ISRAEL DISCOUNT BANK

ANNUAL REPORT 2008

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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. Director & Vice Chairman of the Board, Israel Discount Bank of New York. Director, Discount Bancorp Inc; S. Zohar Consulting & Management Ltd.

Ilan (Eilon) Aish Joint Managing Director, Harvest Capital Markets Ltd.. Director, Harisha Tuff Lanka (Private) Limited.

Ilan Biran (Outside Director) Chairman, Rafael Advanced Defense Systems Ltd. Chairman, manager committee, Kinneret College on the Sea of Galilee (R.A). Venture Partner Consultant, The Challenge Fund - Etgar L.P.

Betzalel Eiger Chairman & CEO, Dorea Investments & Development Ltd. Chairman & CEO, Liberty Properties Ltd. Chairman, Ortam Sahar Engineering Ltd. Director, Comsec. 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.; Otzar Hityashvuth Hayehudim B.M.

Ben-Zion Granit Management Consultant. Member of the Audit Committee, The Friends of Kaplan Medical Center.

Edith Lusky (Outside Director)

Dr. Arie Ovadia Managing Partner, Shamrock Israel Growth Fund Advisors Ltd. Chairman, Giron - Development and Building Ltd., Destiny Holdings (1993) Ltd., Teva Naot - Distribution Ltd, Naot Footwear Agricultural Cooperative Association Enterprise Ltd., Nadlan.com.Israel Ltd., Peer Stream Ltd., Director, Shamrock - Cinema City Ltd., Destiny Investments (1993) Ltd., Destiny Properties (1991) Ltd., Israel Petrochemical Enterprises Ltd., Hadar Givun Investments Ltd., Strauss Group Ltd., Scailex Corporation Ltd., Elron Electronic Industries Ltd., Compugen Ltd., Carmel Olefins Limited, Polar Investments Ltd., Intercure Ltd., I. Q. S. Shalev Ltd., I.Q.S Hydraulics Ltd., Maxtech Technologies Ltd., Maxtech Communication Networks Ltd, Mantisvision Ltd., Paycard Ltd., Viryanet Ltd., Adsmarket G.M. Ltd., Telem Finance Solutions Ltd., A.O. Adav Consultants Ltd., A.O. Adav Consulting and Management (2007) Ltd., Anatz Consultants Ltd., Benjamin Ovadia Consultants (2007) Ltd., G.A.

Dr. Dafna Schwartz Business and Economics Consultant. A faculty member at the Department of Business Administration, Guilford Glazer School of business and Management, Ben Gurion University: Head of the MBA Specialization (Magama) in Entrepreneurship and High-Tech Management, and Director, Bengis Center for Entrepreneurship and High-Tech Management. Outside Director, Oil Refineries Ltd.; Giron - Development and Building Ltd.; Strauss Group Ltd.

Dr. Yitzhak Sharir Private Investor. Outside Director, Zur Shamir Holdings Ltd. Chairman, Revolutionare Ltd. Director, Israel Discount Capital Markets & Investments Ltd.

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

Zvi Streigold Attorney-at-Law . 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, 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 **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.

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

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The Board of Directors, on March 31, 2009, approved and authorized for publication the consolidated financial statements of the Bank and its subsidiaries for the year ended December 31, 2008.

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 four 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 142 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 71 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;
- Non-financial investments and underwriting – the subsidiary "Israel Discount Capital Markets and Investments Ltd." engages in investment banking, investments in private equity funds, venture capital funds and in other non-financial investments. This subsidiary also engages in underwriting and managing the issue of securities.

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. Activities in the pension advisory services field began in 2008, after a pension consulting license was received by the Bank and Mercantile Discount Bank. 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 to the financial statements.

In the course of 2008, the Bank continued to strengthen its position in the retail banking market by several central processes: The continued effort to attract State employees, the continued campaign for the marketing of mortgages jointly with the subsidiary Discount Mortgage Bank, and the beginning of the pension advisory services activity.

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.

Since the middle of 2008 the Bank has been operating against the background of the international financial crisis, the signals of which are being noticed in the Israeli economy, while taking the necessary steps required under the circumstances.

The sharp drops in prices on the capital markets in Israel and abroad and the collapse of international financial institutions required the Bank to record provisions for impairment of securities held in its "nostro" portfolio and in the Group's non-financial investments in a total amount of NIS 516 million.

Against the background of the crisis and its implications, the Bank adopted in 2008 efficiency and savings measures that are to also be continued in 2009. Details regarding the efficiency and savings plan are presented under "Developments in Income and expenses".

In view of the deteriorating conditions in the economy, the Bank performed in the third quarter of the year a review, mapping and examination of customer files, revealing customers who might be adversely affected by the crisis occurring in the capital and financial markets. Following this, the problematic credit portfolio as well as the specific provision for doubtful debts increased in the second half of 2008.

A general description of the crisis and its implications is given hereunder in the Chapters "The global economic crisis", "Main developments in the Israeli economy" and "Principal economic developments in January-March 2009"; details as to the Bank's "nostro" securities portfolio and developments occurring therein, including the impairment of available for sale securities and the Bank's investments in asset backed securities, are presented under "Development of assets and liabilities" and in Note 3 to the financial statement; details regarding the Bank's exposure to foreign financial institutions are presented under "Exposure to risks and risk management."

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, through IDB New York, also holds a commercial bank in Montevideo and Uruguay. The bank also holds a bank in Switzerland, 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, Buenos Aires and Santiago.

MARKET SHARE

Based on data relating to the banking industry as of September 30, 2008, 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, 2008	December 31, 2007	December 31, 2006
		In%	
Total assets	17.7	17.6	17.8
Credit to the public	16.6	16.0	15.5
Deposits of the public	17.4	18.0	18.0
Earnings from financing operations	23.4	18.5	17.0
Provision for doubtful debts	16.3	25.2	18.9
Operating income	18.5	17.5	17.2
Operating expenses	20.4	20.9	21.0

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.

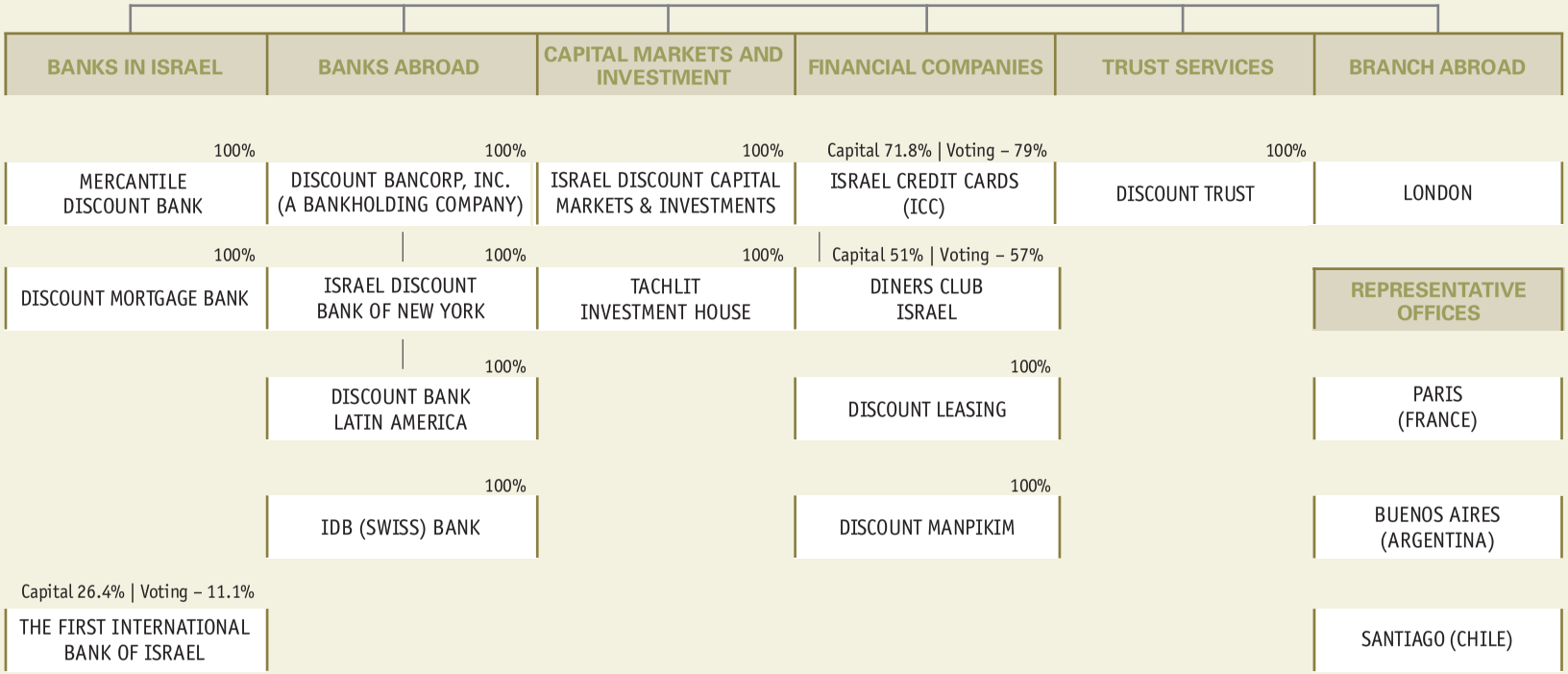
Actual results of the Bank might differ materially from those indicated in the forward-looking information due to a large number of factors, including, among other things, global and local capital market changes, macro-economic changes, changes in the geo-political situation, regulatory changes and other 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 STRUCTURE



DISCOUNT GROUP SEGMENT OF OPERATIONS - 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.
- **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. The segment also includes customers of IDB New York's corporate banking segment.
- **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 includes customers of IDB New York's commercial banking segment.
- **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 and the London branch, of medium and high wealth, all the activity of IDB (Swiss) Bank and the private banking customer activity at IDB New York including all the operations of the subsidiary Discount Bank Latin America.
- **Financial Management Segment:** This segment includes activities that are characterized as banking operations, but do not involve customers of the Group (except for activity with the dealing room). These activities are mainly comprised of their own account operations of the Bank, Mercantile Discount Bank and IDB New York 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.

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 and pension products. The operations include the activity of the Bank's securities department, pension layout 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.
- **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 Mercantile Discount Bank, IDB New York and the London Branch and the loans for the purchase or construction of commercial property segment at Discount Mortgage Bank and the building project finance segment at Discount Mortgage Bank.
- **Mortgage and Housing Loan Activity:** 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 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.

MAJOR FIGURES FROM THE CONSOLIDATED FINANCIAL STATEMENTS

PROFITABILITY

	For the year ended December 31			Rate of change in%	
	2008	2007	2006	2008	2007
				Compared with	
	In NIS millions			2007	2006
Income from financing activities before provision for doubtful debts	4,127	4,225	3,790	(2.3)	11.5
Provision for doubtful debts	780	447	570	74.5	(21.6)
Income from financing activities after provision for doubtful debts	3,347	3,778	3,220	(11.4)	17.3
Non-financing income	2,490	2,572	2,359	(3.2)	9.0
Of which: operating commissions	2,339	2,214	1,911	5.6	15.9
Non-financing expenses	5,265	5,066	5,020	3.9	0.9
Operating income before taxes	572	1,284	559	(55.5)	129.7
Operating income after taxes	403	718	209	(43.9)	243.5
Income (loss) from income after taxes	(10)	558	348	(101.8)	60.3
Net income	245	1,265	836	(80.6)	51.3
Net income disregarding certain components*	540	840	597	(35.7)	40.7
Net earnings per share of NIS 0.1 par value (in NIS)	0.25	1.29	0.85		
The return on shareholders' equity, in %	2.7	14.7	11.7		
The return on shareholders' equity disregarding certain components, in %*	5.9	9.7	8.4		

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

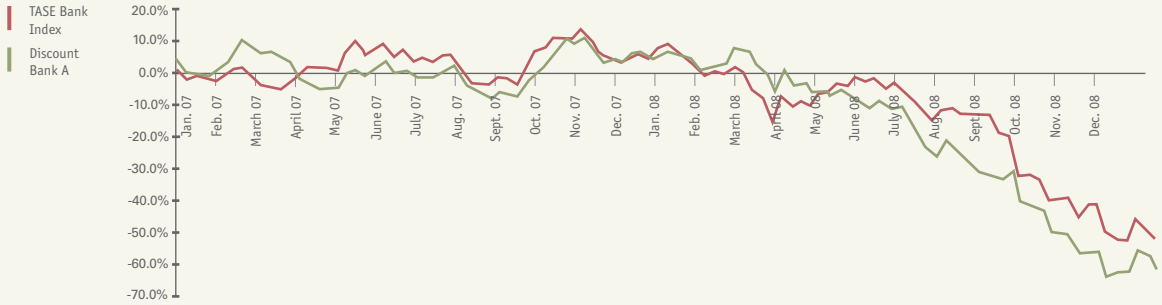
BALANCE SHEET

	As at December 31		Rate of change
	2008	2007	
	In NIS millions		in %
Total assets	182,248	168,719	8.0
Credit granted to the public	116,800	101,899	14.6
Securities	31,535	37,278	(15.4)
Deposits from the public	139,232	130,518	6.7
Shareholders' equity including minority interests	9,023	9,351	(3.5)
Shareholders' equity	8,797	9,204	(4.4)

FINANCIAL RATIOS

	As at December 31	
	2008	2007
	In %	
Capital resources in relation to total assets	5.0	5.5
Ratio of capital to risk assets	10.27	10.89
Ratio of the provision for doubtful debts to credit to the public	0.64	0.41
Ratio of credit to the public to total assets	64.1	60.4
Ratio of credit to the public to deposits of the public	83.9	78.1
Ratio of deposits of the public to total assets	76.4	77.4
Ratio of operating income to operating expenses	47.3	50.8
Operating expenses relative to total income	79.6	74.5

THE PRICE OF THE DISCOUNT BANK SHARE AND THE TASE BANK INDEX



THE STRATEGIC PLAN

CHANGES IN THE MULTI-ANNUAL STRATEGIC PLAN

Following several years of prosperity in Israel and around world over, the Israeli economy entered a slowdown period in 2008. The Bank's strategic plan for the years 2007-2011, an accelerated growth plan that has been successfully implemented up to now, was written under assumptions of growth in the markets in which the Bank operates. This plan determined a framework for enlarging the value of the Bank and relied upon growth generators in addition to the growth in the current operations of the Bank.

The changes in the economic climate introduced a work assumption indicating that the year 2009 will be a challenging year necessitating a different configuration. The uncertainty regarding the duration and extent of the economic slowdown, dictates with adjustments to the rate of growth over time.

Management of the Bank intends to update the objectives of the strategic plan during the second quarter of 2009, and to bring them for approval of the Board of Directors. As an interim action, the strategic focuses for 2009 have been revised and adapted to the changes in the economic environment.

RISK MANAGEMENT

Emphasis will be put on intelligent risk management that is adapted to the situation and the resultant uncertainty.

INVESTMENTS

The Bank will focus on non-financial investments to which it had committed in the past though at this stage these will not be enlarged.

FOCUSING ON THE RETAIL SEGMENT

Continuation of attracting new customers, preservation of old customers and intensifying activities with the State employee and teaching staff populations, which serve as a leverage for expanding the customer base of the Bank.

THE CORPORATE CUSTOMER SEGMENT

The Bank will focus on activity with existing customers. Attracting new customers will be done on a selective basis. The rate of credit growth will be moderate.

INCREASING EFFICIENCY AND IMPROVING EFFECTIVENESS

Improving operational efficiency by implementing the "lean banking" project and the shutting down of Unisys, the Bank's old computer system brought about and are expected to bring about the curbing of expenses and an additional reduction in manpower.

Improving the management information abilities by implementing new processes, improving the infrastructure and the establishment of a professional unit for information management.

HUMANE BANKING

The humane banking vision and the strategic backbone of the Bank, formulated in 2004, will continue to guide the Bank's operations and to form a basis for all its activities.

The year 2009 is designated to the improvement of service and treatment of customer complaints customers.

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 will bring about the realization of 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.

SALE OF FINANCIAL PRODUCTS AND ENTRY INTO THE PENSION ADVISORY SERVICES FIELD

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. Within the framework of the organizational change (see hereunder) the pension and investment consultation layouts have been combined into one consultation layout that will attend to the overall needs of the customer and will be able to provide optimal service.

CORPORATE GOVERNANCE

The Bank is preparing for 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 being formulated in light of the rules and regulations applying to the Bank as a banking corporation and in the light of the Goshen Commission recommendations, Basel II guidelines in the matter of strengthening corporate governance in banking corporations and of practices adopted in other countries around the world, while modifying it to the characteristics and the unique requirements of the Discount Group.
As part of the implementation of the corporate governance plan, the Bank will act towards the formation 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 strategic focuses discussed above include assessments and plans considered a forward-looking statement. Such assessments and plans are based on the most recent information and data in the hands of the Bank's management at date of publication of the financial statements and they reflect Management's plans as of that date. Such assessments and plans might change as a result of changes in the economic environment and/or changes in regulations having a material effect, which may require changes in the said focuses and updating of the plans.

INCOME AND PROFITABILITY

The Group's net income in 2008 totalled NIS 245 million, compared with NIS 1,265 million in the preceding year, a decrease of 80.6%.

Net Income disregarding certain components, as detailed hereunder, would have totaled NIS 540 million in 2008, compared with NIS 840 million in the preceding year, a decrease of 35.7%.

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	2008	2007
Reported net income		245	1,265
Provision for impairment of securities in the "nostro" portfolio	23E	197	-
Loss and provision for impairment of available for sale securities	25	74	28
Dividend from Visa Europe	25	(69)	-
Expenses in respect of encouragement of early retirement	27	-	56
Loss (income) from severance pay fund		51	(112)
The cost of implementing improvements and examinations in IDB New York	6D	6	30
Settling income tax assessments and reversal of the tax provision in respect of the Bank's share in ICC's earnings	29	(51)	-
Loss on impairment of consolidated subsidiaries	6B	88	-
Gain on the sale of the provident fund activity and KAHAL	6E, 19C 20	-	(557)
Provision for taxes in respect of the investment in the First International Bank	6F	-	130
Net income disregarding certain components		540	840
The return on shareholders' equity disregarding certain components		5.9%	9.7%

Return on shareholders' equity for 2008 was 2.7%, compared with 14.7% in the preceding year.

Return on shareholders' equity, disregarding certain components, as detailed above, would have reached in 2008 a rate of 5.9% compared with 9.7% in 2007.

Net earnings per one share of NIS 0.1 par value amounted in 2008 to NIS 0.25, compared with NIS 1.29 in 2007.

Net earnings per one share of NIS 0.1 par value, disregarding certain components, as detailed above, would have reached in 2008 NIS 0.55 compared to NIS 0.86 in 2007.

Following are the main factors that had an effect on the business results of the Group in 2008, compared with 2007:

(a) A decrease of 2.3% in income from financing activities before provision for doubtful debts.

(b) A decrease of 74.5% in provisions for doubtful debts.

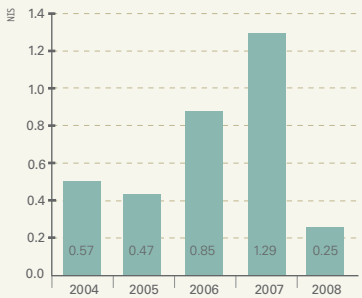
(c) A decrease in operating and other income at the rate of 3.2% that was affected by a decrease of 66.7% in other income and by a decrese in gains from investments in shares at a rate of 12.1%, which was partly offset by an increase in operating commissions at the rate of 5.6%.

(d) An increase in operating and other expenses at the rate of 3.9%, affected by an increase of 2.5% in payroll and related expenses, an increase of 11.1% in buildings an equipment depreciation and maintenance expenses, and an increase of 2.6% in other expenses.

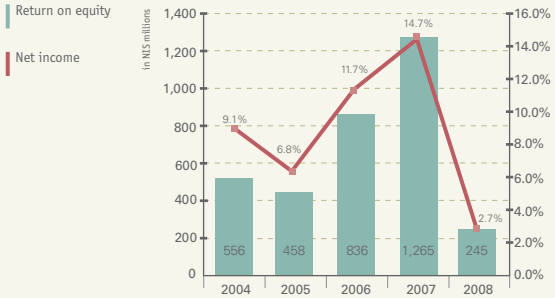
(e) The Bank's share in earnings from ordinary operations of affiliates in 2008 totalled a loss of NIS 70 million, compared with income in the amount of NIS 45 million in 2007.

(f) In 2007 a net gain on the sale of the provident fund activity in the amount of NIS 483 million, and a net gain on the sale of KAHAL in the amount of NIS 74 million, compared to a net loss from extraordinary operations of NIS 10 million in 2008.

NET EARNING PER SHARE



NET INCOME AND RETURN ON EQUITY



DEVELOPMENTS IN INCOME AND EXPENSES

Income from financing activities before provision for doubtful debts amounted to NIS 4,127 million in 2008, compared with NIS 4,225 million in the preceding year, a decrease of 2.3%.

Following is the development of financing income disregarding certain components (in NIS millions):

	2008				
	Annual	Fourth quarter	Third quarter	Second quarter	First quarter
Reported financing income	4,127	873	1,057	1,132	1,065
Effect of adjustments to fair value of derivative financial instruments ALM	28	28	(163)	33	130
Effect of tax hedging in respect of IDB New York	(15)	133	24	(69)	(103)
Gains on sale of available for sale bonds, net	(202)	(67)	(51)	(24)	(60)
Provision for impairment of available for sale bonds	311	139	169	3	-
Net realized and unrealized losses on bonds in the trading portfolio	58	(23)	86	16	(21)
Financing income after adjustments	4,307	1,083	1,122	1,091	1,011

	2007				
	Annual	Fourth quarter	Third quarter	Second quarter	First quarter
Reported financing income	4,225	1,075	1,212	916	1,022
Effect of adjustments to fair value of derivative financial instruments ALM	(5)	31	(54)	8	10
Effect of tax hedging in respect of IDB New York	(66)	(58)	(78)	70	-
Gains on sale of available for sale bonds, net	(67)	(5)	(14)	(29)	(19)
Provision for impairment of available for sale bonds	-	-	-	-	-
Net realized and unrealized losses on bonds in the trading portfolio	43	13	10	25	(5)
Financing income after adjustments	4,130	1,056	1,076	990	1,008

The principle factors affecting profits from financing operations before provision for doubtful debts in 2008, compared with 2007, were:

a. An increase at the average rate of 9.9% in the income producing financial assets, from an amount of NIS 226,599 million to NIS 249,035 million, mostly due to the increased derivative financial instruments operations;

b. Adjustments to fair value of derivative financial instruments which created a negative gap of NIS 33 million, due to lack of matching between the methods of accounting for the value of base assets for these transactions, measured on an accrual basis, and of accounting for the value of the derivative financial instruments used as hedge for such base assets, measured on a fair value basis;

c. Increased contribution of the active capital, in the CPI linked and the non linked segmets;

d. A net decrease in other finance (as seen from the following Management Review) in the amount of NIS 285 million, mainly due to of negative exchange differences, net, recorded in respect of monetary asset and liability balances in a foreign consolidated subsidiary, due to a provision for impairment of available for sale bonds in the amount of NIS 311 million and an increase of NIS 15 million in realized and unrealized losses from adjustment to fair value of trading bonds, net, which were offset by an increase of NIS 135 million in gains on sale of available for sale bonds;

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 15 million in profits from financing operations in 2008 compared to an increase of NIS 66 million in the income from financing operations in 2007. The effect of this hedging operation has been fully offset by the taxes on income item (hedging operations commenced in the second quarter of 2007, 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 in the fourth quarter of 2008 amounted to NIS 873 million, compared to NIS 1,075 million in the corresponding period last year, a decrease of 18.8%.

The main factors affecting the earnings from financing activities before provision for doubtful debts in the fourth quarter of 2008, compared to the corresponding period last year, are as follows:

a. An increase of 5.3% in the average balance of income generating financial assets, from an amount of NIS 245,499 million to NIS 258,611 million.
b. A negative gap in the amount of NIS 191 million between quarters due to the effect of tax hedging in respect of IDB New York.

Income from financing activities before provision for doubtful debts in the fourth quarter of 2008 amounted to NIS 873 million, compared to NIS 1,057 million in the third quarter of 2008, a decrease of 17.4%.

The main factors affecting the earnings from financing activities before provision for doubtful debts in the fourth quarter of 2008, compared to the third quarter of 2008, are as follows:

a. An increase of 4.6% in the average balance of income generating financial assets, from an amount of NIS 247,126 million to NIS 258,611 million.
b. A negative gap in the amount of NIS 191 million between quarters due to adjustments to fair value of derivative financial instruments.
c. A decline in the contribution of the active capital in the CPI linked segment amounting to NIS 82 million, as a result of a drop of 0.5% in the CPI for the fourth quarter of 2008, compared to a rise of 2.1% in the CPI for the third quarter of 2008.
d. An increase in other financing, net in the amount of NIS 221 million, mostly due to a decrease in a provision for impairment of available-for-sale bonds in the amount of 30 million, and to a decrease of NIS 109 million in losses realized and not yet realized on adjustment to fair value of trading bonds, net, and due to an increase of NIS 16 million in gains on sale of available-for-sale bonds.
e. A negative gap in the amount of NIS 109 million between quarters due to the effect of tax hedging in respect of IDB New York.

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						
	2008			2007			
	Contribution to profit			Contribution to profit			Changes in
	Volume of activity* in %	in NIS millions	Change in %	Volume of activity* in %	in NIS millions	Change in %	contribution in NIS millions
Unlinked shekels	47.3	2,391	57.9	39.7	1,992	47.2	399
CPI-linked shekels	10.4	295	7.1	9.8	365	8.6	(70)
Foreign Currency	42.3	1,377	33.4	50.5	1,519	35.9	(142)
	100.0	4,063	98.4	100.0	3,876	91.7	187
Options		(109)	(2.6)		(75)	(1.8)	(34)
Other derivative financial instruments (not including hedged derivatives and ALM)		27	0.7		89	2.1	(62)
Financing commissions		139	3.4		125	3.0	14
Other financing income (expenses), net		7	0.2		210	5.0	(203)
Total		4,127	100.0		4,225	100.0	(98)

* 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 2,391 million in 2008, compared with NIS 1,992 million in 2007, an increase of 20.0%. Income from this segment constituted 57.9% of total net interest income in 2008, compared with 47.2% in 2007.

