemented immediately;
 - (c) If the ratio of the original tier I capital to risk assets of the Bank, as stated in the annual financial statements or in the quarterly interim financial statements of the Bank for the reporting period, falls in a certain quarter below 6% but not lower than 5.5%, and does not recover to a rate of at least 6% until the end of the two quarters following that quarter, as stated in the interim financial statements of the Bank - conversion will be implemented immediately (even if the ratio of the overall tier I capital exceeds 6% at that time), unless the Supervisor of Banks directs otherwise;
 - (d) If the ratio of the original tier I capital, as stated in the annual financial statements or in the quarterly interim financial statements of the Bank for the reporting period, falls in a certain quarter below 5%, immediate partial conversion will be implemented in an amount that would recover the original primary capital ratio of the Bank published for that quarter to at least 5%;
 - (e) If the Bank's retained earnings become negative;
 - (f) If the independent auditors of the Bank drew attention in their audit report or review report attached to the annual financial statements or to the interim financial statements of the Bank, respectively, to notes to the financial statements which express significant uncertainties regarding the continued existence of the Bank as a "going concern".
9. Change in terms, premature redemption, and/or increase in interest rate - the subordinate capital notes will be issued for a period of 99 years and may be redeemed at the discretion of the issuer, subject to advance written approval from the Supervisor of Banks, after a minimum period of 15 years. Additionally, other terms of the subordinate capital notes may not be changed without advance written approval from the Supervisor of Banks.
- Without detracting from this condition, one step-up of interest by up to 100 base points over the original margin determined for the first period of 15 years is enabled, after at least 15 years from the issuance date.
10. Subordination - Except for the rights of creditors in accordance with similar capital instruments, the capital notes are subordinate to claims of all other creditors, including holders of capital notes issued as secondary capital.
11. Collateral - The liabilities according to the capital notes are not secured by any collateral.
12. Issuance to related entities - The Bank will not issue subordinate capital notes to provident funds and/or mutual funds controlled and/or managed by the bank (insofar as this condition is at the Bank's discretion in the primary allocation).
13. Transparency - The terms of the issuance will be clear and disclosed, including full disclosure in the Bank's published annual financial statements of all conditions of the hybrid tier I capital, inter alia, the following details regarding the compound primary capital: amount, components, share in the total overall primary capital and principal characteristics.

Regarding recognition of the capital notes as preferred tier I capital, the Board of Directors adopted a capital adequacy policy according to which the Bank will maintain an original primary capital adequacy ratio (excluding the compound primary capital) of at least 6.5%, at all times.

The Bank is presently considering an additional issue of Hybrid Tier I Capital.

15. PLEDGES

- A.** IDB New York placed a lien on securities in favor of the Federal Reserve Bank in New York, which serves as security for certain liabilities of IDB New York, stemming from its appointment as a recipient of deposits of payments and taxes for the U.S. Treasury and as collateral security for certain liabilities, which include the payments and undertakings for indemnity against members of the Clearing House in New York, in accordance with the rules of the Clearing House, and as part of its obligations as a recipient of deposits of money administered within the scope of bankruptcy proceedings. The market value at December 31, 2007, of the pledged securities amounts to US\$23 million (NIS 89 million) [December 31, 2006 - US\$23 million (NIS 97 million)].

In addition, IDB New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US\$327 million (NIS 1,259 million) as of December 31, 2007 as a collateral for deposits received from it [as at December 31, 2006: US\$309 million (NIS 1,305 million)].

- B.** IDB New York has sold securities, under buyback terms, in the amount of US\$1,901 million (NIS 7,309 million) as of December 31, 2007 [as at December 31, 2006: US\$807 million (NIS 3,408 million)].
- C.** Deferred notes issued by the Bank in accordance with a Prospectus of April 1997, are not secured by a pledge on the assets of the Bank, except for a token first charge on a deposit of NIS 1.
- D.** The Bank is a member of the Euroclear Clearing House, which serves as a clearing system for transactions in securities traded on international markets, made through this clearing house. For this purpose, the Bank has pledged cash and securities in the amount of US\$ 20 million.
- E.** Discount Leasing Ltd. registered in favor of the State of Israel, a first floating charge on its assets, unlimited in amount, in respect of investment grants received.
- F.** Note 19 C 6 describes the risk fund established by the Ma'of clearing house. The Bank's share in the fund, deriving from the volume of the clearing activity on behalf of the Bank's customers as of December 31, 2007, amounted to NIS 38 million (December 31, 2006: NIS 18 million). The balance of the security, which the Bank has to provide in favor of the clearing house (an off-balance sheet liability) based on scenarios devised by the Stock Exchange in respect of the activity of the Bank's customers and in respect of the activity of the Bank itself (nostro) as of December 31, 2007, was NIS 112 million (2006: NIS 70 million).

According to the Memorandum and Bye Laws of the Ma'of clearing house all member of the clearing house, including the Bank signed pledge agreements to secure their liabilities in favor of the Ma'of clearing house and deposited liquid security only (State of Israel bonds and/or cash). The Bank provided the Ma'of Clearing House with a first degree pledge on all monies that had been deposited by the Bank in an account in the name of the Ma'of Clearing House at the Stock Exchange Clearing House and at an account in the name of the Ma'of Clearing House in another bank, all as collateral for amounts that the Bank will be liable for in respect of Ma'of transactions to which it is responsible towards the Ma'of Clearing House. The obligation is subject to conditions, and the Bank is entitled, under certain conditions, to demand the repayment of certain amounts. Within the framework of these accounts the Bank has pledged bonds in favor of the Ma'of Clearing House, the amount of which at December 31, 2007, totaled NIS 616 million (December 31, 2006: NIS 434 million).

- G.** In accordance with an agreement signed by the Mercantile Discount Bank and the Ma'of Clearing, the bank made a collateral in favor of the Ma'of Clearing, in respect of its responsibility towards the Clearing for transactions effected by the bank or by its customers and for the bank's share in the Risk Fund. According to the agreement, the Clearing House is committed to refund to Mercantile Discount Bank the amount of the collateral together with the profits thereon. Nonetheless, the Ma'of Clearing House, at its discretion, retains the right to realize the collateral, in whole or in part, in reducing the debt of Mercantile Discount Bank towards it by a similar amount.

The value of the collateral in favor of the Ma'of Clearing House, as stated, amounted on December 31, 2007, to NIS 181 million (December 31, 2006: NIS 59 million).

15. PLEDGES (CONTINUED)

- H.** As collateral for the obligations of Yatzil Finance and its subsidiaries towards the banks, the said companies registered an assignment by way of a pledge and a fixed and floating pledges on all their rights according to agreements with business houses for the discount of IsraCard, VISA, American Express and Diners Club Israel vouchers, and all the rights to receive monies and payments from IsraCard, ICC, American Express and Diners, under power of assignment of rights and under the business house agreement. As of balance sheet date there was no obligation towards the banks.
- I.** Israel Discount Bank (Switzerland) has pledged assets in the amount of SFR 10 million (December 31, 2006: SFR 11.5 million), as collateral for credit facilities in the amount of US\$2 million.
- J.** As detailed in Note 19 C 7 hereunder, in accordance with the requirements of the Articles of the Stock Exchange Articles and the bylaws of the Clearinghouse, and pledged as security for its obligations towards the Clearinghouse all the Bank's rights in the security deposit managed by the Clearinghouse (in which the Bank deposits securities) and all its rights in an account opened with another bank. The value of the collateral amounted on December 31, 2007, to NIS 61 million (as at December 31, 2006: NIS 24 million).
- K.** According to an agreement signed between Mercantile Discount Bank and the Tel-Aviv Stock Exchange Clearinghouse Ltd. (hereinafter - "the Clearinghouse"), this bank deposited a security - Government bonds - in favor of the Clearinghouse, in respect of the responsibility of the bank towards the Clearinghouse for transactions made by the bank or by its customers by means of the Clearinghouse. The value of the collateral as of December 31, 2007, amounted to NIS 6 million (December 31, 2006: NIS 5 million).
- As security for this agreement Mercantile Discount Bank registered on April 13, 2005, a first degree fixed charge on the said security and the rights therein, in favor of the Clearinghouse
- L.** 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, deposited at the Stock Exchange Clearing House in an account in the Bank of Israel's name.
- At the end of July 2007, the Bank deposited with the said account bonds valued, as at December 31, 2007, at NIS 5 billion.
- 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 599 million.
- In December 2007, the floating pledge over the inventory of bonds, created by the Bank in May 2005 in favor of the Bank of Israel, was cancelled.
- M.** As part of a general agreement for a credit facility from the Bank of Israel and for securing all sums that are or will be due to the Bank of Israel in respect of credit received or to be received by Mercantile Discount Bank from the Bank of Israel, Mercantile Discount Bank registered, on May 30, 2005, in favor of Bank of Israel, a first floating charge on two types of Israel Government bonds included in its securities portfolio (excluding bonds loaned to the public).

15. PLEDGES (CONTINUED)

	Balance as of December 31, 2007	Highest balance during the year	Average balance in 2007
In NIS millions			
Pledged securities(market value)	-	1,130	910
Deposits with the Bank of Israel	169	471	175
Deposits by Bank of Israel	-	350	3

- N.** The Bank enters into Credit Support Annex (CSA) type agreements with foreign banks intended to minimize mutual credit risks arising on derivative trading between banks. According to these agreements, the value of the inventory of derivative transactions made by the parties is measured periodically, and in the event that the net exposure of one of the parties exceeds a predetermined limit, that party is obligated to transfer deposits to the other party by way of a pledge, until the date of the next measurement.

As of December 31, 2007, the Bank allocated in favor of foreign banks deposits in a total amount of NIS 17.5 million.

16. EMPLOYEE BENEFITS

- A.** The liability of the Bank and its subsidiaries for severance pay to their employees, based on the customary one month's salary for each year of employment, is fully covered by deposits with severance pay funds, by insurance policies and pension funds. The redemption value of the insurance policies and amounts accumulated in pension funds are not included in the balance sheet since they are neither controlled nor managed by the Bank or its subsidiaries.

Members of the Bank's Management are entitled to the customary severance payments, while several of whom are entitled also to an "adjustment" bonus of up to 12 months' salary upon retirement pursuant to individual agreements signed with them, and in respect of which adequate provisions have been included. The pension liability of foreign subsidiaries is covered by current deposits into a recognized foreign pension fund, based on actuarial computations.

In certain consolidated banking subsidiaries, several officers are entitled to "adjustment" bonus" equal to six to twelve months' salaries, and in respect of which adequate provisions have been included.

- B.** The Bank's employees and those of its consolidated subsidiaries in Israel are entitled to long-service bonuses equal to a certain number of monthly salaries, and to a certain number of additional vacation days, upon completing 20, 30 and 40 years of employment in the Bank. In accordance with instructions of the Supervisor of Banks the provision in respect of this liability is computed on an actuarial basis and stated at its present value. The capitalization rate, set by the Supervisor of Banks, on an actuarial computation is 4%, and considering the future payroll increases, the amount of the liabilities for employee rights, in respect of the Bank employees, is capitalized at a payroll increase rate of 2.5%, similar to 2006. The financial statements include provisions for long-service bonuses totaling: Consolidated - NIS 454 million (2006: NIS 447 million); the Bank - NIS 392 million (2006: NIS 386 million).

An agreement with the representatives of the employees was signed in November 2007, regarding the redemption in cash of "Jubilee vacation" days. The agreement provides that upon reaching the entitlement date, the vacation days due could be redeemed immediately in one lump sum or in installments by every single employee. The agreement also abolished the entitlement of new employees to "Jubilee vacation".

Employees of the Bank and its consolidated subsidiaries in Israel are entitled to annual vacation as provided by labor agreements in force, and subject to the guidelines of the Annual Vacation Law - 1951. The financial statements include provisions for vacation pay as follows: Consolidated - NIS 141 million (2006: NIS 128 million); and for the Bank - NIS 113 million (2006: NIS 101 million).

16. EMPLOYEE BENEFITS (CONTINUED)

- C.** Employees of the Bank and its subsidiaries are entitled to certain benefits after retirement. The liability was computed on an actuarial basis at a discount rate of 4%. The amount of the provision at balance sheet date: Consolidated - NIS 374 million (2006: NIS 432 million); the Bank - NIS 324 million (2006: NIS 344 million).

D. THE PROVISION AND DEPOSITS FOR EMPLOYEES' SEVERANCE PAY ARE AS FOLLOWS:

	Consolidated		The Bank	
	December 31			
	2007	2006	2007	2006
	in NIS millions			
Deposits	2,286	2,181	2,024	1,917
Provision	1,812	1,702	1,549	1,447
Excess of deposit over provision	474	479	475	470
The excess (shortage) of amounts deposited over the provision is included in the item:				
Other assets (Note 8)	479	482	475	470
Other liabilities (Note 12)	(5)	(3)	-	-
Total, Net	474	479	475	470

The Bank and its subsidiaries are not permitted to withdraw these deposit funds except for the purpose of making severance payments.

- E.** In the years 2005-2007, the Bank encouraged early retirement of employees, focusing on an employee population having defined characteristics, in respect of which a focused effort to encourage their early retirement was made. In this framework, the said employees were approached and were offered early retirement at beneficial terms.
(As to expenses relating to early retirement, see note 27).

- F.** Several of the subsidiaries have adopted employee remuneration plans, according to which the General Managers and/or other employees of these subsidiaries are entitled to a bonus, the amount of which is based upon their business results. The necessary provisions in respect of these bonuses are included in the financial statements.

The previous general manager of one of the subsidiaries is entitled to a share of the gain on investments made in the period of his employment by the subsidiary, also during a number of years subsequent to his retirement.

- G. An award plan for members of the Bank's management.** In March 26, 2006, the board of directors of the Bank resolved to approve an award plan to members of the Bank's management, including the Internal Auditor. In terms of the plan the Bank is to grant to every member of management an annual award in respect of each year in which he served as member of management in the period from 2006 to 2010. The annual award would be derived in part from the rate of the annual return on equity and in part by the decision of the President and CEO (within the framework of an additional budget, the volume of which will also be derived from the annual rate of return on equity), in a differential manner according to his judgment, and in accordance with the extent of achievement of the specific targets set by him for each management member. The said distribution requires the approval of the board of directors of the Bank.

The minimum annual rate of return required for a distribution of an award to members of management in a particular year, is 8.5%.

The board of directors of the Bank is entitled to eliminate exceptional profits or losses, that do not stem from current operations, for the purpose of computing the rate of annual return on equity. The board of directors of the Bank is entitled to change or cancel the

16. EMPLOYEE BENEFITS (CONTINUED)

award plan, in whole or in part, provided that the change or cancellation would take effect in the calendar year following the year in which the decision for cancellation or change was taken.

The award plan to members of management of the Bank, including the Internal Auditor, was ratified by the Audit Committee and by the Board of Directors at the meetings held on July 15 and 16, 2006.

For details regarding a stock option plan for officers of the Bank, see Note 13 D.

Award plan to employees and managers of the Bank in 2007-2008. In March 2007, the Board of Directors approved an award plan to employees and managers of the Bank for 2007. The budget for the plan would be determined on the basis of the annual return to capital of earnings from ordinary operations. The awards would be granted according to the rate of return. The aim of the plan is to create a structured relation between the success of the Bank and the remuneration of employees and managers in the short and long term. In March 2008 the Board of Directors approved a similar stock option plan for 2008.

- H. IDB New York has a liability for the payment of pensions to its employees, in respect of which it has established a pension fund, in which contributions by the employer and by the employees are deposited. The annual deposits with the fund are based on calculations made by an independent actuary. Following are the principal details concerning the said liability:

	As at December 31	
	2007	2006
	In US\$ millions	
The actuarial liability for pension payments	27	34
Fair value of the pension fund assets	22	24
The actuarial liability for pension payments, net of market value of the Fund's assets	(5)	(10)
Balance of the deferred actuarial loss	8	7
The outstanding net assets of the pension fund, as reflected in the financial statements (Note 8)	3	-
The outstanding net liability of the pension fund, as reflected in the financial statements (Note 12)	-	3
Pension payment expenses recognized in the income statement	(3)	4
The assumptions used for the measurement of the components of the pension plan:		
	%	%
The annual discount rate	6.37	5.88
The anticipated annual rate of return on the Fund's Assets	8.50	8.50
The annual rate of increase in employee payroll	4.25	4.25

- I. For details as to an agreement signed in February 2005, alongside with the agreement signed for the sale of a control core of the Bank, between the New Federation of Labor, the Representative Committee of Discount Bank Employees and the Accountant General at the Ministry of Finance, and which determined, among other things, that the "entitled employees" (as defined in the agreement) will receive, under certain conditions, a bonus from the State and from the Bank, and that the power of the employment charter as a collective employment agreement at the Discount Bank would be extended for a period of five years, see Note 32 hereunder.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS

CONSOLIDATED

December 31, 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	5,465	1,102	6,628	4,670	1,985	-	19,850
Securities	13,580	2,685	17,736	1,319	185	1,773	37,278
On securities borrowed or purchased under resale agreements	346	-	-	-	-	-	346
Credit granted to the public	48,074	18,642	27,207	3,734	4,242	-	101,899
Credit granted to the Government	9	362	3	-	-	-	374
Investments in affiliated companies	45	32	-	-	-	1,931	2,008
Buildings and equipment	-	-	-	-	-	2,780	2,780
Other assets	1,460	30	1,789	314	241	441	4,275
Total assets	68,979	22,853	53,363	10,037	6,653	6,925	168,810
Liabilities							
Deposits from the public	55,066	11,578	50,832	10,003	3,039	-	130,518
Deposits from banks	1,077	515	3,237	190	53	-	5,072
Deposits from the Government	75	5	45	-	-	-	125
Securities loaned or sold under buy-back arrangements	-	-	5,895	-	-	-	5,895
Subordinated capital notes	867	6,570	-	-	-	-	7,437
Other liabilities	8,658	214	853	206	265	216	10,412
Total liabilities	65,743	18,882	60,862	10,399	3,357	216	159,459
Difference	3,236	3,971	(7,499)	(362)	3,296	6,709	9,351
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	284	(3,066)	5,489	596	(3,303)	-	-
Options in the money, net (in terms of base asset)	150	-	33	(183)	-	-	-
Options out of the money, net (in terms of base asset)	179	2	(118)	(62)	(1)	-	-
Total	3,849	907	(2,095)	(11)	(8)	6,709	9,351
Options in the money, net (discounted nominal value)	529	-	(312)	(217)	-	-	-
Options out of the money, net (discounted nominal value)	961	179	(1,004)	(141)	4	1	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)
CONSOLIDATED (CONTINUED)

	December 31, 2006						Total
	Israeli currency		Foreign currency ⁽¹⁾			Non monetary items	
	Non-linked	Linked to the CPI	In US\$	In Euro	In other currencies		
in NIS millions							
Assets							
Cash and deposits with banks	*2,697	1,250	14,525	4,712	1,916	-	25,100
Securities	*13,732	1,946	20,368	1,308	416	1,207	38,977
Credit granted to the public	*40,457	*17,778	25,273	2,907	3,682	-	90,097
Credit granted to the Government	*314	3	7	-	-	-	324
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	21,003	61,846	8,964	6,090	5,679	162,523
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
Deposits from the Government	49	6	64	-	-	-	119
Subordinated capital notes	128	6,174	-	-	-	-	6,302
Other liabilities	*7,270	126	1,288	53	118	264	9,119
Total liabilities	59,954	19,082	63,158	8,754	2,944	264	154,156
Difference	(1,013)	1,921	(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	2,039	1,183	(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.

17. ASSETS AND LIABILITIES - CONTINUED ACCORDING TO LINKAGE TERMS (CONTINUED)

THE BANK

	December 31, 2007						
	Israeli currency		Foreign currency ⁽¹⁾			Non monetary items	Total
	Non-linked	Linked to the CPI	In US\$	In Euro	In other currencies		
in NIS millions							
Assets							
Cash and deposits with banks	5,311	7,657	5,031	4,441	1,794	-	24,234
Securities	12,430	1,332	1,427	1,253	22	1,081	17,545
Securities borrowed or purchased under resale agreements	346	-	-	-	-	-	346
Credit granted to the public	34,366	6,801	11,334	3,351	3,722	-	59,574
Credit granted to the Government	-	363	-	-	-	-	363
Investments in affiliated companies	5	626	58	-	-	7,291	7,980
Buildings and equipment	-	-	-	-	-	2,141	2,141
Other assets	1,203	22	685	289	225	109	2,533
Total assets	53,661	16,801	18,535	9,334	5,763	10,622	114,716
Liabilities							
Deposits from the public	45,323	9,814	25,962	9,058	2,473	-	92,630
Deposits from banks	1,007	165	1,581	211	77	-	3,041
Deposits from the Government	32	5	-	-	-	-	37
Subordinated capital notes	181	3,656	-	-	-	-	3,837
Other liabilities	4,999	182	328	148	223	87	5,967
Total liabilities	51,542	13,822	27,871	9,417	2,773	87	105,512
Difference	2,119	2,979	(9,336)	(83)	2,990	10,535	9,204
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	230	(2,713)	5,221	336	(3,074)	-	-
Options in the money, net (in terms of base asset)	200	-	(25)	(175)	-	-	-
Options out of the money, net (in terms of base asset)	179	2	(118)	(62)	(1)	-	-
Total	2,728	268	(4,258)	16	(85)	10,535	9,204
Options in the money, net (discounted nominal value)	313	-	(118)	(195)	-	-	-
Options out of the money, net (discounted nominal value)	935	179	(988)	(126)	-	-	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED) THE BANK (CONTINUED)

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	*2,812	6,525	11,878	4,629	1,781	-	27,625
Securities	12,703	1,136	1,181	1,159	34	724	16,937
Credit granted to the public	28,784	6,782	9,972	2,586	3,343	-	51,467
Credit granted to the Government	*306	3	4	-	-	-	313
Investments in affiliated companies	4	146	63	-	-	6,405	6,618
Buildings and equipment	-	-	-	-	-	2,032	2,032
Other assets	1,346	12	290	32	61	222	1,963
Total assets	45,955	14,604	23,388	8,406	5,219	9,383	106,955
Liabilities							
Deposits from the public	40,463	9,749	24,683	7,549	2,266	-	84,710
Deposits from banks	3,192	176	1,857	246	55	-	5,526
Deposits from the Government	-	5	-	-	-	-	5
Subordinated capital notes	213	3,667	-	-	-	-	3,880
Other liabilities	4,079	84	381	48	99	178	4,869
Total liabilities	47,947	13,681	26,921	7,843	2,420	178	98,990
Difference	(1,992)	923	(3,533)	563	2,799	9,205	7,965
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	2,374	(407)	1,474	(639)	(2,802)	-	-
Options in the money, net (in terms of base asset)	126	-	(198)	77	(5)	-	-
Options out of the money, net (in terms of base asset)	460	60	(520)	(1)	1	-	-
Total	968	576	(2,777)	-	(7)	9,205	7,965
Options in the money, net (discounted nominal value)	1,007	-	(928)	90	(169)	-	-
Options out of the money, net (discounted nominal value)	943	206	(1,209)	59	1	-	-

*Reclassified.

Footnote:

(1) Includes those linked to foreign currency.

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS⁽¹⁾

CONSOLIDATED (IN NIS MILLIONS)

A. Anticipated Future Contractual Cash Flows as of December 31, 2007

	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Israeli currency, non-linked:				
Assets	25,431	11,173	8,174	7,461
Liabilities	35,771	5,077	19,391	3,312
Difference	(10,340)	6,096	(11,217)	4,149
Derivative instruments (excluding options)	(1,339)	(836)	2,353	100
Options (in terms of base assets)	(26)	(40)	153	(60)
Israeli currency, CPI-linked:				
Assets	749	563	2,623	3,385
Liabilities	516	691	2,667	3,087
Difference	233	(128)	(44)	298
Derivative instruments (excluding options)	(125)	(91)	(230)	(333)
Options (in terms of base assets)	-	-	-	-
Foreign currency-local activity⁽³⁾:				
Assets	12,545	4,258	2,653	2,039
Liabilities	20,939	11,145	5,990	294
Difference	(8,394)	(6,887)	(3,337)	1,745
Derivative instruments (excluding options)	1,177	925	(1,719)	165
Options (in terms of base assets)	26	40	(153)	60
Foreign currency-foreign activity of extensions:				
Assets	12,340	4,096	5,380	3,269
Liabilities	14,870	9,061	4,421	1,897
Difference	(2,530)	(4,965)	959	1,372
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Total:				
Assets	51,065	20,090	18,830	16,154
Liabilities	72,096	25,974	32,469	8,590
Difference	(21,031)	(5,884)	(13,639)	7,564
Derivative instruments (excluding options)	(287)	(2)	404	(68)

* Reclassified.

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assets and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts the allocation of which over periods is made in accordance with an estimate based on the credit periods in respect of which they were made.