In 2008, assets exceeded liabilities in this segment by NIS 4,454 million, compared with 2007, where assets exceeded liabilities by NIS 3,650 million, contributing to the increase in earnings from financing operations in this segment.

The average balance of assets in this segment increased in 2008 by 31.1% compared with the preceding year.

The interest margin of the segment declined from a rate of 2.10% in 2007 to a rate of 1.88% in 2008. 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 and due to income of NIS 120 million in respect of fair value adjustments of derivative financial instruments in 2008 compared to an expense of NIS 28 million in 2007. 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.

In the CPI-linked shekel segment, net interest income totalled NIS 295 million in 2008, compared with NIS 365 million in 2007, a decrease of 19.2%. Its proportion of total net interest income in 2008 was 7.1%, compared with 8.6% in 2007.

The average asset balance in this segment in 2008, rose by 16.8% compared with the preceding year.

The decline in the earnings of this segment stems mainly from adjustments to fair value of derivative financial instruments, which created a negative gap of NIS 77 million due to the inconsistency in accounting between the method for computing the value of the base assets for these transactions, measured on an accrual basis, and the method for computing the value of derivative instruments used to hedge the base assets, which are measured on the basis of fair value. If such adjustments were eliminated, the interest spread in the CPI linked segment would have reached 0.79% in 2008, compared to 1.10% in the corresponding period last year. This compared to an actual rate of return of 0.42% in 2008 and a rate of 1.05% in the corresponding period last year.

The said decrease was offset by the increase in contribution of the active capital, mostly due to a rise of 4.5% in the CPI for 2008, compared to a rise of 2.8% in the CPI for 2007.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net interest income amounted to NIS 1,377 million in 2008, compared with NIS 1,519 million in 2007, a decrease of 9.3%. Its proportion of all net interest income was 33.4% in 2008, compared with 35.9% in 2007.

In 2008, the average balance of assets in this segment increased by 8.1% compared with the preceding year.

The interest margin of the segment increased from a rate of 1.31% in 2007 to a rate of 1.32% in 2008.

The decline in segment earnings is mainly due to adjustments to fair value of derivative financial instruments creating a negative difference of NIS 105 million, due to an inconsistency in accounting between the method for computing the value of the base assets for these transactions, measured on an accrual basis, and the method for computing the value of derivative instruments used to hedge the base assets, which are measured on the basis of fair value.

In addition, a hedging operation performed by the Bank resulted in an increase of NIS 15 million in earnings from financing operations in 2008, compared to an increase of NIS 66 million in the corresponding period last year.

Total interest margin in 2008 was 2.98%, compared with 2.64% 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 1.57% in 2008, compared with a rate of 1.71% 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 December 31		
	2008	2007	Rate of change in %
	In NIS Millions		
Retail - household segment	1,338	1,184	13.0
Retail - small bussiness segment	837	744	12.5
Corporate marker segment	1,001	940	6.5
Middle market segment	624	723	(13.7)
Private banking segment	337	314	7.3
Financial management	(10)	320	(103.1)
Total	4,127	4,225	(2.3)

The decline in the commercial banking segment was due mainly to a decline in the volume of operations. The decline in the financial segment was due mainly to provisions for impairment of bonds in the available-for-sale portfolio.

Provision for doubtful debts totalled NIS 780 million in 2008, compared with a provision of NIS 447 million in the preceding year, an increase of 74.5%. In 2008, the provision constituted 18.9% of the income from financing activities before provision for doubtful debts, compared with 10.6% of this income in the preceding year.

Following are details regarding the provision for doubtful debt expenses:

	For the year ended December 31		
	2008	2007	Rate of change in %
	In NIS Millions		
Specific provision for current year	997	710	40.4
Reduction of specific provision and collection of debts written-off in previous years	(223)	(251)	
Change of specific provision	774	459	68.6
Change of supplemental provision	6	(12)	
Provision charged to statement of Income	780	447	74.5

The annual provision for doubtful debts, as a ratio of credit to the public, not including off-balance sheet credit risk, was 0.64% in 2008 (0.43% - including off-balance sheet credit risk), compared with 0.41% (0.27% - including off-balance sheet credit risk) in 2007.

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 6,054 million in 2008 (NIS 6,302 million - including provision for off-balance sheet credit risk). The balance of this provision constitutes 4.93% of the credit to the public (3.38% - including off-balance sheet credit risk), compared with a balance of the provision in the amount of NIS 5,781 million, not including provision for off-balance sheet credit risk (NIS 5,975 million - including provision off-balance sheet credit risk), constituting 5.37% of the credit to the public (3.64% - including off-balance sheet credit risk) at the end of the preceding year.

The specific provision for doubtful debts amounted to NIS 774 million in 2008, compared with NIS 459 million in the preceding year, an increase of 68.6%.

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 supplemental provision for doubtful debts. An additional provision for doubtful debts in the amount of NIS 36 million, recorded by the Bank and by its banking subsidiaries in Israel, was reversed in 2008, compared with a reversed provision of NIS 22 million in the previous year. The supplemental provision for doubtful debts is based on the quality of the credit portfolio in accordance with risk factors, as determined by the proper banking directives.

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

	2008				2007			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
Specific provision	345	187	120	122	94	110	162	93
Supplemental provision	21	(5)	19	*(29)	(9)	(2)	(4)	3
Total	366	182	139	93	85	108	158	96
Rate of specific provision from credit granted to the public**	1.13%	0.62%	0.43%	0.44%	0.35%	0.43%	0.64%	0.39%

* Of which an amount of NIS 13 million stems from negative exchange rate differentials recorded in respect of the general provision of a foreign consolidated subsidiary.
** On an annual basis.

The increase in the provisions for doubtful debts in the third quarter of 2008, and at an accelerated rate in the fourth quarter of the year, largely reflects the impact of the global economic crisis on the Bank's customers.

Income from financing activities after provision for doubtful debts amounted to NIS 3,347 million in 2008, compared with NIS 3,778 million in the preceding year, a decrease of 11.4%.

Non-financing income in 2008 amounted to NIS 2,490 million, compared with NIS 2,572 million in the preceding year, a decrease of 3.2%.

Income from capital market activity in 2008 amounted to NIS 387 million, compared with NIS 594 million in 2007, a decrease of 34.8%.

Presented below are details regarding earnings from capital market operations in the years 2006-2008:

	Consolidated		
	2008	2007	2006
	In NIS millions		
Income from customers' securities transactions	318	326	243
from provident funds	-	107	189
Provident funds operating fees	22	12	-
Management fees from mutual funds	4	6	100
Distribution fees of mutual funds	43	54	24
Profit from severance pay funds	-	89	49
Total	387	594	605

The decline in earnings from management fees and in the reimbursement of expenses by provident funds stems from the sale of the provident fund operations. For details see Note 6 E to the financial statements. The decline in earnings from distribution fees collected in 2008 from mutual funds management companies stemmed from the drop in market value of the mutual funds and from a change in the mix of funds held by customers and the transition to monitory funds, the distribution fees of which are lower.

Commissions totalled NIS 2,339 million in 2008, compared with NIS 2,214 million in the preceding year, an increase of 5.6%. The increase results mainly from an increase in income from credit cards, ledger fees, payment order system

service and credit and contracts service (for details as to legislation in the matter of bank commissions, see "Legislation and supervision" below.

Income from credit card operating activities amounted to NIS 849 million in 2008, compared with NIS 760 million in 2007, an increase of 11.7% (Interest income on credit to customers via credit cards amounted to NIS 110 million in 2008, compared with NIS 95 million in 2007, an increase of 15.8%).

Gains on investment in shares, net, amounted to NIS 51 million in 2008, compared to NIS 58 million in 2007. The profit in 2008 stems mostly from dividend on available-for-sale and on trading shares in the amount of NIS 168 million of which dividend in the amount of NIS 110 million received by the Board and Israel Credit Cards Ltd. from Visa Europe. The said dividends include, among other things, and a dividend of NIS 38 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 a dividend of NIS 70 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). The income was partly offset by losses and by a provision for impairment in value of available for sale securities in the amount of NIS 117 million, of which NIS 67 million in respect of a fund of hedge funds, compared to NIS 44 million in 2007 (for additional details see hereunder: "Securities" under "Development of assets and liabilities").

Other income in 2008 totalled NIS 100 million, compared with NIS 300 million in the preceding year, a decrease of 66.7%, Mainly from a decrease of NIS 110 million in income from provident and mutual funds mostly due to the decrease in income from provident funds, as detailed above, and due to the fact that in 2008, no profits of the severance pay fund were recorded as part of other income, while in the corresponding period last year an amount of NIS 89 million was so recorded.

Following are the components of operating and other income:

	2008	2007	2006
	In NIS millions		
Revenue from management fees	282	252	225
Payment order system services	488	475	424
Revenue from credit cards	849	760	640
Revenue from capital market activities	438	563	621
Profits of the severance pay fund	-	89	49
Computerized services, information and confirmations	28	38	45
Foreign trade activity and special foreign currency services	73	79	93
Margins and fees on credit from deposits according to collection	19	18	19
Other	313	298	243
Total	2,490	2,572	2,359

Non-financing expenses totalled NIS 5,265 million in 2008, compared with NIS 5,066 million in 2007, an increase of 3.9%.

Salaries and related expenses amounted to NIS 3,106 million in 2008, compared with NIS 3,030 million in the preceding year, an increase of 2.5%.

Following is an analysis of the effects of certain components on salaries and related expenses:

	For the year ended December 31			Change in %	
	2008	2007	2006	2008 compared to 2007	2007 compared to 2006
	In NIS millions				
Salaries and Related Expenses - as reported	3,106	3,030	3,202	2.5	(5.4)
The bonus paid to the employees in respect of the sale of the controlling interesting the Bank	-	-	232		
Awards	52	169	51		
Expense resulting from share based payment transactions	15	27	8		
Encouragement of early retirement expenses	-	91	174		
The influence of the severance pay fund	81	(96)	(88)		
Salaries and Related Expenses - Disregarding certain components	2,958	2,839	2,825	4.2	0.5

The increase in payroll expenses in 2008, as compared to the corresponding period last year, was affected mainly by the increase in severance pay expenses, due mostly to the losses recorded by the Bank's and a consolidated company's severance pay fund in 2008, compared with profits for 2007.

In 2008, the Bank's severance pay fund recorded net losses of NIS 81 million, a loss which increased the severance pay expense recorded. In 2007 the severance pay funds recorded earnings of NIS 183 million, used to cover the increase in the liability for severance pay in respect of previous years in the amount of NIS 96 million, caused by the wage agreement for 2007, the balance of the earnings being reflected in other income, as stated above.

The financial statements for 2007, include an expense of NIS 91 million in respect of early retirement. For additional details, including details on employees retired in 2006-2008, see "Human Resources" below.

Salaries expenses, excluding related expenses, amounted in 2008 to NIS 2,009 million, compared with NIS 2,146 million in 2007, a decrease of 6.4%, affected primarily by a decrease in the provision for awards.

Depreciation and maintenance of building and equipment totalled NIS 910 million in 2008, compared with NIS 819 million in the previous year, an increase of 11.1%. 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 1,249 million in 2008, compared with NIS 1,217 million in the preceding year, an increase of 2.6%. The increase was mostly affected by the increase in communication expenses, commissions and amortization of goodwill, partly offset by a decrease in advertising, professional services and other expenses.

The cover rate of non-financing income to non-financing expenses reached 47.3% in 2008, compared with 50.8% in the preceding year.

The cover rate of non-financing expenses by non-financing income, disregarding the expenses detailed above, would have reached 48.3% in 2008, compared with 50.4% in 2007.

Total operating expenses in relation to total income reached a rate of 79.6% in 2008 compared to 74.5% in 2007.

Total operating expenses in relation to total income, disregarding the expenses mentioned above, reached in 2008 a rate of 74.6%, compared to a rate of 74.3% in 2007.

Operating income before taxes totalled NIS 572 million in 2008, compared with NIS 1,284 million in the preceding

year, a decrease of 55.5%.

Provision for taxes on operating income totalled NIS 169 million in 2008, compared with NIS 566 million in the preceding year. The ratio of the provision for taxes in relation to earnings from ordinary operations reached 29.5% in 2008, compared with 44.1% in 2007. The decrease in the effective tax rate derives mainly from the reversal of the provision for taxes in respect of the Bank's share in ICC's earnings, in view of the decision of ICC's Board not to distribute dividends that would cause the capital ratio to fall below 15.5% and the decision of the board of directors of ICC not to distribute dividends out of profits earned up to December 31, 2008. (See "Main investee companies" hereunder and Note 29 K to the financial statements) and from settling income tax assessments for 2003. This decrease was off-set in part as a result of hedging operations made by the Bank, as detailed above. The tax expense was also affected by the abolition of the Adjustments Law (see Note 29 J to the financial statements).

Operating income after taxes totalled NIS 403 million in 2008, compared with NIS 718 million in the preceding year, a decrease of 43.9%.

The Bank's share in operating income after taxes of affiliated companies in 2008 totalled a loss of NIS 70 million, compared with income in the amount of NIS 45 million in the preceding year. The loss in 2008 stemed primarily from a provision for impairment in respect of KFS (see Note 6).

Operating income totalled NIS 255 million in 2008, compared with NIS 707 million in the preceding year, a decrease of 63.9%.

The ratio of operating income before taxes to shareholders' equity, including minority interest, was 7.8% in 2008, compared with a ratio of 16.4% in the preceding year.

The ratio of operating income after taxes to shareholders' equity, including minority interest, was 5.5% in 2008, compared with a ratio of 9.6% in the preceding year.

Net loss from extraordinary operations, after taxes, amounted, in 2008, to NIS 10 million, compared to earnings of NIS 558 million in 2007 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), and a net gain in the amount of NIS 74 million from the sale of Kahal (see Note 19 C 20 to the financial statements).

Net income in 2008 amounted to NIS 245 million, compared with of NIS 1,265 million in the preceding year, a decrease of 80.6%.

Net income, disregarding certain components as detiled above, would have amounted to NIS 540 million in 2008, compared with NIS 840 million in 2007, a decrease of 35.7%.

Return on shareholders' equity reached a rate of 2.7% in 2008, compared with a rate of 14.7% in the preceding year.

The return on shareholders' equity, disregarding certain components as detailed above, would have reached in 2008 a rate of 5.9% compared with 9.7% in 2007.

Net earnings per one share of NIS 0.1 par value amounted in 2008 to NIS 0.25 compared with NIS 1.29 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 2008 NIS 0.55, compared with NIS 0.86 in 2007.

The loss in the fourth quarter of 2008 amounted to NIS 121 million, compared with net income of NIS 110 million in the third quarter of 2008 compared to income of NIS 41 million in the corresponding quarter last year.

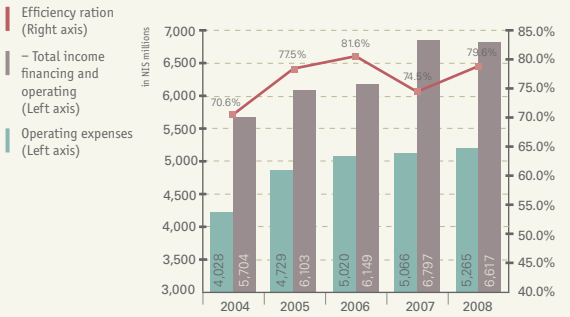
Return on shareholders' equity in the fourth quarter of 2008 reached an annualized negative rate of 5.5%, compared with a positive rate of 4.8% in the third quarter of 2008, and compared with a positive rate of 1.8% in the corresponding quarter last year.

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

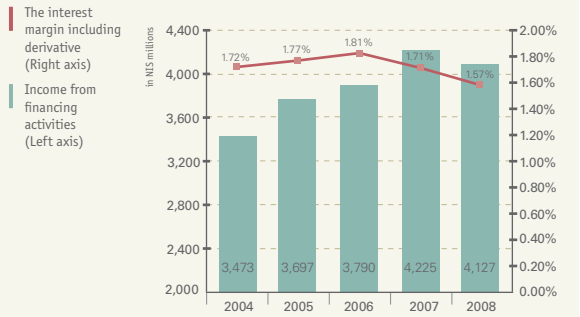
	2008		2007
	Quarter 4	Quarter 3	Quarter 4
Reported net income (loss)	(121)	110	41
Provision for impairment of securities in the "nostro" portfolio	88	107	-
Loss and provision for impairment of available for sale securities	25	20	26
Dividend from Visa Europe	(70)	-	-
Encouragement of early retirement expenses	-	(2)	51
Loss (income) from severance pay fund	24	48	(21)
The effect of the provision in respect of the wage agreement on the increase in liabilities provisions for wage related expenses	(19)	(18)	(17)
The cost of implementing improvements and examinations in IDB New York	-	2	4
Settling income tax assessments and reversal of the tax provision in respect of the Bank's share in ICC's earnings	(31)	-	-
Loss on impairment of consolidated subsidiaries	78	10	-
Gain on the sale of the provident fund activity and KAHAL	-	-	(83)
Provision for taxes in respect of the investment in the First International Bank	-	-	130
Net income (loss) disregarding certain components	(26)	277	131
The return on shareholders' equity disregarding certain components	(1.2%)	12.5%	5.8%

An estimate of the effect of the Bank's wage agreements and the sale bonus on the business results for the first quarter of 2009. The Bank will include in its financial statements for the first quarter of 2009, the full increase in the provisions for wage related liabilities in accordance with Management's evaluation of the cost of the wage agreement for 2009, in the estimated amount of NIS 99 million. For details regarding the efficiency and saving efforts, see below.

OPERATING EXPENSES TO TOTAL INCOME



INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS - CONSOLIDATED



EFFICIENCY AND SAVINGS EFFORTS

As part of the implementation of the strategic plan, the Bank implemented in 2008 various efficiency and savings efforts. Against the background of the economic crisis, these actions have been expanded and they are intended to also continue in 2009.

Among the actions taken were:

- **"Lean organization" project improving the effectiveness of the branch layout.** Within the framework of the project, various operational activities are being transferred to a back office operated at the Bank's Operational Department. The transfer of these operations is intended to allow a certain reduction in manpower at the branches as well as a gradual reduction in office space of the branches while transferring the operations to a central and more efficient unit.
- **Change in the organizational structure.** This change that was decided on towards the end of 2008 is being implemented in 2009, in the framework of which the Marketing and Strategic Planning Division as well as the Asset Management Division have been dissolved. This change includes, among other things, a reduction in the number of Management members and the scaling down of various headquarter office units (for additional details, see "Changes in organizational structure" under "Human resources" hereunder).
- **Efficiency plan in the computer field.** This plan was implemented in 2008 along two central lines: the one, an effort regarding the management of the information system development at the Bank with a view of increasing productivity. The other, a gradual shut-down of some of the specialized units that had taken part in the Ofek Project as well as a gradual retirement of the staff engaged in the Project.
- **Shut-down of "Unisys".** Completion of the conversion of all systems still operating on the Unisys computer is planned for the middle of 2009, so that in September 2009, all work with the Unisys computer would be terminated. The Bank believes that the shutting down the Unisys computer will save costs in the amount of NIS 60-70 million in computer operating licenses and computer maintenance and will allow for manpower reduction in the relevant units.
- **Reduction in manpower.** The above detailed actions are expected to result, among other things, in the reduction in the number of staff at the Bank to the tune of approximately 300 positions during 2009. This, following a significant reduction in staff since March 2008 numbering 406 employees until the end of 2008 (a decrease of 253 employees between December 31, 2007 and December 31, 2008).
- **Waiver of remuneration.** The Bank's Chairman of the Board and the President and CEO announced in February 2009, that they forego 10% of their pay for a period of 12 months beginning in February 2009. Members of Management also gave-up 7.5% of their pay for the same period. Employees of the Bank of various categories also gave-up a portion of their pay and/or certain other components of their remuneration to which they are entitled. The total savings expected as a result of these actions is estimated by Management at NIS 60 million.
- **Cost reductions.** In response to the Bank's approach, most of the Bank's suppliers have agreed to a 6%-10% reduction in the price of goods and services supplied to the Bank. Concurrently, the Bank is examining all the components of operational expenses and is acting towards their reduction, to the extent possible, on condition that the Bank's core business activities are not adversely affected.

Some of the information presented above constitute a forward-looking statement, which reflects Management's plans and estimated at date of publication of this report. The said information might not materialize in the event that delays occur in the date of shut-down of the Unisys computer; changes occur in the scope and priorities of tasks regarding information systems, in view of changes in regulations and urgent business needs, which may cause a change in preparations or in the ability to carry-out the Bank's existing plans at date of publication of this report; delays or disruptions occur in the implementation in full of the organizational changes at the Bank.

DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2008 amounted to NIS 182,248 million, compared with NIS 168,719 million at the end of the preceding year, an increase of 8.0%.

Following are the developments in the principal balance sheet items:

	December 31		Rate of
	2008	2007	change
	In NIS Millions		in %
Assets			
Cash and deposits with banks	21,554	19,850	8.6
Securities	31,535	37,278	(15.4)
Credit granted to the public	116,800	101,899	14.6
Liabilities			
Deposits from the public	139,232	130,518	6.7
Deposits from banks	4,555	5,072	(10.2)
Subordinated capital notes	9,373	7,437	26.0
Shareholders' equity	8,797	9,204	(4.4)

CREDIT GRANTED TO THE PUBLIC

General. Credit to the public as at December 31, 2008, totalled NIS 116,800 million, compared with NIS 101,899 million on December 31, 2007, an increase of 14.6%. The ratio of credit granted to the public to total assets reached 64.1% at the end of 2008, compared with 60.4% at the end of 2007.

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. The dispersal of risk is reflected in the distribution of the credit portfolio between the various economic sectors and between borrowers and various borrower groups. Principles and rules are determined within the framework of the credit policy, both at the level of the individual borrower and at the level of economic sectors and the various segments of operation.

The Bank adopts a cautious credit policy with respect to the various economic sectors and credit segments. The credit policy takes into account the economic slowdown as well as the rise in the risk involving the entire system.

A discussion of the credit policy is held at least 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 Bank's business targets are determined according to the general outlines of the credit policy.

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. Furthermore, a detailed policy is determined for additional areas, such as: the acquisition of means of control, diamonds, real estate, London branch.

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.

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. The scale and/or quality of the collateral are derived from the level of risk that the Bank is ready to accept upon the granting of credit, while emphasizing borrowers' repayment ability.

The regulatory restrictions applying to the Bank within the framework of the Bank of Israel directive concerning an individual borrower, a group of borrowers and the six largest borrower groups, impose effective limitations on the Bank in granting credit to certain borrowers.

Authority to grant credit at the Bank is determined by the Board of Directors and is defined in the Bank's procedures, starting with authority of managers of various levels, continuing with the credit committees right up to the credit committee of the Board of Directors.

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, 2008		December 31, 2007		
	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of changes in %
Non-linked shekels	56,363	48.3	48,074	47.2	17.2
CPI-linked shekels	21,016	18.0	18,642	18.3	12.7
Foreign currency and foreign currency-linked shekels	39,421	33.7	35,183	34.5	12.0
Total	116,800	100.0	101,899	100.0	14.6

Credit to the public denominated in foreign currency and in Israeli currency linked thereto increased by 12.0% compared with December 31, 2007. In U.S. Dollar terms, credit to the public in foreign currency and foreign currency linked Shekels increased by US$1,220 million as compared to December 31, 2007, an increase of 13.3%.

The total credit to the public, which includes credit in foreign currency and Israeli currency linked to foreign currency, computed in dollar terms, increased by 15.1% as compared to December 31, 2007.

Developments in the provisions for doubtful debts and in credit to problematic borrowers in the group. The balance of the provision for doubtful debts to credit to the public (excluding off-balance sheet credit risk) reached 4.93% in 2008 compared to 5.37% in 2007.

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	September 30	December 31
	2008	2008*	2007*
Non-performing debts	2,242	1,852	2,230
Reorganized debts[2]	354	233	278
Debts due for reorganization[3]	231	35	33
Debts temporarily in arrears	690	403	387
Debts under special supervision[4]	4,330	4,292	3,521
Total balance sheet credit to problematic borrowers	7,847	6,815	6,449
Off-balance sheet credit risk regarding problematic borrowers[5]	1,348	1,308	1,038
Debentures of problematic borrowers	26	21	21
Other assets in respect of derivative	209	69	22
Total overall credit risk concerning problematic borrowers	9,430	8,213	7,530
Bonds in respect of which a provision for impairment was recorded	47	-	-

* 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 622 million, presented net of specific provision made thereof, and housing loans of NIS 178 million, in respect of which a provision according to the period of default exists (September 30, 2008: NIS 823 million and NIS 182 million, respectively; December 31, 2007: NIS 893 million and NIS 188 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, financial services and industry sectors.

In the fourth quarter of 2008, the overall volume of problematic credit portfolio increased by NIS 1,217 million, an increase of 14.8% compared to September 30, 2008.

Within the framework of credit risk management, the Bank examines and evaluates on a regular basis customers' exposure to changes in market conditions and in their business environment. A review, mapping and examination of customer files performed since the third quarter of 2008, revealed customers who might be adversely affected by the occurring crisis in the capital and financial markets, and it has been decided to classify them as borrowers under special supervision. This refers to a rather limited number of borrowers

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 U.S. accounting principles and on the directives of the bank regulatory authorities in the U.S. 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 instruction and the principal changes included therein as compared with prevailing instructions, see Note 1 Y (3) to the financial statements.

The instruction states that it 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 Bank is preparing for the implementation of the Directive within the framework of a project being 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 was 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.

Within the framework of the preparations made to date, a gap review was performed, the data obtained has been analyzed and a work plan for the implementation of the Project has been designed, which includes a detailed characterization of the changes required to be made to the Bank's various information systems, 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 based on a requirement characterization document, current project management, and so forth. In carrying out the project the Bank engaged outside consultants.