(2) Includes past-due receivables totaling NIS 2,046 million (2006: NIS 1,897 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

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Balance sheet amount ⁽⁴⁾								
Over 2 years and up to 3 years	Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total cash flows	No fixed maturity date ⁽²⁾	Total
5,377	5,001	1,620	5,453	1,983	77	71,750	3,082	68,979
408	296	180	829	666	109	66,039	113	65,743
4,969	4,705	1,440	4,624	1,317	(32)	5,711	2,969	3,236
23	(37)	(120)	-	34	-	178	-	284
5	12	(197)	119	362	1	329	-	329
3,149	2,314	2,847	7,979	5,373	696	29,678	211	22,853
2,095	2,411	2,308	6,608	2,601	2	22,986	80	18,882
1,054	(97)	539	1,371	2,772	694	6,692	131	3,971
(310)	(251)	(331)	(2,114)	(635)	-	(4,420)	-	(3,066)
-	-	-	2	-	-	2	-	2
2,164	1,278	1,346	2,784	571	-	29,638	921	29,363
190	156	98	104	57	-	38,973	27	39,293
1,974	1,122	1,248	2,680	514	-	(9,335)	894	(9,930)
231	275	424	2,088	618	-	4,184	-	2,782
(5)	(12)	197	(121)	(362)	(1)	(331)	-	(331)
2,423	1,456	1,087	4,624	10,079	11,099	55,853	206	40,690
1,257	800	1,552	3,479	21	-	37,358	18	35,325
1,166	656	(465)	1,145	10,058	11,099	18,495	188	5,365
-	-	-	-	-	-	-	6,925	6,925
-	-	-	-	-	-	-	216	216
-	-	-	-	-	-	-	6,709	6,709
13,113	10,049	6,900	20,840	18,006	11,872	186,919	11,345	168,810
3,950	3,663	4,138	11,020	3,345	111	165,356	454	159,459
9,163	6,386	2,762	9,820	14,661	11,761	21,563	10,891	9,351
(56)	(13)	(27)	(26)	17	-	(58)	-	-



18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS⁽¹⁾ (CONTINUED) CONSOLIDATED (IN NIS MILLIONS)

B. Balance Sheet Amount at DecemBer 31, 2006

	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Total:				
Assets	*50,161	18,781	24,689	13,873
Liabilities	*66,822	25,985	32,306	10,086
Difference	(16,661)	(7,204)	(7,617)	3,787
Derivative instruments (excluding options)	(11)	(71)	98	(30)

* Reclassified.

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assets and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts the allocation of which over periods is made in accordance with an estimate based on the credit periods in respect of which they were made.

(2) Includes past-due receivables totaling NIS 2,046 million (2006: NIS 1,897 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

Balance sheet amount ⁽⁴⁾								
Over 2 years and up to 3 years	Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Total Over 20 years	No fixed cash flows	maturity date ⁽²⁾	Total
11,429	9,354	8,864	18,114	11,809	17,985	*185,059	9,474	*162,523
4,496	3,517	3,577	10,073	2,888	127	*159,877	406	*154,156
6,933	5,837	5,287	8,041	8,921	17,858	25,182	9,068	8,367
(16)	(2)	7	23	(3)	-	(5)	-	-

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS⁽¹⁾ (CONTINUED)

THE BANK (IN NIS MILLIONS)

A. Anticipated Future Contractual Cash Flows as of December 31, 2007

	On demand or within 1 month	1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Israeli currency, non-linked:				
Assets	18,950	7,797	5,846	6,257
Liabilities	25,891	4,285	16,619	2,823
Difference	(6,941)	3,512	(10,773)	3,434
Derivative instruments (excluding options)	(1,306)	(854)	2,321	99
Options (in terms of base assets)	(8)	(50)	180	72
Israeli currency, CPI-linked:				
Assets	568	449	1,990	2,565
Liabilities	219	437	1,771	1,587
Difference	349	12	219	978
Derivative instruments (excluding options)	(185)	(72)	(230)	(314)
Options (in terms of base assets)	-	-	-	-
Foreign currency-local activity⁽³⁾:				
Assets	12,647	3,910	2,456	1,827
Liabilities	18,943	10,504	5,477	122
Difference	(6,296)	(6,594)	(3,021)	1,705
Derivative instruments (excluding options)	1,203	935	(1,700)	144
Options (in terms of base assets)	8	50	(180)	(72)
Foreign currency-foreign activity of extensions:				
Assets	2,114	777	1,349	670
Liabilities	2,514	1,349	214	-
Difference	(400)	(572)	1,135	670
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Total:				
Assets	34,279	12,933	11,641	11,319
Liabilities	47,567	16,575	24,081	4,532
Difference	(13,288)	(3,642)	(12,440)	6,787
Derivative instruments (excluding options)	(288)	9	391	(71)

* Reclassified.

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assets and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts the allocation of which over periods is made in accordance with an estimate based on the credit periods in respect of which they were made.

(2) Includes past-due receivables totaling NIS 1,347 million (2006: NIS 1,335 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

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Balance sheet amount ⁽⁴⁾								
Over 2 years and up to 3 years	Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total cash flows	No fixed maturity date ⁽²⁾	Total
4,398	4,549	1,461	5,190	1,786	53	56,287	2,461	53,661
253	219	141	840	587	115	51,773	194	51,542
4,145	4,330	1,320	4,350	1,199	(62)	4,514	2,267	2,119
23	(40)	(121)	(11)	(4)	-	107	-	230
112	42	21	9	1	-	379	-	379
2,275	2,067	1,998	6,184	2,325	512	20,933	185	16,801
1,486	1,746	1,924	5,233	2,551	-	16,954	80	13,822
789	321	74	951	(226)	512	3,979	105	2,979
(291)	(232)	(312)	(2,018)	(175)	-	(3,829)	-	(2,713)
-	-	-	2	-	-	2	-	2
2,236	1,148	1,253	2,293	249	-	28,019	869	28,189
57	68	88	72	1	-	35,332	27	35,986
2,179	1,080	1,165	2,221	248	-	(7,313)	842	(7,797)
208	252	401	1,975	174	-	3,592	-	2,483
(112)	(42)	(21)	(11)	(1)	-	(381)	-	(381)
526	161	83	-	-	-	5,680	28	5,443
-	-	-	-	-	-	4,077	-	4,075
526	161	83	-	-	-	1,603	28	1,368
-	-	-	-	-	-	-	10,622	10,622
-	-	-	-	-	-	-	87	87
-	-	-	-	-	-	-	10,535	10,535
9,435	7,925	4,795	13,667	4,360	565	110,919	14,165	114,716
1,796	2,033	2,153	6,145	3,139	115	108,136	388	105,512
7,639	5,892	2,642	7,522	1,221	450	2,783	13,777	9,204
(60)	(20)	(32)	(54)	(5)	-	(130)	-	-



18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS⁽¹⁾ (CONTINUED) THE BANK (IN NIS MILLIONS)

B. Balance Sheet Amount at DecemBer 31, 2006

	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Total:				
Assets	32,474	11,624	15,706	8,959
Liabilities	41,803	18,201	21,739	5,970
Difference	(9,329)	(6,577)	(6,033)	2,989
Derivative instruments (excluding options)	(14)	(74)	87	(32)

* Reclassified.

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assets and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts the allocation of which over periods is made in accordance with an estimate based on the credit periods in respect of which they were made.

(2) Includes past-due receivables totaling NIS 1,347 million (2006: NIS 1,335 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

Balance sheet amount ⁽⁴⁾									
	Over 2 years and up to 3 years	Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Total No fixed Over 20 years	cash flows	maturity date ⁽²⁾	Total
	7,381	6,535	6,744	10,793	2,003	90	102,309	12,319	106,955
	1,542	1,533	1,959	6,499	2,826	121	102,193	406	98,990
	5,839	5,002	4,785	4,294	(823)	(31)	116	11,913	7,965
	(18)	(6)	5	6	1	-	(45)	-	-

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			

A. Off-Balance Sheet Financial Instruments

Contract balances or their stated amounts at year end

Transactions involving credit risk:

Letters of credit	1,421	1,982	562	553
Credit guarantees	2,880	1,976	1,473	1,367
Guarantees for home purchasers	3,151	2,834	1,947	1,381
Other guarantees and obligations ⁽³⁾	4,339	3,898	3,764	3,341
Unutilized credit line for credit cards	20,965	12,862	8,832	8,251
Unutilized revolving and other credit lines	8,247	8,457	7,291	7,200
Irrevocable commitments to extend credit approved but not yet granted	8,909	11,341	6,955	4,000
Commitment to issue guarantees	3,373	2,732	2,304	2,045

B. Off-Balance Sheet Commitment at Year-End Regarding activity

based on loan repayments⁽¹⁾

Balance of loans granted out of deposits repayable according to the
repayment of the loans⁽²⁾

Israeli currency - non linked	262	291	216	257
Israeli currency - linked to the CPI	2,075	2,194	27	32
Foreign currency	736	723	736	723
Total	3,073	3,208	979	1,012

Footnotes:

(1) Loans and deposits granted out of deposits, the repayment of which to the depositors is conditional upon the collection of these loans (or deposits), with a margin or with a collection commission (instead of a margin).

(2) Standing loans and government deposits made in respect thereof, totaling NIS 169 million (2006: NIS 211 million), have not been included in the table.

(3) see Note C 6.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)**B. OFF BALANCE SHEET COMMITMENT AT YEAR-END REGARDING ACTIVITY BASED ON LOAN REPAYMENTS (CONTINUED)****2. Cash flows in respect of collection commissions and interest margins of activity based on loan repayments - Consolidated⁽¹⁾**

	December 31, 2007						2006	
	Up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total	Total
Future contractual flows	17	30	26	54	42	1	170	186
Expected future flows based on Management's estimates of early repayments	17	29	24	43	28	1	142	153
Discounted expected future flows based on Management's estimates of early repayments ⁽²⁾	17	27	20	33	17	-	114	124

3. Information as to the granting of loans during the year by the mortgage banks:

	31.12.2007	31.12.2006
Loans out of deposits repayable according to the repayment of loans	65	95
Standing loans	1	2

Footnotes:

(1) The CPI linked segment includes the foreign currency segment. The CPI linked segment includes also the non-linked shekel segment as amounts in this segment do not exceed 10% of total amounts repayable according to collection of loans granted therefrom.

(2) Discounted at the rate of 3.58% (2006: 3.78%).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2007	2006	2007	2006
	in NIS millions			
1. Long-term lease contracts - rent payable in future years ⁽²⁾ :				
First year	87	88	47	42
Second year	79	74	42	35
Third year	65	63	32	27
Fourth year	54	47	22	16
Fifth year	80	53	17	8
Sixth year and thereafter	133	145	26	12
Total	498	470	186	140
2. Guarantees to ensure rights of members in provident funds ⁽³⁾ (nominal)	-	6,699	-	6,699
3. Commitment to acquire buildings and equipment	44	26	29	1
4. Borrowed securities ⁽¹⁾	157	316	120	28

Footnotes:

(1) Not including transactions of lending securities to cover securities short sales, where the Bank serves as an at-risk broker between customers and institutional bodies, which are presented in the Bank's balance sheet as credit to the public and as deposits of the public, respectively. The balance of these transactions at December 31, 2007 was NIS 354 million.

(2) For details as to long-term lease agreement, see section 18 hereunder.

(3) See Section 19 hereunder.

6. The Bank and Mercantile Discount Bank, which are members of the Ma'of Clearing House Ltd., are responsible along with other Ma'of Clearing House members towards the Clearing House for any financial obligations resulting from option transactions conducted on the Stock Exchange.

For this purpose, the Ma'of Clearing House established a risk fund. The share of the Bank in the risk fund as of December 31, 2007, amounts to NIS 38 million, comprising 3.48% of the total risk fund at that date. The two banks were required to provide collateral in favor of the Ma'of Clearing House by way of securities (Government bonds) in an amount that would cover their possible liability in respect of their share in the risk fund, as stated, as well as an additional amount derived from the volume of operations in this field of each of the banks (see Note 15 G and H).

Each of the banks is also committed to pay the Ma'of Clearing House any monetary charge that may result from operation of their customers involving the writing of options traded within the framework of the Clearing House.

7. According to the articles of the Stock Exchange and the byelaws of the Tel Aviv Stock Exchange Clearing House, the members are committed towards the Clearing House to cover any amount resulting from the obligations on behalf of themselves or their customers as well as for other Stock Exchange members who are not members of the Clearing House and their customers, in respect of transactions conducted by way of the Clearing House. In addition, each member is responsible for its share in the risk fund based on the ratio of the monetary turnover as described above. As collateral for their obligations towards the Clearing House, the Bank and Mercantile Discount Bank pledged their rights to accounts maintained at the Clearing House (in which securities are deposited) and at another bank (in which cash is deposited). (See Note 15 J and K).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

8. a) The Bank is committed to indemnify the subsidiary Tachlit Investment House Ltd. (hereinafter – “Tachlit”) in respect of professional liability lawsuits filed against it in excess of the insured amount of US\$16 million, purchased by Tachlit. The amount of indemnification is limited to US\$4.5 million in accordance with a claim that will be received from Tachlit until March 31, 2009.
- b) Tachlit is committed towards Tachlit Global Dollar Ltd., held by Tachlit at the rate of 20%, and toward Synergetica Ltd., which owns approximately 80% of Tachlit Global Dollar Ltd., to transfer to Tachlit Global Dollar Ltd., a company that issues basket certificates, a total amount not exceeding US\$1 million, to cover its current operating expenses and to fulfill its obligations towards the holders of its basket certificates. The Bank granted Tachlit an indemnification as collateral for the said commitment.
A similar indemnification from the Bank, in an identical amount, was given by the Bank in respect of Tachlit Basket Certificates Ltd.
9. Consolidated subsidiaries of the Bank are engaged in providing a variety of trusteeship services and serve, inter alia, as trustees for certain debentures issued to the public according to a prospectus and which are traded on the Stock Exchange.
10. a) The previous Articles of Association of the Bank, which were amended in March 2002, prescribed that the Bank shall indemnify any person who serves or served as a representative of the Bank, or at its request, as a Director in another company in which the Bank has an interest, for the expenses incurred by such person in connection with legal proceedings instituted against him in respect of acts of commission or omission in the course of fulfilling his duties as a Director of such other company, and for an amount he is ordered to pay under a judgment handed down in such legal proceedings, including by way of a settlement to which the Bank has agreed, unless the judicial authority in such proceedings has found that the acts as aforesaid on the part of such person were performed not in good faith. The Bank is entitled to issue a letter of indemnity to any such Director of another company, including a Director of the Bank who serves as a Director in the other company, at terms and conditions approved by the Board of Directors. Accordingly, the Bank has issued letters of indemnity, unlimited as to amount, to Directors who serve or served at the Bank's request in other companies held, directly or indirectly, by the Bank.
- b) According to the Articles of Association of the Bank, any employee or clerk of the Bank who is not an executive officer, will be indemnified out of the funds of the Bank for any liability incurred by him in his capacity as an employee or clerk of the Bank in defending himself in any legal proceedings, whether civil or criminal, in which a judgment is given in his favor or in which he is acquitted, and the Bank is entitled to indemnify him for any financial liability imposed on him in favor of another person for an act done in his capacity as an employee or clerk of the Bank.
- c) The Articles of Incorporation of certain consolidated subsidiaries of the Bank allow for indemnification of officers under certain conditions, subject to the provisions of the Law. Certain companies in certain cases granted such indemnification.
- d) Discount Manpikim Ltd., a wholly owned and controlled subsidiary of the Bank, has granted indemnification to its Directors, with respect to a financial liability that might be imposed on any of them and with respect to reasonable legal expenses in connection with a Prospectus for the public issue and the listing for trade of subordinated capital notes, published in March 2004, of subordinated capital notes in a total amount of NIS 500 million, under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification payable to all Directors as a group will not exceed the gross proceeds of the said issue. Discount Manpikim Ltd. has granted its Directors identical indemnification in connection with a Prospectus regarding the offer to the public and the listing for trade of subordinated capital notes issued in November 2004, of subordinated capital notes in a total amount of NIS 600 million.



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

- e) Discount Manpikim Ltd. granted in September 2006 indemnification to directors as well as the CEO of the company with respect to monetary liability that might be imposed on any of them and with respect to reasonable litigation expenses in connection with a shelf prospectus for the issue and listing for trade of subordinated capital notes, dated September 2006, and this under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification granted to all of the directors and to the CEO as a whole shall not exceed the gross proceeds of the said issue, and in any case no more than NIS 1.5 billion. In September 2007, Discount Manpikim Ltd. approved a similar indemnity to the CEO appointed subsequently to the issue of the Shelf Prospectus, regarding shelf offering reports to be published subsequently to the date of the resolution, in accordance with the said Shelf Prospectus.
- f) Discount Manpikim Ltd. granted in February 2008 indemnification to directors as well as the CEO of the company with respect to monetary liability that might be imposed on any of them and with respect to reasonable litigation expenses in connection with a shelf prospectus for the issue and listing for trade of subordinated capital notes, dated February 2008, and this under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification granted to all of the directors and to the CEO as a whole shall not exceed the gross proceeds of the said issue, and in any case no more than NIS 2 billion.
- g) Concurrently with approval of the engagement in an agreement for the sale of the provident fund management activity, as stated in Note 6 E 3 above, the Bank committed to indemnify Discount Gemel Ltd. and its executive officers under conditions and circumstances in which the Bank is permitted to grant such indemnification in accordance with the relevant provisions of the Companies Law, with respect to their activity as officers of the company relating to approval of the sale agreement and implementation of the said sale, including any financial liabilities, expenses, consultation with legal and other experts, as required, and reasonable litigation expenses, provided that the cumulative amount required to be paid by the Bank shall not exceed the consideration receivable by the Bank under the sale agreement, and provided that realization of the indemnification will not impair the capital adequacy ratio, which the Bank is required to maintain under Proper Banking Management Directive No. 311, all as stated in the indemnification letter.
- h) For details as to the indemnification granted to the purchasers of the Ilanot-Discount shares, see Note 6 E 2 above.
For details as to the indemnification granted to the purchasers of the operations of the provident funds, see Note 6 E 3 above.
- i) **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 officers 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 officers, the officer 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 officers and for officers in the Bank prior to the period of the insurance policy, including two former officers who served as directors in subsidiaries and who are also controlling shareholders in the Bank.
- j) **Advance exemption and indemnification of directors and other officers.** On June 26, 2007 a special General Meeting approved advance exemption from responsibility of directors and other officers in the Bank and of former directors and officers 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 officers in the Bank and of former directors and officers 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 officers in the Bank and to officers 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 adequacy ratio in accordance with Regulation 311 of the Proper 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 officers in the Bank, subject also to fulfillment of additional conditions customary 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 officers 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 Proper 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.

11. The practice of the Bank is to grant, from time to time, and at terms and circumstances customary in the banking business, letters of commitment and of indemnification, limited or unlimited in amount, and for limited or unlimited periods, and everything in the ordinary course of business of the Bank. Inter alia, such letters of indemnity are granted within the framework of the regulations of the Clearing House as to lost checks; are granted to Receivers and Liquidators; are granted in respect of negligence claims, to providers of various services including assessors, project manager etc; to customers in respect of lost check books; to credit card companies as part of the accountability with them; or indemnification granted as part of a contractual obligation.

This includes a full indemnification granted by the Bank to an assessor, in respect to any damage, which might be caused to him as a result of rendering valuation opinions, except in the case where gross negligence or malfeasance might be found; and a similar indemnification that the Bank gave to an expert who had provided the bank with an economic opinion.

12. The Bank is obligated to Visa International Service Association, that should Israel Credit Cards Ltd. ("ICC") or one of the banks recommended by it for membership in Visa International, breach, deny or neglect the payment of any sum, or will do or refrain from doing anything required of it according to the bylaws of Visa International and its standards of operations, the Bank shall unconditionally indemnify Visa International and its members against all losses, damages, costs, expenses, etc. which may be caused as a result, and which exclusively relate to international payments outside of Israel.



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

The Bank's guaranty to Visa International is a continuous guaranty, which will remain fully in force until all the moneys and obligations due are fully settled and fulfilled.

In November 2004, the Bank endorsed the above guarantees in favor of Visa Europe Services Inc., an autonomous branch of Visa International representing Visa members operating in Europe.

13. Within the framework of permits granted to the Bank for the construction of a building at 156 Herzl Street, Tel Aviv, which was sold during the course of its construction to a third party, the Bank is obligated to the Tel Aviv Municipality and to the third party, to bear the costs involved in evacuating tenants from the plot. To the best of the Bank's knowledge as at the date of the financial statements, the Municipality had not yet begun evacuating the tenants from the plot, and the Bank is unable to assess the cost of its participation in the evacuation of tenants as aforesaid.

14. Various actions against the Bank and its consolidated subsidiaries:

Various actions are pending against the Bank and its consolidated subsidiaries. These include class action suits and requests to approve actions as class action suits. Among others, allegations are raised in these claims with regard to the unlawful debiting of interest and/or the debiting of interest not in accordance with agreements, subjecting one service to another service, failure to execute instructions, applications for the confirmation of attachment orders in respect of attachments served by third parties on the assets of debtors which they allege are held by the Bank, the unlawful debiting of accounts, mistakes in value dates, the invalidity of collateral security and the realization thereof, applications for injunctions ordering the Bank to refrain from paying out bank guarantees or documentary credit, as well as allegations pertaining to provident funds, securities, construction loans, applications for the removal of restrictions on an account pursuant to the Dishonored Checks Law, 1981. 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 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, amounts to approximately NIS 193 million.

- 14.1 In November 1999, the Bank received notice of a request for exemption from litigation levy submitted to the Tel-Aviv District Court by a former customer of the Bank, to enable him to file a claim against the Bank in the amount of NIS 467 million. The plaintiff was awarded an exemption from Court fees, which would have applied to the action, of NIS 456 million.

In the action, the plaintiff alleges wrongful doings made in his accounts until 1989. According to the plaintiff, who maintained a business account with the Bank, the Bank exploited his mental and physical condition, and made use of his account and the accounts of his family members as if they belonged to the Bank, while opening dozens of additional accounts without permission, concealing information, forging signatures, taking out loans in the name of the plaintiff, buying and selling securities fictitiously and embezzling funds.

Hearing of evidence in respect of this claim commenced in January 2004.

The Bank, inter alia, raised an argument of obsolescence and the Court determined that this argument will be considered in the framework of the verdict.

Based on the opinion of legal counsel, management of the Bank believes that the amount of the claim is excessive and the arguments of the plaintiff are baseless.

- 14.2 A request to approve an action against the Bank and against Mercantile Discount Bank ("MDB") as class action suit:

An action and a request to have it approved as a class action suit under the Banking Law (Customer Service), 1981, were submitted

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

on December 8, 2002, against MDB and against the Bank by a customer, who in the past had submitted an action on the same ground together with a request to have it approved as a class action suit under the Securities Law, which action was dismissed because of non-payment of Court fees. The ground for the claim is the alleged damage caused to the claimant as a result of impairment in value of securities purchased on his behalf by portfolio managers, who unlawfully hiked up the prices of securities. The claimant argues that the connection of MDB to the damage claimed results from the credit granted by the Bank to the said portfolio managers, which enabled them to conduct transactions in the said securities, and from the impression received by that customer that the granting of credit served to support the prices of the securities.

As estimated by the claimant, the damage caused to him amounts to NIS 735 thousand. The total amount of damage stated in the request for approval of a class action suit against MDB and the Bank together, is NIS 500 million.

See section 15.1 hereafter for details of an action filed against the Bank in relation to the same subject matter, based on other grounds.

- 14.3** On November 27, 2002, a personal legal action was filed against the Bank and against a third party (also in relation to the subject matter of the proceedings discussed in Note 14.2 above and in note 15.1 hereunder) by a customer of the Bank, who is also the brother of that third party with whom he held control over a publicly traded company. The action is in an amount of NIS 24 million. On February 24, 2003, the Court permitted the claimant to amend the amount of the claim to NIS 45 million.

The claimant alleges that the Bank and the third party, contrary to the law, conspired to artificially cause the public issue of shares by the said company to succeed, by opening bogus accounts and unlawfully providing credit to these accounts, so that the share issue will deem to comply with the requirements of the Stock Exchange as to proper dispersal and minimum holdings. The claimant further alleges that even after the issue of the shares, the Bank and the third party continued to carry out unlawful transactions in the shares by way of share price hiking.

The Bank had submitted a defense brief on April 10, 2003. The other defendant (the said third party) submitted a defense brief on May 27, 2004.

In 2005, mediation proceedings were conducted in this regard, which terminated unsuccessfully in January 2006. At this stage, preliminary proceedings are being conducted between the parties.

The case was fixed for a preliminary hearing on June 18, 2008.

- 14.4** On December 8, 2005, a former customer of the Bank (hereinafter – “the plaintiff”) filed a lawsuit in the amount of US\$300 million 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 damages were 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 in Israel by the plaintiff and others 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



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

in New York, following the admittance of the Bank's argument regarding improper forum.

The Bank motioned the Court in the United States for a dismissal in limine of the action on grounds of lack of authority and improper forum.

On June 26, 2007, the lawsuit was dismissed in limine on grounds of inappropriate forum. On September 4, 2007, the plaintiff appealed the said ruling of the Federal Court. The Federal Court decided that the appellant must submit his arguments by March 24, 2008, and that the Bank must respond by April 23, 2008.

14.5 Request to approve an action against Discount Mortgage Bank ("DMB") as a class action suit and a claim against Discount Mortgage Bank and against the Bank:

14.5.1 On November 2, 1997 a law suite was filed with the Tel-Aviv District Court and a motion to approve the filing of a class-action suit against DMB and against three additional mortgage banks regarding the charging of commissions for life assurance and property insurance of borrowers. It was argued, inter alia, that the Bank compelled the plaintiffs to purchase these insurance policies as a condition for signing the loan and mortgage agreements. The amount set in the class-action suit is NIS 500 million, with no specific allocation to the banks involved. Whereas, with respect to another request to approve an action as a class action, in a matter practically identical, the Court had already handed down its decision, which was appealed against, the Judge presiding in this case has decided that it will be heard only after the Supreme Court will issue a judgment in principle on the matters in dispute that were raised in the appeal against the ruling already given with respect to the other motion.