It should be noted that in view of the large number of assignments imposed on the banking industry along side to the preparation for the implementation of the said Directive, the foremost of which being the preparation for the implementation of the Basel II Project, the Bank devotes many resources and efforts towards advancing the preparations for the implementation of the directive, despite the multitude of tasks imposed on the banking industry along side the above mentioned preparations, the outstanding of which is the preparation for the implementation of the Basel II project.

The risk characterization of the credit to the public portfolio. The deterioration in the quality of the portfolio is also reflected in the increase in the rate of outstanding problematic debts to the total Group's outstanding credit to the public, from 6.3% at the end of 2007 to 6.7% at the end of 2008.

A continued decline took place as from the second half of 2008, in the volume of operations and in the repayment ability of borrowers in most economic sectors.

The provision for doubtful debts of the Group amounted in 2008 to NIS 780 million, compared to a provision of NIS 447 million in 2007, an increase of 74%.

The Group's specific provision for doubtful debts amounted in 2008 to NIS 774 million, compared to a provision of NIS 459 million in 2007, an increase of 69%.

As a result of such deterioration, the rate of the specific provision increased significantly in relation to the outstanding credit to the public from 0.45% in 2007 to 0.7% in 2008.

The deterioration in the quality of the credit portfolio stems from an increase in the volume of problematic debts in all classes, except for non-performing debts, due to the deterioration in the operating profit margin, in cash flows and in the repayment ability of borrowers in most economic sectors.

The non-performing debt maintained stability at a volume of NIS 2.2 billion, due to two contrasting developments: intensifying collection arrangements and/or arrangements with customers for the repayment of the debt, alongside with the deterioration in the financial position of the borrowers and the decline in the value of collateral securing their debt to the Bank.

The deterioration in the financial position of debtors in the different sectors stems from the following developments:

- Commercial sector – deterioration in earnings and in operating profit margins was recorded as a result of the slowdown in current consumption and the decline in the domestic demand level.
- Construction and real estate sector – stability was noted in occupancy rates and rentals of income generating properties (commercial and office premises in preferred areas, alongside the decline in earnings from residential construction due to the decrease in the number of new residential units sold by private promoters.
- Industry sector – production of industrial companies has declined due to a drop in both domestic and foreign demand against the background of the slowdown in global trading volume.
- Communications sector – operating profit margins maintained stability due to more efficiency processes, mergers and acquisitions and a relatively low exposure to the slowdown in economic activity.
- Other business services sector - the circumstances of certain private customers and of small and medium sized businesses in the SEM sector has deteriorated.

Following are the rates of the specific provision for doubtful debts in certain sectors in relation to the consolidated balance sheet credit to the public in these sectors:

Sector	2008	2007
Construction and real-estate	0.8%	0.5%
Hotels, hotel services and food	1.7%	1.0%
Commerce	0.7%	0.3%
Industry	0.8%	0.5%
Communications and computer services	0.3%	0.3%
Business services and other	1.2%	0.4%

The data presented above shows that with the exception of the communications sector, all principal economic sectors registered an increase in the rate of the specific provision for doubtful debts in relation to the credit to the public at the Bank.

Following are the proportionate share of certain economic sectors in the total specific provision compared to 2007:

	Proportion of provision	
Sector	2008	2007
Construction and real-estate	23.6%	20.9%
Hotels, hotel services and food	6.8%	6.1%
Commerce	12.5%	8.9%
Industry	17.6%	19.2%
Communications and computer services	0.9%	1.7%
Business services and other	15.0%	7.4%

The above data indicates the increase in the rates of the provision for doubtful debts in relation to total credit to the public in most principal economic sectors, including the increase in their proportionate share of the overall provision.

Development of credit to the public by economic sectors. Balance sheet credit risk for the construction and real estate sector totalled NIS 22.6 billion as at December 31, 2008, compared with NIS 19.4 billion on December 31, 2007, an increase of 16.4%, which constituted about 18.7% of the total balance sheet credit risk to the public, compared with 18.3% on December 31, 2007.

Off-balance sheet credit risk for the construction and real estate sector (mostly sales guarantees and non-utilized credit lines) amounted to NIS 12.0 billion as at December 31, 2008, compared with NIS 13.5 billion on December 31, 2007, and it constituted 21.2% of the off-balance sheet credit risk, compared with 24.5% as at December 31, 2007.

Total credit risk for the construction and real estate sector constituted 19.5% of the total credit risk to the public as at December 31, 2008, compared with 20.4% on December 31, 2007.

Total credit risk for the industrial sectors totalled NIS 29.6 billion as at December 31, 2008, compared with NIS 28.1 billion at December 31, 2007, an increase of 5.3%, and it constituted 16.6% of the total credit risk to the public under the Group's responsibility, compared with 17.4% as at December 31, 2007. 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, 2008 totalled NIS 3.6 billion, similar to December 31, 2007.

Total credit risk for the commercial sector amounted to NIS 20.4 billion as at December 31, 2008, compared with NIS 19.7 billion as at December 31, 2007, an increase of 3.3%, and it constituted 11.4% of the total credit risk to the public, compared with 12.2% the preceding year.

Total credit risk to individuals was NIS 50.7 billion as at December 31, 2008, compared with NIS 37.4 billion as at December 31, 2007, an increase of 35.6%, and it constituted 27.4% of the total credit risk to the public, as compared with 23.0% as at December 31, 2007.

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

	December 31				
	2008		2007		
	In NIS Millions	% of total credit to public	In NIS Millions	% of total credit to public	Rate of change in %
Retail - household segmemt	29,846	25.6	25,113	24.6	18.8
Retail - small bussiness segmemt	14,152	12.1	12,245	12.0	15.6
Corporate market segment	47,025	40.3	39,925	39.2	17.8
Middle market segment	22,690	19.4	22,360	22.0	1.5
Private banking segment	3,087	2.6	2,256	2.2	36.8
Total	116,800	100.0	101,899	100.0	14.6

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 31.2% of total credit to the public as at December 31, 2008, compared with 28.6% as at December 31, 2007.

The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 52.6% of all credit as at December 31, 2008, compared with 56.1% as at December 31, 2007.

The 74 largest borrowers, in the credit brackets between NIS 200 million and NIS 1,600 million, were granted credit constituting 16.2% of total credit as at December 31, 2008, compared with 61 borrowers that were granted credit constituting 15.5% of the total credit as at December 31, 2007.

Credit granted to the Governments totalled NIS 1,491 million as at December 31, 2008, compared with 374 million as at end of 2007, an increase at a rate of 298.7%.

The balance as at December 31, 2008 includes NIS 1,460 million deposited with the Accountant General's deposit as part of the Bank's success in the teachers tender and the state employees tender. The balance as at December 31, 2007 includes NIS 362 million deposited with the Accountant General's deposit as part of the Bank's success in the teachers' tender. (For additional details see "Retail banking segment - Household segment" under "Activities of the Group according to principal segments of operations" hereunder).

SECURITIES

General. Securities totalled NIS 31,535 million as at December 31, 2008, compared with NIS 37,278 million at the end of 2007, a decrease of 15.4%.

COMPOSITION OF THE SECURITIES PORTFOLIO BY LINKAGE SEGMENTS

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

	December 31		Rate of change in %
	2008	2007	
	In NIS Millions		
Non-linked shekels	8,206	13,580	(39.6)
CPI-linked shekels	3,527	2,685	31.4
Foreign currency and foreign currency-linked shekels	18,434	19,240	(4.2)
Shares - non-monetary items	1,368	1,773	(22.8)
Total	31,535	37,278	(15.4)

Securities in foreign currency and in Israeli currency linked foreign currency declined by 4.2% compared with December 31, 2007. In U.S. Dollar terms, the securities in Israeli currency and in foreign currency linked Israeli currency decreased by US$154 million, a decrease of 3.1% as compared with December 31, 2007.
Total securities, including securities in foreign currency and in Israeli currency linked to foreign currency expressed in U.S. Dollar terms, decreased by 14.8% as compared with December 31, 2007.

COMPOSITION OF THE SECURITIES PORTFOLIO ACCORDING TO PORTFOLIO CLASSIFICATION

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, 2008			December 31, 2007		
	Net adjusted cost	Fair value	Book value	Net adjusted cost	Fair value	Book value
	In NIS millions					
Bonds						
Held-to-maturity	1,917	1,855	1,917	3,345	3,354	3,345
Available-for-sale	26,682	26,260	26,260	29,222	29,134	29,134
Trading	2,027	1,991	1,991	3,021	3,026	3,026
Shares						
Available-for-sale	1,282	1,325	1,325	1,476	1,760	1,760
Trading	52	42	42	13	13	13
Total Securities	31,960	31,473	31,535	37,077	37,287	37,278

The net difference (after tax effect) between the fair value of the available-for–sale portfolio and its written-down cost in the amount of NIS 186 million as of December 31, 2008 (December 31, 2007: NIS 166 million), is included in equity under "adjustments to fair value of available-for-sale securities". In addition, included in equity is the difference, as stated, relating to the Bank's share in equity of the First International Bank amounting to NIS 10 million (December 31, 2007 – NIS 30 million).

Corporate bonds. Discount Group's available for sale securities portfolio as of December 31, 2008, includes investments in corporate bonds in the amount of NIS 4,460 million (an amount of NIS 1,507 million is held by IDB New York and an amount of NIS 2,448 million, directly by the Bank). For details as to the balance of unrealized losses included in the balance of the said bonds, see Note 3 to the financial statements, paragraph G.

Investment in fund of hedge funds. In 2007 the Bank invested an amount of US$100 million in a fund of hedge funds, which is presented as part of available-for-sale shares. The events occurring in the financial markets since June 2007 also impacted the performance of the hedge funds in particular those which were exposed to credit. In view of the performance of the Fund and requests by investors to withdraw their investment, the Fund has begun a structured process of its liquidation.

As of December 31, 2008, a provision for impairment of NIS 63 million was recorded in the financial statements in respect of this investment, part of which stemming from the decrease in the dollar exchange rate this in addition to a provision for impairment of NIS 44 million made in 2007, one half of which in respect of the decrease in the exchange rate of the U.S. dollar. In August and October 2008 some 56% of the Fund's participation units were redeemed. With respect to the said realizations, no further loss was sustained beyond the provision for impairment already recorded in the Bank's books.

Available for sale bonds - data according to economic sectors. Following are details regarding to the distribution of bonds in the available for sale portfolio according to economic sectors:

	December 31,2008				March 13, 2009
			Cumulative other comprehensive income		
	Book value	Fair value[1]	profits	losses	losses
	In millions NIS				
Non governmental bonds and bills					
Industry	125	111	-	14	10
Construction and real estate	230	150	-	80	73
Electricity and water	375	355	-	20	16
Commerce	160	145	1	16	8
Transportation and storage	56	49	1	8	4
Communication	62	63	1	-	-
Financial services[1]	4,119	3,454	5	670	912
Other business services	161	133	-	28	38
Total	5,288	4,460	8	836	1,061
Government bonds and bills					
US government	77	77	-	-	-
Israel Government	9,793	10,118	344	19	3
Other Governments	123	118	-	5	1
Total government bonds and bills	9,993	10,313	344	24	4
Government Sponsored Enterprises (GSE) Agencies					
Freddy Mac	6,762	6,840	84	6	4
Fannie Mae	4,009	4,012	25	22	12
Other	630	635	9	4	2
Total Government Sponsored Enterprises (GSE) Agencies	11,401	11,487	118	32	18
Total available for sale securities	26,682	26,260	470	892	1,083
(1) Following are details regarding available for sale securities in financial services sector:					
Financial services:					
Banks and banking holding companies[2]	3,727	3,145	5	587	834
Insurance	53	42	-	11	15
Other	339	267	-	72	63
Total financial services	4,119	3,454	5	670	912
(2) Following are details according to geographical areas of investments in available for sale securities of banks and banking holding companies:					
North America	2,139	1,680	1	460	672
West europe	1,130	1,028	-	101	149
Israel	317	312	4	9	2
Asia	78	67	-	10	7
Australia	34	32	-	2	2
Other	29	24	-	5	2
Total	3,727	3,145	5	587	834

Held-to-maturity securities - data according to economic sectors. Following are details regarding the distribution of bonds in the held-to-maturity securities portfolio according to economic sectors:

		December 31,2008			March 13, 2009
Sector of activity	Book value	Fair value[1]	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Unrealized losses from adjustment to fair value
		In millions NIS			
Non govermental bonds and bills					
Industry	6	6	-	-	-
Construction and real estate	-	-	-	-	-
Electricity and water	21	21	-	-	5
Commerce	-	-	-	-	-
Transportation and storage	-	-	-	-	-
Communication	-	-	-	-	-
Financial services	517	476	3	44	47
Other business services	10	10	-	-	-
Total non govermental bonds and bills	555	513	3	44	52
Government bonds and bills	830	814	12	28	18
Government Sponsored Enterprises (GSE) Agencies:					
Freddie Mac	533	528	7	12	19
Total held to maturity securities	1,917	1,855	22	84	89

Available for sale securities - data according to economic sectors. Following are details regarding the distribution of bonds in the available-for-sale securities portfolio according to economic sectors:

		December 31,2008			March 13, 2009
Sector of activity	Book value	Fair value[1]	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Unrealized losses from adjustment to fair value
		In millions NIS			
Non govermental bonds and bills					
Industry	43	44	1	-	-
Construction and real estate	5	3	-	2	2
Electricity and water	41	41	-	-	-
Commerce	2	2	-	-	-
Transportation and storage	3	3	-	-	-
Communication	7	7	-	-	-
Financial services	346	266	1	81	99
Other business services	11	10	-	1	-
Total	459	376	2	84	101
Government bonds and bills	1,555	1,600	46	1	-
Other government bonds and bills	14	15	1	-	-
Total bonds for sale securities	2,027	1,991	49	85	101

INVESTMENTS IN ASSET BACKED SECURITIES

General. Discount Group's securities portfolio as of December 31, 2008 includes investment in asset backed securities, primarily in mortgage backed securities (MBS) in the amount of US$3,039 million, which are held for the most by IDB New York, compared to an amount of US$2,252 million as at December 31, 2007, an increase of 34%. About 97% of the mortgage backed securities portfolio is comprised of debentures of various federal agencies (Ginnie Mae, Fannie Mae, Freddie Mac), ranked AAA in the United States. The investment in the said bonds does not include exposure to the subprime market.

As of December 31, 2008, the portfolio of mortgage backed securities (MBS) included unrealized net gains of US$14 million. As at the middle of March 2009, the said balance of bonds included unrealized net gains amounting to NIS$36 million.

U.S. Government Sponsored Enterprises. Fannie Mae and Freddie Mac are government sponsored enterprises (GSE) chartered by the U.S. Congress with mission to provide liquidity and stability to the U.S. housing and mortgage markets. To accomplish their mission, the GSE operate in the secondary mortgage market. Rather than granting home loans directly to the consumers, the GSE work with mortgage banks, brokers, and other primary mortgage market partnerships ensuring they have the funds to lend to home buyers at affordable rates. The GSE fund their mortgage investments primarily by issuing debt securities in the domestic and international markets.

On September 6, 2008, the Federal Housing Finance Agency (FHFA) appointed its Director Mr. James Lockhart as conservator of both GSE. In addition, the U.S. Department of the Treasury agreed to up to US$200 billion of capital as needed to ensure the GSE continue to provide liquidity to the housing and mortgage markets. The market for GSE Mortgage Backed Securities (MBS) has always operated under the assumption that these securities had the implicit guarantee of the U.S. Government, as such the actions taken by the Federal Government, placing the GSE into conservatorship were welcomed by the market.

All of IDB New York's GSE-MBS are performing. As at December 31, 2008 their market value increased by US$19.9 million over their value in the books.

During the fourth quarter the U.S. regulators (the board of Governments of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), The National Credit Union Administration (NCUA), the office of the Comptroller of the Currency (OCC), and the Office of the Thrift Supervision (OTS) proposed new regulations for lowering the current risk rating for regulatory capital purposes from 20% to 10% for GSE-MBS securities.

It is not known at this stage when the said directives will come into effect.

Direct investments in Federal Agencies' bonds. The securities portfolio of the Discount Group as at December 31, 2008, includes a direct investment in Federal Home Loan Bank (FHLB), Fannie Mae and Freddie Mac bonds (hereinafter: "the Federal Agencies"), that are held by a foreign consolidated subsidiary, in an amount of US$203 million, compared to US$1,075 million on December 31, 2007, a decrease of 81.1%. This decrease stemmed mostly from early redemptions in accordance with the CALL options exercised by the Federal Agencies. The said early redemptions have not resulted in losses to the Group.

Developments in the portfolio during 2008. Concurrently with the redemptions in direct investments, IDB New York increased its investments in mortgage based securities (MBS), especially in those of the Federal Agencies.

Exposure to ALT-A loans and to sub-prime loans. IDB New York holds a portfolio of held to maturity bonds, bonds of the RMBS-ALT A type, with a total balance sheet exposure of US$84 million. This investment was made in the course of 2008, and it includes investment in mortgage backed loans of private home owners.

The maturity periods of these bonds vary between 27 years and 39 years. The average maturity of bonds of this type is generally low, due to current repayments of the mortgages backing the loans.

Additional exposure exists to sub-prime RMBS in respect of a single investment amounting at December 31, 2008, to US$0.7 million, which is rated A1, and is due on June 25, 2037.

The valuation of the RMBS type instruments is particularly sensitive to assumptions regarding the rate of repayment of the mortgage loans and the scope of default pertaining to these loans. The higher the rate of repayment of the loans the higher would be the value of the bonds, while the higher the volume of losses on these loans the lower would be the value of the bonds.

Following are details regarding Alt-A and Subprime Exposure as at December 31, 2008:

	Maturity Date	Adjusted cost	Fair Value	Book Value
RMBS Alt-A	2035	114	98	114
	2036	72	60	72
	2037	98	84	98
	2047	34	32	34
Total RMBS Alt-A		318	274	318
Total RMBS Subprime	2037	4	3	3

Exposure to commercial mortgage backed securities (CMBS). IDB New York holds a portfolio of commercial mortgage backed bonds (CMBS) with a total balance sheet exposure of US$20 million. These securities are classified under the trading and other services segment. The collateral pertaining to these securities is all located in the United States. During 2008, there were no purchases or sales of such securities and no losses were recognized in the income statement, since both IDB New York and the Bank believe that the impairment is not of another than temporary nature.

Following are details regarding CMBS Exposure as at December 31, 2008:

Maturity Date	Adjusted cost	Fair Value	Book Value
2039-2040	19	15	15
2045-2047	15	11	11
2049-2051	66	49	49
Total CMBS	100	75	75

INVESTMENT IN BONDS OF FOREIGN FINANCIAL INSTITUTIONS

Investment in Lehman Brothers bonds. On September 15, 2008, the Lehman Brothers Group (hereinafter: "Lehman Group"), which until then was considered one of the four largest investment banks in the United States, collapsed. At this time, the Bank and IDB New York held Lehman Group's holding company's bonds in a total amount of US$57 million. The Bank has also entered into transactions with the Lehman Group involving financial assets. As of September 15, 2008, the Bank's exposure in respect of these transactions was negligible. Furthermore, the Bank manages various accounts of Lehman Group companies, some of which are for their customers.

On September 18, 2008, at the request of Bank Leumi, a temporary comprehensive attachment order was issued with respect to assets and rights existing in the Lehman Group accounts with the Bank in an amount of up to NIS 370 million. On October 6, 2008, Bank Leumi filed a petition for approval of the attachment. The Bank has submitted a defense brief.

On November 17, 2008, the Bank served three companies of the Lehman Group with a notice of setoff in respect of all assets and money held by the Group with the Bank as regards all the Group's debts to the Bank, except for accounts managed on behalf of Lehman Group customers.

On March 12, 2009, an agreement was given the effect of a Court verdict, under which attachments executed by Bank Leumi were approved, subject to the priority rights of the Bank deriving from the right of set-off to which the Bank is entitled.

Investment in bonds of Washington Mutual Bank. Following its collapse, Washington Mutual Bank ("WAMU") has been acquired by J.P. Morgan. The acquisition transaction was assisted by the FDIC, though J.P. Morgan did not accept the liability in respect of the WAMU bonds. At the time of the WAMU collapse, IDB New York held WAMU bonds in a total amount of US$10 million.

Investment in Landsbanki bonds. Landsbanki was the second largest bank in Iceland based on total assets, and the largest based on the number of branches and share in local activity in Iceland. During October 2008, and following the crisis in the markets, this bank was nationalized by the Government of Iceland and all of its domestic assets have been transferred to a new bank with a similar name, with the objective of ensuring the money of local depositors. The old bank entered into receivership. At the time of the collapse of Landsbanki, IDB New York held bonds of that bank in a total amount of US$10 million.

The Bank and IDB New York recorded a provision for impairment in value in respect of the foreign financial institution bonds, which include the Lehman Group, WAMU and Landsbanki in the amount of NIS 283 million.

For further details regarding exposure to foreign financial institutions, see hereunder in the Chapter "Exposure to risks and risk management" and Note 3 to the condensed financial statements.

Held to maturity bonds - data according to economic sectors. Following are details regarding to the held to maturity bonds according to market sectors:

Available for sale securities - data according to economic sectors. Following are details regarding to the distribution of securities in the available for sale portfolio according to market sectors:

DETAILS REGARDING IMPAIRMENT IN VALUE OF AVAILABLE FOR SALE SECURITIES

General. At the beginning of November 2008, the Supervisor of Banks directed banking corporations to include in their directors' report, starting with the report for September 30, 2008, details regarding the impairment in value of available for sale securities.

The point in time for determining the length of the period in which the investment was in a continuous unrealized loss position, is the date of the financial statements for the reporting period during which a continuous impairment first occurred.

The rate of the decline in the fair value below cost is computed as of the reporting date. This is so even if during the period in which the investment was in a continuous unrealized loss position, the rate of decline in fair value below cost was significantly different from the rate applying on the reporting date.

Unrealized losses - shares available for sale. Following are details regarding the distribution of unrealized accumulated losses on shares available for sale, according to the ratio of unrealized loss to the cost of the investment and the period of time in which this loss accrued (in NIS millions):

	December 31, 2008				
	Period of decline in fair value below cost				
Ratio of unrealized loss to cost	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	Total
Up to 20%	-	-	-	-	-
From 20% to 40%	41	-	-	-	41
Over 40%	-	-	-	-	-
Total	41	-	-	-	41

Unrealized losses - asset backed securities available for sale. Following are details regarding the distribution of unrealized accumulated losses on asset backed securities available for sale, according to the ratio of unrealized loss to the cost of the investment and the period of time in which this loss accrued (in NIS millions):

	December 31, 2008				
	Period of decline in fair value below cost				
Ratio of unrealized loss to cost	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	Total
Up to 20%	6	5	4	20	35
From 20% to 40%	-	5	11	7	23
Over 40%	-	-	-	-	-
Total	6	10	15	27	58

Unrealized losses - bonds available for sale. Following are details regarding the distribution of unrealized accumulated losses on the said bonds, according to the ratio of unrealized loss to the cost of the investment and the period of time in which this loss accrued (in NIS millions):

	December 31, 2008				
	Period of decline in fair value below cost				
Ratio of unrealized loss to cost	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	Total
Up to 20%	70	36	55	81	242
From 20% to 40%	29	60	33	278	400
Over 40%	50	7	67	70	194
Total	149	103	155	429	836
Of which: Government bonds	13	-	11	-	24

According to directives and guidelines issued by the Supervisor of Banks and accepted accounting principles applying to banking corporations, available for sale securities are stated in the balance sheet at fair value, except for shares in respect of which fair value is not available, which are stated at cost less a provision for impairment that is not of a temporary nature, which is reflected in the statement of income. Gains or losses not yet realized from adjustment to fair value, less the tax effect, are stated directly as a separate item of shareholders' equity and are taken to the statement of income. Unrealized losses reflected as a capital reserve are losses of a temporary nature only. Losses which are of other than temporary nature are stated directly in the statement of income.

For the purpose of deciding the nature of losses incurred on securities as stated, Management of the Bank and/or of the relevant subsidiary considers the following considerations:

- The ratio of loss to cost/depreciated cost;
- The period in which the fair value of the security is lower than its cost;
- The rate of yield to redemption in the case of bonds;
- The credit rating of the security, including changes in its rating;
- In the case of shares – events of reduction due to the distribution of dividends or its cancellation;
- In the case of bonds – adherence by the issuer to the timely payments of principal and interest.
- Relating the impairment in value to the deterioration in the financial position of the issuer, or to the change in general market condition;
- The intent and ability of the Bank or its relevant subsidiary to continue holding the securities until such time that the expected recovery of the fair value of the securities occurs.

Based on a review of the impairment of the said securities, and where relevant, basing itself also on the review made by the relevant subsidiary, the Bank's Management believes that that the impairment is of a temporary nature.

For further details see Note 3 to the financial statements.

DEPOSITS FROM THE PUBLIC

Deposits from the public as at December 31, 2008, totalled NIS 139,232 million, compared with NIS 130,518 million at the end of the preceding year, an incerase of 6.7%.

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

	December 31 2008		December 31 2007		
	In NIS millions	% of deposits from the public	In NIS millions	% of deposits from the public	change in %
Non-linked shekels	64,770	46.5	55,066	42.2	17.6
CPI-linked shekels	12,516	9.0	11,578	8.9	8.1
Foreign currency and foreign currency-linked shekels	61,946	44.5	63,874	48.9	(3.0)
Total	139,232	100.0	130,518	100.0	6.7

Deposits from the public in foreign currency and in Israeli currency linked to foreign currency decreased at the rate of 3.0%, compared with Decmber 31, 2007. In dollar terms the deposits from the public in foreign currency and in Israeli currency linked to foreign corrency decreased by US$315 million, a decrease of 1.9% compared with December 31, 2007.

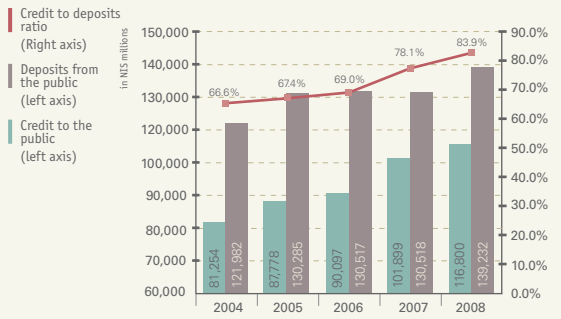
Total deposits of the public, including deposits in foreign currency and in Israeli currency linked to foreign currency, expressed in U.S. Dollar terms, increased by 7.2% as compared with December 31, 2007.

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

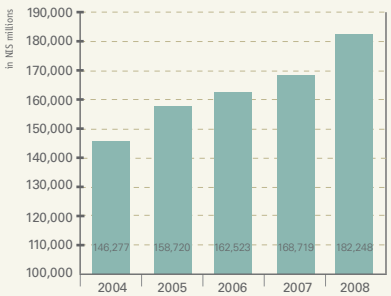
	December 31				
	2008		2007		
	In NIS Millions	% of deposits from the public	In NIS Millions	% of deposits from the public	Rate of change in %
Retail - household segmemt	57,115	41.0	53,151	40.7	7.5
Retail - small bussiness segmemt	12,211	8.8	10,511	8.1	16.2
Corporate market segment	21,720	15.6	16,342	12.5	32.9
Middle market segment	8,844	6.3	12,572	9.6	(29.7)
Private banking segment	39,342	28.3	37,942	29.1	3.4
Total	139,232	100.0	130,518	100.0	6.7

The ratio of total credit to the public to deposits from the public was 83.9% at the end of 2008, compared with 78.1% at the end of the previous year.

CREDIT TO THE PUBLIC AND DEPOSITS FROM THE PUBLIC – CONSOLIDATED



TOTAL ASSETS - CONSOLIDATED



FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2008, the investment in buildings and equipment amounted to NIS 3,039 million, compared with NIS 2,780 million at he end of 2007, an increase of 9.3%.

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, 2008, was 168 thousand square meters, compared with 164 thousand square meters at the end of 2007. Of this area, 99 thousand square meters were freehold property and 69 thousand square meters leasehold property (2007: 100 thousand square meters were freehold property and 64 thousand

square meters leasehold property). At the end of 2008, some 77 thousand square meters served the Bank's branches and the balance served the head office, compared with 74 thousand square meters in 2007.

In November 2008, the Bank acquired a building on 156 Herzel Street in Tel Aviv in consideration for approximately NIS 51 million (including related taxes). The 11,791 sq. mtrs. building, which includes 137 parking places and some 2,000 sq. mtrs. of basement areas and bomb shelters, had been let to the Bank until its acquisition, at an annual rent of NIS 4.4 million. The building was acquired, among other things, as part of the plan to assemble all of the Bank's logistics units at the Herzel compound.

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 servers 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.

For details regarding the engagement for providing computer services to Discount Mortgage Bank, see "Main future projects" below.

COMPLETION OF THE "OFEK" PROJECT AND SHUTTING DOWN THE UNYSIS COMPUTER

In 2001 the Bank launched the "Ofek" Project, the aim of which was renewal of its 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.

Up to 2006, the principal assignments of integrating the core banking system purchased from Accenture, which constituted the very core of the Ofek Project which operates as the Bank's central system, have been successfully achieved and 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.

As of the end of March 2009, the Bank has completed the implementation of all systems purchased from Accenture, and the rate of completion of the project for the renovation of the computer infrastructure now stands at over 90%.

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.

With the completion of the "Ofek" project, several systems that continued to operate in the Unisys environment remained, which required the continued operation of the Unisys computer alongside the IBM computers.

One of the principal projects carried out during 2007-2008, which is expected to continue also in the first half of 2009, is the completion of the conversion of the principal systems to the IBM computers, including the credit system and the securities system. 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, are 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.

Completion of the conversion of all systems still operating on Unisys computers is planned for the middle of 2009, so that in September 2009 it will be possible to discontinue the operation of the Unisys computers.

The Bank believes that shutting down the Unisys computer will save costs in the amount of NIS 60-70 million in computer operating licenses and computer maintenance and will allow for manpower reduction in the relevant units.

The above is considered a forward looking statement based on the Bank's existing work plans at the time of publication of this report and on existing data regarding the development requirements and their order of preference. Changes in legislation and regulation not known at the time of publication of this report, including the change of details of existing initiatives and drafts and the time schedule for their implementation, urgent business requirements and other changes that might affect the scope and priority of the assignments that the Bank must carry out under a given limitation on resources, may bring about changes in the preparations or the ability to realize the Bank's plans as they exist at date of publication of this Report.

LOCATIONS OF THE OPERATION

The mainframe systems of the Bank are located at two different locals, in various cities in the Greater Tel Aviv area. 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 are connected by optical fibers in two different routes.

These sites also house the disc systems of EMC and IBM, 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, the secondary location 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 these matters.

MAIN FUTURE PROJECTS

1. Conversion of the principal systems that are still in operation on the Unisys computer (credit system and securities system); conversion of the principal systems to the IBM computers.
2. E-Banking – a project for the upgrading the Bank's Internet site as well as modifying it for small and medium business customers. This project began in 2007 and is planned to be completed in 2011.
3. Projects intended to conform to regulatory instructions regarding credit and risk management (Basel II) matters and in the matters of securities and the capital market.

The Bank's budget for 2009 in respect of projects for the development of information systems, including for information system development projects, amounts to NIS 100 million (excluding expenses relating to completing the conversion to the IBM system).

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.

Engagement for provision of computer services to Discount Mortgage Bank. In December 2008, the Bank and BDL Computer and Administration Services, a subsidiary of the Bank (hereinafter together in this paragraph: "the Bank") entered into an agreement with Discount Mortgage Bank for the provision of computer services, which includes all the computer systems as well as the "Shamayim" project (Discount Mortgage Bank being in the midst of its development).

At the first stage, services will be provided relying on Discount Mortgage Bank's present systems. At the second stage, the service will be provided on the basis of the Bank's computer systems. Completion of the transition to full use of the Discount systems is planned for March 2011.

The Bank has acquired in full from Discount Mortgage Bank the ownership rights in the "Shamayim" project, purchased and/or developed by Discount Mortgage Bank, in consideration for the accumulated as of the end of 2008.

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 fro 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", "Discount 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, applied 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 see Note 29 J 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%).

Final tax assessments have been issued to the Bank for the years up to and including the tax year 2003 (for details regarding the settling of the income tax assessment for 2003 and its implications, see Note 29 D to the financial statements).

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 a 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 non 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, 38.53% in 2007 and 36.80% in 2008. The statutory tax rate will stand at 35.93% in 2009 and 35.06% as from 2010 onwards.

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 came to an end during the 2007 tax year and the provisions of the law will no longer apply as from the 2008 tax year, except for certain transitional provisions the objective of which is to prevent distortions in the tax calculation.

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. The definitions of "profit" and of "wages" in the Value Added Tax Law have also been amended within the framework of the said amendment, so that tax on profit is to be calculated after deduction of tax on wages, and the definition of wages for the purpose of calculating the tax on wages is to include the employer contribution for Social Security.

For additional details, see Note 29 j to the financial statements.

A QUALIFIED INTERMEDIARY (QI) STATUS

The Bank has been granted the status of Qualified Intermediary (QI), as defined by the US Tax Authorities. The significance of this is that the Bank has entered into an agreement with the US Tax Authorities, whereby it is entitled to withhold tax with regards to its customers' securities transactions.

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.

THE GLOBAL ECONOMIC CRISIS

GENERAL

The activity of the global economy during 2008 was influenced by the global economic crisis, being a combination of three different crises that intensify one another:

- A cyclic slowdown following a long period of heightened economic activity, the slowdown being led by a reverse trend in the real estate market in the United States and in other countries;
- Acute liquidity crisis, the worst since the 1930's, affecting the financial markets in the United States and developing into an international crisis;
- A banking crisis, which until now caused the collapse of banks, large and small alike, around the world the nationalization of financial institutions and the merger of others.

In the course of 2008, the crisis also left its mark on the non-financial economy in the U.S., with a significant deterioration in the fourth quarter of the year. The GDP, which continued growing in the first two quarters of the year, declined in the last two quarters at annualized rates of 0.5% and 6.2%, respectively. The crisis in the labor market intensified as 3 million positions were lost in 2008, of which 1.7 million positions in the last quarter of the year. Industrial production declined during the year by 8.2%, mostly due to a weakness in the automotive industry. According to announcement of the NBER, (an American agency for economic research) the U.S. economy is experiencing a recession since December 2007.

A recession was noticed in the Euro block and Japan already in the second quarter of 2008, in which a negative growth rate was reported, which intensified in the second half of the year. In developing markets, as a whole, a significant slowdown in activity was noticed in the last quarter of 2008, following the decline in global demand, falling prices of commodities and the disappearance of foreign investors.

THE HOUSING MARKET IN THE UNITED STATES

One of the central factors that influenced the global economy during 2008 was the housing market in the US, which experienced a very deep recession during the year. Thus, in comparison to the middle of 2007, housing prices dropped at a significant rate, construction companies reduced their operations and the number of new building projects and the volume of sales of new residential units declined by 44% during 2008. Concurrently, banks began to sell foreclosed properties in order to recover loans granted by them, a fact that resulted in the increased supply of apartments and an accelerated drop in prices. The intensifying recession in the property market resulted in the continued decline in the value of mortgages and in the properties backing them, which resulted in considerable losses sustained by financial institutions.

The uncertainty as regards the volume of assets backing the mortgages of the various institutions, and furthermore, the inability to price them in relation to the falling property prices and the increase in the rate of insolvencies, had created uncertainty in the financial system as well as a credit crunch. Banks refused to grant short-term loans to one another and to allocate credit facilities vital to the proper operation of the banking industry. And the spread between the inter-bank interest rate and U.S. Government bonds interest rate has risen to levels unknown for decades (the three months interest spread reached 4.5% in October 2008, compared to 0.4% in July 2007).

THE U.S. MORTGAGE MARKET

Three mortgage agencies operate in the US housing market, the principal of which are:, Fannie Mae and Freddie Mac. The enormous importance of these two agencies is reflected in the fact that about one half of the mortgage debt in

the United States is owned or guaranteed by them. In addition to these agencies, several other entities operate in the mortgage market providing "sub-prime" housing loans to borrowers.

The mortgages in which Fannie Mae and Freddie Mac are involved, comply with strict standards of underwriting. Their stable condition of the agencies and close ties to the U.S. Administration caused their debt to be considered practically risk-free, and they were able to raise funds at a minimal premium above that enjoyed by the Federal Government (generally less than 10 base points). Their debt has been considered extremely attractive and served as a popular channel for investments by international investors, including foreign governments and central banks. These agencies did not directly finance "subprime" loans, therefore, the risk involving holders of mortgage backed securities of Fannie Mae and Freddie Mac is not directly affected by the "subprime" crisis. However, these agencies had invested their own funds in mortgage derivatives in this market, a fact that endangered their continued existence.

RESCUE OPERATIONS BY GOVERNMENTS AND CENTRAL BANKS

The central banks reacted to the crisis resolutely by providing massive liquidity to the system and by aggressively reducing the interest rate. In addition, central banks did not hesitate to intervene in the capital market whenever it seemed that the activity of the system in its entirety and the activity of the non-financial sector were at risk.

A first significant intervention was recorded in March 2008, against the background of the loss of liquidity of Bear Sterns Investment Bank, one of the leading in the U.S. The fear that the crisis might spread to additional banks brought about the FED's intervention, which provided liquidity to this investment bank, a move which enabled its acquisition by J.P. Morgan.

With the intensifying crisis, an unprecedented level of federal intervention was adopted in the U.S. starting with the third quarter of the year: In the United States this was reflected in unprecedented federal intervention: nationalization of the two mortgage agencies, Fannie Mae and Freddie Mac the nationalization of AIG – the largest insurance company in the world, provision of credit facilities to investment banks, unilateral intervention in the sale of investment banks that had encountered difficulties to banking groups and the sale of Washington Mutual to J.P. Morgan.

The nationalization of Fannie Mae and Freddie Mac, on September 6, 2008, was designed to prevent a shock to this major system, the effect of which on the entire financial system and on the international financial system could have caused a severe chain reaction. The concern was that a significant adverse effect on their mortgage backed securities (MBS) prices would threaten the continued operation of the most important mechanism for financing the construction industry.

During September 2008 the Bank of America acquired Merrill Lynch only a short time prior to Lehman Brothers' bankruptcy. The credit crunch has greatly intensified since Lehman Brothers' collapse reaching financial crisis dimensions. In response to this situation, the U.S. Administration declared towards the end of September 2008, a plan of action designed to stop the financial system's losses and to enable it to make capital available for loans to the business sector and to consumers, capital that is vital for continued economic activity. In the course of October 2008, Congress approved the said plan, following certain amendments made thereto. US$700 billion have been allocated, as part of the plan, for the purchase of "poisonous" mortgage backed securities and their elimination from the financial statements of banks as well as for investment in banks. At a later stage, it had been decided to allocate a part of that amount for other purposes, including backing of the US automotive industry, which faced collapse. In addition, Congress decided on the refund of taxes to individuals and businesses and on the increase of guarantees for bank deposit to an amount of US$250 thousand.

On October 8, 2008, in view of the intensifying credit crisis, several central banks (including the FED, the European Central Bank Block and the Bank of England) reduced the interest rates simultaneously, in a coordinated move taken at an extraordinary meeting.

The efforts made by governments and central banks the world over to bailout the global economy have not ceased. These steps included: providing capital to banks and financial institutions as well as their nationalization, guarantees for the banks' debts, acquisition of mortgage loans, mortgage backed assets and loans of various kinds, providing loans out of central bank funds to non-banking entities, tax refunds and the continued reduction of interest rates. Particularly outstanding was the US Administration bailout action taken in November 2008 to avoid the collapse of Citibank by providing it with capital and a commitment by the Administration to provide guarantees for problematic assets stated in the bank's financial statements.

Similar actions have been taken in additional countries around the world. Outstanding also is the British government's bailout plan presented in October 2008, which included providing 50 billion worth of assistance to the large banks in return for the nationalization of a part of their shares, providing government collateral to the banks and providing banks and real estate companies with short-term loans to the tune of some 200 billion, in order to increase their liquidity.

In the course of the year, against the background of the dramatic actions taken to provide liquidity to the financial system, the inter-bank credit market has calmed down and the inter-bank interest spread, which as stated had reached a record high in October 2008, dropping to about 1% (the Ted Spread for three months).

The International Monetary Fund has also provided assistance in an amount of US$50 billion, mainly to economies in crisis such as Iceland, Hungary, Latvia, Pakistan and others, which had not been able to raise funds for the fiscal expansion required for avoiding the crisis.

According to data published by the International Monetary Fund, write-offs reported by banks until the end of January 2009, amounted to US$792 billion, and the loss potential in respect of debt instruments, including securitization instruments, stood at US$2.2 trillion.

INFLATION AND MONETARY POLICY

The inflation in 2008 was largely influenced by developments in commodity and energy prices in the world. The increase in prices of commodities, foodstuffs and energy in the world continued to rise in the first half of 2008, and certain commodities even registered dramatic price increases of several dozen percent.

The rise in commodity, energy and foodstuffs prices has created inflationary pressures and resulted in a rise in inflation rates in both developed and developing economies. Notwithstanding, since the end of June 2008, a marked downward adjustment was recorded in commodity and energy prices, this on background of the intensifying credit crisis and evaluations that the growth rate of developed economies and the global economy will be lower than that forecasted in the past.

Thus the price of an oil barrel at the end of 2008 was US$44.2 as against US$93.7 at the beginning of the year and a record high of US$147 in July 2008. Concurrently, the annual inflation rate in the U.S. fell from a level of 5.6% in July to only 0.1% in December. However, the annual inflation rate as measured by the core index remained stable throughout most of the year at a level of 1.8%, though in the last three months of 2008 the core index fell by an annualized rate of 0.3%.

Against the background of the concern that the U.S. economy will enter a deflationary spin and in view of the credit crunch and the assessments that the capital market is not going to recover in the near future, the FED reduced the interest rate in December 2008 to a marginal rate of between 0% and 0.25%, the lowest interest rate ever set in the U.S. The FED noted that in view of the economic slowdown, its intention is to leave the interest rate at these low rates for a lengthy period of time.

Similarly, in the Euro block the annual inflation rate (for the past twelve months) fell in December 2008 to a level of 1.6%, after having reached 4% in July. The ECB, unlike the FED, has started to reduce the interest rate at a relatively late stage, and has handled it in a gradual and moderate manner bringing it down to a level of 2.5% from a high of 4.25%. In addition, the authorities in Europe have adopted drastic steps to assist the capital market and increase liquidity.

The weakness of the U.S. economy and the low dollar interest rate were the cause of the continued weakness of the dollar in relation to most of the principal currencies in the world at the beginning of 2008. However, in July-November 2008 the U.S. dollar has rallied against the Euro, despite the interest rate gap which remained unchanged, this as a result of a change in expectations and the assessment that the decline in economic activity in the Euro block will be more severe in view of the more vigorous bailout actions taken by the U.S. A partial adjustment occurred in December when the dollar weakened as against the Euro.

For details regarding additional developments, see hereunder "Principal economic developments in January-March 2009."

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY IN 2008

GENERAL

The Israeli economy entered the recession at a relatively late stage compared to Western economies, however, clear signs of an accelerating recession were evident in the fourth quarter of 2008.

The growth rate slowed down in 2008, a trend that took a significant turn to the worse in the fourth quarter of the year. The growth rate in 2008 reached 4% compared to an annual growth rate of over 5% in the four preceding years. An analysis of half-year periods shows that while in the first half of 2008 the GDP grew at an annualized rate of 4.9%, the recorded growth of the GDP during the second half was at an annualized rate of 1.3%, including a regression at the rate of 0.5% in the last quarter of the year.

A significant slowdown was recorded in 2008 in the export of goods and services. This was due mainly to a sharp drop in the export of diamonds. A sharp decline was also recorded in investment in fixed assets and a slowdown in private consumption. As a result of the decline in the overall applications in the economy, a marked slowdown was also noticed in the import of goods and services. As stated, the fourth quarter of 2008 recorded a decline in the GDP coupled with sharp drops in import and export and a drop in private consumption.

This trend is also reflected in the Combined State of the Economy Index published by the Bank of Israel, which fell on an average by an annualized rate of 6% in the fourth quarter of 2008, following a growth of 1% in the third quarter and a rise of 13% in the first half of the year.

The sharp decline in the Index in the fourth quarter of the year indicates the intensifying slowdown in economic activity reflected in a decline in all Index components, including the industrial production indices and the commercial and services indices, the goods and services import and export indices, as well as the employee positions in the business sector.

Industrial production grew in 2008 at a rate of 7.1%, while industrial production excluding the hi-tech industries expanded by only 1.9%.

According to the trend data, a decline in industrial production was recorded in the months of October-December 2008, at an annualized rate of 5.6%.

The decline in economic activity in the last quarter of 2008 was only partly reflected in the unemployment data. The rate of unemployment in the last quarter of 2008 increased to 6.3% compared to 6.0% in the second and third quarters of the year and 6.6% in the fourth quarter of 2007.

In February 2008, the international rating agency Fitch raised Israel's debt rating from a level of "-A" to that of "A".

Subsequently, the international rating agency Moody's raised the credit Israel's rating in foreign and local currencies from "A2" to "A1".

Notwithstanding, in October 2008, the international rating agency S&P reduced the forecast for Israel's long-term foreign currency credit rating from "positive" to "stable", following the expected deterioration in the global economic environment, which is expected to effect on the export oriented Israeli economy.

DEVELOPMENTS IN FOREIGN EXCHANGE RATES AND INFLATION RATES

In the course of 2008 the Shekel appreciated as against the dollar by 1.1% and against the Euro by 6.4%. However, the stability of the Shekel against the dollar at the end of 2008 comparison to the end of 2007 veils the sharp fluctuations that took place in the exchange rate during the year – an appreciation of 13% in the first half of 2008 and a devaluation at a similar rate in the second half of the year. Most of the devaluation in the second half of the year happened in the last quarter and amounted to 11%.

In 2008, for the first time in a decade, the Bank of Israel intervened in the foreign currency market. In the middle of March, in view of the unusual conduct of the Shekel exchange rate, the Bank of Israel purchased foreign currency in an amount of approximately US$600 million. Later on that month, the Bank of Israel announced that it will put into operation a plan for increasing Israel's foreign currency reserves to a level of between US$35 to US$40 billion, through the daily purchase of an amount of US$25 million. As from July 2008, when the Bank of Israel realized that this intervention was not sufficient to support a devaluation of the Shekel, it increased the purchase of foreign currency to a daily level of US$100 million. This step, coupled with the strengthening of the dollar around the world, resulted in the devaluation of the Shekel as against the dollar in the second half of 2008. Total purchases of foreign currency by the Bank of Israel amounted to US$12 billion.

The Consumer Price Index increased in the course of 2008 at the rate of 3.8%, compared to an increase of 3.4% during 2007, the increase in the CPI, excluding the energy item increased by 5%. A decrease of 0.6% in prices in the general index was recorded in the last quarter of 2008, against the background of the decline in prices of commodities and energy in the world, while the index excluding the energy item increased by 0.9%.

A review of change in prices during 2008 according to principal consumption groups, indicates striking increases in the housing item (12.1%), foodstuffs excluding fruits and vegetables (9.1%), and housing maintenance (3.9%). In contrast, decreases were recorded in the apparel and footwear (3.0%), fruits and vegetables (2.0%) and transportation and communication (2%) items. The trend of detachment from the Shekel-dollar exchange rates of the self-owned housing item intensified during 2008. As a result the correlation between the exchange rate and the self-owned housing item has nearly disappeared completely, resulting in the exchange rates having a significantly lower effect on the rate of inflation in Israel than in the past.

FISCAL AND MONETARY POLICY

Fiscal policy. The budget implementation data in 2008 indicate a deficit (excluding the net granting of credit) of NIS 15.2 billion, comprising 2.1% of the product. This is the first increase in the deficit following four consecutive years of a decline in Government deficit from 5.4% in 2003 to zero in 2007. The cause of the increase in the deficit is the drop in tax revenues at a real-term rate of 4.6%, the downward trend in tax revenues being noticeable in the second half of the year. Tax revenues in 2008 amounted to NIS 184.1 billion, an amount NIS 6.5 billion lower than the original forecast. The decline in tax revenues stems from the decline in collection of direct taxes at a real-term rate of 7.8%. In

addition, the deficit has been affected by an increase of NIS 4.4 billion in expenses designed at accelerating economic activity and from advancing expenses in respect of 2009 in order to ease the burden on Government offices in view of the non-approval of the budget.

Monetary policy. The year 2008 was typified by fluctuations in interest rates against the background of changes in the of Bank of Israel's forecasts with respect to inflation on the one hand and the intensification of the recession on the other hand. Over the course of 2008 the interest rate was reduced from 4% in December 2007 to 2.5% in December 2008. In the last quarter of 2008, the Bank of Israel reduced the interest rate from 4.25% to 2.5%. Against the background of the sharp slowdown in economic activity and interest rate reductions around the world, the Bank of Israel twice reduced interest rates at extraordinary meetings during the last quarter of 2008.

Similarly to bailout plans adopted around the world and against the background of the intensifying slowdown in economic activity in Israel, the Israeli Government announced bailout plans which include, among other things:

- Recognizing corporate bonds and non-marketable assets held by institutional entities, in a volume of up to 10% of total managed assets, at their adjusted value, in order to reduce fluctuations in prices of these assets;
- Creation of a "safety net" for depositors over the age of 57 having long-term savings deposits in amounts up to NIS 1.5 million, in order to curb withdrawal of deposits;
- Formulation of a growth acceleration plan by increased investments in infrastructure, research and development and in employment solutions;
- The establishment of leverage funds – subsidies and Government guarantees to a fund providing credit to corporations for the purpose of raising capital or recycling debts. These funds are intended to alleviate the credit crunch on the off-banking market;
- Setting up Government guarantees for the raising of funds by banks, in a total amount of NIS 6 billion, in order to reduce the cost of capital raising of the banks and reduce the credit crunch;
- Considering the possibility for the appointment of credit officers for the off-banking corporation debt in order to facilitate the formation of debt arrangements while protecting the rights of bondholders and alleviating the pressure on the banking industry.

In addition, the Bank of Israel has announced a monetary plan for the increase of liquidity in the financial system and the reduction of its cost, the principal items of which are: reducing the absorption of surplus liquidity by reducing the MAKAM securities issuance; providing monetary loans to the banking industry for longer time periods; reducing the spread regarding the Bank of Israel interest rate applying to the credit and deposit windows.

THE CAPITAL MARKET

The year 2008 was typified by a trend of realizations of investments and sharp drops in prices on the capital markets in Israel and around the world. The general share index fell during the year by 46.5%, compared to a rise of 23.3% in 2007. The sharp drops in share prices engulfed all sectors. The TA-25 Index fell by 46.2%, the TA-100 Index fell by 51.1% and the Tel-Tech Index fell by 60.9%. In 2007, the TA-25 Index rose by 31.4%, the TA-100 Index rose by 24.3% and the Tel-Tech Index fell by 3.5%.

Exceptionally sharp drops in prices were recorded in the last quarter of 2008, when the general share index fell by 25.8%, the TA-25 Index fell by 26.2%, and the TA-100 Index fell by 29.8%. The price drops on the Tel Aviv Stock Exchange in the last quarter were of a magnitude higher than the decline on the leading Exchanges around the world.

Following the sharp drops in market prices, the mutual funds recorded during 2008 withdrawals in an amount of NIS 9.6 billion

compared to deposits of NIS 5 billions made in 2007. Heavy withdrawal were recorded in all types of mutual funds, excluding the monetary funds (Shekels and foreign currency) which raised deposits in a net amount of NIS 28.2 billion.

The trading in options on the TA-25 Index slowed down in 2008, and the average daily trading turnover amounted to 332 thousand contracts, compared to an average turnover of 385 thousand contracts in 2007, the first decline since this activity was launched 14 years ago.