At the hearing held on January 6, 2002, the Court decided to defer the hearing of the case to an undefined future date, anticipating the decision in principle of the Supreme Court. It should be noted that on April 3, 2003 the Supreme Court ruled in another case (not related to the banking sector). The Court ruling states that the effectiveness of Regulation 29 (of the Civil Proceedings Regulations) should be interpreted in a narrow manner, an interpretation that supports the Banks' claim in the matter. A verdict has also been given in an additional hearing in this case at the Supreme Court, according to which it is not possible to file a class action suit under Regulation 29 of the Civil Code Regulations.

In a preliminary hearing held on January 26, 2006, the plaintiff waived the cause of action in as much as they rely on the said Regulation 29. The hearing of this action was again suspended with no date.

14.5.2 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 scope claimed. According to the indictment, in the future the petitioners will append professional opinions prepared by an appraiser and accountant.

The plaintiffs requested an exemption from Court fees in respect of this claim 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.

The plaintiffs submitted in August 2007 supplementary depositions and additional documents, this in response to the arguments of the State and the defendants claiming that the plaintiffs did not comply with their duty to submit full information as to their economic situation. On December 24, 2007, the Court dismissed the motion for exemption from Court fees ruling that the Plaintiffs did not convince the Court that the shareholders of the plaintiff companies were unable to raise funds to cover the Court fees. Following this ruling, the Plaintiffs requested the withdrawal of their claim.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

14.6 Hereunder are details regarding a class action suit, which has been appealed against as such:

A lawsuit was filed on September 12, 2006, against the Bank, Bank Leumi Le'Israel Ltd. ("Bank Leumi") and Bank Hapoalim Ltd. ("Bank Hapoalim") (together: "the defendant banks"), as well as a motion for approval of the lawsuit as a class action suit. The Plaintiff assessed the amount claimed at NIS 7 billion in respect of all the defendant banks, reserving the right to amend this amount in accordance with developments during the course of the litigation.

The Plaintiff argued that most of the credit to the public is concentrated in the hands of the defendant banks, and that they coordinated among themselves the prices applying to five parameters: the basic interest rate charged on loans (prime rate); the risk increment; interest rate charged on overdrawn amounts; credit facility commission and ledger fees (together: "the five parameters") in everything relating to accounts of non-linked Shekel loans in general and with respect to revolving commercial credit accounts in particular.

The Plaintiff alleges that the similarity in prices of the five parameters at the defendant banks indicates the existence of coordination between them. This, according to the Plaintiff, resulted in huge profits to these banks and caused enormous damage to the public and to the economy. Part of the arguments in the lawsuit is based on the findings of the Bachar Committee and on the Bank of Israel data and the financial statements of the defendant banks for the years 1998-2005.

The Plaintiff argued that it has a cause of action both under the Restrictive Trade Practices Law (Antitrust Law), there being a prohibited binding arrangement, and under the Banking Law (Customer Service), as it is argued that the defendant banks exploited customers' distress, their ignorance and inexperience in order to provide them with banking services under unreasonable terms.

The Plaintiff claims in respect to the personal damage caused to her in the management of her bank account and requested permission to sue on behalf of all customers of the defendant banks that had been granted non-linked shekel loans at the prime interest rate, and/or that paid a credit facility commission at the uniform rate and/or a uniform interest rate on overdrawn amounts, as well as on behalf of all the commercial customers that had been granted a revolving non-linked Shekel credit facility and were charged a rate of interest based on the prime rate and/or with the addition of the maximum risk increment at a uniform rate and/or credit facility allocation commission at a uniform rate and/or with the addition of a uniform interest rate on overdrawn amounts and/or fixed ledger fees in a uniform amount.

The relief requested by the Plaintiff is a retroactive reduction in the prices of the five parameters charged during the past ten years for all customers of the defendant banks. Alternatively, the Court is asked to rule a different relief in favor of all members of the class or in favor of the public.

The Bank has filed a response to the motion for approval of the lawsuit as a class action suit.

On January 21, 2007, the District Court admitted the Plaintiff's motion to recognize the lawsuit as a class action suit on grounds derived from the Restrictive Trade Practices Law (hereinafter: "the decision of the District Court").

In its ruling, the Court noted, inter-alia, that the Antitrust Authority (hereinafter: "the Authority") is conducting a widespread criminal investigation "the largest ever conducted by the Authority regarding suspicion of felonies committed by the banking industry in contravention of the Restrictive Trade Practices Law, 1988", as noted in the letter of the legal counsel for the Antitrust Authority dated May 20, 2007, which had been attached by the Plaintiff to the material presented to the Court. On March 19, 2008, the Bank received a summons for a hearing before the Authority. The summons states that in view of the findings of the investigation by the Authority, the Antitrust Commissioner (hereinafter: "the Commissioner") is considering acting on her authority under the Law and determine that binding arrangements had in fact existed between Bank Hapoalim, Bank Leumi, Mizrahi Bank, the First International Bank and the Bank, the objective of which was transmittal of information regarding commissions.

The summons detailed matters to which the Commissioner is considering, inter-alia, to relate in arriving at her determination, and the



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

Bank was given the opportunity to present its position to her in writing before the Antitrust Commissioner decides whether to act on her authority as above stated. The position of the Bank has not yet been submitted.

The Bank intends to apply to the Supreme Court for permission to appeal the decision of the District Court. According to a procedural arrangement which was granted on November 27, 2006, the power of a court ruling, the hearing of the class action by the District Court is to be stayed until the Supreme Court gives its ruling on the motion for approval of the appeal or on the appeal itself, as the case may be.

14.7 On June 19, 2006, an action was filed 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 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 for the restitution claim 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. On February 10, 2008, the Tel Aviv District Court dismissed the motion of Discount Bank, Mercantile Discount Bank and the provident funds to dismiss in limine the motion for approval of the suit as a class action suit. The Court dismissed the motion only as against the insurance companies. dismissed the motion only as against the insurance companies. On March 23, 2008 the Bank applied for permission to appeal to the Supreme Court against the decision of the District Court.

14.8 On November 23, 2006, a lawsuit was filed to the Jerusalem District Court together with a motion for its approval as a class action suit against the Bank, Bank Hapoalim Ltd. and Bank Leumi Le Israel Ltd. ("the defendant banks"). 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 "a concentration group", which according to them misuses its monopolistic power, while reducing competition and causing harm to the public 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 - misleading consumers with respect to the accepted price for credit service to the household sector and to the determination of interest rates.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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

bank accounts. The personal claim of each member is assessed by the claimants at 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.

The Bank has motioned for a stay in proceedings in view of the Court ruling in the case described in item 14.6 above. A decision in the matter has not yet been given.

- 14.9** On January 31, 2007, members of provident funds and of further education funds filed a lawsuit 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 responded to the motion for approval of the class action. A date for the hearing has not yet been fixed.

- 15.** 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:

A class action suit and requests to approve certain actions as class action suits are pending against the Bank and its consolidated subsidiaries, which in the opinion of the Bank's, 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 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.

- 15.1** A request to approve a certain action against the Bank as class actions:

On December 8, 2002, a lawsuit was filed against the Bank and against Mercantile Discount Bank together with a plea to have it approved as a class action suit under the Banking Law (Customer Service) 1981. This lawsuit was filed by a former customer of the Bank and of Mercantile Discount Bank, who in the past filed a suit on the same ground and a plea to have it approved as a class action suit under the Securities Law, which lawsuit was rejected as a result of non payment of Court fees.

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 is a Bank customer and granted credit to hundreds of "Straw Customers" without obtaining collateral.

It is also alleged that, at a later stage, the Bank enabled the manipulation in the price of the shares. The plaintiff alleges that in doing so, the Bank violated the Securities Laws (Dispersion obligations, reporting obligations, responsibility for misstatement in a Prospectus and fraudulently manipulating the price of the shares), violating the Banking Laws (Banking Rules (Customer Service) [Investment consulting]), violated proper banking procedures, caused damaging injustice (negligence, fraud and violation of legal obligations) and also performed illegal acts.

It should be noted that the corporation and its Chief Executive Officer were indicted in criminal proceedings to which the Bank was not a party.

The plaintiff estimates that the damage caused to him amounts to NIS 5.7 million. The total amount of the damage stated in the



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

petition for a class action against the Bank and Mercantile Discount Bank together is NIS 500 million.

The Bank and Mercantile Discount Bank have submitted several preliminary pleas, including a plea for dismissal of the action due to the non-payment of Court fees, pleas for summary dismissal of the action, due to duplicate proceedings and misuse of the judicial process, and a plea for deleting documents and items from the claim brief. A date for the hearing the said pleas has not been fixed as yet.

The Court has deferred the date by which the reaction to the request for approval may be submitted until such time as these requests are decided, so that in effect, at this stage, the proceeding is in practice delayed until the decision on the preliminary requests.

On October 23, 2006, the District Court admitted one of the preliminary motions served by the Bank and Mercantile Discount Bank, and ordered the appellants to pay the Court fees in respect of the personal claim of each of them by November 30, 2006. The fee that the appellants were ordered to pay amounts to NIS 70 thousand. The Court also ruled that if the appellants do not comply, their motion to approve their claim as a class action would be dismissed. As to the other preliminary motions, the Court has decided to hear them only after evidence of fees remittance, as ordered, is presented.

On November 20, 2006, the appellants paid NIS 20 thousand in respect of the first half of the Court fees. On November 30, 2006, the Bank petitioned the Court for dismissal of the claim following the non-payment of the full amount of the first half of the Court fees, as alleged by the Bank. No decision has yet been received in this regard.

See section 14.2 above for details of the action filed against Mercantile Discount Bank in relation to the same subject matter, based on other grounds. For details of an additional action filed against the Bank and against a third party in relation to the same subject matter, see Section 14.3 above.

15.2 On September 1, 2004, an application for exemption from the Court fee was submitted 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 partially accepted 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 \$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. At a preliminary hearing held on December 6, 2007, the Court fixed the dates for submitting preliminary litigation motions by the Plaintiffs and the Defendants. The Bank filed on January 16, 2008, a request for amendment of the claim brief that had been filed against the Bank so that the amount claimed thereby would be correctly defined. On February 28, 2008, the Bank motioned for the in limine dismissal of the claim on grounds of limitation. The Plaintiffs submitted on February 10, 2008, a motion for the stay of proceedings in this case until they form their position in view of the Court ruling to dismiss the case against a number of the defendants on grounds of limitation. No decisions have as yet been given regarding the motions stated above.

15.3 A request to approve a certain action against Discount Mortgage Bank ("DMB") as class action suit:

On June 19, 2000, two borrowers of DMB filed with the District Court a petition for approval of an action as a class action suit against DMB and against the Israel Phoenix Insurance Co. Ltd. ("Phoenix"), where the properties of the borrowers are insured. The action is for an amount of NIS 105 million.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, since the insured amounts included the land component, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

On September 10, 2000, DMB filed its response to the petition for approval of a class action suit, in which the Court is requested to dismiss the petition in limine and as regards its substance. It should be noted that Phoenix Insurance also responded to the petition requesting the Court dismiss the petition in limine and as regards its substance.

On October 29, 2000, the claimants submitted their reply to the above response, in which they repeat the request for approval of a class action suit.

On December 25, 2000, the Court decided that the arguments raised in this petition were similar to the arguments raised in the pleas for approval of class actions discussed in 14.5.1 above, and consequently the Court decided to defer the hearing of the said petition until after the verdict is given in those other pleas. The Supreme Court rejected on April 4, 2001, a plea for permission to appeal this decision. In its decision of December 25, 2000, the District Court did not determine that proceedings against Phoenix Insurance should also be deferred. Phoenix Insurance petitioned the Supreme Court for permission to appeal in this respect. On January 28, 2002, the Supreme Court admitted the plea of Phoenix Insurance and ordered to stay proceedings against it at the District Court as well.

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. The case was transferred for hearing at the District Court of the Central Region, and the hearing fixed for January 7, 2008, was cancelled.

The District Court of Central Region decided to suspend the hearing of the case until after a ruling is given at the Supreme Court, in accordance with the decision that had already been taken in this case by the District Court in 2000.

- 15.4** On December 12, 2007, a company (and its parent company) which had been financed by Discount Mortgage Bank for the construction of a commercial center, filed a lawsuit against the bank. According to Discount Mortgage Bank's records, the company's debt amounts to NIS 63 million. The company requested the Court for a declaratory relief stating that the company does not owe any money to Discount Mortgage Bank, and in addition that this bank owes the company an amount of NIS 25 million. Together with the filing of the lawsuit, the company motioned for an exemption from Court fees. The Plaintiff claimed that Discount Mortgage Bank was negligent in foreclosing on the mortgage attached to real-estate mortgaged in its favor, principally in that it dragged its feet in selling the property. Among other things, it is argued that Discount Mortgage Bank violated the duty of care, the fiduciary duty, did not conduct itself in good faith contrary to accepted conduct and has damaged the Plaintiff.

Court fees have not been paid in respect of this suit, therefore permitting the lawsuit to remain or permitting the amount claimed is subject to the Court's approval, which has not yet been granted. The Attorney General in his response to the motion for exemption from Court fees opposed the motion and the Plaintiff has submitted its reaction to the response of the Attorney General.

The parties are negotiating for an outside courtroom compromise agreement, and under these circumstances an extension has been granted for the submission of a response to the motion for exemption from Court fees 30 days from the date on which either party informs that the negotiations have failed.

- 15.5** Israel Discount Capital Markets and Investments Ltd. ("DCMI") – a legal procedure.

On December 21, 1999, an indictment was filed with the Magistrate Court in Tel-Aviv against several parties including DCMI and its two former employees. The felonies attributed to DCMI and the said two employees, constitute violations of the Securities Law, which allegedly were committed during the years 1994 and 1995.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

DCMI denied the accusations. On May 18, 2006, the court decided, among other things, to acquit DCMI and its two former employees from the charges brought against them.

On June 26, 2006, the State Attorney placed an appeal against this verdict. The hearing of the appeal was fixed for June 5, 2008.

- 15.6** A lawsuit was filed on April 1, 2007 with the Tel Aviv District Court against the Bank, Bank Hapoalim, Bank Leumi, First International Bank, Harel Investment House Ltd., Clal Finance Batuchah Investment Management Ltd. and Migdal Stock Exchange Services (N.E.) Ltd., together with a motion for approval of the lawsuit as a class action. The Plaintiffs argue 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 regulation 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 amount of approximately NIS 62 million.

The Bank has responded to the motion for approval of a Class Action Suit. A date for a hearing has not yet been fixed.

- 15.7** 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 is not presenting any supporting evidence tying the Bank to the activities forming the basis of the actions brought against it. The Bank, Mercantile Discount Bank and IDB New York filed a motion for the in limine dismissal of the third party notice. The Bank and Mercantile Discount Bank argue that the Court in the United States has no international jurisdiction and that the forum in the United States not appropriate. All the banks argue that no possibility exists of filing a third party notice in actions based on anti-terror legislation.

In a response filed by Arab Bank, it was argued, among other things, that the US judiciary system has a judiciary authority with respect to Discount Bank and Mercantile Discount Bank due to the fact that IDB New York constitutes the long-arm of IDB New York, which is sufficient to apply authority onto the entire Discount Group. A response on behalf of Discount Group was submitted on November 30, 2007. The Plaintiffs also oppose the motion for a third party notice in these claims.

A date has not yet been fixed for the hearing of the motions submitted by the banks and the Plaintiffs.

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.

At the beginning of February 2008, Arab Bank filed with the New York Court third party notices within the framework of an additional

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

claim filed against it. The third party notices were served against the Bank, Mercantile Discount Bank and IDB New York. The Plaintiffs in this case are Soldiers in the Israeli Defense Forces (IDF), citizens of the United States, who were injured during their military service in the IDF. The arguments of Arab Bank are similar to those presented in previous claims, though in the present case additional arguments have been raised according to which the Israeli banks knew that certain bank transfers had been forbidden and were intended for informal purposes, or that the banks negligently turned a blind eye to such information. The banks also intend to file a motion for an in limine dismissal with respect to the said third party notices.

- 15.8** On September 25, 2007, a lawsuit was filed with the Tel-Aviv District Court together with a motion for approval of the lawsuit as a class action against the Bank. The plaintiff estimates the claim at NIS 61 million.

The claim is based on the argument that the Bank has unduly charged his customers with a commission on the purchase/sale of securities. According to the plaintiff the Bank has charged a minimum commission in respect of each partial performance of one purchase order that was divided into several sub-transactions. As a result the total amount of commission paid by the customer was higher than the amount that would have been paid had the purchase been executed in one transaction.

The Bank has responded to the motion for approval of a Class Action Suit. A date for a hearing has not yet been fixed.

In the opinion of the Bank's Management, the claim is most excessive.

- 15.9** On September 25, 2007, a lawsuit was filed with the Tel-Aviv District Court together with a motion for approval of the lawsuit as a class action against the Bank. The Plaintiffs argue that the Bank has cancelled the benefit granted to customers setting up deposits through the Internet without providing full disclosure to customers as to the rate of the benefit being cancelled; that the Bank has unduly collected a purchase/sale commission on participation units in mutual funds; that the Bank has charged excessively minimum securities deposits management fees in certain cases and/or has charged excessively a minimum commission on securities transactions.

The plaintiffs state a personal damage of NIS 205. They estimate the damage caused to the class as a whole at about NIS 219 million. It should be noted that the plaintiffs have stated the amounts arbitrarily without any evidential basis in support of their calculations. At face value, the claimed amount seems to be extremely excessive.

- 15.10** A motion for exemption from Court fees regarding a lawsuit in the amount of NIS 96 million filed with the Tel Aviv District Court on February 6, 2008. The motion was filed by the controlling shareholder of a company, being a debtor of the Bank, in respect of which both a receivership order and a liquidation order had been issued.

The Plaintiff claims that the Bank, in a negligent manner lacking good faith, had applied for a receivership order against the company and at a later date also applied for an order to liquidate the company despite the fact that the total value of the company's assets exceeded the amount of the debt to the Bank.

The Plaintiff attributes to the Bank the responsibility for the acts and/or omissions of the Receiver and/or of the Liquidator of the company, which as alleged by him, caused the company heavy damage.

On the face of it, the claim against the Bank has no legal and/or factual grounds and the amounts claimed are most excessive.

As long as exemption is not granted or the Court fee is not paid, the lawsuit is not considered as filed. At this early stage where the response to the motion for exemption has not yet been submitted, it is not possible to assess the prospects of the claim.

- 16.** Certain requests for approval of class actions against FIBI:

The financial statements of FIBI 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 FIBI, after consulting with legal advisors, is unable to estimate, at



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

this stage, the prospects of these claims and therefore no provision has been made therein, make mention 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 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 assurance 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 a fundamental decision is to be given in the matter of the status, applicability and terms of Section 29 of the Civil code Regulations, a question standing at the heart of the said appeal.

On April 2, 2003, a judgment was given in that other appeal in the matter of 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 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. Until the date of publication of these financial statements, no such motions have been filed by any of the claimants as stated above. Gross earnings recorded by FIBI Group's mortgage activity, from management fees and services in respect of life assurance and property insurance of borrowers provided as collateral within the mortgage activity, amounted in 2007 to NIS 16 million, compared with NIS 21 million 2006. If the said motions were granted, the earnings of FIBI Group would be significantly reduced.

17. Israel Discount Capital Markets and Investments Ltd. (“DCMI”) is a partner in several venture capital funds, private investment funds and in this respect is obligated to invest in these funds.

As of December 31, 2007, DCMI has a commitment to additional investments in 16 such entities amounts totaling US\$247.3 million (as of December 31, 2006, US\$39 million).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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. As of December 31, 2007, guaranties have been provided in the amount of NIS 37.7 million. In 2007, guarantees in the amount of NIS 7 million provided by DCMI were realized.

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. Following the difficulties encountered in reaching agreements with respect to the addendum to the shareholders' agreement as well as in view of certain business developments in Menif, DCMI is negotiating with the Seller as to the amendment of the agreement for the purchase of his rights in Menif.

In addition, as of December 31, 2007, the Bank is committed to invest US\$4.18 million in a venture capital fund. Furthermore, Mercantile Discount Bank has a commitment to invest in five venture capital funds amounts totaling NIS 3 million, as of December 31, 2007 (as of December 31, 2006 – NIS 4 million).

18. Sale of properties:

- a) On September 19, 2002, the Bank signed an agreement for the sale of a warehouse area in Ashdod of some 37 dunums, in consideration for US\$6.1 million.

The Bank is committed to lease an area of some 15.2 thousand square meters, of which a built-up area of 6.5 thousand square meters, for a period of 11 years, at an annual cost of US\$309 thousand.

- b) On June 4, 2004, the Bank signed an agreement with another party for the sale of the building in Ramat-Gan, which had previously been designed to serve as the offices of the Bank's management, as well as for the sale of additional rights in the property, present and future. The proceeds of the sale amount to NIS 229 million.

The bank has undertaken to lease for a period of ten years an area of 430 sq. mtrs. in the commercial floor and an area of 2,145 sq. mtrs. in the office floors, in consideration for US\$578 thousand per annum (two floors out of the 20 floors being built).

19. Mercantile Discount Bank has committed to compensate the members of the "Mercantile Central Severance Pay Fund" in the event that the value of their rights in the Fund falls below the nominal amount deposited by them with the Fund. As of December 31, 2007, the nominal amount deposited by members of the Fund, in respect of which the commitment had been given, totaled NIS 103 million. Mercantile Discount Bank's exposure as at December 31, 2007 (with respect to the negative difference between the value of members' rights and the nominal amount deposited by them, as stated) amounted to NIS 16,000. Mercantile Discount Bank computed the fair value of this liability based on an actuarial valuation according to the guidelines of the Supervisor of Banks. A provision in respect of this liability is included in the item "Other liabilities" in the balance sheet. A legislation amendment has recently been passed according to which admittance of new members into central severance pay funds shall be disallowed in the future. According to an agreement between Mercantile Discount Bank and the purchasers of the control over the operations its provident funds, of Mercantile Discount Bank's guarantee will expire in August 2011 at the latest.



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

20. The sale of KAHAL. On May 26, 2006, the Bank, Bank Leumi Le'Israel Ltd., 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 further education 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 net profit derived from this transaction reached NIS 73 million, and was recorded in 2007.

21. 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 (services provided till then by Yahav Bank 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 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 in locations 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 or in government centers, as detailed in the agreement, and in three branches located in hospitals. In these locations, Yahav Bank branches are presently located. The agreement does not include the government's commitment to vacate these branches.

Following the success in the public tender, competition has developed between the Bank and Yahav Bank with respect to the provision of services to State employees, which, inter-alia, was reflected in an advertising campaign launched by Yahav Bank to attract new

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

customers and to preserve existing customers from among State employees, as well as in a motion to the Supreme Court (see hereunder).

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.

Shortly after attaining the tender the Bank had begun preparations to modify the Bank's computer systems to accommodate the operations required by the tender. All the developments required in order to adapt the computer systems have been completed. Concurrently, great effort has been invested in construction: renovation of existing branches and setting up new branches. The Bank has complied with the time schedules determined in the tender.

The initial cost in 2007 of the preparations for providing the said services amounted to NIS 38 million, not including expenses in respect of manning the branches.

The Bank estimates that the cost of preparations for the provision of services in 2008 will reach an additional amount of NIS 21 million. 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. To the best of the Bank's knowledge, the Accountant General decided that Yahav Bank shall continue to handle the existing loan portfolio.

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. Yahav Bank's main argument 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.

On September 11, 2007, the Court decided to dismiss the plea.



19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

As part of the decision, the Bank declared that it had acted and will continue to act in accordance with the law and with the terms of the public tender, without prejudicing Yahav Bank's right to apply to the Supervisor of Banks in this respect.

The approval of the Bank of Israel for the opening of special branches was received on September 24, 2007, as well as an approval for opening of 25 special branches, as part of the Bank's preparations for the implementation of the terms of the tender.

The permit expired on December 31, 2007, and on January 1, 2008, the Bank was granted an additional permit to operate special branches and to transact business with State employee customers. This permit is in effect until April 30, 2008.

Additional motion to the Supreme Court. On February 13, 2008, Yahav Bank filed an additional motion with the Supreme Court against the Minister of Finance, the Accountant General at the Ministry of Finance and against Discount Bank. Within the framework of the motion, the Court was asked to issue orders whereby Yahav Bank would be able to continue the direct deduction of loan repayments granted by this bank from State employees' pay slips.

Within the framework of the motion Yahav Bank argues that the new criteria determined by the Accountant General for direct deduction of amounts from State employees' pay slips are criteria that discriminate in favor of Discount Bank and constitutes unwarranted interference on the part of the Accountant General in favor of Discount Bank within the context of the competition between the banks.

In addition Yahav motioned for an interim order whereby it would be able to continue the direct deduction from State employees' pay slips of the repayments of loans granted by it, until the Court's ruling in the matter is given.

The Bank has responded to the motion.

On March 24, 2008, The Supreme Court ruled that there was no cause for the issue of an Interim Order. The State and the Bank have submitted their response to the motion and requested its dismissal.

22. Investment in activities abroad.

In September 2007 an agreement for investment in two companies owned by

Mayer Cars and Trucks Co. Ltd. (hereinafter: "the Mayer Group") was signed. The Bank, through DCMI, has committed itself to investing an amount of up to Euro 40 million in Mayer (Keshet) Real Estate Ltd. (hereinafter: "Mayer Real Estate") and an amount of up to Euro 30 million in Mayer Europe Ltd. (hereinafter: "Mayer Europe").

The Bank's said commitment is subject to a parallel commitment on the part of Mayer Group to invest an amount of up to Euro 160 million in Mayer Real Estate and an amount of up to Euro 120 million in Mayer Europe. Mayer Real Estate is a holding company established at the beginning of 2007, centralizing the entrepreneurial real estate activities of the Mayer Group in Israel and abroad, including the hotel field. Mayer Europe is a holding company established in 2006, centralizing the leasing, trading, rental and import activities of new and used private vehicles of Mayer Group in European countries. Mayer Europe holds the Hertz leasing franchise in Hungary and might enter similar operations in additional countries in the near future.

The investment in the said companies would entitle DCMI to an equity interest of 20% and to the right to appoint one of five Directors in each of these companies.

Up until December 31, 2007, DCMI invested an amount of Euro 7.3 million in the two companies of the Mayer Group.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE GENERAL

1. Transactions in derivative financial instruments involve market, credit and liquidity risks.
 - a. The activity of the Bank involves exposure to various risks, including market risk. The market risk includes, inter-alia, linkage base, interest and exchange rate fluctuation risks, in the correlation characteristics between the various economic parameters, etc. As part of the overall Bank's strategy for the management of market risk, as stated above, the Bank combines in its financial asset and liability management and as a market maker, a wide range of derivative financial instruments. Among these financial instruments are: Forward transactions, IRS, FRA, SWAP, options purchased or written by the Bank, which hedge against changes in foreign currency exchange rates, inflation rates, interest rates, share indices, embedded options, etc.
 - b. The credit risk involved in these transactions derives from the fact that the stated amount of the transaction does not necessarily reflect its credit risk. Such risk is measured according to the maximum amount of the loss that the Bank might sustain if the other party to the transaction will not honor its terms, net of amounts subject to enforceable set-off agreements.
 In computing the fair value, the Bank takes into consideration the credit risk relating to the counter party to the transaction, as regards two categories: customers and banks, considering the type of the product.
 The credit risk during the period of engagement is assessed at the amount that a similar engagement would have cost, had it been entered into at the reporting date with the same customer and for the period remaining until its expiration. The Bank's policy as regards the collateral required in respect of customer derivative financial instrument transactions resembles the policy regarding other credit granted, excluding customers' Ma'of activity. The collateral comprises various types. The Bank may also grant to customers' credit facilities without collateral, as the case may be.
 - c. Market liquidity risk derives from the fact that it might not be possible to contain rapidly the exposure involved, mainly in markets of low level trading.
2. Where a derivative instrument is not intended as a qualified hedging, it is stated according to its fair value, changes in fair value being taken currently to income. Certain of these derivatives are intended and qualified as fair value hedging and cash flow hedging, while others are purchased or written as part of the asset and liability management of the Bank (ALM).
3. It is possible for the Bank to enter an agreement that in itself does not constitute a derivative instrument but which contains an embedded derivative. In respect of each contract the Bank evaluates whether the economic characteristics of the embedded derivative are not clearly and closely connected to those of the hosting agreement, and examines whether an independent instrument with the same terms of the embedded instrument would have agreed with the definition of a derivative instrument. Where the above terms are fulfilled, the embedded derivative is separated from the host agreement, treated as a derivative in its own right and stated in the balance sheet together with the host agreement at its fair value, changes in its fair value being taken currently to income. Where the Bank is unable to reliably identify and measure an embedded derivative for the purpose of its separation from the host agreement, the agreement as a whole is stated in the balance sheet at fair value.
4. The Bank maintains a written documentation of all hedging relations between hedging instruments and the items hedged, as well as the object and strategy of risk management by way of creating the various hedging transactions. The documentation includes the specific identification of the asset, liability, the firm commitment or the anticipated transaction, which were determined as the hedged item, and the manner in which the hedging instrument is expected to hedge against risks involved in the hedged item. The Bank assesses the effectiveness of hedging relations both at the beginning of the transaction and on a continuing basis, in accordance with its risk management policy.



20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE (CONTINUED)

5. The Bank discontinues its hedging accounting from the following points onward when:
 - a. It has been determined that the derivative is no longer effective, setting off the changes in fair value or the cash flows of the hedged items;
 - b. The derivative has expired, cancelled or realized;
 - c. The designation of the derivative as a hedging derivative is discontinued, due to the probability of the execution of the transaction being remote.
 - d. A firm hedging commitment no longer complies with the definition of a firm commitment.
 - e. Management cancels the designation of the derivative as a hedging derivative.

When hedging accounting is discontinued due to the fact that a derivative is no longer qualified as hedging an effective fair value, the derivative will continue to be stated in the balance sheet at its fair value, however the hedged asset or liability will no longer be adjusted for changes in fair value. When hedging accounting is discontinued due to the fact that the hedged item no longer qualifies as a firm commitment, the derivative will continue to be stated in the balance sheet at fair value and every asset or liability which previously were stated based on the recognition as a firm commitment shall be removed from the balance sheet and recognized as income or loss for the reported period.

The net income or loss in respect of derivatives related to discontinued hedging of cash flow, will continue to be stated as part of other cumulative comprehensive profit, unless it is probable that the anticipated transaction will not materialize until the end of the initially determined time period (as documented at the beginning of the hedging relations) or within a period of two months thereafter. Notwithstanding the above, on rare occasions, the existence of mitigating circumstances related to the nature of the anticipated transaction, which are not subject to the control or influence of the Bank, might indicate the probability that the anticipated transaction would in fact materialize at a date subsequent to the end of the additional two month period. In such a case, the net profit or loss in respect of the derivative, which hedges the discontinued cash flow, will continue to be reported as part of other cumulative comprehensive profit, until they are reclassified when the anticipated transaction will affect the income statement. If it is probable that the additional period of two months and the anticipated hedged transaction do not fall even under the exception mentioned above, the profit or loss reported as part of other cumulative comprehensive profit, are to be immediately reclassified to the income statement.

FAIR VALUE HEDGING

6. Certain derivatives are being designated by the Bank as hedging fair value. The changes in the fair value of derivatives hedging against exposure to changes in fair value of an asset or liability, are currently recognized in the income statement, as well as the changes in the fair value of the hedged item, that could be related to the risk being hedged.

In 2007, the Bank did not record any expenses in respect of the lack of effectiveness related to fair value hedging in the item "Income from financing operations (before provision for doubtful debts") (In 2006: NIS 0.02 million).

CASH FLOWS HEDGING

7. The Bank designates certain derivatives as hedging against cash flows. The accounting treatment of changes in derivatives hedging against exposure to changes in the cash flow derived from an asset, liability or an anticipated transaction depends on the effectiveness of the hedging relations.

The effective part of the change in the fair value of the derivative designated to hedge cash flow, is initially recognized in the shareholders equity (and not in the income statement) as a component of other comprehensive profit, and later on, when the anticipated transaction affects the income statement, it is reclassified to the income statement.

The non-effective part of the change in the fair value of the derivative designated as above is forthwith recognized in the income statement.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)**A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS****1. Par value of derivative instruments**

	December 31, 2007				
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
	in NIS millions				
A. Hedging derivatives⁽¹⁾					
Forward contracts	-	-	114	-	-
Swaps	-	995	-	-	-
Total	-	995	114	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate		741			
B. ALM derivatives⁽¹⁾⁽²⁾					
Futures contracts	-	124	-	-	-
Forward contracts	1,690	11,715	31,963	-	-
Other option contracts:					
Options written	-	-	9	-	-
Options purchased	-	-	239	2	-
Swaps	-	38,136	3,653	-	-
Total	1,690	49,975	35,864	2	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	19,985			
C. Other derivatives⁽¹⁾					
Forward contracts	60	1,299	639	1,805	255
Marketable option contracts:					
Options written	-	-	1,097	5,140	
Options purchased	-	-	1,053	5,140	
Other option contracts:					
Options written	-	1,389	12,394	352	84
Options purchased	-	1,430	11,575	364	103
Swaps	-	2,647	-	-	-
Total	60	6,765	26,758	12,801	442
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	334			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	6,929	-	-

Footnotes:

(1) Excluding credit derivatives and SPOT foreign currency swap contracts.

(2) Derivatives comprising a part of the asset and liability management system which were not designated for hedging relations.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)

1. Par value of derivative instruments (CONTINUED)

	December 31, 2006				
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
in NIS millions					
A. Hedging derivatives⁽¹⁾					
Forward contracts	-	-	175	-	-
Other option contracts					
Options purchased	-	-	6	-	-
Swaps	-	*800	-	-	-
Total	-	800	181	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	770			
B. ALM derivatives⁽¹⁾⁽²⁾					
Futures contracts	-	216	-	-	-
Forward contracts	340	*2,616	27,596	-	-
Marketable option contracts:					
Options purchased	-	-	-	1	-
Other option contracts:					
Options written	-	-	43	-	-
Options purchased	-	*37	297	1	-
Swaps	-	*16,190	*2,907	-	-
Total	340	19,059	30,843	2	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	7,797			
C. Other derivatives⁽¹⁾					
Futures contracts	-	582	-	-	-
Forward contracts	200	2,798	170	1,449	3,064
Marketable option contracts:					
Options written	-	-	508	5,641	-
Options purchased	-	-	487	5,624	-
Other option contracts:					
Options written	-	445	10,438	706	23
Options purchased	-	512	10,750	*754	*24
Swaps	-	983	-	-	-
Total	200	5,320	22,353	14,174	3,111
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	259			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	4,879	-	-

* Reclassified.

Footnotes:

(1) Excluding credit derivatives and SPOT foreign currency swap contracts.

(2) Derivatives comprising a part of the asset and liability management system which were not designated for hedging relations.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)**A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)****2. Gross fair value of derivative instruments**

December 31, 2007					
	Interest rate contracts		Foreign	Contracts	Commodities
	Shekel/CPI	Other	currency contracts	on shares	and other contracts
in NIS millions					
A. Hedging derivatives					
Positive gross fair value	-	18	2	-	-
Negative gross fair value	-	19	3	-	-
B. ALM derivatives					
Positive gross fair value	10	312	833	-	-
Negative gross fair value	22	342	806	-	-
C. Other derivatives					
Positive gross fair value	1	50	409	180	21
Negative gross fair value	1	72	360	170	20

December 31, 2006					
	Interest rate contracts		Foreign	Contracts	Commodities
	Shekel/CPI	Other	currency contracts	on shares	and other contracts
in NIS millions					
A. Hedging derivatives					
Positive gross fair value	-	*11	4	*-	*-
Negative gross fair value	-	*19	*-	-	-
B. ALM derivatives					
Positive gross fair value	9	*90	451	-	-
Negative gross fair value	-	*153	*544	-	-
C. Other derivatives					
Positive gross fair value	-	58	303	*333	*35
Negative gross fair value	-	202	242	127	29

* Reclassified.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

B. DERIVATIVE INSTRUMENT CREDIT RISK BASED ON THE COUNTERPART TO THE CONTRACT, ON A CONSOLIDATED BASIS

December 31, 2007					
	Stock markets	Banks	Dealers/ brokers	Others	Total
In NIS millions					
Gross positive fair value of derivative instruments ⁽¹⁾	58	1,010	47	721	1,836
Net of set-off agreements	19	-	-	145	164
Balance of assets deriving from derivative instruments ⁽²⁾	39	1,010	47	576	1,672
Off-balance sheet credit risk in respect of derivative instruments ⁽³⁾	144	8,657	68	2,090	10,959
Total credit risk in respect of derivative instruments	183	9,667	115	2,666	12,631

Footnotes:

(1) Of which, NIS 155 million of positive gross fair value of derivative instruments.

(2) Of which, a balance of non-related derivative instruments of NIS 1,517 million reflected in the item "Other assets".

(3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness.

December 31, 2006					
	Stock markets	Banks	Dealers/ brokers	Others	Total
In NIS millions					
Gross positive fair value of derivative instruments ⁽¹⁾	42	445	88	719	1,294
Net of set-off agreements	15	-	-	128	143
Balance of assets deriving from derivative instruments ⁽²⁾	27	445	88	591	1,151
Off-balance sheet credit risk in respect of derivative instruments ⁽³⁾	138	4,375	163	1,807	6,483
Total credit risk in respect of derivative instruments	165	4,820	251	2,398	7,634

* Reclassified.

Footnotes:

(1) Of which, NIS 277 million of positive gross fair value of derivative instruments.

(2) Of which, a balance of non-related derivative instruments of NIS 874 million reflected in the item "Other assets".

(3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)**C. DUE DATES - PAR VALUE: CONSOLIDATED YEAR END BALANCES**

December 31, 2007					
	Up to 3 months	From 3 months to 1 year	From 1 Year to 5 years	Over 5 years	Total
In NIS millions					
Interest rate contracts					
Shekel/CPI	1,080	170	300	200	1,750
Other	10,895	16,783	19,703	10,354	57,735
Foreign currency contracts	42,993	19,705	3,442	3,525	69,665
Contracts on shares	11,492	446	865	-	12,803
Commodities and other contracts	192	71	179	-	442
Total	66,652	37,175	24,489	14,079	142,395

December 31, 2006					
	Up to 3 months	From 3 months to 1 year	From 1 Year to 5 years	Over 5 years	Total
In NIS millions					
Interest rate contracts					
Shekel/CPI	50	430	60	-	540
Other	3,600	10,731	7,866	2,982	25,179
Foreign currency contracts	32,299	20,976	2,884	2,097	58,256
Contracts on shares	12,362	1,060	754	-	14,176
Commodities and other contracts	3,062	2	47	-	3,111
Total	51,373	33,199	11,611	5,079	101,262



21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS

A. GENERAL

The instruction of Bank of Israel regarding the determination of the fair value of financial instruments (the “instruction”), was applied based on the methods and principal assumptions described hereunder. Nothing in the data presented hereunder should be taken as an indication of the economic value of the Bank, nor does the data purport to assess such value.

B. FAIR VALUE OF FINANCIAL INSTRUMENTS

Most of the financial instruments of the Bank do not have a ready “market price” because there is no active market in which they are traded. Therefore, in accordance with the instruction, fair value is based on accepted pricing models, such as the present value of future cash flows discounted at a rate which reflects the estimated risk level related to the financial instrument.

Assessing the fair value by discounting future cash flows and determining the discount rate, is subjective. Therefore, the data for most of the financial instruments given hereunder, does not serve as an indication for the realization value of the financial instrument on the reporting date. Discounting the future cash flows was made, where possible, by discount rates in effect at the reporting date, without taking into consideration fluctuations in interest rates. Using different discount rates assumptions, may result in significantly different fair value amounts. This relates particularly to financial instruments bearing a fixed interest rate or non-interest bearing.

Additionally, in arriving at the fair value amounts, no consideration was given to commissions receivable or payable as part of the business activity, neither do they include the tax effect.

It should be further noted, that the differential between the book value of the financial instrument and its fair value, may never be realized, as the Bank usually holds the financial instrument to maturity.

In consequence of the above, it should be stressed that the data included in this Note, is no indication of the value of the Bank as a going concern.

Furthermore, due to the wide range of valuation techniques and possible assessments used in determining the fair value, and in view of the methods and assumptions used in applying the instruction, care should be taken when examining the fair value data itself as well as when comparing it with the fair value data presented by other banks.

C. METHODS AND MAIN ASSUMPTIONS USED IN ESTIMATING THE FAIR VALUE OF FINANCIAL INSTRUMENTS

Bank deposits, non-marketable bonds and loan notes and credit to the Government - discounting future cash flows at rates at which the Bank transacted business at the reporting date.

Marketable securities - At their market value.

Credit to the public - Fair value of the balance of credit to the public was determined at the present value of future cash flows using an appropriate discount rate. The credit balance was segmented into homogeneous groups, the cash flows of which were discounted at rates, which reflects the estimated risk related to the credit in each group.

The classification into homogenous categories in the business sector, has been made, to the extent possible, on the basis of a grading model used at present by the Bank, which reviews the level of risk inherent in the debt in accordance with financial and other indices. It should be noted that as of December 31, 2007, the Bank has classified some 94% of the indebtedness which has to be classified according to the directives of the Supervisor of Banks (31.12.2006: 94%).

In certain cases, where grading data is not available, the segmentation is made on the basis of an overall evaluation of the risk level relating to the business sectors in which the borrowers operate. In this respect, it should be noted that the general risk level, as evaluated for a particular business sector, is not necessarily identical to the risk level of a particular borrower operating in that sector, none the less, to the risk level relating to the credit which the Bank grants to that borrower.

The discount rates used were generally determined according to interest rates applying to similar transactions effected at the reporting

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

date. With respect to short-term credit balances (initial period of up to three months), or balances bearing variable market interest (prime, LIBOR, etc.), it was assumed that the amount stated in the balance sheet reflects their fair value.

The fair value of problem debts, net of the provision for loan losses, was calculated using discount rates reflecting the high credit risk involved. In any event, these discount rates are not less than the higher interest rate applying to transactions made by the Bank at the reporting date. Problem debts having no maturity date, are stated according to their value in the books of the Bank, as in the circumstances, it was not practicable to evaluate the timing of their repayment rate, and therefore no expected future cash flow was calculated in their respect. The general, supplemental and special provisions for doubtful debts were not deducted from the balance of outstanding credit for the purpose of calculating the cash flows when determining the fair value.

Deposits and subordinated capital notes - Capitalizing future cash flows at a rate at which the Bank pays interest on similar deposits, or on the issue of similar bond and loan notes at the reporting date. Marketable subordinate capital notes are stated at market value.

Financial instruments (except for derivatives and marketable financial instruments) for an initial period of up to three months and at a variable market interest rate - It is assumed that the amounts stated in the balance sheet reflect their fair value.

Derivative financial instruments - Such financial instruments, which have an active market, were evaluated at their market value, and where several such markets exist, the evaluation was made in accordance with the most active market.

Derivative financial instruments which are not traded on an active market were evaluated according to models in use by the Bank in its current operations and which take into account the risks involved in the financial instrument: market, credit and other risks. The consideration as regards the credit risk relating to the counter party to the transaction, relates to two categories: customers and banks, considering the type of the product.

Off balance sheet financial instruments which involve credit risk - The fair value is presented according to the outstanding balance of commissions on the said transactions, which approximate fair value. The fair value of irrevocable commitments to grant credit, which were approved but not yet executed, does not differ materially from the value of these commitments, as they are presented in Note 19 A.

The bank and its banking subsidiaries in Israel present the balances and fair value estimates of Financial Instruments according to the directive of the Supervisor of Banks. A banking subsidiary abroad presents the balances and fair value estimates of Financial Instruments according to generally accepted accounting principles in the US, which do not materially differ from those of the Supervisor. In the consolidated financial statements, the general provision of the subsidiary company was not deducted from the outstanding balance of credit in estimating the fair value.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

D. COMPOSITION - CONSOLIDATED

December 31, 2007				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets				
Cash and deposits with banks	18,254	1,596	19,850	19,832
Securities	33,023	3,346	36,369	36,377
Securities borrowed or purchased under resale agreements	346	-	346	346
Credit to the public	53,672	48,227	101,899	101,919
Credit to the Government	11	363	374	311
Other financial assets	1,862	-	1,862	1,862
Total financial assets	107,168	53,532	160,700	160,647
Financial liabilities				
Deposits from the public	82,653	47,865	130,518	131,050
Deposits from banks	4,264	808	5,072	5,072
Deposits from the Government	37	88	125	127
Securities loaned or sold under buy-back arrangements	1,462	4,433	5,895	5,889
Subordinated capital notes	1,142	6,295	7,437	7,546
Other financial liabilities	7,973	-	7,973	7,973
Total financial liabilities	97,531	59,489	157,020	157,657

December 31, 2006				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets				
Cash and deposits with banks	*24,098	1,002	25,100	*25,212
Securities	*33,990	4,783	38,773	*38,741
Credit to the public	*50,503	*39,594	90,097	*90,344
Credit to the Government	*317	7	324	*323
Other financial assets	1,345	-	1,345	1,345
Total financial assets	110,253	45,386	155,639	155,965
Financial liabilities				
Deposits from the public	83,728	46,789	130,517	130,725
Deposits from banks	7,420	679	8,099	8,147
Deposits from the Government	36	83	119	117
Subordinated capital notes	1,146	5,156	6,302	6,530
Other financial liabilities	6,769	-	6,769	6,769
Total financial liabilities	99,099	52,707	151,806	152,288

Footnotes:

(1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.

(2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)**E. COMPOSITION - THE BANK**

December 31, 2007				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets				
Cash and deposits with banks	15,757	8,477	24,234	24,467
Securities	17,175	-	17,175	17,175
On securities borrowed or purchased under buy-back agreements	346	-	346	346
Credit to the public	31,081	28,493	59,574	59,323
Credit to the Government	-	363	363	301
Other financial assets	1,465	-	1,465	1,465
Total financial assets	65,824	37,333	103,157	103,077
Financial liabilities				
Deposits from the public	65,336	27,294	92,630	92,789
Deposits from banks	2,606	435	3,041	3,050
Deposits from the Government	20	17	37	37
Subordinated capital notes	947	2,890	3,837	3,927
Other financial liabilities	4,250	-	4,250	4,250
Total financial liabilities	73,159	30,636	103,795	104,053

December 31, 2006				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets				
Cash and deposits with banks	*20,269	7,356	27,625	*27,870
Securities	16,891	-	16,891	16,891
Credit to the public	25,534	25,933	51,467	51,488
Credit to the Government	*306	7	313	*312
Other financial assets	833	-	833	833
Total financial assets	63,833	33,296	97,129	97,394
Financial liabilities				
Deposits from the public	57,731	26,979	84,710	84,954
Deposits from banks	4,950	576	5,526	5,536
Deposits from the Government	-	5	5	5
Subordinated capital notes	963	2,917	3,880	4,037
Other financial liabilities	3,309	-	3,309	3,309
Total financial liabilities	66,953	30,477	97,430	97,841

* Reclassified.

Footnotes:

(1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.

(2) Other financial instruments.



22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

A. BALANCES

December 31, 2007										
	Interested parties ⁽¹⁾						Related parties held by the Bank			
	Controlling Shareholders		Directors and President & CEO ⁽²⁾		Other Shareholders		Affiliated companies		Others ⁽³⁾	
	(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)
in NIS millions										
Assets										
Securities ⁽⁶⁾	-	-	-	-	-	-	-	-	15	15
Credit granted to the public	(A)	(A)	8	8	19	22	417	433	48	62
Deposits with banks	-	-	-	-	-	-	-	422	-	-
Investments in affiliated companies ⁽⁶⁾	-	-	-	-	-	-	2,008	2,008	-	-
Other assets	-	-	-	-	-	-	6	11	-	-
Liabilities										
Deposits from the public	6	12	1	2	29	48	351	761	167	1,045
Deposits from banks	-	-	-	-	-	-	253	499	-	1
Debentures and subordinated capital notes	-	-	-	-	-	-	6	21	24	172
Other liabilities	-	-	-	-	-	-	9	12	-	-
Shares (included in shareholders' equity)	2,393	2,393	-	-	-	-	-	-	-	-
Credit risk in off-balance-sheet financial instruments ⁽⁷⁾	3	3	1	1	1	2	1,576	1,681	42	178

(A) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 30 million for credit received by a third party. For notes to the tables see after item D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

A. BALANCES: (CONTINUED)

December 31, 2006									
Interested parties ⁽¹⁾						Related parties held by the Bank			
Controlling Shareholders		Directors and President & CEO ⁽²⁾		Other Shareholders		Affiliated companies		Others ⁽³⁾	
(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)
in NIS millions									
Assets									
Securities ⁽⁶⁾	-	-	-	-	-	1	2	14	14
Credit granted to the public	(A)-	(A)-	8	8	*15	*105	488	488	*53
Deposits with banks	-	-	-	-	-	-	4	-	-
Investments in affiliated companies ⁽⁶⁾	-	-	-	-	-	1,367	1,367	-	-
Other assets	-	-	-	-	-	2	2	8	8
Liabilities									
Deposits from the public	-	-	2	3	85	143	356	356	1,704
Deposits from banks	-	-	-	-	-	-	*187	350	-
Debentures and subordinated capital notes	-	-	-	-	-	-	20	26	161
Shares (included in shareholders' equity)	2,071	2,071	-	-	-	-	-	-	-
Credit risk in off-balance-sheet financial instruments ⁽⁷⁾	4	4	-	-	-	-	456	456	447

(A) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 37 million for credit received by a third party.

* Reclassified.

For notes to the tables see after item D.