The index for the overall return on bonds of all kinds fell in 2008 by 0.7%, compared to a rise of 4.1% in 2007. However, while government bonds recorded an increase of 9.6%, corporate bonds sustained falling prices of 14%. In the government bonds market, the indices for CPI linked bonds and for the non-linked bonds increased by similar rates (9.5% and 9.7%, respectively).

The main drop in prices of corporate bonds, at a rate of 11%, occurred in the last quarter of 2008, while about one half of the yearly increase in the government bonds index occurred in that same quarter (4.6%). As a result of these contradicting trends, the general bonds index fell in the fourth quarter of 2008 by 1.4%.

The daily trading turnover in bonds on the Tel Aviv Stock Exchange increased from NIS 3.3 billion in 2007 to NIS 4 billion in 2008, continuing the trend of recent years.

THE ASSET PORTFOLIO HELD BY THE PUBLIC

The value of the asset portfolio held by the public amounted at the end of December 2008 to NIS 1,886.8 billion, compared to NIS 2,057.9 billion at the end of December 2007, a decrease of 8.3%.

Following are the changes in the composition of the portfolio recorded in 2008:

1. A sharp drop in the equity securities component from 27.9% at the end of 2007 to 14.3% at the end of 2008. The decline was mostly due to the equity securities component in Israel.
2. The non-linked assets component increased from 27.6% to 35.4%;
3. The CPI linked assets component increased from 29.6% to 35.1%;
4. The foreign currency linked assets component increased from 14.9% to 15.2%.

THE BANKING INDUSTRY

In the last few months, the Israeli banking industry exhibited impressive stability. The reasons for this were many, among which may be noted: strict regulation (rigid rules regarding entitlement to mortgage loans, credit and liquidity management rules, etc.), and the banks' focus on classic banking activity based mostly on customers (both on the asset and liability sides), low investments in complex and novel instruments, a relatively low leverage level in balance sheets of Israeli banks compared to their counterparts abroad and reliance on deposits from the public as the main source of finance.

PRINCIPAL ECONOMIC DEVELOPMENTS IN JANUARY-MARCH 2009(1)

- Against the background of the intensified global crisis, the International Monetary Fund (IMF) updated downwards its growth forecasts. According to these forecasts, the global product in 2009 will drop by a rate of between 0.5% and 1%, while the product of developed countries (Israel's main trading partners) will decline by 3% to 3.5%;
- The new Administration in the United States launched an additional support plan to the tune of US$787 billion, against

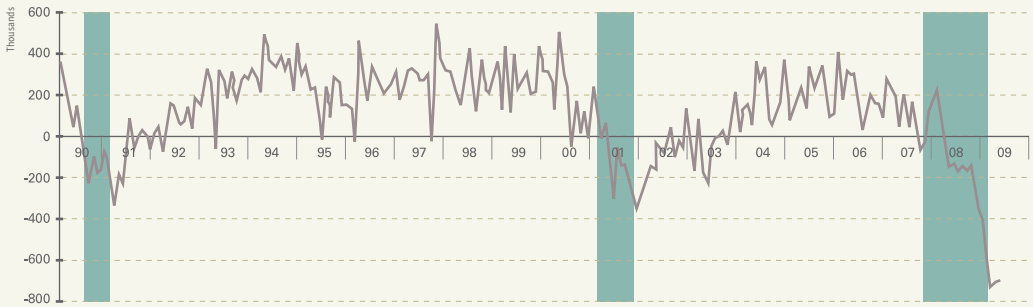
(1) All the data in this chapter, with the exclusion of graphs, refer to the period from January 1 to March 25, 2009.

the background of the understanding that not only the financial sector was in need of support, but also the failing non-financial economy. The core of the plan includes tax benefits to employees, relief for house purchasers, investment in infrastructure and development of the energy industry. The plan includes the continued generous support of the financial sector, but conditions it upon a "stress test" for banks interested in such support. The budget for 2009 is expected to amount to a massive deficit of US$1.75 trillion, equal in size to 12% of the United States' GDP.

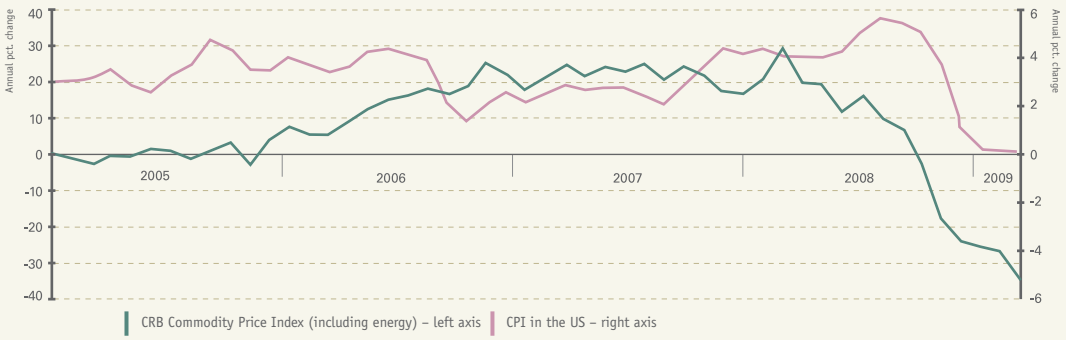
- The drop in prices on the capital markets abroad intensified. This, following anxiety as to the situation of the financial sector and the non-financial economy. Leading share indices around the world have dropped below the lowest point recorded at the end of November 2008. Equity securities of the financial sector have led the decline registered on stock exchanges around world. In March a certain adjustment was recorded and at the end that month. The S&P 500 Index fell by 9.9%, the FTSE 100 Index fell by 12% and the Nikkei 225 Index fell by 20.37%.
- 21 banks have collapsed in the United States since the beginning of the year. Bank of America and Citibank were in need of government support in order to avoid collapse. Bank of America was granted Government support of US$25 billion against the background of its exposure to "toxic" securities originating in Merrill Lynch, which it had acquired. Citibank applied to the Administration for assistance. In response, the US Government has converted that bank's preferred stock into common stock, resulting in the US Government owning 36% of the equity in Citibank.
- A sharp decline in share prices of bank shares around the world was registered as a result of additional losses being disclosed, deterioration of bank balance sheets and the fear of nationalization. The US and British governments have announced additional bailout packages designed to stabilize the banks. For illustration purposes, the banking sector in the Dow Jones index has declined by 18%.
- The European Central Bank (ECB) has reduced the interest rate from 2.5% to 1.5% and hinted that it might use other means for relieving the credit crunch Also the Bank of England (BOE) has reduced the interest rate from 2% to 0.5%.
- The economic crisis in Eastern Europe intensified in recent months. Against the background of the above, Hungary has put-up a proposal for the establishment of a bailout fund in the amount of €190 billion. The proposal was rejected at the meeting of Heads of the European Union on the grounds that the crisis factors in each of the member states are different and the scope of assistance to each country has to be examined separately and not through a joint fund.
- The US Administration presented a plan for dealing with the toxic assets and providing assistance to the financial system. According to this plan, the Administration will invest an amount of US$75 to US$100 billion and will grant subsidized loans to investment funds for the purchase of the toxic assets.
- The Governor of the Federal Bank (FED) announced his intention to purchase long-term government bonds (2-10 years) in an amount of US$300 billion. He also announced that the FED will increase in the current year the purchase of bonds issued by the agencies Fannie Mae, Freddy Mac and Ginnie Mae in an amount of US$750 billion reaching a level of US$1.45 trillion.
- In Israel, the current data indicates an intensifying recession, and the combined index for the months of January-February declined at rates of 1.0% and 1.1%, respectively. Against the background of the current data and the downward updating of growth and international trade forecasts, the Bank of Israel has reduced its growth forecast for 2009 to -1.5%.
- The Governor of the Bank of Israel has reduced the interest rate from 2.5% to 0.5% against the background of the slowdown in economic growth and the indicators for the intensification of the recession in the Israeli economy in the first half of 2009.
- The S&P credit rating agency has left unchanged Israel's "A" credit rating along with a stable rating forecast. The rating agency has reduced Israel's growth forecast to 1.4% in 2009 and to 3.6% in 2010.

- The State of Israel's risk reflected by the CDs spread for five years, increased sharply in this period from 161 base points to 265 base points, but adjusted towards the end of March to 225 base points.
- The State Budget recorded in the first two months of 2009 a deficit of NIS 1.5 billion, compared to a surplus of NIS 3.5 billion in the corresponding period last year. This was due to deterioration in the collection of taxes and levies by the Government. It should be mentioned that in this period, the expenditure by Government offices was especially low, since due to the absence of an approved budget for 2009, the Government has been operating within the monthly expenditure framework of 1/12 of the previous year's budget.
- The Ministry of Finance informed that it would raise foreign currency deposits from the financial system (banks and other institutions), for periods of between one to three years. The first tender was held at the beginning of March, in which an amount of US$140 million was deposited (of the US$250 million offered) at an interest rate of 2.08%, which is lower than the LIBOR rate.
- The Government of Israel has issued abroad bonds for a period of 10 years in the amount of US$1.5 billion, compared to the original plan for US$0.5 billion, at a margin of 2.6% compared to a parallel U.S. government bond.
- The Bank of Israel has announced that it would acquire Governmental bonds, in a daily average volume of NIS 200 million, in order to increase liquidity and increase the effectiveness of monetary activity and their effect upon the long-term interest rates. The Bank of Israel also announced that it will continue to purchase foreign currency to the daily tune of approximately US$ 100 million
- In the period January-March the shekel was devalued as against the US dollar at the rate of 7.9%, to a level of NIS 4.1 to US$1. This was concurrent with the strengthening of the dollar around the world (at the rate of 2.8% as against the Euro).
- The CPI fell in January-February by 0.5% and 0.1%, respectively. The annual inflation rate (previous twelve months) amounted to 3.4% in February.
- Unlike most stock exchanges around the world, the Tel Aviv Stock Exchange registered a trend of rises. The TA 25 Index by 9.6% and the TA 100 Index rose by 16%. The Government bonds Index rose by 2.6%. The corporation bonds market recorded rising prices, probably due to the rise in price of Government bonds, following the slight increase during this period in the spread between the yield on corporation bonds and that on Government bonds.

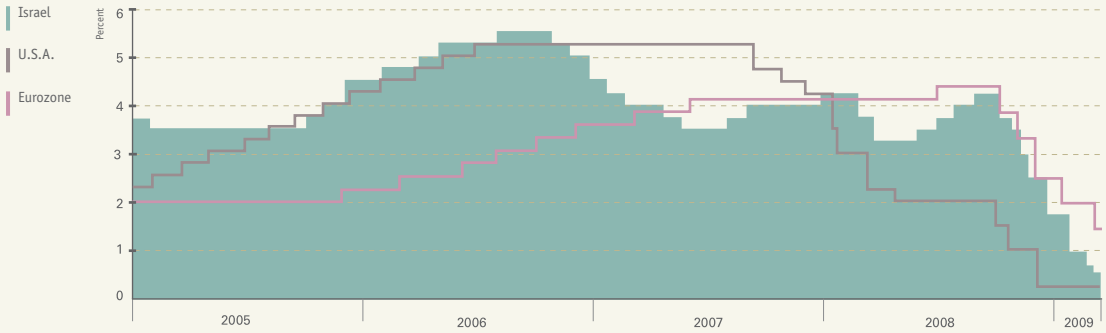
U.S RECESSIONS AND CHANGE IN NUMBER OF JOBS



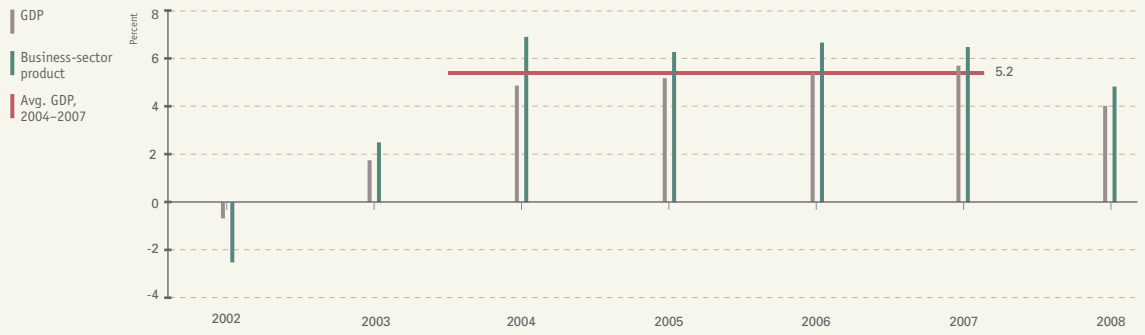
U.S. INFLATION AND CHANGE IN COMMODITY PRICES



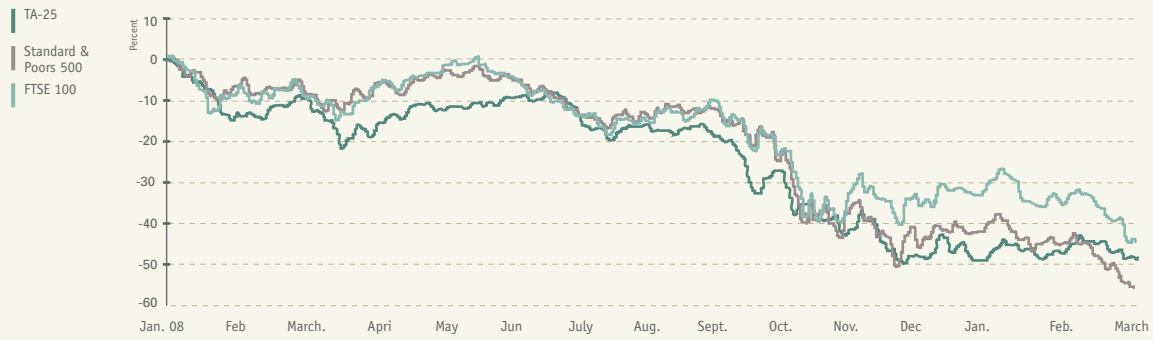
ISRAEL, EUROZONE, AND U.S. MONETARY INTEREST RATES



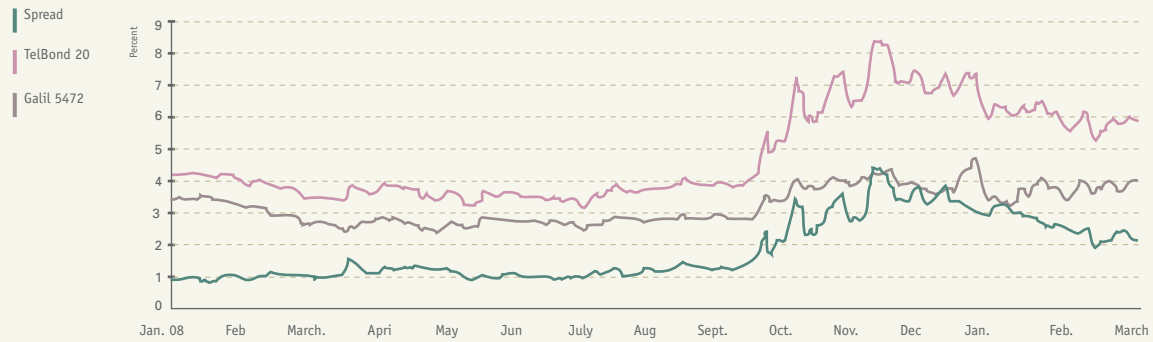
ISRAEL GDP GROWTH



CUMULATIVE CHANGE IN THE TA-25 AND SELECTED FOREIGN EQUITIES INDICES SINCE JAN. 1, 2008



TELBOND INDEX YIELD, GALIL 5472 GOVERNMENT BOND YIELD, AND THE SPREAD BETWEEN THEM



CAPITAL RESOURCES

COMPONENTS OF CAPITAL

The Bank's capital resources as at December 31, 2008, including minority interest, totalled NIS 9,023 million, compared with NIS 9,351 million at the end of the preceding year, a decrease of 3.5%.

Shareholders' equity as at December 31, 2008, totalled NIS 8,797 million, compared with NIS 9,204 million at the end of the preceding year, a decrease of 4.4%.

The change in shareholders' equity in 2008 was affected, among other things, by earnings in that period, by a dividend in the amount of NIS 250 million and by a decline of NIS 393 million in the "net adjustments for the presentation of available for sale securities at fair value, net of tax" item.

The ratio of shareholders' equity, including minority interest, to total assets as at December 31, 2008, stood at 4.95%, compared with 5.54% at the end of the preceding year.

Ratio of tier I capital to risk assets as of December 31, 2008, reached a rate of 7.44%, compared with 8.15% 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 6.54% as of December 31, 2008, compared to 7.29 % 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 10.27% on December 31, 2008, compared with 10.89% at the end of 2007. Considering the hybrid tier I capital issued at the end of March 2009 and the subordinated capital notes which as a result will be included in the Bank's tier II capital, the ratio of capital to risk assets amounts to 10.65% in terms of December 31, 2008.

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, 2008 amounted to NIS 1,223 million, compared with NIS 1,044 million at the end of 2007. 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, 2008, the compound primary capital amounted to 12.07% of the overall primary capital (December 31, 2007: 10.49%). At the end of September 2008, the Bank issued hybrid tier I capital by way of enlarging the existing series of capital notes (series "A") through a private issue to classified investors (as defined in the Securities Regulations (Offer of Securities to the Public), 2007), in a total amount of NIS 135 million. (For further details see Note 14 to the financial statements). The balance of the hybrid tier I capital that may be issued until the limit is reached was NIS 349 million as of December 31, 2008, compared to NIS 528 million at the end of the preceding year.

As described below, on March 26, 2009, the Bank entered into an engagement for the private placement of hybrid tier I capital in a total amount of NIS 350 million.

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 5,322 million as at December 31, 2008, including NIS 5,065 million of subordinated capital notes and NIS 254 million of general provision for doubtful debts. The extent of subordinated capital notes is limited to 50% of the tier I capital that was not allocated against market risks. As of December 31, 2008, the said ratio was 50% (December 31, 2007: 45.84%). In March 2008, Discount Manpikim issued subordinate capital notes in a total amount of NIS 1,021 million (see hereunder). In September 2008, Discount Manpikim issued subordinate capital notes in the amount of NIS 946 million (see hereunder). In view of the said restriction, capital notes in the amount of NIS 1,168 million were not included in the Bank's tier II capital as of December 31, 2008. The raising of hybrid tier I capital in the amount of NIS 350 million, as described below, will allow the inclusion of capital notes in the amount of NIS 175 million in the Bank's tier II capital.

Upper tier II capital. The volume of the Tier II capital is limited to 100% of the tier I capital. The balance of the upper tier II capital that the Bank is permitted to raise as of December 31, 2008, amounted to NIS 4,809 million.

Resolution regarding the issue of upper tier II capital. The Board of Directors, in its meeting of December 17, 2008, resolved to act towards the issue of upper tier II capital by way of the issue of subordinated capital notes through Discount Manpikim. As part of the said resolution, the shelf Prospectus of Discount Manpikim has been amended (see hereunder). The raising of the capital, its volume and terms as well as the actual issuance will be determined in accordance with the Bank's needs and with market conditions. For details regarding the terms for the recognition of the subordinated capital notes as ypper tier II capital, see Note 14 (6) to the financial statements.

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.

It should be noted that in view of the changes that have occurred in the economic environment in which the Bank operates, against the background of the international financial crisis, and their impact on the Bank's profitability on the one hand and on the fund raising possibilities in the capital market on the other hand, that the Bank was not able to achieve the interim goal set for 2008.

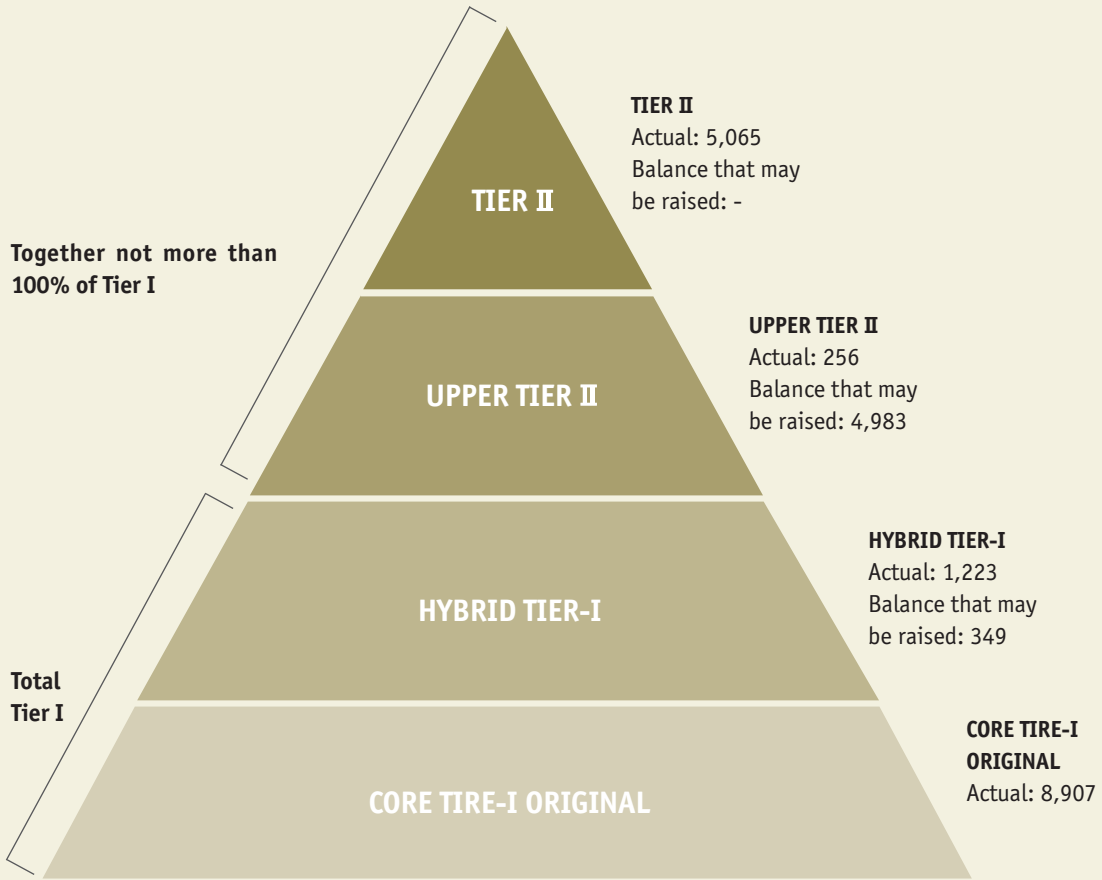
Issue of hybrid tier I capital in March 2009. In accordance with resolutions of the Board of Directors dated February 9, February 23 and March 25, 2009, The Bank entered into an agreement with Migdal Insurance Company Ltd. (participation in profits), Migdal Insurance Company Ltd. (nostro) and Migdal Makefet Pension Funds and Provident Funds Management Ltd., each of them separately according to its share, for the private placement of NIS 350 million par value of subordinated capital notes (Series "B") of the Bank in a total consideration for NIS 350 million.

In accordance with the approval of the Supervisor of Banks, the capital notes to be issued as above will comprise the Bank's hybrid tier I capital.

Additional issues of tier I hybrid capital Series "A". The remainder of the not yet issued subordinated capital notes Series "A" amounted, at December 31, 2008, to NIS 853 million. It should be noted that the balance of the shares remaining in the registered share capital of the Bank, which may be used in the event of a compulsory conversion of capital notes Series "A" (NIS 83 million; see Note 13 C above) may enable additional issues in the amount of approximately NIS 202 million, and each additional issue in excess of the said amount will require the increase of the Bank's registered share capital.

REGULATORY CAPITAL STRUCTURE

In NIS millions



Following are details regarding the components of the upper tier capital (primary capital):

	December 31 2008	December 31 2007
	in NIS millions	
Share capital	3,597	3,597
Hybrid tier I capital	1,223	1,044
Capital reserves	(34)	12
Retained earnings	5,390	5,398
Minority interest	226	147
Excess of cost investments in investee companies not attributed to tangible assets	(272)	(246)
	10,130	9,952
Investments deducted from capital:		
First International Bank of Israel Ltd.	1,453	1,451
Automatic Bank Services Ltd.	9	9
Bank Clearing Center Ltd.	6	6
Others	4	-
	1,472	1,466

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

	2008			2007		
	Balances	Weighted credit risk	Requested capital	Balances	Weighted credit risk	Requested capital
	in NIS					
Assets						
Cash and deposits with banks	21,554	2,133	192	19,850	3,493	314
Securities	31,535	7,066	636	37,278	7,692	692
Securities borrowed or purchased under resale agreements	25	-	-	346	-	-
Credit granted to the public	117,129	101,749	9,157	102,188	86,132	7,752
Credit granted to the government	1,491	20	2	374	2	-
Investment in affiliated companies	1,782	313	28	1,930	457	41
Buildings and equipment	3,039	3,039	274	2,780	2,780	250
Other assets	5,904	3,399	306	4,184	2,866	258
Total assets	182,459	117,719	10,595	168,930	103,422	9,307
Off-Balance Sheet Instruments						
Transactions whose balance represents credit risk	13,179	12,086	1,088	13,804	12,599	1,134
Derivative financial instruments	11,038	4,337	390	10,959	3,844	346
Other	61	61	5	56	56	5
Total off-balance sheet instruments	24,278	16,484	1,484	24,819	16,499	1,485
Total credit risk assets	206,737	134,203	12,080	193,749	119,921	10,792
Total assets as above	182,459			168,930		
General provision	(211)			(211)		
Total assets according to the financial statements	182,248			168,719		

Below is the distribution of credit risk assets at the Bank in accordance with the various risk levels determined in the directive:

	0%	20%	50%	100%	Total
	in NIS millions				
Cash and deposits with banks	11,913	9,385	-	256	21,554
Securities	12,358	15,105	-	4,072	31,535
Securities borrowed or purchased under buy-back agreements	25	-	-	-	25
Credit granted to the public	10,268	2,929	5,538	98,394	117,129
Credit granted to the government	1,471	-	-	20	1,491
Investment in affiliated companies	*1,472	-	-	310	1,782
Buildings and equipment	-	-	-	3,039	3,039
Other assets	560	2,432	-	2,912	5,904
Transactions whose balance represents credit risk	671	287	386	11,835	13,179
Derivative financial instruments	251	7,982	58	2,747	11,038
Other	-	44	-	17	61
Total credit risk assets	38,989	38,164	5,982	123,602	206,737
Deduction factors included in the above credit risk rates:					
Securities:					
Bonds and deposits	23				
Guarantees received	207	64			
Credit granted to the public:					
Bonds and deposits	10,002				
Guarantees received	266	2,728			
Transactions whose balance represents credit risk:					
Bonds and deposits	586				
Guarantees received	-	287			
Derivative financial instruments:					
Bonds and deposits	251				

* Investment in affiliated companies classified as above were offset against equity

Below is the distribution of credit risk assets at the Bank in accordance with the various risk levels determined in the directive:

	2007				
	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	-	2,660	4,184
Transactions whose balance represents credit risk	378	741	469	12,216	13,804
Derivative financial instruments	145	8,657	89	2,068	10,959
Other	-	-	-	56	56
Total credit risk assets	34,845	45,419	5,296	108,189	193,749
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				

* Investment in affiliated companies classified as above were offset against equity.

ISSUE OF SUBORDINATED CAPITAL NOTES

Issuance of subordinated capital notes in 2008. During 2008 the Bank issued subordinated capital notes in the amount of of NIS 151 million, of which NIS 135 million were raised by the issue of marketable capital notes. This compared with NIS 1,196 million in 2007, of which NIS 1,148 million by the issue of marketable capital notes. The total amount of funds raised by the Group in 2008 amounted to NIS 2,133 million.

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"). In March 2008, Discount Manpikim issued NIS 665 million par value of subordinate capital 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, in consideration for NIS 1,011 million.

In September 2008, Discount Manpikim issued NIS 411 million par value of subordinate capital notes (series "G") and NIS 495 million par value of subordinate capital notes (series "H"), in accordance with a shelf offer report dated September 9, 2008, for a total consideration of NIS 946 million.

Amendment of the shelf Prospectus of 2008. On December 24, 2008, Discount Manpikim published an amendment to the shelf Prospectus of February 2008. The amendment added the option for issuance according to the Prospectus of up to NIS 3 billion subordinated capital notes (for each of the series 1-3), to serve as upper tier II capital.

Issuance of Capital Notes in 2009. An amount of NIS 557 million of capital notes issued in the past will be deducted in the course of 2009 from the secondary capital of the Bank, used in calculating the ratio of capital to risk assets.

THE BANK'S CAPITAL ADEQUACY

Since 1983 the Bank has not been able to issue shares, except for the share issue effected in October 2001, within the framework of a private placement of the Bank's shares, in which an insignificant amount of NIS 142 million was raised. Accordingly, the increase in equity required for compliance with the ratio of capital to risk assets, was based on two sources: annual earnings, net of dividend distributions, and the issue of subordinated capital notes and capital notes recognized as hybrid tier I capital.

The appreciable profitability in the years 2004-2007 on the one hand and the issue of subordinated capital notes, and in particular the raising of the hybrid tier I capital, significantly improved the ratio of capital to risk assets, from a rate of 9.35% on December 31, 2003, to a rate of 10.9% on December 31, 2007.

The said improvement enabled the Bank to complete in the years 2006-2008 several significant steps and to develop its business rapidly, including:

- Purchasing Discount Mortgage Bank's shares held by the public, in consideration for NIS 256million;
- Carrying-out non-financial investments in a total amount of NIS 793 million;
- Significant increase in credit, from a level of NIS 87.8 billion at the end of 2005, to a level of NIS 116.8 billion at the end of 2008 (an increase of 33% during three years);
- Distribution of a dividend in October 2008, in the amount of NIS 250 million.

The accelerated development in the Bank business continued during 2008 – an increase of 14.6% in credit to the public. The said accelerated development, which caused a growth in the Bank's risk assets, and the changes in the business environment in which the Bank operates against the background of the international financial crisis and their effect on the Bank's profitability on the one hand and the possibility of raising funds on the capital market on the other hand, brought about a situation in which not only was the Bank unsuccessful in reaching the interim goal set-out by it – a ratio of capital to risk assets at the end of 2008 of 11.25%-11.50% - but the ratio of capital to risk assets even dropped to 10.3%.

The Bank is examining various possibilities for improving its capital adequacy. Within this framework, the Bank has been preparing in recent months for the possibility of raising additional hybrid tier I capital, for the possibility of raising upper tier II capital and the possibility of raising upper tier II capital under Government guarantee. The timing and scope of realization of each of the said alternatives, or a combination of them, is to a large extent dependent on the market conditions.

As described above, on March 26, 2009, the Bank entered into an engagement for the private placement of hybrid tier I capital in a total amount of NIS 350 million.

The raising of hybrid tier I capital in the amount of NIS 350 million, as described above, will allow the inclusion of capital notes in the amount of NIS 175 million in the Bank's tier II capital.

RATING THE BANK'S LIABILITIES

Rating of the Bank by Ma'alot. Standard & Poor's, Ma'alot (formerly: "Ma'alot - the Israeli Securities Rating Company Ltd."; hereinafter: "Ma'alot") determined in Decmeber 2007 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. On June 26, 2008, following a review of the rating methodology for subordinate debt notes, issued by the banking industry and rated by Ma'alot, and its adjustment to the international rating methodology of S&P, Ma'alot informed of the downgrade of all debt notes issued by the banks, by one rating level below the rating level that had been determined for the issuing bank. Accordingly, the debt notes issued by the Bank directly and through Discount Manpikim Ltd. have been rated "AA-". The rating of deposits made with the Bank remained "AA". On December 23, 2008, Ma'alot announced that it confirms the issuer rating determined for the Bank at "AA" and determines an "A+" rating for the upper tier II capital to be issued by the Bank. The rating's horizon remains stable.

Ma'alot informed on March 18, 2009, that it is lowering the rating of the Bank's hybrid tier I capital as well as the rating of the upper tier II capital (not yet issued). It should be noted that the rating for the Bank remained unchanged at "AA".

The examination by Ma'alot of the above mentioned instruments was made following an approach by the Bank requesting a rating for the upper Tier II capital, as part of the process towards its initial issuance.

The approach of the Bank was made following a significant improvement in the terms of this instrument, approved recently by the Supervisor of Banks, according to which the trigger regarding the non-payment of interest to the holders of the instrument "during six consecutive quarters of a cumulative loss" has been removed.

The updated rating of the upper tier II capital (not yet issued) is "A" (instead of "A+").

The updated rating of the hybrid tier I capital is "BBB" (instead of "A").

In its explanations for lowering the rating, Ma'alot based itself upon its forecasts regarding the profitability of the Bank and its capital ratios in 2009. It is emphasized, that no material information has been provided to Ma'alot over and above the information made available to the public at large. The Bank agrees with the said forecasts of Ma'alot.

Rating of the Bank by Midroog. Midroog Ltd. (hereinafter: "Midroog") 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. On October 6, 2008, Midroog informed that the capital notes of the banks being rated by it, including those of the Bank and of Discount Mortgage Bank, had been put on the "watch list" list in view of the possibility of downgrading these notes due to the increased level of uncertainty in the financial markets and the risk level existing in the business environment in which the domestic banking industry is operating. On December 14, 2008, Midroog announced a downgrade of the Bank's deferred capital notes from Aa2 to Aa3. This announcement was made as part of the steps taken by Midroog's towards downgrading of all of its deferred capital note ratings in all the major banks rated by it. The rating of the long-term deposits (Aa2) and of short-term deposits (P-1) remained unchanged.

Rating of the Bank by international rating agencies. In February 2008, the international rating agency 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 rating of the Bank's long-term deposits was increased by the international rating agency Moody's on April 22, 2008 to A-1, following the increase in the rating of the State Israel. Moody's also confirmed the Bank's rating with a "C-" rating for the financial stability parameter. On December 16, 2008, Moody's announced that it had made changes in rating and/or in the forecast of the rating of banks in Israel. According to Moody's announcement, the change is based upon deteriorating macro-economic data both in the global and in the local markets and the implications this might have on the Israeli banking industry. Regarding Israel Discount Bank, a change in the forecasted rating of long-term

deposits (both in local and foreign currency) has been reported, reducing it from "stable" to "negative". It should be noted that the rating of long-term deposits in itself has not been changed. It is further noted that no change has taken place in the financial stability rating of the Bank, which remains "C-". Furthermore, no change has occurred in the deposits rating, which remained at "Prime-1". On December 30, 2008, Moody's updated the Bank's rating as follows: long-term foreign currency deposits were rated A1 (Negative) and local currency deposits were rated P-1 (Stable). The Bank's financial stability rating remained unchanged at C- (Stable).

Rating primary tier I capital. Ma'alot had given an "A" ranking to 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%. Midroog also noted that the determined ranking is based on the Bank's overall capital adequacy ratio. As part of the said steps taken to reduce the rating of deferred capital notes of all the large banks being rated by it, Midroog informed on December 14, 2008, of the decrease in the rating of the capital notes from A1 to A2. As stated, in March 2009, Ma'alot reduced the rating of the capital notes (Series "A") to "BBB"

Rating Mercantile Discount Bank. "Ma'alot" ranked an "AA-" rating to the subordinated capital notes (series "A") issued by Mercantile Discount Bank. On June 26, 2008, Ma'alot informed of the downgrade of the debt notes issued by Mercantile Discount Bank to a level of "A+".

Rating Discount Mortgage Bank. Midroog awarded a rating of "Aa2" to the subordinate capital notes issued by Discount Mortgage Bank. In September 2008 Midroog awarded an "Aa2" (Stable) rating to long-term deposits with Discount Mortgage Bank and to its traded deferred capital notes as well as a "P-1" (Stable) rating to short-term deposits.

In October 2008, Discount Mortgage Bank's subordinated capital notes were added to Midroog's watch list. On December 14, 2008, Midroog informed that Discount Mortgage Bank's subordinated capital notes remain on the watch list.

DIVIDENDS

The Bank has not distributed dividends to its shareholders since 1996 until just recently (see hereunder), 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 October 29, 2008, the General Meeting of Shareholders resolved to approve as final dividend for the year 2007, the interim dividend at the rate of 6% paid on December 27, 2007, to the holders of 40,000 Cumulative 6% Preferred Shares NIS 0.00504 par value each. On November 3, 2008, the Board of Directors of the Bank resolved to pay on December 30, 2008, an interim dividend of 6% to the holders of the said preferred shares, and to recommend to the annual General Meeting of Shareholders, that will convene in 2009, to declare such dividend as final.

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 of 2007 and against the 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 in March 2008 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. Such offer will relate, among other things, to the maintenance of the capital adequacy at a adequate level in accordance with the policy set by of the Board of Directors in this respect and the Bank's ability to continue and develop its business.

In view of the above, and taking into account the changes in the economic environment, against the background of the global financial crisis, the Bank's Management estimates that it will not distribute any dividends in the coming year. Accordingly, the Bank's Management decided in February 2009 to defer the date of presenting the proposal for a dividend policy to the Board of Directors to the first quarter of 2010.

Distribution of dividend in 2008. The Special Meeting of Shareholders convened on September 22, 2008, approved of the Bank's Board of Directors' recommendation dated August 31, 2008, for the distribution in cash of a dividend in the amount of NIS 250 million, out of earnings of the years 2007-2008. The dividend was paid on October 23, 2008, to the shareholders that held shares of the Bank as of October 6, 2008 (the determining date). The amount distributed comprises approximately NIS 0.255 per share of NIS 0.1 par value (255%).

LIQUIDITY AND THE RAISING OF SOURCES IN THE BANK

GENERAL

During the fourth quarter of 2008, the monetary base increased by an amount of NIS 3.8 billion, in continuation to an increase of NIS 4.5 billion during the period from January to September 2008. The increase in the monetary base in the fourth quarter stemmed from the inflow of cash generated by the Government, which was partly offset by Bank of Israel absorption on the part of the Bank of Israel.

For the whole of 2008, the monetary base increased by NIS 8.3 billion, against the background of an inflow NIS 26.7 billion generated by the Bank of Israel and an absorption by the Government of NIS 17.4 billion. The increase in the monetary base in 2008 amounts to more than double the increase in 2007 (NIS 4 billion), and is also higher compared to prior years.

Following are the components of the effect of the Bank of Israel on the monetary base in the fourth quarter of 2008:

- Cash provided through the purchase of foreign currency (NIS 19 billion in the fourth quarter, compared to NIS 25 billion in the period from January to September).
- In addition, inflow of cash through open market activity, principally the reduction of the MAKAM securities (NIS

6.9 billion in the fourth quarter, compared to NIS 3.9 billion in the period from January to September).

- On the other hand the Bank of Israel acted to absorb liquidity from the system by way of increasing the scale of tenders for Shekel deposits (absorption of NIS 28.3 billion) as well as by reducing monetary loan tenders (absorption of NIS 4.9 billion). The reduction in the monetary loans tenders in the fourth quarter actually offsets all the inflow of cash generated through this channel as from the beginning of the year.

As a result of the above actions, the absorption of cash by the Bank of Israel in the fourth quarter of the year amounted to NIS 7.5 billion, compared to a cash inflow of NIS 34.2 billion in the period from January to September.

In contrast to the above, Government actions resulted in the fourth quarter in an inflow of cash amounting to NIS 11.4 billion, compared to cash absorption of NIS 29 billion in the first three quarters of the year. The said cash inflow in the fourth quarter originates in the high Government deficit and not in its activity on the capital market, where an actual surplus raising of funds was recorded.

The rate of fund raising by the Government on the local bond market in the fourth quarter of the year was relatively higher than in previous quarters, amounting to NIS 16 billion, compared to repayments of principal and interest amounting to NIS 9.7 billion. During the whole of the year, the Government raised a total of NIS 53 billion through marketable bond issues, compared to repayments of principal and interest amounting to NIS 35 billion. Thus a net raising of funds in the amount of NIS 18 billion was recorded in 2008, compared to a net negative raising of funds in the years 2005-2007.

In contrast, the rate of fund raising on the corporate bonds market declined sharply, nearly reaching a complete halt. In the fourth quarter of 2008, bond issues amounted to NIS 1.2 billion only (NIS 3.5 billion in the third quarter and NIS 17.4 billion in the first half of the year), of which, an amount of NIS 1.1 billion was raised by banks. During 2008, the private sector raised NIS 22 billion through bond issues, of which about NIS 9 billion were raised by the banking sector. The volume of bond issues in 2008 was significantly lower compared to 2007, in which an amount of NIS 82 million was raised by issues of corporate bonds.

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 2008:

The non-linked segment. The volume of non-linked deposits of the public with the Bank reached at the end of 2008 an amount of NIS 55.3 billion, compared with NIS 45.3 billion at the end of 2007, an increase of 22.1%.

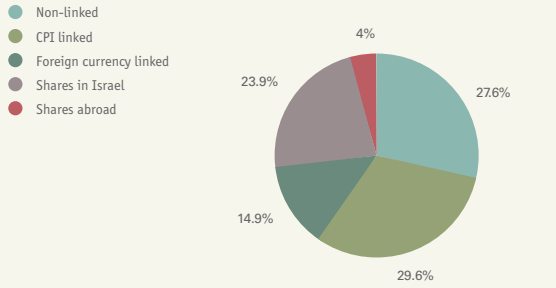
The CPI linked segment. The total of CPI linked financial resources amounted to NIS 11.7 billion at the end of 2008, compared with NIS 9.8 billion at the end of 2007, an increase of 19.4%.

In the course of the fourth quarter of 2008, the volume of non-linked and CPI linked Shekel deposits, of amounts lower than NIS 10 million, increased by NIS 1.8 billion. Furthermore, the volume of deposits for periods of one year and over increased by NIS 2.5 billion.

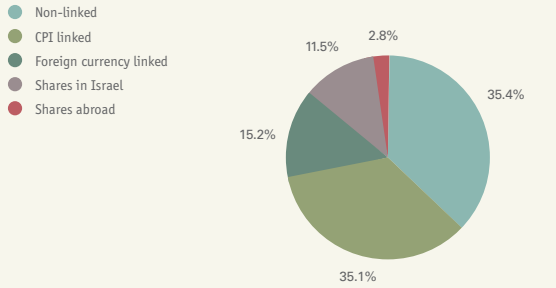
The foreign currency and foreign currency linked segment. The volume of non-linked deposits of the public with the Bank reached US$9.3 billion at the end of 2008, compared to US$9.7 billion at the end of 2007, a decrease of 4.1%. The majority of the decline (of US$ 400 million) stemmed from changes in exchange rates of the currencies as against the US dollar.

Raising of capital. For details regarding the issuance of secondary capital and hybrid tier I capital in 2008 see “Capital resources” above.

FINANCIAL ASSETS PORTFOLIO OF THE PUBLIC DISTRIBUTION BY TYPE OF ASSET - 2007



FINANCIAL ASSETS PORTFOLIO OF THE PUBLIC DISTRIBUTION BY TYPE OF ASSET - 2008



EXPOSURE TO RISKS AND RISK MANAGEMENT

MEANS OF CONTROL AND APPLICATION OF THE POLICY

RISK MANAGEMENT OBJECTIVES AND POLICY

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 STRUCTURE AND ORGANIZATION OF THE RISK MANAGEMENT FUNCTION

The Risk Management Department. The Bank attributes strategic importance to the subject of risk management and corporate governance, and accordingly the Bank invests considerable efforts and resources in developing this area. For the purpose of implementing this strategic target, the Bank established in 2007, the Risk Management Department, which answers to the Bank's Chief Risk Manager. This Department coordinates the management of the general risk at the Bank and at the Group's overall risks, excluding legal risks and compliance and regulation risks, which are managed by the Legal Services Group and excluding financial reporting risks, which are handled by the Accounting Group.

The Department is responsible for an array of subjects, which include: integration of the risk management culture in the entire Group, establishing a policy and methodology in all areas of risk management, and t he implementation of advanced risk management procedures at the Bank and in the Group. Furthermore, the Department is engaged in assembling and analyzing information respecting the areas of market risk management, credit risk management and operational risk management. In addition, the Department is responsible for coordinating and managing the three layered Basel II Project in the entire Discount Group.

Risk Management Committee. The Bank has a committee of risk managers headed by the Bank's Chief Risk Manager. The committee's members are:

Ms. Dorit Ben-Simon, Executive Vice President -	Chief 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 -	IT Risk Manager;
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.

Mr. Joseph Beressi, Senior Executive Vice President and the Bank's Chief Accountant is responsible for the management of financial reporting risks.

The Risk Management Committee of the Board. The Risk management Committee of the Board supervises the 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. Generally, the committee convenes once a month. During the year, the Board of Directors and its Risk Management Committee discussed various issues relating to risk management.

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 by the Board of Directors within the framework of the exposure document. This document includes a report on the Bank's overall exposures to various types of risks in the past quarter. This document also relates to risks at the banking subsidiaries.

DESCRIPTION OF EXPOSURE TO AND MANAGEMENT OF MARKET AND LIQUIDITY RISKS

MARKET AND LIQUIDITY RISK MANAGEMENT POLICY

Group risk management. Proper Banking Management Directive 339 states that the risk management system of a banking corporation should also cover its branches in Israel and abroad and should take into account the risk exposure of its subsidiaries in Israel and abroad, based on available information received from these entities as part of the information and management layout. The current management of market and liquidity risks is conducted separately at the Bank and at each of its main banking subsidiaries. Notwithstanding, the Bank frequently reviews, at least once in every quarter, the inclination of the Bank and its banking subsidiaries to take risks and the actual market and liquidity risks. In addition, the Boards of Directors of the banking subsidiaries have also determined policies regarding the maximum exposure to market and liquidity risks, and the subsidiaries manage their market and liquidity risk, each subject to the policy determined by its own Board of Directors.

The Bank applies the necessary steps for measuring and assessing the overall exposure of the Group to risks, as well as to absorb the group management concept at the Bank and at the Group's companies. Determination of the Group's risk inclination has been put into practice, at the first stage, for the Group's market risk as a whole. The Board of Directors determined in this respect Group restrictions in VaR terms and in terms of the maximum loss upon a parallel change in interest graphs. Recently, the Bank has tightened supervision over its domestic and foreign banking subsidiaries with respect to market and liquidity risks management.

The following review presents, for the first time, the Bank's market and liquidity risks and its banking subsidiaries (Mercantile Discount Bank, Discount Mortgage Bank, IDB New York and IDB (Swiss) Bank).

The hierarchy of authority with respect to market and liquidity risks management. An authority and responsibility hierarchy exists at the Bank in the matter of market and liquidity risks. The supreme forum for market and liquidity risk management at the Bank's management level is the asset and liability management committee, headed by the Bank's President and CEO. This committee is composed of several members of management who meet once every month. The committee discusses the Bank's exposure situation to market and liquidity risks, and makes decisions regarding the acceptable exposure at the Bank level. In addition, the committee discusses the Bank's compliance with limitations and guidelines dictated by the Board of Directors.

Responsibility for the ongoing risk management rests with the financial forum headed by the head of the Finance Division. This forum meets on a weekly basis discussing and examining the Bank's exposure to market risks. This forum makes decisions as to the Bank's short-term exposure, subject to the guidelines of the asset and liability management committee.

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 limits determined by the Board, the asset and liability management committee and Head of the Finance Division. The Bank's procedures requires those who accept the risk and the control factors to report to the Head of the Financial Division in respect of any exceptional events, e.g. loss exceeding the predetermined limit, deviations from limitations and so forth.

The Middle Office Department of the Finance Division, which answers directly to the Head of the Finance Division, performs ongoing control over the operations of the dealing room, and over deviation from determined risk limitations. In the second half of 2008, the process of boosting this Department with additional professional staff was completed.

Any deviation from the limitations is immediately reported to the market and liquidity risks manager, who determines how these deviations should be dealt with as well as the reaction to exceptional developments in the various markets. Any deviations, if at all, are reported to the asset and liability management committee, to the market risk controller and to the Board of Directors.

The Risk Management Department in the Financial Division reports weekly to the Market and Liquidity 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.

A further control circle exists at the Bank - the Market Risk Controller, who answers directly to the President and CEO. The Market Risk Controller independently monitors the risk management process in order to identify and draw attention to any failures in risk management and deviations from the determined policy. Market Risk Controller also examines the exposure of the principal banking subsidiaries in the Group.

No deviations in the implementation of the determined policy were recorded in the course of 2008 (except for several pinpoint deviations of a negligible scope).

HEDGING AND MARKET RISK 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 rasing of non-marketable financial instruments (mainly deposits by banks and large customers);
- Activity in derivative financial instruments with banks and large customers.

MARKET AND LIQUIDITY RISKS

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

(1) BASE RISK EXPOSURE

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

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

	As at December 31, 2008				
	Non-linked shekels	CPI linked shekels	Foreign currency[2][3]	Non-monetary asset	Total
Assets	76,351	27,061	72,180	6,656	182,248
Liabilities	77,097	20,871	75,076	181	173,225
Balance sheet difference	(746)	6,190	(2,896)	6,475	9,023
Derivatives	3,859	(5,423)	1,564	-	-
Options	194	264	(458)	-	-
Total Difference	3,307	1,031	1,790	6,475	9,023

	As at December 31, 2007				
Assets	68,888	22,853	70,053	6,925	168,719
Liabilities	65,644	18,882	74,618	224	159,368
Balance sheet difference	3,244	3,971	(4,565)	6,701	9,351
Derivatives	284	(3,066)	2,782	-	-
Options	329	2	(331)	-	-
Total Difference	3,857	907	(2,114)	6,701	9,351

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.
(3) Including foreign currency-linked shekels.

The exposure to base risk is measured and managed as a percentage of the Bank's available economic capital. The Bank's avaialbe economic capital is defined as the Bank's equity, less fixed assets 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.

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

Following is the distribution of investment of the Group's actual available capital compared to the limitations (the data is presented in relation to the available economic capital):

		2008				2007			
			Range of exposure				Range of exposure		
Segment of operations	Limitation[1]	year end	from	to	average	year end	from	to	average
Non-linked Shekel	(38%)-135%	94%	70%	94%	85%	95%	55%	95%	70%
Linked Shekel	(24%)-118%	6%	6%	30%	15%	5%	5%	44%	29%
Foreign currency	(42%) - 45%	-	(1%)	-	-	-	(1%)	13%	2%

(1) The limitations setout in the table present the total limitations approved (separately) by the Bank and by its banking subsidiaries.

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

The limitations stated in the table present the total limitations approved (separately) by the Bank and its principal banking subsidiaries.

No deviation from the limitations were recorded in 2008.

Capital sensitivity to changes in exchange rate. The capital's 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, 2008.

The capital sensitivity of the Bank of changes in exchange rates (in NIS millions):				
Segment	10%	5%	-5%	-10%
USD	(18)	(2)	(2)	(29)
EUR	2	2	(1)	-

Notes:
(1) The theoretical change in the economic value of the Group (in terms of present value) as a result of the scenario.
(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.
(3) The theoretical calculation made with respect to the Japanes Yen, the British Pound Sterling and the Swiss Frank indicate negligible changes in the economic value, therefore these currencies are not presented in the table.

This impact was calculated on the basis of the expected change in the economic positions handeled 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.

It should be mentioned that in accordance with a new directive of the Supervisor of Banks, which is expected to come into effect in 2009, the format of computation presented above will change.