22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

B. SUMMARIZED RESULTS OF TRANSACTIONS WITH RELATED AND INTERESTED PARTIES

For the year ended December 31, 2007					
	Interested parties ⁽¹⁾		Related parties held by the Bank		
	Controlling Shareholders	Directors and president & CEO ⁽²⁾	Other Shareholders ⁽²⁾	Affiliated companies	Others ⁽³⁾
in NIS millions					
Income from financing activities before provision for doubtful debts*	-	-	-	(9)	(22)
Non-financing income	-	-	-	4	⁽⁸⁾ 107
Non-financing expenses**	-	(38)	-	(2)	-
Net income from extraordinary items	-	-	-	50	-
Total	-	(38)	-	43	85

For the year ended December 31, 2006					
	Interested parties ⁽¹⁾		Related parties held by the Bank		
	Controlling Shareholders	Directors and president & CEO ⁽²⁾	Other Shareholders ⁽²⁾	Affiliated companies	Others ⁽³⁾
in NIS millions					
Income from financing activities before provision for doubtful debts*	-	1	2	(14)	(32)
Non-financing income	-	-	-	1	⁽⁸⁾ 189
Non-financing expenses**	-	(15)	-	(4)	-
Total	-	(14)	2	(17)	157

* See Note D.

** See Note C.

***Reclassified.

For notes to the tables see after item D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)**C. BENEFITS FROM THE BANK AND CONSOLIDATED SUBSIDIARIES TO INTERESTED PARTIES:**

	For the year ended December 31			
	2007		2006	
	Directors and President & CEO ⁽²⁾		Directors and President & CEO ⁽²⁾	
	Total	Number of benefit Recipients	Total	Number of benefit Recipients
	in NIS millions			
Interested parties employed by the Bank or on its behalf	35	2	12	*3
Directors who are not employed by the Bank or on its behalf	2	**16	***3	**20
Total	37	18	15	23

For notes to the tables see after Note D.

* Including the Chairman of the Board of Directors who retired at the end of January 2006.

** Including three and six Directors who retired during 2007 and 2006 respectively.

*** Including an amount of US\$130,000 paid to a Director of the Bank in respect of his tenure as Director of IDB New York, which at date of payment has not as yet been approved by the authorized organs at the Bank. In December 2007, the payment was approved by the Audit Committee of the Bank and it is now subject to approval of the general meeting of shareholders.

For notes to the tables see after item D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

D. RESULTS OF FINANCING TRANSACTIONS (BEFORE PROVISION FOR DOUBTFUL DEBTS) OF THE BANK AND ITS CONSOLIDATED COMPANIES WITH RELATED AND INTERESTED PARTIES*

	Consolidated		Of which from Affiliated Companies			
	2007	2006	2005	2007	2006	2005
	in NIS millions					
A. On assets						
Credit granted to the public	11	44	34	7	5	4
Total	11	44	34	7	5	4
B. On liabilities						
Deposits from the public	(28)	(58)	(54)	(8)	(1)	(2)
Deposits from the banks	(11)	(3)	(6)	(11)	(3)	(6)
Debentures and subordinated capital notes	(8)	(11)	(17)	(2)	-	(1)
Other liabilities	-	(1)	-	-	(1)	-
Total	(47)	(73)	(77)	(21)	(5)	(9)
C. On Derivative Financial Instrument						
Financing income (expenses) from other transactions	6	(14)	1	6	(14)	1
Total	6	(14)	1	6	(14)	1
D. Other						
Other financing expenses	(1)	-	-	(1)	-	-
Total	(1)	-	-	(1)	-	-
Total expenses from financing activities before provision for doubtful debts	(31)	(43)	(42)	(9)	(14)	(4)

* In respect of transactions made on the same terms that would have been made with a person that is not a related or interested party.

Footnotes: (relating to Note 22 A,B & C):

(1) Interested party - as defined by Securities Regulations. Related party - as defined in Opinion 29 of the Institute of Certified Public Accountants in Israel, but is not an interested party.

(2) Including spouses and their infant children.

(3) A corporation in which a banking corporation holds 10% or more of its issued share capital or of the voting rights therein, or is entitled to appoint 10% or more of the members of its board of directors or is entitled to appoint its president and CEO, and another corporation that a related party holds 25% or more of its issued share capital or of the voting power therein or of the right to appoint its directors.

(4) The balance at balance sheet date.

(5) The highest balance during the year on the basis of month-end balances.

(6) Details of these items are included also in the following notes:

Securities - Note 3.

Investments in Investee Companies - Note 6

Guarantees - Note 19A.

(7) Credit risks of off-balance sheet derivative financial instruments as calculated for the purpose of setting borrower's limits.

(8) Income received from provident funds managed by the Bank and by a consolidated subsidiary.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)**E. DATA IN REGARD TO PROVIDENT FUNDS ACCORDING TO THEIR BALANCE SHEETS WHICH HAVE NOT BEEN CONSOLIDATED:**

	December 31	
	2007	2006
	In NIS millions	
(1) Managed by Discount Provident Fund Management Ltd. and the Bank ⁽¹⁾ :		
Members' balance	-	30,947
Investments in securities of related and interested parties	-	515
Deposits with the Bank and with its consolidated subsidiaries and affiliated companies	-	1,497
Capital notes	-	142
Management fees	65	114
(2) Managed by Mercantile Discount Bank ⁽²⁾ :		
Members' balance	-	3,778
Investments in securities of related and interested parties	-	66
Deposits with the Bank and with its consolidated Subsidiaries	-	257
Management fees	26	26

Footnote:

(1) Including "Kahal" - Employees Supplemental Training Fund Ltd. and "Kahal" - Management of Further Education Funds (1996) Ltd., managed jointly with Bank Leumi Le Israel Ltd. The transaction of the sale for the operations of the Bank's provident funds was completed in June 2007 (see Note 6 E 3 above). The transaction for the sale of operations of KAHAL further education funds was completed in July 2007.

(2) The transaction for the sale of control (51%) of the operations of the provident funds of Mercantile Discount Bank was completed in December 2007. See also Note 19 C 2.

F. As from October 31, 1993, through January 31, 2006 the State of Israel held a majority of the shares of the Bank (on December 31, 2005, it held 57.09% of the shares). The Supervisor of Banks has exempted the Bank from defining the State as "a related party" in the Bank, and accordingly balances and transactions with the State and companies under its control are not given.

G. On January 31, 2006, the control of the Bank passed to the Bronfman Schron Group (for additional details see Note 32 hereunder).

H. Personal contract with the Chairman of the Board and the President & CEO. On March 26, 2006, the board of directors of the Bank resolved to approve the engagement of the Bank in a personal contract with the Chairman of the Board. The period of the personal contract is for five years, starting on February 6, 2006, to be renewed subsequently for an indeterminate period until its cancellation. In the event that the Bank should terminate the contract before the end of the period of five years, the Chairman would be entitled to compensation in an amount equal to his full salary, including the benefits and provisions (as stated in the agreement), for the remaining period of the five years, as well as to a proportionate part of the yearly award for the year in which the contract was terminated.

The contract stipulates also, among other things, that the Bank would grant the Chairman of the Board, in respect of each year in which he holds office, starting with 2006 and as long as the agreement with him is in force, a special award (hereinafter - "the annual bonus"), derived from the annual rate of return on equity, at rates of between 0.45% of the net annual earnings if the annual return on equity will equal 8.5%, to a maximum rate of 0.70% on the net annual earnings if the annual return on equity will reach 13% or more. In computing the annual rate of return on equity, the Board of Directors is entitled to eliminate exceptional profits or losses that do not derive from current operations. As regards details of the proposal for the granting of option warrants to the Chairman of the Board as part of an option plan for officers of the Bank, see Note 13.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

The Board of Directors of the Bank resolved on March 26, 2006, to approve an amendment to the personal contract with the President and CEO of the Bank, in a manner that would include provisions identical to the provisions described in section I above.

The remuneration and terms of employment of the Chairman of the Board were included on the agenda of a special general meeting of shareholders called for April 26, 2006. On March 26, 2006, the State informed of its consent to the terms of service of the Chairman of the Board of Directors and of its consent with regards to voting together with the controlling shareholders, by power of the option shares held by the State. (For details as to the notice given on June 20, 2006, canceling the said consent, see Note 13 D (2) above).

As detailed in Note 13 D (2) above, at the request of the Chairman of the Board and the President and CEO, the remuneration plan in their respect was removed from the agenda of the said General Meeting and it is being brought for renewed discussion by the authorized organs of the Bank.

Approval terms of engagement with the Chairman of the Board of Directors and with 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 as stated 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.

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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 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.
The Chairman and the President and CEO complied in 2007 with the determined indices, and they are entitled to a bonus of NIS 4.4 million each in respect of this year.

I. "INTERESTED PARTY" TRANSACTIONS - IDB NEW YORK

- (1) In September 2005, even prior to the closing of the transaction for the transfer of control of the Bank, the then management of IDB New York signed an agreement with a company controlled by Mr. Matthew Bronfman (hereinafter - "the Company"), according to which IDB New York is to sublease to the Company for a period of 10 years, one floor in the building in New York leased by IDB, in which its offices are located.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

Pursuant to the agreement, IDB New York is to sublease the area to the Company in consideration for a monthly rental fee of US\$45.19 per one square foot which is the fee paid by the former tenant of the area. The agreement states that the rental fees are to be paid on a monthly basis. The rental agreement further provided that IDB New York is to grant to the company a loan of US\$900,000 for the renovation of the property, for a period of ten years and at an annual interest of 7%. It has been agreed that in total the company would pay a monthly amount of US\$34,407 in respect of rent and the repayment of the loan, making US\$ 412,884 on a yearly basis. The said floor was put at the disposal of the Company in January 2006, and in April 2006 the Company moved into it, following the completion of the renovation.

The loan of US\$900,000 was given to the Company in March 2006.

The draft report of a review performed recently at the request of IDB New York by an independent lawyer, indicates that both the sublease transaction and the granting of the loan did not receive the required approvals, including the approval of the Board of Directors of IDB New York, the transaction was not scrutinized as a related party transaction and as such, did not receive the required approvals. It should also be noted that already on June 2006, according to the recommendations of the said lawyer, the Company repaid the loan to IDB New York.

In addition, rental fees in respect of the period April to December 2006 were paid in January 2007. As from January 2007, the rental fees are being paid in a regular manner. The said examination was concluded in November 2007 (see Note 6 D above). In view of the recommendations of the examination report, the company paid IDB New York interest in respect of the delay in the payment of rent. In addition, according to the recommendations of the report, an opinion of an independent appraiser has been received with respect to the appropriate amount of rent as of the date of the examination report. In view of the opinion of the assessor, IDB New York negotiated to change the rental fees and it has been agreed to increase such fees by US\$4 per square foot.

The amendment of the agreement regarding the amount of rental fees has been approved by the authorized organs of IDB New York and will be submitted for approval by the authorized organs at the Bank as an entitled transaction. At the present stage, the transaction is being discussed by the Audit Committee of the Bank and the discussion has not yet been completed.

The company paid in 2007 rental fees of US\$303 thousand (2006 - US\$328 thousand).

- (2) With a view of improving the return which IDB New York earns on its investments and in order to provide a benchmark for the measurement of returns, the Board of Directors of IDB New York decided in July 2006, to enter into an engagement with Ernest Partners Corporation, in which Mr. Matthew Bronfman has a 20% equity interest, for the management of assets in the amount of US\$150 million. As of December 31, 2007, Ernest Partners Corporation managed on behalf of IDN New York an investment portfolio of US\$145 million (2006 - US\$78 million). The management fee payable in consideration thereof is at the rate of between 0.2% and 0.35% of the volume of the managed portfolio. In 2007, an amount of US\$278 thousand was paid to Ernest Partners Corporation in management fees (2006 - US\$40 thousand).
- J.** (1) The Bank conducted negotiations for the rental of an area of 200 Sq. Mtrs. In the "Ma'ayan Soreq" location in Rishon Le'Tziyon, that is planned to be built by companies related to the Bronfman group. The negotiations came to a stop due to planning difficulties experienced by the promoter.
- (2) On May 23, 2006, the Bank (which at a later date transferred its rights to Mercantile Discount Bank) entered into an agreement with a third party, who owns the commercial center in Upper Beitar, for the lease of an area of 250 sq. meters, intended for a new Bank branch. About a month following that date, the said third party sold the commercial center to a company in which Mr. Matthew Bronfman has a 35% equity interest. The monthly rental and management payments amount to US\$23 per sq. meter and the lease period is for five years with an option granted to the lessee to extend the lease period by two additional periods of five years each.



22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

- K.** (1) The preceding Chairman of the Board of Directors ended his tenure of office on January 31, 2006, following the closing of the transaction for the sale of a controlling interest in the Bank (see Note 32 hereunder). His remuneration and terms of employment were approved by the general meetings of shareholders held on January 15, 1998, October 5, 1999 and June 14, 2004, including his entitlement to regular severance pay and an adaptation award equal to full twelve months salary.
- (2) In 2004, the board of directors of the Bank decided that in the event that the preceding Chairman would have to terminate his tenure of office following a change in ownership of the Bank due to privatization, then he would be entitled to a payment equal to a full fifteen months salary in addition to the amounts due to him in accordance with the personal contract with him. This issue was on the agenda of the general meeting of shareholders held in June 2004, but was not discussed at that meeting.
- (3) In 2004, the board of directors of the Bank resolved to approve the preceding Chairman an additional remuneration of 6.5% as from July 2004, together with an award equal to seven months salary (comprising 89% of the award approved to the President and CEO of the Bank). These matters have not yet been brought for approval by the general meetings of shareholders.
- (4) In May 2005, the board of directors of the Bank resolved to approve the preceding Chairman an award in the amount of NIS 1,255 thousand. This matter has not yet been brought for approval by the general meetings of shareholders.
- (5) Without derogating from the resolutions detailed in items 2 to 4 above, the Bank intends to bring for approval of the board of directors of the Bank a proposal for a one-time payment of NIS 10 million to the preceding Chairman, as compensation for the termination of his tenure as Chairman of the board of directors and to express appreciation for his outstanding contribution to the Bank.
- (6) The financial statements include full provisions in respect of items 2-4 stated above.
- (7) In a letter dated March 26, 2006, the controlling shareholders of the Bank informed the Accountant General at the Ministry of Finance and the CEO of M.I. Holdings Ltd. of their intention to bring for approval of the authorized organs of the Bank, as the case may be, the proposals for various payments to the preceding Chairman of the board of directors of the Bank, as detailed in items 2 to 5 above. The controlling shareholders clarified that, for the sake of propriety they deemed it proper to bring to the attention of the Government the proposed payments by the Bank to the preceding Chairman, as detailed above, though, in their opinion, such payments are not considered payments to an interested party within its meaning in the agreement for the sale of the controlling interest in the Bank, and therefore do not require the consent of the Government.
- (8) In a letter dated March 26, 2006, the Accountant General at the Ministry of Finance informed that the State opposes the intended payments as detailed in the letter of the controlling shareholders (see 7 above). In view of the above said, the Bank did not record a provision in respect of the amounts stated in 5 above.
- L.** The Bank has a commitment to pay directly to subordinated capital notes holders of the consolidated subsidiaries: Manpikim Discount Bank Issues Corporation Ltd. and Discount Mortgage Bank Ltd., upon the debentures' maturity, the amounts of the principal plus accrued interest and linkage differentials. The undertaking is in respect of the repayment of debentures, the proceeds of which were deposited with the Bank. The total of the liability in respect of the debentures of the consolidated subsidiaries, as at December 31, 2007, amounted to NIS 2,731 million (as at December 31, 2006 - NIS 1,517 million).
- M.** The Bank and Mercanile Discount Bank have commitments towards the Tel-Aviv Stock Exchange and towards the "Ma'of" clearing house as mentioned in Note 19 C 6 and Note 19 C 7.
- N.** Investee companies of the Bank are included in the framework of the undertaking granted by the Bank to VISA International (as stated in Note 19 C 12).

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

O. As to indemnification for interested and related parties and for details as to arrangements for insurance, exemption and indemnification of Directors at the Bank or persons appointed as Directors of certain subsidiaries, including two former officers who acted as Directors of consolidated subsidiaries and who are also controlling shareholders of the Bank - see Note 19 C 10.

P. Upon granting of the control permit of Discount Bank (hereinafter - "the Bank"), Mr. Milstein has been granted an exemption from the reporting of corporations related to him with regard to Proper Banking Management Directive 312 - The business of a banking corporation with related parties, subject to certain conditions.

In view of the above, the Supervisor of Banks informed that the Bank is to obtain from Mr. Milstein the following details with respect to corporations related to him, which may be considered as interested parties or related parties of the Bank, even for purposes of the annual public financial reporting:

- A written declaration by Mr. Milstein, to be obtained each year, about one month prior to the publication of the financial statements to the public, according to which:
 - (1) Mr. Milstein, his spouse, his children, their spouses and corporations owned by them and which are interested parties in the Bank or are related parties to the Bank, did not enter into any transaction with the Bank during the period of three years ending on the date of the Report, or alternatively, report the details of all transactions entered into as above;
 - (2) At the end of the reporting year and at the end of the preceding reporting year, neither Mr. Milstein nor his spouse, his children, their spouses and corporations owned by them and which are interested parties in the Bank or are related parties to the Bank had any debts to the Bank or any deposit or other credit balance with the Bank or with a corporation under the control of the Bank, or alternatively, report the details of any debt or deposit as above.
- In addition to the above, Mr. Milstein shall immediately report to the Secretary and to the Chief Accountant of the Bank, any transaction or debt as above of himself, his spouse, his children, their spouses and corporations owned by them and which are interested parties in the Bank or are related parties to the Bank.

For the purpose of this item, interested parties and related parties are as defined in the public reporting instructions.

- The Report issued to the public shall include adequate disclosure of this arrangement.

The Bank received a declaration from Mr. Milstein as required.



23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBFUL DEBTS

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
A. On Assets**						
Credit granted to the Public	4,162	*3,709	*6,760	2,645	*2,403	*3,372
Credit granted to the Governments	3	(2)	25	4	(2)	24
Deposits with the Bank of Israel and cash	(55)	(49)	48	(23)	(26)	9
Deposits with Banks	144	244	467	586	*553	*805
Securities borrowed or purchased under buy-back agreements	10	-	-	10	-	-
Bonds	84	*(26)	*3,462	811	*798	*858
Total	⁽¹⁾ 4,348	3,876	10,762	4,033	3,726	5,068
B. On Liabilities**						
Deposits from the public	(41)	*(64)	*(6,754)	(961)	(1,183)	(3,111)
Deposits from the Government	(2)	(1)	(10)	(1)	-	(1)
Deposits from the Bank of Israel and cash	(44)	(30)	(3)	(44)	(30)	(3)
Deposits from banks	73	45	(453)	7	(56)	(129)
Securities loaned or sold under buy-back arrangements	310	-	-	-	-	-
Debentures and subordinated capital notes	(539)	(287)	(413)	(320)	(193)	(291)
Total	(243)	(337)	(7,633)	(1,319)	(1,462)	(3,535)
C. In Respect of Derivative Financial Instruments and Hedging Activities						
Income (expenses) net in respect of ALM derivative instruments***	(231)	*(45)	*219	(218)	(134)	190
Income (expenses) net in respect of other derivative instruments	16	105	(18)	(4)	84	(38)
Total	(215)	60	201	(222)	(50)	152
D. Other						
Commissions on financing activities	125	123	138	71	65	70
Other financing income	126	79	215	90	93	53
Interest income on problem debts	110	103	84	77	78	71
Gain from sale of loans	2	-	-	2	-	-
Other financing expenses	(28)	(114)	(70)	(40)	(27)	(31)
Total	335	191	367	200	209	163
Total income from financing activities before provision for doubtful debts	4,225	3,790	3,697	2,692	2,423	1,848
Of which: Net exchange differences	115	(80)	(67)	337	166	(244)

* Reclassified.

** Including the effective component of hedging relations

*** Derivative instruments comprising a part of the assets and liabilities management system of the Bank, which were not designed for hedging relations.

Footnote:

(1) Financing income generated by mortgage backed securities (MBS) amounted to US\$97 million. Following translation of such income into Shekels and the recording of the effect on this investment of exchange differences due to the decline in the exchange rate of the US Dollar as against the Shekel, an expense of NIS 467 million was recorded in respect of the said securities.

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS (CONTINUED)

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					

E. Results of Activity in Investments in Bonds⁽¹⁾

Accrual basis, financing Income (expenses) from bonds:

Held-to-maturity	(209)	(262)	611	-	*-	*-
Available for-sale	83	*151	*2,688	638	693	789
Trading	210	85	163	173	105	69
Total included in income on assets from financing activities	84	(26)	3,462	811	798	858
Gains on sale of available-for-sale bonds	68	50	32	33	29	19
Losses on sale of available-for-sale bonds	(1)	(58)	(2)	-	(1)	2
Net realized and unrealized gains (losses) from adjustment of trading bonds to fair value**	(43)	30	2	(37)	23	3
Total included in other financing income	24	22	32	(4)	51	24
Total from investments in bonds	108	(4)	3,494	807	849	882

F. Details of the Net Effect of Derivative Instruments Hedging Earnings From Financing Operations

Financing income (expenses) in respect of assets (item A)	6	10	44	6	10	6
Financing income (expenses) in respect of liabilities (item B)	-	-	(3)	-	-	(3)

* Reclassified.

** Of which: a part of the gains and losses relating to trading bonds that are still on hand at balance sheet date. Consolidated - NIS 8 million, the Bank - NIS (22) million (2006: consolidated - NIS 134 million, the Bank - NIS 8 million, 2005: consolidated - NIS 16 million, the Bank - NIS 1 million)

Footnote:

(1) Financing income generated by mortgage backed securities (MBS) amounted to US\$97 million. Following translation of such income into Shekels and the recording of the effect on this investment of exchange differences due to the decline in the exchange rate of the US Dollar as against the Shekel, an expense of NIS 467 million was recorded in respect of the said securities.



24. OPERATING COMMISSIONS

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Ledger fees (in Israeli and in foreign currency)	252	225	268	167	146	182
Payment order system service (in Israeli and in foreign currency)	475	424	440	324	304	318
Income from credit cards	760	640	570	85	58	54
Credit and contracts service	218	177	150	140	114	93
Computerized services, information and confirmations	38	45	42	31	38	36
Foreign trade transactions and special foreign exchange services	79	93	80	62	60	58
Income from customers' securities transactions	328	*243	*231	220	164	160
Margins and collection fees on credit and deposits, from deposits according to collection:						
Collection commissions on credit granted out of Treasury funds	15	16	16	-	-	-
Commissions and other margins	3	3	4	4	3	4
Management fees and commissions from life insurance	14	15	16	-	-	-
Management fees and commissions from property insurance	10	11	11	-	-	-
Commission on transfer of rent	-	1	3	-	-	-
Other income	24	*18	*32	21	16	17
Total operating fees	2,216	1,911	1,863	1,054	903	922

* Reclassified.

25. NET GAIN (LOSSES) FROM INVESTMENTS IN SHARES

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Gains on sale of shares available-for-sale	-	8	-	-	8	-
Provision for decline in value of available-for-sale shares	(46)	(7)	(9)	(44)	-	-
Net realized and unrealized gains (losses) from adjustment of trading securities to fair value ⁽¹⁾	(4)	3	2	(3)	2	-
Dividends from available-for-sale or trading shares	108	61	10	60	34	-
Total from investments in shares	58	65	3	13	44	-

Footnote:

(1) Of which part of the income (loss) related to trading shares that are still on hand at balance sheet date: consolidated: NIS (4) million, Bank: NIS (0.4) million, (2006 - consolidated: NIS 1 million, Bank: NIS 2 million, 2005 - consolidated: NIS (1) million, Bank: NIS (1) million).

26. OTHER INCOME

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Management fees and expense refunds from provident funds	107	189	177	65	114	109
Provident funds operating fees	12	-	-	-	-	-
Management fees from mutual funds	6	100	182	-	15	20
Distribution fees of mutual funds	52	24	-	51	47	52
Management fees from consolidated subsidiaries	-	-	-	3	3	3
Profit from severance pay funds	89	49	160	87	46	145
Other income	32	21	21	54	54	49
Total other income	298	383	540	260	279	378



27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Salaries	2,144	*2,209	*1,920	1,322	1,388	1,236
Expense resulting from share based payment transactions ^{(1)/(2)}	27	8	-	27	8	-
Severance pay, further education fund, seniority bonuses, vacation and medical insurance	246	*248	345	193	187	232
National Insurance and payroll taxes	380	399	382	286	309	288
Other related expenses	99	99	93	58	57	53
Adjustment of reserves for salary-related expenses due to changes in salaries during the year	43	65	31	21	42	27
Voluntary retirement program expenses ⁽³⁾	91	*174	196	68	91	196
Total salaries and related expenses	3,030	3,202	2,967	1,975	2,082	2,032
Includes: Overseas salaries and related expenses	426	499	394	22	17	17

* Reclassified.

Footnotes:

(1) See Note 13 D.

(2) The whole expense derives from share based payment transactions, settled in capital instrument.

(3) Including payroll tax.

28. OTHER EXPENSES

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	In NIS millions					
Advertising	235	202	153	96	73	51
Communications	115	115	109	60	60	53
Computer services	228	256	223	195	206	173
Office expenses	34	34	29	13	12	13
Insurance	38	34	39	9	11	17
Professional services	196	196	119	61	50	39
Directors' fees	10	9	8	2	2	2
Instruction and training	18	18	10	15	13	8
Fees	37	56	45	27	20	19
Amortization of goodwill	32	11	12	-	-	-
Other	274	*208	*(1)345	108	93	73
Total other expenses	1,217	1,139	1,092	586	540	448

* Reclassified.

Footnote:

(1) 2005: Including a provision in the amount of NIS 113 million in respect of a settlement signed by IDB New York with the regulatory authorities in the USA (See Note 6 D).