(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 possible effect on the present value of assets and liabilities. 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 effect of hypothetical changes in interest rates on the fair value of financial instruments of the Bank and of its consolidated subsidiaries:

Fair value of financial instruments excluding non financial items (before effect of hypothetical changes in interest rates):

	in NIS millions				
	December 31, 2008				
	Israeli currency		Foreign currency		
	Non linked	CPI linked	Dollar	Other foreign currency	Total
Financial assets	76,137	36,572	55,941	15,108	183,758
Liabilities	73,874	30,628	57,726	13,759	175,987
Net off balance financial instruments	4,278	(5,710)	1,951	(1,050)	(531)
Net fair value of financial instruments	6,541	234	166	299	7,240

Effect of hypothetical changes in interest rates on fair value, net, of financial intruments (consolidated) excluding non financial items:

	December 31, 2008								December 31, 2007	
	Israeli currency		Foreign currency							
Change in interest rates	Non linked	CPI linked	Dollar	Other foreign currency	Offsetting effect	Total	Change in fair value		Change in fair value	
	in NIS millions							in %	in NIS millions	in %
Immediate increase of 1%	6,437	141	393	300	1	7,271	31	0.4%	(208)	(3.03%)
Immediate increase of 0.1%	6,530	230	193	299	-	7,251	12	0.2%	(22)	(0.32%)
Immediate decrease of 1%	6,659	339	(191)	298	1	7,104	(136)	(1.9%)	221	3.23%
Immediate decrease of 0.1%	6,552	244	139	299	-	7,234	(6)	(0.1%)	21	0.31%

Fair value data and the sensitivity analysis for the scenarios presented above are based on fair value computations used for interest exposure management and not on fair value computations used for the preparation of the financial statements, as discussed in Note 21 to the financial statements. The Bank believes that a material difference exists between these two computations, which are mostly due to the interest curves used for discounting purposes, which do not include credit spreads, as well as due to the use of various economic models.

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.
The limit was set at 9% of the equity on the group's exposure to a change of 1% in the interest graphs in addition to the limits determined by the banking subsidiaries. In 2008, the Bank and the Group complied with the determined exposure limits.
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.
The measurement at the banking subsidiaries is carried out using a similar methodology and at a frequency of at least once a month. Exposure to interest risk is managed individually by each of the companies by means of the committees authorized for this purpose.
No weekly cumulative change occurred in the past ten years, which had it occurred in the reported period would have adversely affected the "going concern" assumption used at the basis of preparation of the financial statements.

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, 2008			As at December 31, 2007		
	shkels		Foreign currency and foreign currency linked	shkels		Foreign currency and foreign currency linked
	Non-linked	CPI linked		Non-linked	CPI linked	
Total Assets	72,360	27,061	72,180	64,690	22,853	70,053
Total Liabilities	73,106	20,871	75,076	61,454	18,882	74,618
Average maturity (years):						
Assets	0.64	4.63	0.57	0.71	4.61	1.35
Liabilities	0.50	4.09	0.85	0.41	4.11	0.23
Average maturity gap	0.14	0.54	(0.28)	0.30	0.50	1.12
IRR gap	1.46	0.61	2.77	2.99	0.78	1.74

(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, 2008, between the average maturity of assets and the average maturity of liabilities, amounting to 1.7 months, compared with an average maturity gap on December 31, 2007 of 3.6 months.
- In the CPI-linked shekel segment, the average maturity gap between assets and liabilities as at December 31, 2008, was 6.5 months, compared with 6 months on December 31, 2007. 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, 2008, was 3.4 months, compared with an reversed gap of 13.4 months on December 31, 2007. 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.

(3) MANAGEMENT OF TRADING POSITIONS

The Bank distinguishes between exposure created in the course of managing the assets and liabilities of the Bank and exposure to trading. 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.

The Board of Directors has determined separate sets of limits pertaining to trading activities and to asset and liability activities. Limitations on trading activity were determined by the Board of Directors 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). The management and control factors regarding these activities have also been determined.

The trading activity is conducted while measuring on a daily basis compliance with the limits, effected by the entity managing the portfolio and a daily control effected by the entity in charge of controlling compliance and profitability.

(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 adetiton, the dealing room procedures include limitations on maximum changes in the value of the opotion portfolio in terms of sensitivity indices ("GREEKS").

The boards of directors of the principal banking subsidiaries have also set limitations on the activity in options.

(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 of or 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 therefore, the volume of activity in respect of a certain instrument does not necessarily represent the level of risk inherent therein.

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 setout 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 2008	
	2008	2007
Hedging derivatives	1,537	1,109
ALM derivatives	91,998	87,531
Other derivatives	42,932	46,826
Credit derivatives and SPOT foreign currency	6,134	6,929

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(k) 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 a decrease in the earnings from financing operations by NIS 15 million in 2008, compared with an increase of NIS 11 million in earnings from financing operations in 2007.

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 uniqueness of the credit risk in such transactions stems from the fact that the stated amount of the transaction does not necessarily reflect its entailed credit risk. 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 monitors on a daily basis the credit risk inherent to customers' activity in derivative financial instruments.

The Bank follow-up is performed by means of a computerized system for monitoring credit exposure originating in derivative financial instruments, in the field of foreign currency. This follow-up is based on a computation of the exposure in terms equal to the value of credit that includes a revaluation of the transactions (mark to market), with an add-on of the future exposure being an assessment of an additional potential exposure that may occur following a deterioration in market parameters. In addition, special follow-up is performed with regards to the activities of large customers or customers having complex activity, which includes the application of extreme scenarios.

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 "Nonfinancial 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, 2008		
	Marketable	Non-marketable	Total
Cost	530	752	1,282
Adjustment to fair value	43	-	43
Fair value	573	752	1,325
Market value	573	-	

(7) LIQUIDITY RISK

Liquidity is defined as the Bank's ability to 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 a 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;
- Classification of assets and liabilities according to maturity periods on an economic basis.

The liquidity risk management process takes into account, among other things, the Bank's policy and the trends in the financial markets, the structure and distribution of deposits and their recycling rates, the Bank's goodwill and rating, volume of the securities portfolio and extent of its diversity, the size of the relevant market and price volatility.

The Bank's liquidity risk model also takes into consideration the Bank's evaluation regarding the liquidity situation of subsidiaries, including their present and future liquidity requirements.

Within the framework of the Bank's efforts to strengthen the ability of the Group's subsidiaries to face the challenges set by the financial crisis which occurred during the year, the Bank put at the disposal of certain subsidiaries credit facilities intended to deal with various degrees of possible future extreme situations in managing the liquidity risk.

In view of the improvement that had taken place in liquidity risk of subsidiaries tested in extreme scenarios, the said credit facilities have recently been reduced.

The Banking subsidiaries also conduct their liquidity risk management in accordance with the requirements.

In the course of 2008, the Bank and its principal banking subsidiaries engaged the services of a prominent expert in this field, to assist them in examining the liquidity situation as well as in modifying the models and scenarios used in liquidity management to those accepted in the world as "best practice".

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. The Bank's Board of directors elected to manage the liquidity risk based on an extreme scenario, which includes strict assumptions regarding the rates of withdrawal of public deposits which are the highest ever actually observed.

Several deviations from this restriction were recorded in the course of the second half of 2008. The deviations are the result of the increase in the granting of credit, while using the large surplus deposits in the Bank, thus implementing the accelerated growth strategy of the Bank. The Bank believes that the deviations were not material, however, the Bank adopted measures required to contain them, including the expansion of the deposit base while extending their average duration the raising of tier II capital and hybrid tier I captial in a total amount of NIS 1.1 billion.

Within the framework of the preparation for an extreme scenario and in accordance with Proper Banking Management Directive No. 342, the Bank has in store an alternative plan which defines the steps to be taken in the event of a liquidity crisis, the managerial team in charge of handling such a crisis, and the processes and steps to be taken in dealing with such a crisis. Furthermore, the Bank has defined and is examining several indicators designed to alert a rise in the liquidity risk.

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

The principal changes that occurred in 2008 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, among other things, due to its activity as a market maker with respect to Shekel bonds. 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 tightened the supervision over market and liquidity risks management at the principal banking subsidiaries, including actual exposure, policies and the appetite for risk.

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

computation regarding the entire Bank is performed on a weekly basis and on a daily basis regarding the trading activity. The Board of Directors determined a limitation according to which the VaR of the Group's portfolio (for a range of ten days and at a precision level of 99%) should not exceed 4% of the equity.

	2008				2007
	At year end	Yearly average	Maximum	Minimum	At year end
Estimate of VaR amount (in NIS millions, Group)	239	167	239	96	115

The weight of the VaR in relation to the shareholders' equity as of December 31, 2008 is 2.7%, compared with 1.25% at the end of 2007.

The increase in the assessment of the Group's VaR is explained mostly by the increase in exposure to interest risk of the extensions abroad and by the significant increase in the volatility of risk factors.

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 xtreme 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 if 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 aught to be examined. Recently, following the changes that occurred in the various markets and as part of the Bank's dynamic risk management the stress tests have been intensified and new scenarios have been added to them.
The limitation as regards the maximum market exposure of the Bank under extreme scenarios is that the maximum decline in fair value in case such scenarios materialize shall not exceed 12.5% of the Bank's equity.
The Forum also determines extreme scenarios for the banking subsidiaries and examines the effect of these scenarios on their operations.

(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.
It should be noted that this model is not the main model for the management of exposure to interest rate risk of the Bank and of its principal banking subsidiaries in Israel, but serves as the principal model for the management of exposure to interest rate risks at IDB New York.

(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 4.34 years, lower than the average maturity according to the initial cash flow from savings deposits, which is 4.40 years.
The internal rate of return margin, taking into account the above mentioned assumptions, is 0.19%, compared with an internal rate of return margin of 0.08% 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, 2008			December 31, 2007		
	Non-linked	CPI linked	Foreign currency[1]	Non-linked	Foreign currency[1]	CPI linked
Internal rate of return (in percentages)						
Assets	3.92	4.22	7.30	5.97	4.91	4.99
Liabilities	2.86	4.14	1.79	2.98	4.39	3.29
Average maturity (in years)						
Assets	0.83	4.57	0.31	0.84	4.15	0.24
Liabilities	0.55	4.40	0.27	0.45	4.43	0.21

* And foreign currency - linked shekels.

Creditory 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 0.73 years, compared with 0.55 years for the initial cash flow. The internal rate of return margin is 1.72% compared with the internal rate of return margin of 1.06% 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, 2008	as of December 31, 2007
	In NIS millions	
The Bank:		
Interest rate risk	73	109
Foreign exchange rate and inflation risk	39	20
Share risk	-	-
Option risk	13	44
Total for the Bank	125	173
Total for subsidiary companies	47	21
Total for the banking Group	172	194
Allocation in risk terms	1,916	2,156

The allocation to market risks in risk asset terms comprises 1.4% of the total risk assets as of December 31, 2008. The Bank and its principal banking subsidiaries are preparing for the implementation of the changes required by Basel II.

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 autho rizing a credit application is made up of several stages and includes:

- Application by the customer to the Bank for the granting of credit and/or the Bank's approach to customers within the framework of business development;
- Definition of the customer's needs and examination of the substance future of the customer's operations;
- Discussions with customers in order to determine an outline for credit terms and evaluation of 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 placed on qualitative examination of the credit application and swift response to the customer. In addition, overall financing packages are offered, which the Bank endeavors to adapt to the particular customer needs.
In addition to discussions for approval of new transactions, current discussions are held by the credit committees, at a frequency defined in 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.

REDUCING CREDIT RISK

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

- A risk management department at the Finance Division (ERM) was established, which includes, among other things, the subject of credit risk management. The unit engages, among other things, in the development of models for credit risk assessment, formation of a genera 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, main points were drawn up, with the cooperation of an international consulting company, 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, including, among other things, various aspects of validation and ratification of credit deviating from the regular policy in accordance with defined criteria; responsibility for credit policy aspects; modification of credit processes; participation in the development of models, etc;
- As part of the implementation of the Basel II instructions including the process of implementing ICAAP, the various gaps have been reviewed and mapped. Reducing these gaps is expected to influence the credit risk management processes at the Bank.

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's procedures,

all customers with an indebtedness exceeding NIS 400 thousand are rated at least twice a year using the debt rating model. As of December 31, 2008, 94% of the Bank's total customer indebtedness (net of provisions for doubtful debts) has been rated;

- 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.

Handling the risks created by the financial and non-financial crisis in the markets. The continued decline in the markets and the deterioration in economic activity adversely affect the financial condition of borrowers and the value of their collateral. In view of the economic slowdown, the Bank examines more frequently and with greater care its credit portfolio, while evaluating the expected implications on borrowers in the various economic sectors. The Bank examines the implications of the economic slowdown using various parameters, such as: fluctuations in the prices of raw materials, energy and foodstuffs, decrease in the volume of private consumption and in business activity, volatility of the capital market, volatility in the Shekel exchange rate, decline in demand in the U.S. and European markets and in Israel's other export markets, the decline in value of real estate in the U.S. and Europe and the significant slowdown in the off-banking credit market. The Bank is preparing for this slowdown by increasing its controls on existing credit and being more selective in approving new credit applications.

Credit controls are performed periodically, both at customer level and at the level of reviewing economic sectors and large borrower groups. In the course of 2008 and at the beginning of 2009 several extensive examinations were made with a view to identify and locate warning signs or deterioration in the condition of the customers.

These examinations included the mapping and evaluation of customer exposure to the crisis in the financial and capital markets, current examinations regarding the degree of compliance by borrowers with their off-banking obligations (including borrowers who had issued bonds).

The Bank adopts a cautious credit policy with respect to the various economic sectors and credit segments. The credit policy takes into consideration the economic slowdown. New credit applications undergo close examination, including an analysis of the effect of the slowdown on the customer's operations.

Collateral management and evaluation - policies and procedures. Usually, the Bank grants credit to customers against various kinds of collateral, 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 acquired corporation in the transaction based on the value of the transaction, market value or independent valuation. In certain cases financial covenants are determined for the borrower. 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.

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. A periodic examination is performed with respect to the influence of the global crisis on the various economic sectors and industries and 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. 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, including credit risk, in accordance with the Basel II requirements. Furthermore, the Bank is recently in the midst of integrating a model for the evaluation of the risk pertaining to retail customers (credit scoring).

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.

Control procedures are performed using irregularities reports and debtor reports according to various profiles. The objective of the control is to identify as early as possible defaults in customer accounts and draw attention of the business factors to the need to act urgently towards the settlement of the debts.

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 Bank's Internal Audit. 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 setout by the Bank. I 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 debt repayment that include realization of the collateral at maximum consideration for the Bank.

The Bank runs the Debt Collection Department, which handles problem debt portfolios forwarded for treatment at the Department by the business functions at the Retail Division and in the commercial wing in the Corporate 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.

The survey, mapping and review of customers' credit files, identified borrowers who might be adversely affected by the crisis in the financial and capital markets, and it has been decided to adopt appropriate measures and monitoring.

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. As part of the policy relating to capital market operations, the rules and operating procedures with respect to determining the level of collateral required for the various exposures are in the process of being updated.

Exposure related to credit risk of the counterparty:

	December 31, 2008					
	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	24	1,579	1,899	184	94	3,780
Net of set-off agreements	-	-	228	30	-	258
Net credit exposure	24	1,579	1,671	154	94	3,522

	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

CREDIT EXPOSURE TO FOREIGN FINANCIAL INSTITUTIONS

GENERAL

In view of the intensifying negative trends in global financial markets and the apprehension regarding the implications of this crisis on foreign financial institutions, banking corporations are required to include in the Directors' Report as from the financial statements for September 30, 2008, a separate disclosure regarding credit exposure to foreign financial institutions.

Foreign financial institutions include: banks, investment banks, brokers/dealers, insurance companies, institutional entities and entities controlled by the said entities.

As opposed to the definition of the "financial services" economic sector for the purpose of disclosure in the Management Review concerning the "Overall credit risk according to economic sectors", the exposure in respect of foreign financial institutions presented in the table hereunder includes exposure to foreign banks and to foreign investment banks, which, on the one hand, are not included in credit to the public, and on the other hand, does not include exposure in respect of investment in asset backed securities and in respect of potential off-balance sheet exposure.

The manner of managing credit risk applying to foreign financial institutions. The state of affairs of various financial institutions the world over has deteriorated in the past year and liquidity difficulties have arisen in the various financial markets. These were moderated to a certain extent only through intervention of the Regulators and the formation of recovery programs by various governments around the globe.

During this period, the Bank has been addressing the possibility of the collapse of banks with whom the Bank used to deposit its surplus liquid funds and conduct various financial transactions.

Following are the measures adopted by the Bank during this period preparing itself to withstand the said crisis:

- Increasing the frequency of reporting and improving the reporting and monitoring layout of the exposure to banks in the Group;
- A significant reduction in the number of financial institutions with which the Bank deposits its surplus liquid funds and curtailment of credit facilities to banks. The Bank's exposure to other banks (deposits, new initiated activity) is managed dynamically in accordance with developments;
- Discussion of the Bank's exposure to foreign financial institutions at the Risk Managers Committee and by the Risk Management Committee of the Board;
- Members of Management in charge of the subject hold ongoing discussions and follow-ups examining the current exposure to Bank's foreign financial institutions, and the adoption of immediate action to reduce the exposure, where necessary.

The credit risk related to banks and foreign financial institutions is managed by the Corporate Banking and the Finance Divisions, as follows:

- Credit facilities to states and foreign banks are approved by the Bank's Board of Directors, in accordance with the recommendations of the financial institutions department of the Corporate Banking Division. These recommendations are based upon mathematical models determining the maximum credit facility to states and foreign banks. These models are based, among other things, on the rating of states and banks by the international rating agencies and on the banks' financial data of the banks. In addition, the recommendations are supported by electronic data bases, financial statements, information received from rating agencies and public sources of information: such as the professional media and designated Internet sites;
- A reduction in the rating of a foreign bank and/or a deterioration in its financial data are weighted into the model, and where necessary, the Bank reduces its credit facility accordingly;

- The financial institutions department of the Corporate Banking Division allocates the credit facilities approved by the Board between members of the Group (with the exception of IDB New York and Discount Bank Latin America) and the various units at the Bank, including the Bank's dealing room for which the Finance Division is responsible. As from the end of the first quarter of 2009, this allocation will also be made for IDB New York and for Discount Bank Latin America. Allocation of credit facilities to the Bank's dealing room is in most cases directed towards banks incorporated in developed countries. Monitoring the Bank's compliance with limitations applying to credit facilities approved to the various institutions is conducted according to accepted practices at the Bank with respect to the monitoring of compliance with approved exposure limitations. The department, on a current basis, provides Management with reports regarding actual exposure levels at the Bank as well as regarding negative indications, if such are received;
- Deviations from credit facilities, if at all, are reported to the echelon in charge of the unit to which the credit facility had been allocated, in accordance with credit granting authority;
- Most forward transactions entered into by the Bank are with leading international banks, with whom an ISDA agreement including the CSA annex has been signed;
- The member of Management in charge, based on market developments and using his own judgment, has the power to reduce and/or cancel credit facilities approved in the past. This authority has been used several times during the recent period and even to revert them to the original level, to the extent that he finds that this is justified and compatible with the level of risk approved by him in the past.

The manner of managing market and liquidity risks. The Middle Office Department of the Finance Division coordinates the exposure regarding operations of the Bank's dealing room in Tel Aviv with foreign financial institutions. In addition, independent reports are received from subsidiaries and foreign extensions of the Bank, which are merged into a Group level report and distributed to various factors at the Bank. Ongoing reports are submitted frequently to management, which are used for dynamic decision making regarding exposure to banks, in accordance to their financial condition and subject to the facilities approved to them.

During this period, the Bank's middle office department began performing calculations of exposure of the Bank for the purpose of the transfer of securities by the Bank in accordance with the ISDA agreements.

With respect to liquidity and market risk management, the Bank takes into consideration the level of exposure and its distribution among the foreign banks.

On the asset side, the Bank discontinued several months ago the purchase of bonds issued by foreign financial institutions, and performs careful evaluations as to the timing of the realization of such assets.

Credit risk to foreign financial institutions. The Bank's exposure to foreign financial institutions comprises mostly of exposure to banks and investment banks. As seen from the data presented hereunder, about 89% of the exposure is to financial institutions rated "A-"rating or higher.

The states in respect of which the Bank has exposure as stated above, include, inter-alia, the United States, Germany, Switzerland, Great Britain, France and Belgium. (The United States is the only country in respect of which the exposure exceeds 15% of the Bank's capital base, and therefore details are presented below only in this respect).

Losses in respect of impairment of securities in the amount of NIS 283 million are included in respect of exposure to foreign financial institutions.

Following are details of present credit exposure to foreign financial institutions[1] on a consolidated basis, as of December 31, 2008 (in NIS millions):

	Balance sheet credit risk[2][4][5]	Present off balance sheet credit risk[3][4]	Present credit exposure[4]
Present credit exposure to foreign financial institutions[6]			
External credit rating[7]			
AAA up to AA-	4,175	217	4,392
A+ up to A-	7,747	495	8,242
BBB+ up to BBB-	665	39	704
BB+ up to B-	389	-	389
Less than B-	6	-	6
Not rated	255	267	521
Total present credit exposure to foreign financial institutions	13,237	1,018	14,255
Of which credit exposure to foreign financial institutions:			
in the USA	3,796	21	3,817
Balance of problematic bonds	46	-	46

Notes:
(1) Foreign financial institutions include: banks, investment banks, brokers/dealers, insurance companies, institutional entities and entities controlled by the said entities.
(2) Deposits with banks, credit to the public, investment in bonds, borrowed or acquired securities as part of buy-back agreements and other assets in respect of derivative instruments.
(3) Mainly guarantees and commitments for the granting of credit, including guarantees securing third party indebtedness.
(4) The credit risk is stated net of the specific provisions for doubtful debts.
(5) For further information regarding the composition of the credit exposure reflected in the table showing derivative instruments in relation to banks/dealers/brokers, see Note 7 to the condensed financial statements.
(6) Credit exposure does not include exposure to financial institutions that have explicit and full government guarantees, and which do not include investment in mortgage backed securities (for additional details regarding mortgage backed securities, see Note 20 to the financial statements).
(7) According to the rating of S&P, Fitch and Moody's agencies.
(8) Most of the balance sheet credit risk which has no rating is in respect of wholly owned subsidiaries of banks which have a rating and small banks and financial institutions. Most of the off-balance sheet credit risk which has no rating is in respect of exposure to a company engaged in foreign trade insurance in an OECD country that has an investment rating of A-.

In addition to the exposure presented in the above table, as of December 31, 2008 a potential off-balance sheet exposure exists in respect of derivative instruments of foreign financial institutions (as defined in Section (4)(a) to the definition of indebtedness in Proper Banking Management Directive No. 313 regarding "Restrictions on indebtedness of a single borrower and of a group of borrowers", namely, 10% of the outstanding balance of a future transaction of the "Future rate agreement or of the forward rate agreement" type), in the amount of NIS 5,663 million.

CREDIT RISK IN RESPECT OF LEVERAGED FINANCE

Definition of leveraged finance. The Bank defines credit granted for the finance of acquiring means of control, in line with Proper Banking Management Directive No. 323, as leveraged finance. Financing the acquisition of means of control over corporations is typified by large amounts or by high financing rates, the repayment of the loan being mainly based on the acquired corporation, at times even without recourse to the borrower.

Credit risk in respect of leveraged finance. Following are data regarding credit risk pertaining to leveraged finance. Disclosure is focused on exposure in respect of the acquisition of means of control, each of which exceeds NIS 10 million.

The Bank's exposure to leveraged finance as of December 31, 2008 according to the economic sector of the acquired corporation (in NIS millions):

Sector	Balance sheet credit	Sector's exposure of overall exposure to leveraged finance (in %)
Agriculture	591	15.8%
Industry	1,205	32.2%
Construction and real estate	707	18.9%
Electricity and water	18	0.5%
Commerce	12	0.3%
Hotels, hotel service and food	15	0.4%
Communications and computer services	611	16.3%
Financial services	586	15.6%
Total	3,745	100.0%

Additional details:

Exposure to leveraged finance as of December 31, 2008 amounted to NIS 3,784 million, compared to NIS 2,095 million at the end of 2007, an increase of 81%. The outstanding balance of exposure presented in the above table is net of a provision for doubtful debts of to NIS 32 million in 2008, compared to NIS 10 million at the end of 2007. After deducting qualified collateral, the total balance sheet exposure in respect of leveraged finance as of December 31, 2008 amounted to NIS 3,517 million, compared to NIS 1,977 million at the end of 2007, an increase of 78%.

The off-balance sheet exposure to leveraged finance as of December 31, 2008 amounted to NIS 286 million, compared to with NIS 21 million at December 31, 2007, and reflects a commitment to grant credit for the acquisition of means of control in a corporation.

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 products 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. The operational risk controllers of each division assist, among other things, the division and layout heads in the management of operational risks, in communicating with and reporting to the Risk Management Department. 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 theoe 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 formulating 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. The operational risk management policy was updated and subsequently approved by the Board of Directors in the last quarter of 2008, in view of the Basel II principles.

The objectives of the operational risk management policy are to define and communicate the operational risk management requirements to all the Bank's units and to ensure the effectiveness of managing, controlling and supervising the operational risks inherent in the Bank's activities. The policy is also intended to ensure:

- Existence of processes for the identification, evaluation and ongoing monitoring of the risks, minimizing risk and current control in all Bank units;
- Existence of an organizational and operational structure at the Bank supporting operational risk management;
- Full reporting of failure events, including “almost failed” events, and the existence of an effective process for drawing conclusions.

In addition, the policy states that:

- The Bank's Management, by means of the Risk Management Department, is to examine consistently and in an ongoing manner the substance and intensity of the operational risks affecting the Bank in order to confront such risks in an effort to minimize the Bank's exposure to the occurrence of failure events. Such examination should take into consideration material changes in the following factors: relevant regulatory instructions, the economic situation and the level of exposure to risks in Israel and the world over, the organizational structure and work procedures at the Bank, information systems supporting the various procedures, business or operational processes, the volume of operations of the Bank (increase or decrease in the volume of the business and operational activities at the Bank) which might change the scope of potential damage, technological tools, including the opening of systems to new distribution channels, implementation of means of control, integration of new information systems and the launching of new products;
- The Board of Directors and Management are to formulate core principles in the operational risk management field, including the determination of tolerance levels and risk thresholds, definition of authority framework for taking on risks, definition and maintenance of the organizational structure supporting operational risk management;

- The limitations on the exposure to operational risks are to be comprehensive at the Bank and Group levels, in order to enable effective, responsible and cost saving operational activity;
- The Chief Risk Manager is responsible for the development of methodology and models and for forming work tools and evaluation methods for the assessment of the operational risks of the Group in order to create quality, effective and active risk management at the Bank. The Chief Risk Manager is also responsible for reporting to Management and to the Board of Directors;
- In each division or layout, the officers taking the risk, from the lowest managerial level to top management level, are those in charge of the risk and responsible for its ongoing management by identifying the risk, evaluating its level, monitoring the risk, determining and effecting plans to reduce the level of the residual risk, as well as reporting to their superiors and to the Risk Management Department;
- The Risk Management Department is responsible for the implementation of operational risk management by defining optimal work processes and procedures in this field;
- An examination, analysis and evaluation of the operational risk management and their scale are to be performed periodically with respect to each risk center, taking into consideration the changes occurring in new processes, new operations and products. The evaluation is to be performed in accordance with the risk evaluation methodology used by the Bank during the operational risk survey, while giving special attention to the control environment.