29. PROVISION FOR TAXES ON OPERATING INCOME

A. COMPOSITION:

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS millions					
Taxes for current year	365	391	346	137	104	47
Taxes for previous years	1	1	(1)	-	(1)	-
Total current taxes	366	392	345	137	103	47
Addition (deduction):						
Deferred taxes for current year	199	(42)	(23)	104	-	(21)
Deferred taxes for previous years	1	-	2	-	-	-
Total deferred taxes	200	(42)	(21)	104	-	(21)
Total provision for taxes on operating profit	566	350	324	241	103	26
Includes taxes of foreign subsidiaries	140	62	105	17	6	-

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)**B. RECONCILIATION BETWEEN THE THEORETICAL TAX WHICH WOULD APPLY HAD THE OPERATING INCOME BEEN TAXED AT THE STATUTORY TAX RATE APPLYING TO A BANK IN ISRAEL, TO THE PROVISION FOR TAXES ON OPERATING INCOME, AS CHARGED IN THE STATEMENT OF INCOME:**

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in percentage					
Statutory tax rate on banks in Israel	38.53	40.65	43.59	38.53	40.65	43.59
	in NIS millions					
Income tax at the statutory tax rate	494	227	298	253	80	(88)
Income tax (tax savings) on:						
Increment (deduction) for inflation	(41)	3	(17)	(21)	1	4
Income of foreign subsidiaries ⁽¹⁾	110	90	(75)	11	-	-
General and supplemental provision for doubtful debts	(9)	1	8	(5)	5	6
Income exempt from tax or taxed at preferred rates	9	8	3	9	10	5
Adjustment differences on depreciation and capital gains	(20)	(6)	(10)	(19)	(10)	(11)
Other non-deductible expenses	56	96	25	39	80	19
Deferred taxes in respect of non-financial assets	-	-	(5)	-	-	(4)
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	(31)	(88)	46	(28)	(89)	42
Profit tax on payroll tax	27	29	25	22	24	21
Change in the balance of deferred taxes resulting from the change in tax rates	(19)	5	37	(20)	3	32
Taxes for prior years	1	1	(1)	-	(1)	-
Income of Israeli subsidiaries	(11)	(16)	(10)	-	-	-
Provision for taxes on income	566	350	324	241	103	26

Footnote:

(1) Excluding the tax effect of the addition to equity as of the beginning of the year on the provision for taxes for the current year.

C. (1) Final tax assessments have been issued to the Bank for the tax years up to and including 2002.

(2) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2001 to 2005.

D. In December 2007, the Bank received a tax assessment for the 2003 tax year. In January 2008, the Bank filed an objection to the said assessment. The amount of tax in dispute for the said tax year is NIS 68 million (including interest and linkage). The Bank and its professional advisors are of the opinion that if the objection is not admitted and the Bank will have to pay the amount in dispute, this would not affect the Bank's business results as the said demanded taxes reflect timing differences.**E.** The consolidated balance as of December 31, 2007, of the carry forward tax losses, deductibles and timing differences amounted to NIS 140 million (December 31, 2006: NIS 146 million).**F.** On February 9, 2000, the Bank's shares in IDB New York were transferred to Discount Bankcorp. Inc. (hereinafter – "Bankcorp"), a wholly-owned holding subsidiary of the Bank, registered in the State of Delaware, U.S. The transfer of the shares to Bankcorp was



29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

made at their value in the Bank's books, in consideration for shares issued by Bankcorp.

The transfer of the shares was made in accordance with the provisions of Section 104A of the Israeli Income Tax Ordinance. The Bank is obligated to pay taxes in Israel with respect to the said transfer of shares, if and when such shares will be sold. The Bank has provided the Israeli Income Tax Authorities with a guarantee as to the payment of such taxes.

G. In August 2005 the Knesset published the Income Tax Ordinance Amendment Law (No.147) – 2005 (hereinafter – “the Amendment”).

The Amendment provides for a further gradual reduction in the rate of company tax, as follows: a rate of 31 % for 2006, a rate of 29% for 2007, a rate of 27% for 2008, a rate of 26% in 2009 and a rate of 25% for 2010 and thereafter.

H. Reduction in the rate of “Payroll tax” and “Profit Tax”. On June 29, 2006, the Minister of Finance signed a Value Added Tax Order (The tax rate applying to not for profit organizations and financial institutions) (Amendment), 2006, whereby the “Profit tax” and “Payroll tax” rates applying to banking corporations were reduced as from July 1, 2006, from 17% to a rate of 15.5%. Following this amendment, the statutory tax rate applying to banking corporations decreased to 40.65% in 2006; 38.53% in 2007; 36.80% in 2008; 35.93% in 2009 and 35.06% as from 2010 onwards.

I. On March 6, 2008, the Israeli Income Tax Law (Inflationary Adjustments) (Amendment No. 20) – 2008 (“the Amendment”) was published. According to the Amendment, the Inflationary Adjustments Law will no longer be applicable subsequent to the 2007 tax year, except for certain transitional provisions.

Further, according to the Amendment, commencing with the 2008 tax year, the adjustment of income for the effects of inflation for tax purposes will no longer be calculated. Additionally, depreciation on fixed assets and tax loss carryforwards will no longer be linked to future changes in the CPI, such that these amounts will continue to be linked only to the CPI as of the end of the 2007 tax year and will not be linked to CPI changes after this date.

Based on the data on capital as of December 31, 2007, the Bank believes that the tax expense of the Group in future years will increase by an amount of NIS 14 million per year in respect of each 1% increase in the Consumer Price Index.

Within the framework of the said Amendment, the terms “profit” and “wages” in the Added Value Tax Law have been amended so that profit tax would be computed after deducting the wage tax, and the definition of wages for the purpose of computing wage tax is to include also the employer's contribution to National Insurance.

The Bank estimates that the said Amendment will decrease the tax expense of the group in future years by an amount of between NIS 12 and 14 million, per year.

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

J. PRESENTED BELOW IS THE ADJUSTED AMOUNT OF NON-MONETARY ASSETS, THE DEPRECIATION OF WHICH WILL NOT BE RECOGNIZED AS A DEDUCTIBLE EXPENSE OR AS PART OF THE COST WHEN SOLD, AND WHICH IS DEEMED A PERMANENT DIFFERENCE IN RESPECT OF WHICH NO DEFERRED TAXES ARE RECORDED:

	Consolidated		The Bank	
	December 31			
	2007	2006	2007	2006
	in NIS millions			
Balance at beginning of year	85	94	74	82
Non-deductible amount for the current year	(7)	(9)	(10)	(8)
Balance at end of year	78	85	64	74

K. YEAR-END BALANCES OF DEFERRED TAXES RECEIVABLE AND PROVISION FOR DEFERRED TAXES:**1. CONSOLIDATED**

	Deferred tax receivable				Provision for deferred taxes			
	balance		The average tax rate		balance		The average tax rate	
	2007	2006	2007	2006	2007	2006	2007	2006
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	77	55	35.2	35.4	-	-	-	-
On provision for vacation pay, seniority bonuses								
provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	349	328	33.9	32.2	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	172	174	35.0	35.0
forward deductions	55	287	25.7	25.0	-	-	-	-
On foreign operations	170	259	38.5	40.7	-	-	-	-
On securities	-	-	-	-	107	119	36.8	38.5
On adjustment of depreciable non-monetary assets	-	-	-	-	104	87	27.9	26.9
On adjustment of other non-monetary assets	53	39	28.4	27.5	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	153	10	25.3	9.5
Total, net	704	968	33.7	31.2	536	390	30.5	31.6

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

K. YEAR-END BALANCES OF DEFERRED TAXES RECEIVABLE AND PROVISION FOR DEFERRED TAXES:

2. THE BANK

	Deferred tax receivable				Provision for deferred taxes			
	balance		The average tax rate		balance		The average tax rate	
	2007	2006	2007	2006	2007	2006	2007	2006
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	51	43	35.1	35.1	-	-	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	309	290	33.8	31.8	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	166	165	35.1	35.1
On excess of deposits forward deductions	51	287	25.0	25.0	-	-	-	-
On securities	-	-	-	-	94	104	36.8	38.5
On adjustment of depreciable non-monetary assets	-	-	-	-	90	74	27.5	26.3
On adjustment of other non-monetary assets	16	27	25.1	28.2	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	153	10	25.3	9.5
Total, net	427	647	32.1	28.4	503	353	30.3	31.3

	Consolidated		The Bank	
			December 31	
	2007	2006	2007	2006
	in NIS millions			

Deferred taxes are included:

In "Other assets" (Note 8)	335	602	91	318
In "Other liabilities" (Note 12)	(167)	(24)	(167)	(24)
Total, net	168	578	(76)	294

30. NET INCOME ON EXTRAORDINARY ITEMS, AFTER TAXES

	Consolidated			The Bank		
	2007	2006	2005	2007	2006	2005
	in NIS million					
Capital income on sale of buildings and equipment	3	5	16	3	4	16
Capital loss on sale of buildings and equipment	(3)	(13)	(3)	(1)	(13)	(3)
Provision for impairment in value of buildings ⁽¹⁾	(1)	(4)	(10)	(1)	(5)	(10)
Income on sale of shares of previously consolidated subsidiary	2	419	-	1	419	-
Loss on the writing-off of an investment in an affiliate	-	(2)	-	-	(2)	-
Gain on sale of provident funds activities.	681	-	-	557	-	-
Gain on sale of further education funds activities.	107	-	-	107	-	-
Income before taxes	789	405	3	666	403	3
Provision for taxes on profit from extraordinary items:						
Current taxes	(159)	(73)	-	(90)	(72)	-
Deferred taxes	(118)	14	1	(144)	14	1
Total provision for taxes	(277)	(59)	1	(234)	(58)	1
Income after taxes	512	346	4	432	345	4
Bank's share in income on extraordinary items of investee (in consolidated-affiliated) companies, after taxes	46	2	-	126	3	-
Income on extraordinary items, after taxes	558	348	4	558	348	4

Footnote:

(1) According to the estimated recoverable value amount of the buildings.



31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION

A. GENERAL

In December 2001, the Supervisor of Banks in Israel issued directives concerning segment information reporting in a banking corporation, which followed the approval of Accounting Standard No. 11 regarding segment reporting by the Israeli Accounting Standard Board and in view of the application abroad of accounting standards concerning segment information, and in particular the application of the US Accounting Standard FAS 131 (Disclosure about segments of an enterprise and related information), implementing certain modifications concerning the special characteristics of banking corporations, mostly on the basis of the disclosure prevalent in the US banking system.

According to the directives, a segment of operations is a component of a banking corporation having the following three characteristics:

- (a) Engaged in business activities that may produce income and bear expenses (including income and expenses deriving from transactions with other components of the same banking corporation);
- (b) The results of its operations are reviewed on a current basis by Management and the Board of Directors in order to make decisions as to the allocation of resources to the segment and evaluate its performance;
- (c) Separate financial information exists with regard to the segment.

In addition, the directives determine the disclosure requirements and the manner of presenting the financial results of segments in the financial statements.

The Supervisor of Banks clarified in January 2002, that he expects that a banking corporation heading a banking group would include disclosure as to the following segments: corporate banking, retail banking, middle market banking, private banking, real estate and construction, mortgages, credit card operations, capital market operations, non-financial companies.

Towards the publication of financial statements for 2004, the Supervisor clarified that the retail banking segment should be split into two segments, as follows: "household segment" and "small business segment", and the "financial management segment", which previously appeared as part of "other operations and adjustments", should be presented separately.

In July 2005, the Supervisor of Banks published a "Questions and Answers" file about the disclosure of segment information. The issued circular clarified that the answers appearing in the said file were to be regarded as a Statement of Opinion (SOP) of the Supervisor of Banks' staff regarding guidelines for implementation so long as the Supervisor of Banks has not issued Directives in the matter.

In the said file the number of segments that would require disclosure in the relevant note to the financial statements were, among other things, reduced to the following: Households, Private Banking, Small Businesses, Middle Market Banking, Corporate Banking, Financial Management and Other (if relevant, on a specific basis in the reporting banking corporation). The segments relating to banking products (credit cards, capital market activity, mortgage loans and construction and real estate) are to be presented in the relevant customer segments. Notwithstanding, it is required to include in the Directors' Report, in respect of each segment in a separate column, a disclosure as to the banking product.

The said file 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. Beginning with the financial statements as of December 31, 2006, after IDB New York completed its preparations for presenting the data according to the required segmentation, the data for the international operations segment is presented in the form that the operations of the Group in Israel are presented. In addition a disclosure is included regarding the said operations in the item "International operations". Whereas the data cannot be produced retroactively in the required form, the comparative figures for 2005 are presented in the form that was presented by the Bank in the past, with the approval of the Supervisor of Banks.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

The Bank is installing a management information system to manage profit centers according to customers, products and additional profiles (the cost and profit centers system). 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 as a whole has not yet been completed and implemented, the use of it as a management tool has begun, thought 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. On the other hand, in view of the frequent changes in the definition of segments, as discussed above, together with the fact that the system is not able to provide retroactive data, a periodic series of data segmentized according to operating segments has not yet been created. 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 required.

It should be noted that in the said questions and answers file, the Supervisor of Banks requires banking corporations to consolidate the data of their subsidiaries according to quantitative characteristics determined by the parent company. Providing such data requires the maintenance of a double database for earnings and segments of subsidiaries, and involves tremendous difficulties.

Mercantile Discount Bank completed its preparations in this respect and accordingly, starting with the financial statements as of December 31, 2007, the Bank consolidates the data of Mercantile Discount Bank according to quantitative characteristics set by the Bank. As it is not possible to retroactively produce the required data according to the said premises, the comparative figures for 2006 are presented based on segments operations as reported by Mercantile Discount Bank, without adjustments to the differences between activity characteristics of the Bank's customers in a particular segment and those of the customers of Mercantile Discount Bank in the same segment.

The operations of the Group are divided into six principal segments, as detailed hereunder. The segments also include, as aforementioned, the relevant part relating to banking products (credit cards, capital market activity, mortgage loans and construction and real estate).

It should be noted that these segments of operation do not accord with the organizational structure, mainly due to the fact that certain operations are reflected in the various segments, such as credit card activities and the capital market activity, and not within the organizational framework in which they are being operated.

- **Retail Banking – Household Segment:** This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as VIP customers (the definition excludes customers of the private banking centers). The segment also includes the customers of Mercantile Discount Bank in that bank's household segment – private customers of Mercantile Discount Bank, whose activities are typical of those of households, including credit of a volume not exceeding NIS 200 thousand and deposits of a volume not exceeding NIS 500 thousand.
- **Retail Banking – Small Business Segment:** This segment includes customers of the Bank's Retail Division and customers of Mercantile Discount Bank which are defined as small companies and small businesses with borrowings of up to NIS 10 million. The segment also included, up to December 31, 2006, the customers of Mercantile Discount Bank in that bank's small business segment - that bank's small business segment customers (individuals and corporations) whose granted volume of credit does not generally exceed NIS 1 million.
- **Corporate Banking:** The segment includes mainly companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 50 million, which are customers of the Bank and of Mercantile Discount Bank. The segment also included, up to December 31, 2006, customers of the business segment of the Mercantile Discount Bank – corporations whose annual business turnover generally exceeds NIS 100 million and public companies handled by the corporate division of Mercantile Discount Bank and 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,



31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

- **Middle Market banking:** This segment includes mainly companies with annual turnovers exceeding NIS 30 million and/or total indebtedness of NIS 10-50 million, which are customers of the Bank and of Mercantile Discount Bank. The segment also included, up to December 31, 2006, customers of the Middle Market banking of Mercantile Discount Bank – business 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.
- **Private banking:** This segment includes as part of the Bank's operations customers of the Bank's Retail Division (individuals and corporations) who maintain their accounts at the private banking centers. These customers are generally Israeli customers having deposits of NIS 2 million and over, as well as foreign residents. The segment also includes customers of Mercantile Discount Bank of medium and high wealth, all the activity of the subsidiary in Geneva and the private banking customer activity at IDB New York.
- **Financial Management Segment -** 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 for their own account operations of the Bank and Mercantile Discount Bank 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 sub-segment of non-financial corporations. This sub-segment's main activity was the Bank's investment in Harel Ltd. that was sold and investments undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd., as well as direct investments by the Bank.

B. THE PRINCIPAL ASSUMPTIONS, ESTIMATES AND PRINCIPLES USED IN THE PREPARATION OF SEGMENT INFORMATION

The classification of the business results of the Group into the various segments of activity, as stated above, was prepared based on the principles, assumptions and estimates detailed hereunder:

1) Income

Income from financing operations before provision for doubtful debts. The segment is credited with the margin resulting from the difference between interest on loans granted to customers of the segment and the interest paid on deposits of customers of the segment and the transfer prices.

The transfer prices reflect the marginal alternative cost of financing sources or the application thereof.

The margins are set at the date the transaction is entered into and stay in effect for the duration of the transaction free of market risks. According to this methodology, earning or losses from financing operations resulting from changes in market conditions, are taken to the "Financial Management" segment.

Income earned on the nostro securities of the Bank is also reflected in the "Financial Management" segment.

Provision for doubtful debts. This is included in the segment in which the activity of the customer is reflected, in respect of which the provision has been created. In the same manner, collection in respect of a debt provided for or the decrease in the provision is also reflected in the segment in which the activity of the customer is reflected.

Operational income. All the operational and other income, which the bank collects from customers, are reflected directly in the segment in which the activity of the customer is reflected. Some of the income derived from foreign currency operations with customers is credited to the trading desk.

2) Expenses

Identifiable direct expenses are specifically and directly reflected in the related segments.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

Overhead expenses (mainly head office expenses), which cannot be related to a specific segment, are charged to the segments using an estimate based on various charging formulas, most of them based on volume of operation indices and some of them based on estimates and assessments of the various units of the Bank. (For details see paragraph 4 hereunder).

Depreciation and amortization expenses are charged as part of the overhead expenses.

The model for the charging of expenses used in calculating the data includes the allocation of inter segment expenses, mainly in relation to operational services provided by the branch setup to customers related to other segments by charging all the branches' expenses to customers of these branches, even if these customers are not amongst the customers of the Retail Division. As stated above, this charge is made by way of an estimate based mainly upon indices for the volume of operations of customers of the Bank's branches.

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.

Taxes on income. In order to exclude the effect of brought forwards tax losses in respect of which deferred tax assets had not been recorded, on the measurement of the profitability according to segments of operation, the following tax computation was made:

The provision for taxes of the various segments of operation was computed on the basis of the statutory tax rate of 38.53% (2006: 40.65%).

Segments showing a loss recorded a tax income computed also on the basis of the statutory tax rate.

The difference between the net taxes attributed to the segments of operation and the provision for taxes recorded in the income statement, is charged to the "Financial Management" segment.

3) Allocation of capital and computation of the return

Shareholders' equity and subordinated capital notes, being part of the financing sources of credit, are being allocated to each segment in respect of its risk assets. The allocated capital notes bear the actual interest expense attributed to them.

According to directives of the Supervisor of Banks, the operational segments are credited with imputed interest on the capital allocated to them, on the basis the risk assets attributed to the segment.

The computation of the return in each segment is based on the amount of shareholders' equity allocated to the segment

4) Presentation of inter-segment income and expenses

The accountability between the profit centers in the Bank is made by a mechanism that allocates the total amount of expenses to customers of the Bank, using various activity indices, and not by allocating the expenses to the profit centers (and the "sale" of inter-segment services).

The method for the allocation expenses used by the Bank is a multi-stage one. In the first stage the direct expenses of the branch are allocated to all the customers keeping their accounts at the branch, (customers attached to various segments). In the second stage, the expenses of designated units are allocated based on an estimate of the distribution of the service to the various headquarters, and the total expenses of the headquarters and administrations to the customers whom they serve. Finally, the costs of the general headquarter units (management, human resources, comptroller, operations and computer services, etc.) to all the customers of the Bank.

According to the system described above, each customer "bears" its own relevant expenses, which are accumulated in the various segments according to the affiliation of customers to these segments.

The format described above does not allow the determination as to what expenses of one segment were charged to another segment (referred to in the reporting format as "inter-segment activity"). The Supervisor of Banks permitted the Bank to report on the basis of the mechanism it developed for the purpose of allocating income and expenses, and in consequence thereof not to report inter-segment transfers.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS

Reported Amounts

For the year ended December 31, 2007								
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Non-Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	144	897	1,244	1,234	134	(13)	585	4,225
- Intersegmental	1,064	(162)	(316)	(514)	180	(23)	(229)	-
Total Income from financing activities	1,208	735	928	720	314	(36)	356	4,225
Non-financing and other income	1,582	359	230	204	140	32	25	2,572
Total Income	2,790	1,094	1,158	924	454	(4)	381	6,797
Provision for doubtful debts	123	128	60	124	5	-	7	447
Operating and other expenses	2,237	700	549	685	381	4	510	5,066
Operating Income (loss) before taxes	430	266	549	115	68	(8)	(136)	1,284
Provision for taxes on operating income	134	93	207	41	38	(6)	59	566
Operating Income (loss) after tax	296	173	342	74	30	(2)	(195)	718
Bank's share in operating income of affiliated	(2)	-	1	-	-	21	25	45
Minority interest in the income of subsidiaries	(56)	(1)	1	-	-	-	-	(56)
Net gain from extraordinary items, net of taxes	416	55	3	29	13	-	42	558
Net income (loss)	654	227	347	103	43	19	(128)	1,265
Net income (loss) disregarding certain components*	260	185	354	93	43	19	(30)	924
Yield on capital (percentage)	55.4%	36.3%	14.7%	7.5%	18.3%	32.3%	(4.6)%	14.7%
Yield on capital disregarding certain components* (percentage)	22.0%	29.5%	15.0%	6.8%	18.4%	32.3%	(1.1)%	10.7%
Average Assets	24,617	11,923	37,515	21,096	3,950	958	65,065	165,124
Of which - Investment in Investee companies	-	3	2	-	-	69	1,381	1,455
Average Liabilities	53,390	9,966	16,475	17,516	37,346	248	21,335	156,276
Average Risk-assets	19,688	10,428	39,440	22,815	3,950	958	17,932	115,211
Average assets of provident and mutual funds	11,408	1,861	99	908	1,250	-	2,024	17,550
Average customers' securities	27,689	4,748	39,490	11,887	16,724	-	-	100,538
Average other assets under management	3,553	300	152	1,595	708	-	-	6,308
Margin from credits activity	572	571	699	527	46			
Margin from deposits activity	571	123	60	139	266			
Other	65	41	169	54	2			
Income from financing activities before provision for doubtful debts	1,208	735	928	720	314	(36)	356	4,225

* The following components have been eliminated: expenses in respect to early retirement plan, the cost of performing examination at IDB New York, gains on sale of the provident funds activity and the activity of KAHAL and a provision for taxes in respect of the Bank's share in the earnings of the First International Bank.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)**C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)**

Reported Amounts

For the year ended December 31, 2006								
	Households	Small Businesses	Corporate Banking*	Middle Market Banking*	Private Banking	Financial Non-Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From externals	472	736	1,264	1,220	814	(3)	(713)	3,790
- Intersegmental	603	(200)	(365)	(550)	(512)	(15)	1,039	-
Total Income from financing activities	1,075	536	899	670	302	(18)	326	3,790
Non-financing and other income	1,435	331	183	178	130	13	89	2,359
Total Income	2,510	867	1,082	848	432	(5)	415	6,149
Provision for doubtful debts	109	183	159	117	2	-	-	570
Operating and other expenses	2,220	634	555	708	375	4	524	5,020
Operating Income (loss) before taxes	181	50	368	23	55	(9)	(109)	559
Provision for taxes on operating income	79	*26	153	16	32	(4)	48	350
Operating Income (loss) after tax	102	24	215	7	23	(5)	(157)	209
Bank's share in operating income of affiliated	(2)	-	-	-	-	56	134	188
Minority interest in the income of subsidiaries	(79)	(3)	-	-	-	-	-	(82)
Net gain (loss) from extraordinary items, net of taxes	220	25	2	2	8	104	160	521
Net income (loss)	241	46	217	9	31	155	137	836
Net income (loss) disregarding certain components**	144	*74	261	70	56	51	16	672
Yield on capital (percentage)	23.4%	*7.8%	9.9%	0.6%	21.1%	431.2%	*7.1%	*11.7%
Yield on capital disregarding certain components** (percentage)	19.9%	*12.3%	11.9%	5.8%	39.2%	143.3%	*0.8%	*9.4%
Average Assets	19,597	12,007	36,725	22,762	3,533	307	*59,403	154,334
Of which- Investment in Investee companies	1	-	-	-	-	81	1,523	1,605
Average Liabilities	*53,346	7,562	14,408	13,266	37,478	24	*20,898	146,982
Average Risk-assets	17,158	*10,007	36,665	19,986	2,397	601	19,571	106,385
Average assets of provident and mutual funds	25,381	3,499	230	1,505	1,262	-	1,917	33,794
Average customers' securities	22,543	4,347	25,469	10,992	17,390	-	-	80,741
Average other assets under management	3,552	283	130	1,584	626			6,175
Margin from credits activity	435	389	631	453	67			
Margin from deposits activity	548	96	79	180	231			
Other	92	*51	189	37	4			
Income from financing activities before provision for doubtful debts	1,075	536	899	670	302	(18)	326	3,790

* Reclassified.

** The following components have been eliminated: privatization bonus, expenses in respect of early retirement plan, payments to the supervisory authorities in the US, the cost of performing examinations and improvements at IDB New York, reversal of the provision in respect of investment in the First International Bank and gains of sale of shares in Harel and in Ilanot Discount.



31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)

Reported Amounts

For the year ended December 31, 2005									
	Households*	Small Businesses	Corporate Banking*	Middle Market Banking*	Private Banking	International Activity	Financial		Total
							Non-Financial Companies	Financial Management	Consolidated
	in NIS millions								
Income (loss) from									
financing activities before									
provision for doubtful debts									
- From externals	(871)	574	1,591	271	(722)	1,098	5	1,751	3,697
- Intersegmental	1,896	(18)	(811)	91	843	(150)	(20)	(1,831)	-
Total Income from									
financing activities	1,025	556	780	362	121	948	(15)	(80)	3,697
Non-financing and other income	1,427	383	126	145	75	124	1	125	2,406
Total Income	2,452	939	906	507	196	1,072	(14)	45	6,103
Provision for doubtful debts	85	182	307	79	-	38	-	-	691
Operating and other expenses	1,851	697	471	399	129	768	4	410	4,729
Operating Income (loss)									
before taxes	516	60	128	29	67	266	(18)	(365)	683
Provision for taxes on									
operating income	245	40	67	15	32	39	(9)	(105)	324
Operating Income (loss) after tax	271	20	61	14	35	227	(9)	(260)	359
Bank's share in operating									
income of affiliated	-	-	-	-	-	-	54	120	174
Minority interest in the									
income of subsidiaries	(80)	(3)	8	-	-	-	-	-	(75)
Net income (loss)	191	17	69	14	35	227	45	(140)	458
Yield on capital (percentage)	19.1%	*3.4%	3.6%	2.3%	125.5%	16.0%	127.9%	(16.7)%	7.2%
Average Assets	16,231	11,577	29,859	8,840	1,094	45,277	616	35,800	149,294
Of which - Investment in									
Investee companies	4	-	-	-	-	-	461	891	1,356
Average Liabilities	49,944	8,189	12,513	4,769	16,575	40,209	26	9,195	141,420
Average Risk-assets	16,678	8,834	32,210	9,940	471	23,578	583	8,761	101,055
Average assets of provident									
and mutual funds	29,384	5,060	454	2,316	1,069	-	-	1,911	40,194
Average customers' securities	12,624	3,315	20,548	11,242	7,713	10,537	-	-	65,979
Average other assets under									
management	3,246	244	101	1,507	502	129	-	-	5,729
Margin from credits activity	434	*386	616	263	15				
Margin from deposits activity	557	89	102	78	106				
Other	34	81	62	21	-				
Income from financing									
activities before									
provision for doubtful debts	1,025	556	780	362	121	948	(15)	(80)	3,697

* Reclassified.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)**D. INFORMATION ON GEOGRAPHICAL AREAS**

	Income ⁽¹⁾			Net Income			Assets	
	For the year end December 31						As at December 31	
	2007	2006	2005	2007	2006	2005	2007	2006
	in NIS millions							
Israel	5,629	5,201	5,031	1,110	845	231	127,626	121,103
Europe	108	84	65	27	9	5	4,173	4,148
North America	932	741	904	103	(45)	214	35,128	35,400
South America	128	123	103	25	27	8	1,883	1,872
Total Overseas	1,168	948	1,072	155	(9)	227	41,184	41,420
Total Consolidated	6,797	6,149	6,103	1,265	836	458	168,810	162,523

Footnote:

(1) Income-earnings from financing operations before provision for doubtful debts and other operating income.

32. SALE OF A CONTROLLING INTEREST IN THE BANK**A. COMPLETION OF THE SALE OF A CONTROLLING INTEREST IN THE BANK**

On January 31, 2006, the transaction signed on February 1, 2005 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 Buyers”) on the other hand, for the sale of a controlling interest in the Bank (hereinafter – “the Agreement for the sale of a controlling interest in the Bank”), was completed, whereby:

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

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

B. PERMIT OF THE GOVERNOR OF BANK OF ISRAEL

The Governor of the Bank of Israel issued a permit to the group of investors to acquire and hold jointly the control and means of control in the Bank. This involves matters that have an impact on the Bank, including:

1. (a) No dividends shall be distributed from earnings retained by the Bank up to September 30, 2004.

If losses were incurred after that date, no dividends shall be distributed until after such losses have been recovered. Furthermore, no dividends are to be distributed from gains on sale of significant assets of the Bank during the period of five years from date of the permit. After that date, dividends may be distributed from such gains subject to the prior written approval of the Supervisor (The retained earnings of the Bank as of September 30, 2004, which, as stated, may not be distributed, amount to NIS 2,704 million).

- (b) Notwithstanding the aforementioned, dividends may be distributed from gains on sale of significant assets of the Bank during the period of five years from date of the permit, if all the following conditions exist:

- (1) The sale results from legal requirements applying to the Bank;



32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

- (2) The distribution of dividends from such gains shall not cause a reduction in the minimum capital ratio that existed at the Bank prior to the sale of the said assets;
 - (3) The Board of Directors of the Bank shall approve such distribution after having examined the needs of the Bank and its business plans;
 - (4) Prior approval of the Supervisor in writing has been given for such distribution after the Supervisor had examined the capital adequacy of the Bank and the basis for the Board's decision.
2. Members of the Group, their relatives or corporations under the control of any of them, are not to receive management fees or any consideration or other benefit from the Bank or from corporations under the control of the Bank; however, they are permitted to provide services normally provided by suppliers of such services and at market price, as long as a written notice has been given beforehand to the Supervisor as to the type of service and the consideration, at least 14 business days prior to providing the service; in an event that the Supervisor informs that a service is not of the type provided ordinarily to others, or that the consideration for it is not reasonable, such service shall not be given.

The provisions of this Section shall not apply to Directors' remuneration payable to all Directors of the Bank in equal amounts.

C. EMPLOYEES AGREEMENT

On February 1, 2005, concurrently with the signing of the Agreement for the Sale of a Controlling Interest in the Bank, an agreement was signed between the New Histadrut Federation of Labor (hereinafter: "the Histadrut"), the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance (hereinafter – "the Employees Agreement"), which, among other things, is subject to the approval of the Bank (see hereunder). The Employees Agreement is intended to settle several demands raised on behalf of the employees of the Bank in connection with their rights in light of the sale of the controlling interest in the Bank by the State.

Set out below are the provisions of this Agreement:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the remaining balance of 10% of the Bank's shares held by the State, at a 25% discount, and to a subsidized loan by the Bank to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees. In the Employees Agreement it was declared that the value of the benefit for conceding the purchase of the shares as aforesaid is NIS 120 million (hereinafter – "the State Grant to Employees").
- The employees would be entitled to receive from the Bank a bonus on account of 2004, of one salary to each employee (hereinafter – "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter – "the Special Grant").
- The total value of the Special Grant and the Bonus for 2004 is approximately NIS 130 million (hereinafter together: "the Bank Grant to Employees").

It should be clarified that in a conversation held between the President & CEO of the Bank and the Deputy Accountant General at the Ministry of Finance, it was made clear to the Bank that the amount of the Bank Grant to Employees (amounting as stated above to NIS 130 million) reflects the total cost to the Bank as the employer of these employees. The content of this discussion has been put in writing in a letter sent by the Bank to the Deputy Accountant General.

Amounts in excess of the said NIS 130 million, will be paid by the Government.

32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

- The State Grant to Employees and the Bank Grant to Employees (hereinafter – “the Total Grant”) amount to NIS 250 million. The Total Grant shall be paid to the employees subject to the closing of the Agreement for the Sale of the Controlling Interest in the Bank, and on dates determined in the agreement.
- The power of the Labor Charter as a collective labor agreement at Discount Bank, shall be extended for a period of five years, namely until December 31, 2009.
- The Agreement for the Sale of a Controlling Interest in the Bank is to include a provision that in the event that the control of Israel Discount Bank of New York is sold, then the full cash proceeds of such sale will be transferred to the Bank, and that no dividend shall be distributed out of such proceeds for a period of five years from date of signing the Agreement for the Sale of a Controlling Interest in the Bank, unless otherwise agreed with the Representative Committee of the Employees.
- The labor dispute announced on March 11, 2004, with regard to the privatization of the Bank, shall be terminated immediately upon the approval of the Employees Agreement.
- Immediately following the approval of the Employees Agreement, the employees will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in the Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all. (In this regard, it was clarified that the term “employees” in relation to the above does not include the employees of Mercantile Discount Bank Ltd.)
- Subject to the approval of the Employees Agreement, the parties to the Employees Agreement have mutually committed that for the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain “industrial peace”. No one-sided actions will be taken or one-sided organizational changes be made by any of the parties that are not compatible with the Labor Charter. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.
- The employees entitled to the Total Grant are those who at date of closing are employees of the Bank, of Mercantile Discount Bank and of the wholly owned subsidiaries in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which at closing date have been with the Bank for at least one year.

The Employees Agreement was subjected to the approval of the authorized institutions of the Bank. On February 7, 2005, the Audit Committee of the Bank and the Board of Directors of the Bank approved the Bank joining the Agreement. The resolution emphasized that the total cost to the Bank (employer’s cost) will be NIS 130 million (and shall not exceed that amount). On April 5, 2005 the General Meeting of Shareholders of the Bank approved the Bank joining the Employees Agreement. The Employees Agreement was also subject to the approval of the Finance Committee of the Knesset. The Finance Committee approved the Employee Agreement.

In the first quarter of 2006, soon after the closing of the agreement for the sale of a controlling interest in the Bank, the Bank and its relevant subsidiaries paid the overall bonus agreed upon in the Employees Agreement. The total cost of this bonus, including related expenses (payroll VAT and Social Security contributions) amounted to NIS 305 million out of the said amount NIS 73 million were provided for in the financial statements as of December 31, 2004. Accordingly, the bonus that is to be paid by the State will amount to NIS 175 million, of which NIS 120 was paid in March 2006 and the balance will be paid on the date of exercise of the option by the Bronfman-Schron Group, or at the end of three years from date of closing, the earlier of the two.

Mercantile Employees Agreement. On May 22, 2005, the Histadrut, The Representative Committee of Mercantile Discount Bank Employees and the Accountant General at the Ministry of Finance signed an agreement, which, inter-alia, is subject to Mercantile Discount Bank’s approval (see hereunder). The Mercantile Employees Agreement is intended to settle several demands raised by



32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

employees of this bank regarding their rights in light of the sale of the controlling interest in the Bank by the State.

The terms of the Mercantile Employees Agreement are as follows:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the remaining balance of 10% of the Discount Bank's shares held by the State, at a 25% discount, and to a subsidized loan to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees.
- The employees would be entitled to receive from Mercantile Discount Bank a bonus on account of 2004, of one salary to each employee (hereinafter – "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter – "the Special Grant").
- The total amount of the bonus payable to the employees of Mercantile Discount Bank will be the proportional amount applicable to the Mercantile Discount Bank out of the total amount of the bonus (NIS 250 million) as defined in the said Employee Agreement. The said bonus will be paid to the employees subject to the closing of the agreement for the sale of a controlling interest in the Bank, and at dates specified in the Agreement.
- The validity of the collective labor agreements at Mercantile Discount Bank (as the term is defined in the collective agreement dated December 21, 2004 and all its Annexes) will be extended for a specified period until December 31, 2009. At the end of this period, the parties shall act as regards to the validity of the collective agreements, in accordance with the terms of Section 5 of the labor agreement dated May 17, 1968.
- The labor dispute announced at Mercantile Discount Bank on March 29, 2004, with regard to the privatization of Discount Bank, shall be terminated immediately upon the approval of the Mercantile Employees Agreement.
- Immediately following the approval of the Mercantile Employees Agreement, the employees of Mercantile Discount Bank will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in Discount Bank, and for the sale of the remaining balance of shares held by the State, and in any other required process, if at all.
- Subject to the approval of the Mercantile Employees Agreement, the parties to the Mercantile Employees Agreement have mutually committed that in the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes made by any of the parties that are not compatible with the collective labor agreements. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.

The validity of the Mercantile Discount Bank Employees' Agreement was subject to approval of the authorized institutions of this bank, approval of Mercantile Discount Bank Employees' Council and the approval of the Finance Committee of the Knesset.

On May 30, 2005, the Representative Committee of Mercantile Discount Bank Employees approved the Mercantile Employee Agreement. The Board of Directors of Mercantile Discount Bank approved the agreement on June 9, 2005, and the general meeting of shareholders of Mercantile Discount Bank approved the agreement on June 20, 2005. The Finance Committee of the Knesset also approved the Agreement.

D. THE ACCOUNTING TREATMENT OF THE EMPLOYEE AGREEMENT

The financial statements for 2004 include a provision in respect of the bonus for 2004, to the tune of one salary, based on the assessment that in view of the results for the year 2004, the Bank and its other relevant subsidiaries in the Group would have, in any

32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

case, paid such a bonus to their employees. The amount of the said bonus is NIS 73 million.

The provision in respect of the balance of the Bank's Grant to Employees in the amount of NIS 57 million, comprising the said special bonus, was recorded in the financial statements for the first quarter of 2006, in which the conditions precedent in the Employees Agreement were fulfilled, and in particular the closing of the transaction for the sale of a Controlling Interest in the Bank.

As to the State Grant to Employees, the Bank was informed by the Supervisor of Banks that the Grant to be paid by the State (an amount of NIS 175 million, including further amounts in respect of the addition of employer related costs) is considered "a transaction with a controlling party". Therefore the grant paid by the State is to be recorded as part of payroll expenses against a capital reserve.

The expense regarding the State's Grant to Employees was recorded in the financial statements of the Bank in the first quarter of 2006, in accordance with the said directive of the Supervisor of Banks, along with recording the provision for the special bonus.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE

GOVERNMENT RESOLUTION REGARDING THE BANKING SYSTEM

In the course of the years since 1993, the Government adopted various decisions with respect to the banking industry, a number of which turned into Law, other were formed into proposed Bills, and the remainder stayed as Government decisions, whether in their original format or subsequently changed. The principal decisions relate to the following topics:

(a) the holding of shares of banks in the arrangement after October 1993; (b) the splitting-off of banking subsidiaries; (c) the holding of means of control in non-banking corporations by banking corporations; (d) provident funds; and (e) the holding of bank shares by institutional investors controlled by banking institutions.

Most of the amendments relating to the legislation restricted, reduced and regulated the banks' activities in the said areas.

The Bank Shares in Arrangement (Temporary Provision) Law (1993) was, inter-alia, published. The law was designed to regulate the holding of such shares and the exercise of the voting rights attached thereto, and other ancillary matters.

CHANGES IN THE STRUCTURE OF THE CAPITAL MARKET

In November 2004, the Government adopted the recommendations of the inter-office committee, headed by the Director General of the Ministry of Finance (hereinafter – "the Bachar Committee"), the purpose of which was to provide a competitive basis for the capital market to reduce concentration in the market and minimize conflicts of interest.

In continuation to the recommendations of the Bechar Commission, three comprehensive laws were published on August 10, 2005, which relate to the capital market and to the activities of banks and other players therein; The Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Capital Markets in Israel (Legislation amendments), 2005 (hereinafter: "The Law for Increasing Competition"); The Supervision of Financial Services Law (Consulting and Marketing of Pension Schemes), 2005 (hereinafter: "The Pension Consulting Law"); The Supervision of Financial Services Law (Provident Funds), 2005 (hereinafter: "The Provident funds Law"). Further on in 2005 and in the years 2006 and 2007, various Rules and Regulations began to be published, designed to complement the arrangements by way of secondary legislation. In the course of 2007 and at the beginning of 2008, legislation and regulatory amendments were passed designed to change the arrangements in the field of pension savings.

Following is a summary review of the main amendments to the legislation.

THE LAW FOR INCREASING COMPETITION

This Law amends several relevant laws, and per the letter of this Law, is intended to establish a competitive structure in the capital markets, improve efficiency and modes of operation and increase public welfare, mostly by reducing concentration and minimizing



33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

conflicts of interest among entities operating in the market, and expanding supervision and control over such entities and over those who own and control them.

AMENDMENTS TO THE BANKING LAW (LICENSING), 1981

- A banking corporation is forbidden to manage provident funds and mutual investment trust funds ("mutual funds") or to hold, directly or indirectly, any means of control over a company that manages provident funds or mutual funds.
- A bank is forbidden to own over 10% of corporations that control or own over 25% of a company that manages provident funds or of a company that manages mutual funds.
- Concurrently, transitional periods were determined in which banks must divest of the said holdings in a manner that banking corporations, the equity of which does not exceed NIS 10 billion (among which is the Bank), are required to reduce their holdings in provident fund management companies over a period of six years from the date the Law becomes effective, and to reduce their holdings of mutual fund management companies over a period of eight years from the date the Law becomes effective. During these periods the Bank must gradually reduce the relevant market share of the provident fund and mutual fund management companies it owns.
- A bank is forbidden to directly control or own over 5% of any type of the means of control in a portfolio manager who manages investments of a mutual fund, a provident fund or an insurer. The indirect ownership of a bank in a corporation that controls a portfolio manager as stated above was also limited to 20%.

A transitional provision was also passed in this respect, whereby the bank will be entitled to continue exceeding the said maximum ownership until the end of six years from the date on which the Law comes into effect.

- A bank is permitted to provide pension consultation services, subject to the provisions of the Pension Advisory and Marketing Law (see hereunder).
- A duty has been imposed on banks to receive the Supervisor of Banks' approval for the ownership of auxiliary corporations.
- A bank is permitted to have the sole ownership and control of a corporation that is an insurance broker, provided that the insurance business is limited to life insurance and property insurance purchased in connection with granting housing loans to customers of the Group's banking corporations.
- Restrictions as to the ownership of corporations of various kinds have also been imposed on entities controlling banking corporations.
- The Supervisor of Banks has been authorized to impose civil penalties on a bank in respect of violations of a part of the provisions of the Banking Law (Licensing).

The said provisions are effective as from August 10, 2005.

AMENDMENTS TO THE BANKING ORDINANCE, 1941

- The authority of the Supervisor of Banks to issue directives as to bank management has been legislated and the status of the existing directives has been reaffirmed.
- The Supervisor of Banks has been authorized to relate to the regulatory authorities in Israel information attained as part of the performance of his duties.
- The Supervisor of Banks has been authorized to impose a monetary sanction upon a bank if he has reasonable grounds to assume that the bank had violated Proper Banking Management Directives, or other directives issued by the Governor of the Bank of Israel and/or the Supervisor. Concurrently, provisions have been enacted as to the bank's right to appeal the Supervisor's decision.

The said provisions are effective as from August 10, 2005.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

AMENDMENTS TO THE BANKING LAW (CUSTOMER SERVICE), 1981

- The Supervisor of Banks has been authorized to impose a monetary sanction on a bank if he has reasonable grounds to assume that this banking corporation had not corrected certain deficiencies in accordance with this Law or if it had violated certain provisions of this Law and the Regulations passed thereunder.

The said provisions are effective as from August 10, 2005.

AMENDMENTS TO THE LAW REGULARIZING ENGAGEMENT IN INVESTMENT ADVISORY AND INVESTMENT PORTFOLIO MANAGEMENT, 1995

- A distinction has been made between investment consultation services and investment marketing (investment advise regarding products towards which the consultant has an affinity), and the duties of those engaged in these areas have been determined. Banks will be permitted to engage in investment advisory services (by means of investment consultants) and in addition will be permitted to market structured products, options and forward contracts issued by them.
- The holder of a consultant license (including a bank) is not permitted to provide consulting services with regards to financial assets of an institutional entity that controls the bank, is controlled by it or is an interested party in the bank (or affiliated with the bank).
- Similar restrictions which were imposed on a bank have also been imposed on portfolio managers connected to that bank.
- A bank shall not be permitted to issue basket notes.
- The engagement of a bank with a provident fund management company, a mutual fund management company or an insurer for the purpose of providing banking services that are not in the ordinary course of business of a bank, or which is not under accepted market terms, or which might have a significant effect upon the bank's profitability, assets or liabilities, requires the prior approval of the Chairman of the Securities Authority and of the Supervisor of Banks, and in the coming years (until 2010) also of the Antitrust Commissioner.
- Certain restrictions in respect of investment advisory services and the marketing of investments have been imposed also on whoever controls a bank, and also on a bank which the controlling entity holds or controls entities as above.
- Prohibitions and restrictions have been imposed upon the receipt of incentives (except for fees and the reimbursement of expenses) in connection with investment advisory services, the marketing of investments, the execution of a transaction or refraining from executing a transaction in financial assets.

Notwithstanding the aforesaid, an investment consultant is permitted to receive a distribution commission from a mutual fund management company if such commission is paid in accordance with the provisions of the Mutual Investment Trusts Law and the Regulations to be enacted thereunder.

- A bank is not permitted to grant benefits to its employees or its units in connection with investment advisory services, investment marketing, and the execution of a transaction or abstention from executing a transaction, if such benefit is determined considering the identity of the entity that has an affiliation to the financial assets being the subject of the advisory services, the marketing or the transaction.
- The Securities Authority is empowered to impose a civil penalty on whoever violates certain provisions of the Law.

The said provisions are to become effective six months following the enactment of the Law. However, with respect to a bank, the provisions in effect prior to the said effective date, will continue to apply so long as the bank or those who control it or corporations owned by it, are holding means of control in companies managing provident funds or mutual funds, or by the portfolio management company managing the funds of financial institutions on behalf of their customers (all this in the period in which the said holdings were still permitted).



33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

AMENDMENTS TO THE MUTUAL INVESTMENT TRUST LAW, 1994

- The provisions regarding the approval of a mutual fund management company and the cancellation of such an approval have been extended.
- It has been determined that the holding of 30% of a particular type of means of control in a mutual fund management company requires the approval of the Securities Authority.
- The market share of an owner of a mutual fund management company has been restricted to 20%.
- The Minister of Finance has been empowered to determine the maximum rate of commission that a distributor is entitled to collect from a mutual fund management company, provided that a uniform rate of commission is to be collected from the various mutual fund managers.
- The Minister of Finance has been empowered to determine the maximum rate of commission that a distributor is entitled to collect from a purchaser of a unit in a mutual fund.
- The Securities Authority has been empowered to issue guidelines and instructions as to the proper management of mutual funds.

The said provisions are effective as from August 10, 2005.

AMENDMENTS TO THE SUPERVISION OF INSURANCE BUSINESS LAW, 1981

- The authority of the Commissioner of Insurance has been extended, including his power to license the ownership of an insurer and an insurance broker.
- It has been determined that the requirement to receive a permit for holding means of control in an insurer shall also apply to the holding of means of control in an insurer as security for enforcement, unless these are held in a security deposit account of a customer with a bank, and their rate does not exceed 0.001% of the same type of the means of control.
- A pension consultant is also permitted to engage as an insurance broker, provided that the brokerage activity shall be part of the pension advisory services.
- It has been determined that a banking corporation shall not be permitted to receive an insurance brokers license in the pension insurance field.
- The Commissioner of Insurance has been authorized to impose a civil penalty and a monetary sanction on whoever acts in violation of certain provisions of the Law.

The said provisions are effective as from August 10, 2005.

THE PENSION CONSULTING LAW

- The law regularizes the activity of consulting services to individuals with respect to the advisability of savings through pension products. The Law specifies two new occupations requiring a license – pension advisory services and the marketing of pension schemes, and the criteria for obtaining a license and the duties of those engaged in these fields have been determined.
- Banks shall not be permitted to engage in the marketing of pension schemes but will be allowed to engage in pension advisory services (through licensed pension consultants) on the following terms:
 - A. The banking corporation does not own over 5% in the Insurer and does not own over 10% of the means of control in another corporation which controls the insurer or owns over 25%;
 - B. The banking corporation does not own any means of control in a provident fund management company and does not own over 10% of the means of control in another corporation, which controls a provident fund management company or owns over 25% of that company;
 - C. The banking corporation does not own any means of control in a mutual fund management company and does not own over 10% of the means of control in another corporation, which controls the mutual fund management company;

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

D. The Commissioner of the Capital Market, Insurance and Savings is convinced that the granting of a license will in no way harm competition and the prevention of concentration in the relevant fields, including banking.

Concurrently, transitional provisions have been enacted according to which the Commissioner is empowered to grant a pension advisory license to a banking corporation, the equity of which and of the banking corporations controlling it or which are controlled by it, does not exceed NIS 10 billion (this includes the Bank) even if this banking corporation controls or owns more than 10% of the means of control in a mutual fund manager or in a provident fund management company, and all within the period in which a banking corporation is permitted to have such holdings.

The transitional provisions further determine that a license granted to a banking corporation with respect to pension advisory services shall, within a specified period (at least until the end of 2009), be restricted in a way that the bank would not be permitted to provide pension advisory services as regards pension funds, provident funds and individual severance pay funds if these funds are insurance funds, and also the bank would not be permitted to provide advisory services as to life assurance schemes or disability insurance schemes that are included in a provident fund or in a further education fund (for details regarding a later amendment in this matter, see hereunder).

- A banking corporation is not permitted to provide pension advisory services with respect to a pension product of an institutional entity that is an interested party in the bank or to which the bank is affiliated.
- Pension advisory services shall be provided only at the branches of the bank.
- A banking corporation is not permitted to control or to have an interest in a corporation engaged in pension advisory services unless that company is a banking corporation.
- A banking corporation is not permitted to enter into a transaction with a representative body of employees for the purpose of providing pension advisory services to such employees, nor is a bank permitted to enter into a transaction with an employer or with an employee organization for the purpose of providing pension advisory services to them or to their employees.
- The engagement of a bank, acting as a pension consultant, with an institutional entity in an agreement that is not within the ordinary course of business of the bank and which might have a significant effect upon its profitability, its assets or its liabilities, requires the prior approval of the Antitrust Commissioner of the Capital Markets and of the Supervisor of Banks, and, in the coming years (until 2010), also of the Antitrust Commissioner.
- Prohibition and restrictions have been imposed upon the receipt of incentives (except for fees and the reimbursement of expenses) in connection with pension advisory services or in connection with the carrying out of a transaction on behalf of a customer. However, under certain conditions and at a maximum rate to be determined by the Minister of Finance, a pension consultant may receive a distribution commission from a provident fund management company. The said distribution commission is not to be computed as a rate of the management fees, which the management company collects from the customer.
- A bank, acting as a pension consultant, is not permitted to grant benefits to its employees or to its organizational units, if such benefit is determined considering the identity of the institutional entity that has an affiliated to the particular pension product or considering the type of the pension product.
- The Commissioner has been empowered to issue instructions as to proper management directives of pension advisory services.
- Certain violations of the provisions of the Law are considered a criminal offense.
- The Commissioner of Capital Markets is empowered to impose a civil penalty and monetary sanctions on whoever violates certain provisions of the Law.



33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

The Law is to come into effect six months following its enactment. However, a bank that, prior to the effective date of the Law, engaged in investment advisory services will be entitled to continue providing such services to provident funds and to individual severance pay funds (which are not insurance funds) for a period of three and a half years from the effective date.

The Provident Funds Law

- This law formalized most of the instructions that had formally been included in the Income Tax Regulations (rules for approval and management of provident funds), 1964, as well as other issues, including the authority of the Commissioner of the Capital Markets to impose a civil penalty and monetary sanctions with respect to violations of certain provisions.
- It has been determined that control of a provident fund management company or the ownership of over 5% of a certain type of means of control in a management company requires the approval of the Commissioner of the Capital Markets.
In this respect, the ownership of the means of control at the said rate as a security for enforcement constitutes ownership that requires a license, unless these are held in a security deposit account with a bank and their rate does not exceed 0.001% of the same type of means of control.
- It has been determined that the rights of a member of a provident fund are not transferable and may not be pledged or foreclosed, unless pursuant to conditions specified in the Law or under regulations to be determined by the Minister of Finance.
- Provident funds are required to continue and keep their cash balances with banks of institutions authorized for this purpose, to keep their securities deposits with a Stock Exchange member or with whoever has been authorized for this purpose by the Commissioner of the Capital Markets.
- A management company will be entitled to collect from the assets of the fund, from members' accounts or from other payments management fees, reimbursement of direct expenses and insurance fees only. The Minister of Finance is empowered to determine the maximum rate of the said expenses and management fees.
- A provident fund management company, or whoever controls it is, prohibited from receiving any benefit over and above the said management fees and expenses.
- A provident fund management company is prohibited from paying a commission or other consideration in respect of a member joining the fund, except for a distribution commission, in respect of which the Minister of Finance is also empowered to determine in regulations an amount or a maximum rate and the mode of computing the commission.

The Law will come into effect 90 days after the publication thereof.

It has also been determined that a management company which had been granted a license in the past under the Income Tax Regulations (provident funds) is entitled to a license also under this Law, provided it filed a request for a license within six months from the effective date.

Amendment of the Pension consulting Law

The amendment made at the end of 2007 to the Pension Consulting Law, specified that the limitation on advisory services by insurance funds shall also apply to a banking corporation the equity of which and of corporations controlling it, or being controlled by it, does not exceed NIS 10 billion (which includes the Bank), and this until the end of 2008 only. As to the large banks, the amendment specifies that they may provide advisory services regarding insurance funds to customers residing in peripheral areas starting with January 1, 2009, and to customers residing in central areas of the country starting with April 1, 2009. Concurrently, the two large banks have reached an agreement with the Commissioner of the Capital Market as to a gradual entry into advisory services field for employed persons, in a manner where full advisory services to all types of customers (employed and self employed) and with respect to all pension products would begin as from August 1, 2010 only. Concurrently, a provision was included in the Insurance Business Supervision Law, whereby a distribution commission may be paid to a pension consultant, similarly to a commission fee paid to an insurance broker, everything in accordance with

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

the principles to be determined by the Minister in Regulations. A further amendment to the Law, published at the beginning of 2008, imposed a duty on a pension consultant to serve, as regards certain matters, as a representative of the management company or the insurer vis-à-vis the customer.

Amendment of the Provident Funds Law

An amendment to the Provident Funds Law passed at the beginning of 2008, provides that as from now onwards there will be two classes of pension provident funds: a pension paying provident fund and a non-pension paying provident fund. Amounts saved as from January 1, 2008, shall be designated in the first place for the payment of pension. The capital provident funds that had existed up to that date shall become non-pension paying provident funds, and no withdrawal of funds shall be permitted therefrom (except for withdrawals in respect of the severance pay component), unless by transfer to a pension paying provident fund. Upon retirement, the member of the fund shall be entitled to capitalize a part of the pension monies and withdraw one lump sum, and this only after leaving with the fund an amount sufficient to secure a minimum monthly pension payment of NIS 3,850. The aim of the amendment is to secure a minimum monthly pension in the above amount upon retirement from work of each fund member. The decision regarding the balance of the saved amount (whether to draw it as a pension payment or to capitalize it and draw one lump sum) is to be taken only upon retirement from work. In addition, taxation principles and tax benefits applying to savings by way of the various pension products have been amalgamated. The amendment further states that central severance pay funds, where the members constitute employers, are to continue in operations only until the end of 2010. Starting on January 1, 2008, these funds may not accept additional employers as new members, and existing members may deposit additional funds with these funds only in favor of employees in respect of whom the employer deposited funds in the period prior to December 31, 2007.

In March 2008 the "pension mobility" Regulations were also published, whereby, starting with the date on which these Regulations become effective at the end of 2008, each member would be entitled at any time he wishes, to transfer the amounts accumulated in his favor in one pension product to another pension product and/or to another management company at no cost. The member would be entitled, at his discretion, to transfer the funds from a life assurance policy to a pension fund and vice versa, and from a capital provident fund to a pension fund (though not vice versa).

Compulsory pension for every employee

The Minister of Industry, Trade and Employment signed on December 30, 2007, an Expansion Order according to which the agreement between the New Federation of Labor and the Economic Organizations Coordination Bureau is to apply to all employees and employers. The said agreement relates to the institution of compulsory pension payment for every employee starting January 1, 2008. According to the agreement contributions for pension are to be made with pension funds in respect of every employee, the rate of which in 2013 is to reach 15% of the employee's wage and related components as defined in the Law and in the Severance Pay Regulations (such rate comprises employee provision of 5%, employer provision for pension insurance of 5% and employer provision for severance pay of 5%). The provision is based on the lower of the wage payable to the employee as above and the average wage in the economy. For the period between the years 2008 and 2013, gradual provision rates have been fixed and the matter was also established in a provisional order under the Income Tax Regulations (Principles for approval and management of provident funds).

Preparations by the Bank

Concurrently with the legislation process in the wake of 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 the Bank. The Bank began to apply several moves intended to enhance its preparations for capital

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

market activities in the post Bachar Committee era. In this context the Bank has completed the sale of all the shares in Ilanot Discount Ltd. and the sale of the operations in the field of provident funds management, as detailed in Note 6 E and above and sold a part of its holdings in Harel Insurance Investments (hereinafter – “Harel”), as details in Note 6 H above. The Bank also completed in July 2007 the sale of the operations in the field of further education funds, as detailed in Note 19 C 20 above. The Bank turned its efforts towards completing the preparations for entry into the pension advisory services market. In December 2007, the transaction was completed for the sale of control of the provident funds of the subsidiary company, Mercantile Discount Bank, and on February 18, 2008, the Bank received a license for the granting of pension advisory services to its customers. Activity in this field began in March 2008. Mercantile Discount Bank is also expected to receive in the coming months a license for pension advisory services.

The Regulations regarding the distribution commissions that a bank would be entitled to collect from provident fund and mutual fund management companies, their rates, the basis of their calculation and circumstances of collection might also have an adverse effect. 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).

The Capital Market Commissioner’s circular from September 2006 regarding agreements for the providing of operational services to institutional bodies limiting the maximum amount of operating fees that may be charged to the management company for management services provided to it, fixing them at 0.1% of the assets of the members in respect of which the services are provided. As from 2008 a new rate, a lower one, has been established for the distribution commission which may be charged in respect of the distribution of mutual funds of the “monetary fund” class, and charging distribution commissions in respect of a certain class of mutual funds has been prohibited. At this stage it is not yet possible, to assess what implications these Regulations, the Commissioners 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 extensive amendments in the field of pension savings, including the “pension mobility” reform and the institution of a compulsory pension for each employee, might significantly increase the population requiring pension advisory services and simplified consulting processes.

The limitations imposed on the additional activities that would be permitted to banks, on the one hand, and the uncertainty regarding the effect of the new arrangements established by legislation and regulation 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 as opposed to the loss of income from provident funds and mutual funds and from the investment in Harel on the other hand.

The income from management fees and the reimbursement of expenses by provident funds amounted to NIS 107 million in 2007, compared to NIS 189 million in 2006.

As a result of the sale of Ilanot Discount, the income from mutual fund management in 2007 amounted to NIS 6 million, as compared to NIS 100 million in 2006.

Earnings from distribution fees charged to managers of mutual funds amounted in 2007 to NIS 52 million, compared with NIS 24 million in the second half of 2006.

As a result of the sale of holdings in Harel no share in equity was recorded in this respect in 2007. The contribution of Harel to the net earnings of the Bank in 2006 totalled NIS 37 million.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

As to the income of the Group from fees for the management of provident and mutual funds, see also Note 26.

For details regarding the sale of the shares of Ilanot Discount and regarding an agreement for the sale of the activity of the provident funds, see Note 6 E above. For details regarding the agreement for the sale of KAHAL, see note 19 C 20 above. For details regarding the agreement for the sale of the holdings in Harel, see Note 6 H above.

34. CREDIT CARD ACTIVITY

A. HOLDING MEANS OF CONTROL IN ISRAEL CREDIT CARD LTD. (HEREINAFTER – “ICC”)

1) Acquisition of the ICC shares held by Fishman Store Chains. Fishman Store Chains Ltd. (hereinafter – “Fishman”) informed ICC and its shareholders on May 31, 2006, of its intention to sell all of its ICC shares, which are 24% of ICC’s equity, as one package along with all the rights and liabilities of Fishman as a shareholder in ICC, in return for an amount reflecting a company value of approximately NIS 1.5 billion, subject to adjustments and terms detailed in the announcement. The shareholders of ICC had the right of first refusal in respect of the shares offered for sale, commensurate with their proportionate holdings in ICC.

On July 28 and 31, 2006, the Bank and the First International Bank (“FIBI”), respectively, announced the exercise of their right of first refusal in acquiring the said shares. Concurrently, the Bank and FIBI reached agreements with respect to the adjustments and changes in the arrangements between them as regards their holdings in ICC, to apply following the acquisition of the offered shares. In the beginning of August, 2006, the Bank and FIBI, announced the exercise of their right to acquire the balance of the offered shares, which was not exercised by Harel.

On December 10, 2006, a transaction was consummated for the acquisition by the Bank of 17.2% of the equity and 13% of the voting rights in ICC in consideration for NIS 232 million, following fulfillment of all related conditions (the said amount is after the deduction of dividends distributed by ICC to Fishman in November 2006 in the amount of NIS 10 million, in respect of the shares purchased by the Bank). On March 13, 2007, additional consideration in the amount of NIS 21.2 million was paid in accordance with the business results of ICC for 2006.

Once the acquisition of the Fishman shares in ICC had been completed the Bank held 68.2% in the equity and 76% in the voting rights in ICC, while FIBI held 26.8% in the equity and 20% in the voting rights in ICC.

On December 10, 2006, alongside the consummation of the agreement for the purchase of the shares in ICC held by Fishman, the Bank and FIBI signed an agreement confirming the understandings between them and regularizing the rights and obligations towards one another as shareholders of ICC. The said agreement amends a previous agreement between the parties dated September 29, 2000.

Within the framework of the amending agreement and subject to maintaining the exclusive control of the Bank over ICC, FIBI was granted veto rights regarding the voting on certain material resolutions in ICC. A preferential right has been determined in the event of the sale of ICC shares by any of the partners, as well as arrangements in the case of a decision to effect a private placement and/or a public offering of ICC shares, and everything in accordance with the terms specified in the agreement. The agreement further states that the rights granted to FIBI under the amending agreement shall not be diminished even if its interest in ICC is diluted following a series of material events as detailed in the agreement.

Within the framework of the agreement, FIBI has committed to accept the rights and obligations of Fishman towards the Bank with respect to the shares purchased by FIBI, and which relate to the valid obligations of Fishman as of date of the consummation of the transaction, including an obligation to act towards the release and indemnification of the Bank with respect to any amount which may be paid under a guarantee or commitment for indemnification, which the Bank may have to grant as a shareholder (due to it being a banking

34. CREDIT CARD ACTIVITY (CONTINUED)

institution) in respect of the operations of ICC or Diners in the credit card field, including a guarantee of the Bank in favor of Visa Europe Services Inc., as stated in Note 19 C 12, and everything in proportion to the holdings of FIBI in ICC or in Diners, as the case may be. This commitment is in addition to a similar commitment, which FIBI accepted in the past, under an agreement signed in 2000, according to which FIBI purchased ICC and Diners shares from the Bank.

- 2) 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 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. The said transaction was completed on May 1, 2007.

Upon 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. The arrangements determined in the agreement between the Bank and FIBI, as described in subsection 1 above, apply respectively also to the shares purchased from Harel.

B. HOLDING MEANS OF CONTROL IN DINERS

- 1) Transfer of control in Diners.** An agreement was signed in January 2005 between ICC and its shareholders, according to which ICC would acquire the balance of the shares in Diners, so that following completion of the sale, ICC would own 100% of the equity and voting rights in Diners. Diners International has approved the transfer of the shares. On August 22, 2006, the Supervisor of Banks approved the move.
- 2) The establishment of the YOU customer club and the sale of the means of control in Diners.** On November 29, 2005, ICC entered into an agreement with Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together – “the Purchasers”) according to which ICC has committed to sell to the Purchasers shares comprising 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter – “Diners”) in consideration of NIS 21.3 million. Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The transaction was consummated on December 18, 2006, following fulfillment of all relevant conditions. Within the framework of the agreement, ICC received preference “A” shares that entitle it to receive that part of the profits of Diners attributed to the operations that are not related to the activity of YOU Club, and this until such time that YOU Club reaches a level of operations determined in the agreement.

The consideration for the shares has been financed by a loan granted to the Purchasers by ICC. The shares sold are to serve as collateral for the loan, which is to be repaid at different dates over a number of years, during which the Purchasers are entitled to decide on returning the shares to ICC instead of repayment of the loan, and ICC on its part is entitled to demand the return of the shares, all in accordance with the terms stated in the agreement for the sale of the shares and therefor the sale was not recognized in the financial statements.

It should be noted that to the Bank’s best knowledge, The Purchasers in accordance with this agreement include certain controlling shareholders which, at the time of entering into and consummation of the transaction, constituted part of the Purchasers in accordance with the agreement for the purchase of the control core of the Bank, or were related thereto. (see Note 32 hereunder).

C. ARRANGEMENTS BETWEEN THE CREDIT CARD COMPANIES AND BETWEEN SUCH COMPANIES AND THE BANKS

- 1)** At the beginning of September 2001 the Bank, ICC, the First International Bank, BLL and Leumi Card (hereinafter – “the Parties”) submitted to the Antitrust Tribunal requests for approval of a binding arrangement between themselves and for temporary permits to act in accordance with such an arrangement. In the motions, the Court was requested to approve the issuer commission rates, according to a mechanism, which among other things, would bring about a gradual reduction in the higher categories of the issuer’s commission.

34. CREDIT CARD ACTIVITY (CONTINUED)

Within the framework of the Court proceedings, the appellants presented a methodology for the determination of the Cross Clearing Commission rate. The Antitrust Authority opposed the methodology proposed by the appellants and offered a different one.

On August 31, 2006, the Antitrust Court handed out a ruling regarding the methodology for the determination of the Cross Clearing Commission, while adopting the principal points of the Commissioner's position on the matter. Among other things, the Court ruled that the proper methodology for calculating the Cross Clearing Commission is composed of a transaction approval fee, the cost of securing the payment and the cost of the credit granted. The Court further ruled that the categories for the purpose of the Cross Clearing Commission shall be determined based on the cost of securing the payment in the different transactions, the cost of approving the transaction and according to the benefit derived from securing the payment.

The Court decided that an independent expert should determine the rate of these costs, to the extent that the appellants will inform of their wish to appoint such an expert. The court noted that whereas the period of the binding arrangement is drawing to a close, the parties should inform whether they wish to appoint such an expert. The Court also noted that the appellants have the option of terminating the Cross Clearing Arrangement, though the Court recommends and wishes they will not do so. ICC, the Bank and the first International Bank are studying the possibility of appealing the Court's decision.

Concurrently with the procedures in court, negotiations have been conducted in the months preceding the Courts' decision between the Commissioner and the credit card companies – ICC, LeumiCard and Isracard – regarding the agreement for the formation of a cross clearing system for VISA cards and MasterCard. In view of the said negotiations, the appellants requested the Commissioner to issue a provisional permit, enabling them to complete the negotiations prior to the expiration of the provisional arrangement between them. On September 6, 2006, the Antitrust Commissioner granted the request, extending the exemption granted to the existing arrangement between the parties until October 31, 2006.

2) 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. The arrangement has been submitted for approval of the Antitrust Court, and five opposing motions have been submitted to the court in this respect.

As part of the preliminary hearing of the opposing motions the Antitrust Court ruled on November 11, 2007, to appoint an expert whose duty will be to examine the cross commission rate determined in the arrangement, and among other things to also evaluate the implications that this commission has on competition. According to the Court's decision, the expert would be appointed and supervised by the Antitrust Authority

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, among other things, prohibit the inter-dependence between various types of credit cards being cleared by a trader 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 trader.

The Agreement specifies further rules that, among other things, do not permit banks that control credit card companies, to link



34. CREDIT CARD ACTIVITY (CONTINUED)

between the services provided to the trader 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, 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.

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 due to, among other things, ICC's ability (and that of LeumiCard) to operate in the field of VISA credit card clearing.

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.

3) A joint issuance agreement between ICC and FIBI. Among other distribution agreements signed by ICC (including Diners) with several banks, is also an agreement signed with FIBI for the joint issue of VISA and DINERS credit cards to customers of the FIBI 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.

FIBI 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, FIBI informed ICC of its wish to conduct, as early as possible, a fast negotiation for the renewal of the engagement between them, based on existing agreements and their appendices, 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 November 15, 2007. On November 20, 2007, a three year agreement for a joint issuance was signed, following which the agreement will be renewed for an additional period of three years, unless either of the parties gives a six month notice of his wish to terminate the engagement.

4) A joint issuance agreement between ICC and the Bank. ICC entered into an agreement with the Bank that is similar to the agreement with FIBI. ICC and the Bank are conducting negotiations regarding the change in the agreement conditions.

5) Arrangements between FIBI and the IsraCard. Reports of FIBI regarding an agreement signed in January 2006 with Bank Hapoalim, for the purchase of means of control in Otzar Hachayal Bank Ltd., stated among other things, that the parties to the agreement determined "arrangements for the continued engagement between Otzar Hachayal Bank and IsraCard Concern and for the cooperation between the bank and the IsraCard".

The approval for the merger granted by the Antitrust Commissioner to the FIBI and Otzar Hachayal Bank, it was provided that the said banks would not be party to exclusivity arrangements, unless a prior approval of the Commissioner is granted. The said banks and Bank Hapoalim were ordered to cancel any exclusivity arrangement to which they are party, in a manner that not restriction shall apply to the said banks as regards the marketing of charge cards that are not charge cards of Bank Hapoalim or of a company under its control.

34. CREDIT CARD ACTIVITY (CONTINUED)

An exclusivity arrangement is any arrangements that provides an undertaking according to which any of the said banks would market charge cards of Bank Hapoalim or companies under its control, including any undertaking involving the number of charge cards of Bank Hapoalim Group that would be marketed by the said banks or the percentage of charge cards of Bank Hapoalim Group out of the total charge cards to be distributed by the said banks.

6) An accord between Mizrahi-Tefahot Bank and IsraCard. According to reports of Mizrahi-Tefahot Bank Ltd., a memorandum in principle was signed on November 13, 2007, between this bank, IsraCard Ltd. and Europay (Eurocard) Israel Ltd., according to which, inter-alia, the parties will conduct accelerated negotiations for the signing of a new agreement (for a period of ten years) the objective of which is the issue of "Mizrahi-Tefahot" branded credit cards, and for the determination of operating and provision of services arrangements by IsraCard and/or Europay for credit cards to be issued by them and distributed by Mizrahi-Tefahot Bank to its customers. ICC cannot assess at this stage the implications of such an agreement, if signed, on competition in the credit card market in general and on the operations of ICC in particular, if at all.

35. LEGISLATION INITIATIVES

Several legislation issues exist (laws, regulations and administrative instructions) which are at different stages of the enactment proceedings. Certain of these issues are liable to have an adverse effect on the operations of the Bank and of its consolidated subsidiaries and their business results in the future. The Bank is not able to evaluate the scope of such effect.

36. LEGISLATION IN THE MATTER OF BANKING COMMISSIONS

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

36. LEGISLATION IN THE MATTER OF BANKING COMMISSIONS (CONTINUED)

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. 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.

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 was extended by three additional months by approval of 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. Following the enactment of the Law, the Governor of the Bank of Israel published on January 8, 2008, the Banking Rules (Customer Service)(Commissions), 2008.

In addition to the Rules, the full commission tariff (applying to customers receiving full banking service) and the shortened tariffs (applying to customers receiving partial banking services). The said tariffs apply to two segments of customers: individuals and corporations the annual income turnover of which does not exceed NIS 1 million (hereinafter: "small businesses").

The main changes reflected in the Rules and tariffs attached to them are:

- The number of overall commissions in the new tariffs has been significantly reduced compared to their present number (at a rate of about 66%) and it was clarified that commissions that are not included in the new tariffs may not be charged to the customer segments to which the Rule applies;
- An individual will be exempt from payment of ledger fees in respect of a current account, with the exception of transactions in his account effected by a teller or through direct channels as detailed below;
- Commission may be charged to an individual customer in respect of the allocation of a credit facility only if this customer has made no use of the credit facility allotted to him. A customer who has made a partial or full use of the credit facility will be charged interest or credit facility allocation commission, the higher of the two;
- Commission for the handling of credit may not be charged to small businesses and to individual customers in respect of loans in an amount not exceeding NIS 50,000. In addition this commission may not be charged upon renewal of a credit facility which does not involve a change in or an increase of the security for the credit. In the event of an increase in the credit facility, a commission may be charged in respect of the additional credit amount only;
- Differentiation has been made between the commission charged for current account services provided by a teller (which include a closed list of eight types of transactions), and commission charged for such services provided through direct channels (which include a closed list of ten types of transactions).

Banking corporations must inform their customers by April 5, 2008, of the service charges included in the tariffs.

The Governor of the Bank of Israel, with the approval of the Knesset Economics Committee, may issue an order to extend the date of

36. LEGISLATION IN THE MATTER OF BANKING COMMISSIONS (CONTINUED)

initial implementation by three additional months. Upon the request of the banking corporations, the Governor of Bank of Israel has applied to the Economic Committee of the Knesset asking its approval for a deferment of the effective date for a period of three months, until July 5, 2008. The Economic Committee consented to a deferment until June 5, 2008, only.

Implementation of the new Rules requires the segmentation of the Bank's customers according to various parameters, part of which are not available to the Bank at this stage. Accordingly, and due to the fact that the amount of certain commissions included in the tariff has not yet been fixed by the Bank, it is difficult to accurately assess the implications that the new Rules will have on the future income of the Group. The Bank believes that upon completion of the process, the Group's income from operating commissions will be adversely affected in an amount initially assessed at about NIS 160 million a year. Notwithstanding, in view of the uncertainties noted above, it is possible that actual implications would in fact differ from this assessment.

37. EARNINGS PER SHARE

	Consolidated		
	2007	2006	2005
Basic earnings⁽¹⁾ Per share of NIS 0.1 (in NIS)			
Net operating income			
Net income from extraordinary items, net of taxes	0.72	0.32	0.47
Net income	0.57	0.53	-
Weighted average of the number of shares	1.29	0.85	0.47
Footnote:	980,639	980,639	980,639
(1) In computing the earnings per share, stock options to officers of the Bank have not been taken into account due to their antidilutive effect.			

38. INFORMATION BASED ON NOMINAL DATA - THE BANK

Information on the Company's Financial Statements		
	December 31	
	2007	2006
	in NIS millions	
Balance Sheet		

Total assets		

Total liabilities	114,229	106,450
Shareholders' equity	105,501	98,980
	8,728	7,470
	For the Year Ended on	
	December 31	
	2007	2006
	in NIS millions	
Statement of Income		

Net income		
	1,285	713



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