Operational risk survey. During the third quarter of 2008, the Bank completed an extensive operational risk survey, which began in the end of 2007, performed with the assistance of outside consultants. The survey included the mapping of all the business and operational procedures at all of the Bank's units and its subsidiaries. The fundamental risks inherent in each process and sub-process as well as existing controls in respect of each risk have been identified and their level evaluated. The integration between them enables a quality evaluation of the residual risk (low, moderate, high or very high).

Upon conclusion of the survey, the Risk Management Department reported 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.

Completion of the survey has created a wide infrastructure for the management of operational risks according to the Basel II instructions, following which the Bank has commenced the stage of formulating and managing plans for reducing material operational risks identified, which are considered having high and very high risk levels.

These reduction plans include recommendations for new controls intended to reduce the probability of a risk materializing and/or the scale of the damage that may result once the risk materializes, thus reducing the level of the residual risk.

The reviewed units have started implementing risk reduction plans. The status of the implementation of the reduction plans is to be reported to Management and to the Board of Directors on a quarterly basis.

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.

ENVIRONMENTAL RISKS

In July 2008, the Supervisor of Banks issued a draft Proper Banking Management Directive regarding exposure and management of environmental risks and a draft circular letter on the subject was distributed in October 2008.

The draft circular defines an environmental risk of a banking corporation as a risk of a loss resulting from instructions relating to environmental protection and their enforcement. Banking corporations may be exposed to environmental

risks in various aspects of their activity, which may be included within the framework of the other risks (such as: credit risk, market risk, operational risk, legal risk and liquidity risk). An environmental risk pertaining to a banking corporation may result from direct liability of the bank to an environmental hazard, including the possibility that the banking corporation would be required to remove such environmental hazard or would be responsible to a third party in respect of such hazard, or as a result of impairment of realized collateral. Furthermore, the risk might be realized in an indirect manner as a result of the deterioration in the financial condition of a third party due to environmental costs originating in regulations relating to environmental protection. A goodwill risk is also possible as a result of a link to the factor causing the environmental hazard, which may be attributed to the banking corporation.

According to the said draft, banking corporations will be obliged to recognize the fact that the identification and evaluation of environmental risks are part and parcel of the proper process of evaluating risks of a banking institution, and will have to integrate the environmental risk exposure management into the overall risks of banking groups, including procedures for the identification of material risk upon the granting of credit and the integration of this risk evaluation into the periodic evaluation of the quality of the credit granted.

Implementation of the provisions of the circular letter will be effected until January 1, 2010, in accordance with criteria and time schedule to be approved by the Board of Directors of the banking corporation, where, for the purpose of the implementation, the banking corporation may adopt accepted international principles and standards applying to environmental risk management, as adjusted for environmental factors in Israel.

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 at the Bank and in the Group, 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. Entry into new activities, frequent changes in legislation and the many regulatory directives that apply to the Bank and to its subsidiaries, in

areas of existing or new operations, require modification of the infrastructure supporting the duties derived from the relevant regulatory instructions 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 relevant 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, 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 pf 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 and in accordance with the various activities performed by the Bank. 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 Bank's Management and the Board of Directors 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 a management member - the Chief Legal Advisor. The Compliance Officer also serves as such in several of the Bank's subsidiaries. For the purpose of her work, the compliance officer is assisted by the coordination committee that meets once in every quarter. The Compliance Officer monitors the Bank's preparations for fulfilling the duties imposed on it under the legislative and regulatory instructions with respect to Bank-customer relations ("consumer instructions"), including verification of compliance by the Bank with the relevant consumer instructions as regards new activities of the Bank. This Officer also follows-up on the correction of various deficiencies as regards compliance with consumer instructions. The Compliance Officer submits periodic reports to the President and CEO of the Bank and to its subsidiaries in which she acts as Compliance Officer, as well as annual reports discussed by managements of the Bank and the said subsidiaries and at their Boards 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 contains an evaluation of the effect of risks on the Group.

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

In view of the global financial crisis (see above "The global economic crisis"), and the risks inherent therein and its impact on the domestic banking industry in general and the Bank in particular, the Bank's management re-examined the various risk factors and the extent of their effect on the Bank. In this respect, credit risks, market risks, liquidity risks and operational risks have been reviewed.

The Bank's management has concluded that no changes are required to be made in the grading of the various risks, as defined in the past, excluding the risk of share prices, the rating of which has been raised from a low influence level to a medium influence level.

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 Borrowers	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 of market risks	Low	A risk of the impairment in the value of the Bank and 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 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 set 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 set limits and is controlled on a current basis.
2.4.	Share price risk	Medium	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. The continued financial and economic crisis intensifies the risk of impairment of the Bank's non-financial investments.
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. Exposure, as measured by an internal model, the examination of the volume and stability of deposits as well as by additional indicators, is low 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, and applies controls regarding the various procedures. The bank has completed a comprehensive risk survey and is acting towards reducing the material risks and ensuring the ability of survival and recovery.
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.

RISK FACTORS TABLE (CONTINUED)

The risk		Risk factor Impact	Risk description
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 ongoint supervision and control over the implementation of instructions and procedures as regards customers, suppliers and employees.
Additional risks relevant to the Bank:			
7.	Regulatory 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 risks	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.

BASEL II

In December 2008, the Supervisor of Banks issued a provisional instruction in the matter of: "A framework for measurement and capital adequacy", which is based upon the Basel Committee recommendations regarding the measurement of capital adequacy, published in June 2006 (hereinafter: "Basel II").

The recommendations of the Basel II Committee grant the Supervisors discretion as to the manner of implementation of certain recommendations of the Committee. The provisional instruction reflects the Supervisor's views with respect to each of the matters where discretion has been granted to the Supervisor.

Within the framework of the formation process of the provisional instruction, which began in the middle of 2007, drafts on various subjects have been distributed to the banking corporations. These have been discussed at current meetings with representatives of the Supervisor of Banks. The subjects raised in these meetings involved, among other things, the definition of the retail credit portfolio, the capital requirements with respect to credit facilities, and the conditions for recognizing financial collateral. The Bank is preparing for the implementation of the decisions adopted, which require preparations from the legal, business and operational aspects.

The Supervisor of Banks has informed that he expects the banking corporations to comply with the standard approaches of the first layer (credit risk, market risk and operational risk) as well as with the requirements of the second and third layers of the Basel II recommendations until the end of 2009, the banking corporations having to report to the Supervisor that the measurement and capital adequacy have been applied according to the new methods starting with the report as of December 31, 2008.

The Basel II instructions focus on the improvement of the risk management procedures of the banking corporations, including procedures for identification, assessment, control and reporting. The change in computing the capital adequacy according to Basel II, compared to Basel I, stems from the first time allocation of capital to operational risks. A change was also made to the assessment of risk components relating to credit risk.

According to the standard approach, credit risk may be measured on the basis of independent credit ratings. A possibility

of implementing the internal models approach also exists, in which the credit risk is measured on the basis of internal credit rating models.

The Basel II instructions are comprised of three layers:

- First tier – minimum capital requirements – defines the manner of computing the capital to risk components ratio. Its aim is to expand and improve the measurement framework for computing the minimum capital requirements in respect of credit risk, market risk and operational risk.
- Second tier – emphasizes the supervision and control process over capital adequacy. Within the framework of the second tier, banking corporations are required to maintain an internal procedure for the assessment of the capital adequacy and to establish a strategy for securing the capital adequacy – Internal capital adequacy assessment process ("ICAAP"). Within the framework of the ICAAP, banking corporations are required to allocate additional capital in respect of risks not covered by the first tier (such as: concentration risk, interest risk in the bank portfolio, etc.) as well as to conduct extreme scenarios for the examination of the capital situation.

  The Supervisor of Banks is required to conduct review and evaluation processes as regards the ICAAP of each of the banking corporations that has prepared an ICAAP document in order to determine whether the capital and capital targets are in line with the risk profile of the particular banking corporation.
- Third tier – reinforces the "market discipline" by increasing transparency of information provided to the public with regards to the activities of the banking corporations, their risk profile and amount of capital allocated in their respect.

The Supervisor of banks has determined that the minimum overall capital ratio shall not fall below 8% in respect of the first layer and 1% in respect of the second layer.

Discount Group's preparations 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.

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 the course of 2008, the Bank continued the process of establishing a system for the calculation of capital adequacy and credit risks management, in order to be fully ready for the implementation of the Basel II requirements by the end of 2009. The implementation program is carried out throughout the entire Discount Group in Israel and abroad.

Within the framework of tier II the Bank is adressing the preparation and updating of the risk management policy documents, focusing on the credit field. The operational risk management policy was updated in the last quarter of 2008 and approved by the Board of Directors. At the same time, the Bank performed a comprehensive survey of the differences existing between the processes and procedures carried out at the Discount Group as a whole, compared to that required by the documents published by the Basel Committee. This survey began in December 2007 and was completed in the third quarter 2008. The results of the survey were validated and approved by the business factors and presented to the Bank's Management and Board of Directors in the last quarter of 2008. The results of the survey

serve as a basis for the preparation of a comprehensive plan for reducing and eliminating the identified differences. Furthermore, the Bank is preparing for the adjustment of the organizational structure in accordance with the risk management requirements of Basel II, as well as the formation and implementation of an internal process of assessing the fairness of the capital (ICAAP) and the documentation thereof.

In December 2008, the Supervisor of Banks issued a guideline regarding the structure of documenting the ICAAP paper, which banking corporations will be required to present to the Supervisor for review, beginning with the paper in respect of the end of 2009 and annually thereafter. The Bank has engaged an international consulting company experienced in implementing and documenting ICAAP processes in Europe, to assist it in implementing the process.

The overall preparations for the implementation of Basel II require investment of a considerable volume of resources. Among other things, changes and adjustments to work processes and infrastructure systems would be required as well completion of data collection processes, establishing data bases, development of various models and integration of new methods for the implementation of the computation of capital requirements.

ACTIVITY OF THE GROUP ACCORDING TO PRINCIPAL SEGMENTS OF OPERATION

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 U.S. 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 U.S. 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.

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, 2008						
Reported net income	224	215	321	159	173	(847)	245
Net income for Management reports	216	203	286	148	172	(780)	245
Difference	8	12	35	11	1	(67)	-
Fllowing the composition of the difference:							
Income from financing activities before provision for doubtful debts	13	19	56	17	2	(107)	-
Profit from sevarance pay funds	-	-	-	-	-	-	-
Total Income that was transferred	13	19	56	17	2	(107)	-
Provision for taxes on operating income	5	7	21	6	1	(40)	-
Difference	8	12	35	11	1	(67)	-

	For the year ended December 31, 2007						
Reported net income	637	232	356	106	43	(109)	1,265
Net income for Management reports	605	213	329	89	41	(12)	1,265
Difference	32	19	27	17	2	(97)	-
Fllowing the composition of the difference:							
Income from financing activities before provision for doubtful debts	14	18	31	19	1	(83)	-
Profit from sevarance 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)	-

The segment data presented below also reflects earnings disregarding certain components. Details of disregarded components are included in Note 31 to the financial statements. In the segment data for 2007 presented below, the assets of provident funds that have been sold are included up until their sale in the average balance of assets of provident funds and mutual funds.

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.

Until the end of 2008, the business operations of the Bank had been conducted by four divisions: Retail Division, Corporate Banking Division, Finance Division, and Asset Management Division. (for details regarding the change in the organizational structure, which began in December 2008, and within the framework of which the Assets Management Division was dissolved see "Human Resources" below).

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, the Tel-Aviv main branch and the London branch.

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

The Asset Management Division was 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.

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 branches were modified 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 2008, the Bank operated 142 branches across the country, organized within the framework of five regions. Mercantile Discount Bank operated 71 additional branches.

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 2008, the Bank opened 6 specialty branches designated for State employees as well as 5 branches of the "Household Discount" line. For further details regarding the branch layout, see "Household Segment" hereunder. Mercantile Discount Bank opened another branch in 2008.

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 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").

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. The traditional Discount branches are undergoing a "face lift". Within this framework, each branch was divided into two areas: the daily banking area - "Discount rapid" and the specialized banking area.

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 SEGMENTION

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 and allows full compatibility with the needs of the customer.
In the small business sector three principal kinds of customers were identified: 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 has absorbed in 2008 a customer focused supporting system. This system places the customer at the center and customizes the products according to his needs and preferences.

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 trains 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.

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 xceeding NIS 500 thousand.

SERVICE

Banking products. 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.

Telebank - personal service. 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. For details regarding the upgrading of the Internet site, see below "Technological changes that may effect the segment".

ATM stations adapted to the needs of the visually impaired. In December 2008, the Bank launched a new service for the benefit of the visually impaired. Audio devices have been installed at some 100 ATM stations of the Bank and Mercantile Discount Bank all over the country, this in addition to existing identification measures by way of touch, which together help those with the visually impaired to perform banking operations.

Most of the ATM stations are installed at a height that enables use by handicapped persons in wheelchairs.

The Bank intends to complete installation of these devices in most of the ATM stations of the Bank and Mercantile Discount Bank, until the middle of 2009.

ADJUSTMENT OF BRANCH LAYOUT

As part of the Bank's differentiation measures, unique concept branches are being established with a view of providing customer tailored service 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. At the end of 2008 33 "Discount Rapid" centers were in operation.

"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. At the end of 2008, five branches of the "Discount Your Way" line were in operation: 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. 9 "Household Discount" branches operated at the end of 2008.

Program for 2009. The plan for 2009 includes opening five "Discount Rapid" centers, one "Discount Your Way" branch and two "Household Discount" branches.

CONSULTING LAYOUT

Investment centers. Customers having deposits of over NIS 750,000 or customers active in the capital market are entitled to consultancy services regarding their funds at ten 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.

The opening of three investment center extensions is planned for 2009, which will provide service to customers with deposits of NIS 250,000 and over.

Consulting services in Bank branches. Customers with deposits in the range of NIS 250-750 thousand are entitled to advisory services provided at the branches by authorized investment consultants that specialize in the capital market.

Pension advisory services. As from March 2008, the Bank began providing pension advisory services at the Bank's branches and investment centers. (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.

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

In view of the Bank's strategy to focus on the retail sector as the principal source for growth and profitability, the Bank is taking steps towards increasing its retail customer base. The three principal moves made in this respect in the last two years were:

- 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 the 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 crease 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 leadership in personal and professional service;
- Development of new and unique products and customizing them to customer needs;
- The continued attraction of State employees and teachers 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 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.
- Increased customer satisfaction by upgrading the experience of visiting the branch and benefiting from optimal service.

COMPETITION

Competitors. The number of competitors in the household segment is the same as the number of banks operating in the markrt. The Bank's principal competitors are the four other major banks in Israel - Bank Hapoalim, Bank Leumi, the First International Bank and Mizrahi-Tefahot Bank. Israel Discount Bank is third in size amongst the five banks. Furthermore, competition has arisen in recent year from "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.

Means of handling the competition. Handling the competition is conducted while making an effort to differentiate the Bank from its competitors on several levels:

- Increasing the retail market share by attracting customers while focusing on public sector employees;
- Providing mortgages within the framework of "Discount Layout" as a mechanism for attracting customers;
- Service groups specializing in investment consulting, pension and credit advisory services;
- The activity of over 100 branches, which are also open for customer service on Fridays.

In addition, as stated, the Bank focuses on implementing the segment strategy by specialization in the various fields and providing specialized service according to population segments and their needs.

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

No material changes occurred in 2008 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

During 2008, a new, user friendly and easy to operate site was launched. Among the new additions are the possibility of making payments to Government Authorities by debiting the customer's account, conversion of foreign currency and the issue of a password by means of the Internet.

In addition, new "Mail@Discount" service has been inaugurated, which enables the receipt of notices from the Bank by way of the Internet alone (and not by the Israeli postal services), with the possibility of restoring mail messages within a period of up to 180 days. This service facilitates matters for the customer on the one hand and it contributes to the Bank's savings and efficiency efforts on the other hand.

As part of intensifying activities with the various sectors, new marketing sites have been launched aimed at Russian and French speaking customers.

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;
- Providing service and professional response to the customer compatible with his needs and preferences;
- 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 reputatable service level, leadership, professionalism and reliability established over many years.
- The movement of customers from one bank to another requires the investment of efforts and impedes the attraction of new customers.

In order to facilitate the process of transferring business from one bank to another, the Supervisor of Banks issued in July 2005 an amendment to Proper Banking Management Directive No. 432, according to which a banking corporation is required to provide information to a customer considering to transfer his banking operations to another bank, and to carry out a series of operations on his behalf within a short and predetermined period.

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 eligiable 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 is 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. The Bank has opened branches in all the places specified in the tender, with the exception of the Government Compound at Sheikh Jarrah in Jerusalem, where a branch is to be opened in 2009. Until now, the Bank has opened ten branches and extensions for the benefit of State employees at hospitals in Ashkelon, Tel Hashomer, Nahariya, Rambam in Haifa, Assaf Harofeh, and Wolfson in Holon, as well as at the Binyanei Ha'Uma Parking Lot, the Jubilee Building and extensions at two defense installations.

Commencement of operations under the terms of the tender was January 1, 2008, and until such date the Bank had to make the necessary preparations in order to be a ble 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 Bank estimates that the tender serves 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 which were dismissed by the Court.

Preparations by the Bank. 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.

In 2008 an emphasis has been placed on attracting State employees as Bank customers. As part of this activity, the Bank continues to operate 18 designated field teams (this activity began in September 2007 with 25 teams). 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, State employees also enjoy prompt loan approvals through the Bank's website which is at their disposal. The website also provides information as to all loans available to State employees, and allows these customers to submit through the Internet an "all purpose" loan request form.

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 was granted for short periods and extended from time to time, the most recent one until December 31, 2008. Subsequent to this date, the Bank is entitled to act under the permit granted to it in the past for operating provisional branches, under which the Bank may operate up to 30 provisional branches at any given time. The validity of that permit has been extended to February 28, 2010.

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. Following the success achieved in the tender and approaches made by various organizations in the public sector, the Bank has entered into special arrangements with organizations not forming part of the population entitled to State employee terms, and has devised similar benefit terms to their employees.

Until December 31, 2008, 39,964 new accounts of State employees were opened of which 4,244 operational accounts used for providing loans to State employees only. As of a date proximate to the publication of the financial statements the Bank had around 57,341 accounts of State employees, of which about 41,659 new accounts opened since the beginning of the activity with State employees.

PROVISION OF SERVICES TEACHERS

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.
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.
For details regarding the marketing of mortgages within the framework of "Discount layout", see "Mortgage and housing loan activity" under "Further details as to activity in certain products" hereunder.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Most of the income from credit card issue operations is related to the household segment.
Net income of the segment in 2008 amounted to NIS 224 million compared with NIS 637 million in 2007, a decrease of 64.8%. Disregarding certain components (see hereunder), net income would have amounted to NIS 173 million in 2008, compared with NIS 197 million in 2007, a decrease of 12.2%.
The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 15.1% in 2008, compared with 50.3% in 2007. Disregarding certain components (see hereunder), the return on equity would have been 11.6% in 2008, compared with 15.5% in 2007.
Provision for doubtful debts in this segment amounted in 2008 to NIS 176 million, compared with NIS 123 million in 2007, an increase of 43.1%.

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

	Domestic operations					International operations:	
	Banking and finance	Credit cards	Capital market	Mortgage	Total domestic operations	Banking and finance	Total
	For the year ended December 31, 2008						
Income (loss) from financing activities before provision for doubtful debts							
- From external sources	(276)	222	12	195	153	2	155
- Intersegmental	1,322	(59)	-	(80)	1,183	-	1,183
Total income from financial activity	1,046	163	12	115	1,336	2	1,338
Operating and other income	436	699	212	50	1,397	-	1,397
Total Income	1,482	862	224	165	2,733	2	2,735
Provision for doubtful debts	125	51	-	-	176	-	176
Operating and other expenses	1,360	481	219	126	2,186	1	2,187
Operating Income (loss) before taxes	(3)	330	5	39	371	1	372
Provision for taxes on operating income	(19)	84	11	16	92	-	92
Net income (loss)	16	191	(6)	22	223	1	224
Net income (loss) disregarding certain components	47	106	(3)	22	172	1	173
Return on equity (percentage)	4.1	50.4	-	3.3	15.2	7.0	15.1
Return on equity disregarding certain components (percentage)	11.5	28.1	-	3.3	11.7	7.0	11.6
Average Assets	7,986	6,948	7	12,959	27,900	117	28,017
Average Liabilities	55,132	833	-	2,070	58,035	-	58,035
Average Risk-assets	6,354	5,858	7	10,573	22,792	117	22,909
Average assets of provident and mutual funds	-	-	50	-	50	-	50
Average customers' securities	-	-	27,488	-	27,488	-	27,488
Average other assets under management	206	-	1,389	2,022	3,617	-	3,617
Components of income from financial activities:							
Margin from credit activity	389	160	-	99	648	-	648
Margin from deposits activity	602	-	-	-	602	2	604
Other	55	3	12	16	86	-	86
Income from financing activities before provision for doubtful debts	1,046	163	12	115	1,336	2	1,338

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

	Domestic operations					International operations:	
	Banking and finance	Credit cards	Capital market	Mortgage	Total domestic operations	Banking and finance	Total
	For the year ended December 31, 2007						
Income (loss) from financing activities before provision for doubtful debts							
- From external sources	(249)	184	7	172	114	6	120
- Intersegmental	1,177	(55)	7	(65)	1,064	-	1,064
Total income from financial activity	928	129	14	107	1,178	6	1,184
Operating and other income	491	580	296	48	1,415	1	1,416
Total Income	1,419	709	310	155	2,593	7	2,600
Provision for doubtful debts	71	41	-	10	122	1	123
Operating and other expenses	1,367	437	175	113	2,092	4	2,096
Operating Income (loss) before taxes	(19)	231	135	32	379	2	381
Provision for taxes on operating income	(31)	91	49	4	113	-	113
Net income	12	97	502	24	635	2	637
Net income (loss) disregarding certain components	(8)	96	83	24	195	2	197
Return on equity (percentage)	3.0	29.2	-	4.7	50.7	16.6	50.3
Return on equity disregarding certain components (percentage)	(2.2)	28.8	-	4.7	15.5	16.6	15.5
Average Assets	7,214	6,027	10	10,519	23,770	207	23,977
Average Liabilities	50,915	699	-	2,401	54,015	74	54,089
Average Risk-assets	6,217	5,123	10	7,923	19,273	207	19,480
Average assets of provident and mutual funds	-	-	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 financial activities:							
Margin from credit activity	332	126	-	85	543	5	548
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	129	14	107	1,178	6	1,184

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 4,357 (of which 795 are managerial positions) 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 4,366 positions in 2007.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

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

Commissions. An Amendment to the Banking Law (Service to customer) 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 (Service to customer)(Commissions), 2008. Amendments were also made to the Proper Banking Management Directives dealing with commissions. Following this, the following amendments have been published in the Official Gazette: Amendment to the Banking Rules (Service to customer) (Fair disclosure and the delivery of documents), amendments to the said rules regarding commissions, update to the schedule of services under control and the maximum prices fixed in respect thereto and circular letters concerning clarifications with respect to the implementation of the price lists and the new rules.

In addition to the rules, the full tariff and shortened tariff lists, derived from the full tariff list, which relates to certain types of 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 July 1, 2008, of the service charges included in the tariffs.

The Bank and additional subsidiaries in the Group have published tariff lists in accordance with the format fixed in the

said rules and informed their customers accordingly.

Following the publication of the new price lists for banks and the coming into effect of the amendment to the Law at the beginning of July 2008, the Bank of Israel and the banks were publicly criticized in that the reform regarding bank commissions did not bring about, as alleged by the critics, the anticipated reduction in commission prices. Following this, several private Bills have even been tabled proposing further restrictions on the manner in which commissions are fixed by the banks and on the Bank of Israel's supervision in this respect, even to the extent of prohibiting by law the charging of certain commissions, or determining by law the maximum rate of certain commissions, as well as legislation restricting commissions collectible from certain populations.

An amendment to the Banking Rules (Service to customer) (Commissions) effective as from September 1, 2008, was published on August 26, 2008. According to this amendment, an apartment building representative committee shall be considered an individual, and accordingly shall no longer be charged with the ledger commission charged to small businesses (as defined in the Rules); senior citizens, the handicapped and customers who do not have a cash withdrawal card shall be entitled to 4 teller transactions per month at a price of direct channel transaction; as well as each transaction by way of a service box being considered as a direct channel transaction.

At this stage, it is not possible to predict whether further changes would be made to the legislation and rules applying to bank charges and what the nature of such changes, if at all, would be.

The Bank believes that the customers gradually adjust their consumer conduct to the spirit of the Reform, so that activity involving the direct channels has increased at the expense of operations conducted through Bank clerks.

According to initial assessments, based on the volume of commissions charged by the Bank in the first two quarters since the reform came into effect, it would seem that the Group's income is not expected to be materially adversely affected. However, it should be emphasized that in view of the short period of time since the Law came into effect, the said changes in the conduct of customers and of various proposals being raised by certain factors, difficulties exist in evaluating the implications of the Commission Law upon the Group's income.

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

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 (28 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.

Mercantile Discount Bank views the retail segment as a central target of its business development and is diligently working on broadening the branch layout in the segment as well as improving the service to its customers. In this respect, Mercantile Discount Bank opened in the fourth quarter of 2008 an additional branch in this area, which has a high potential for providing banking services to the retail segment.

For details as to the consequences of the capital market Reform, see "Operations in the capital market" hereunder under "Further details as to activity in certain products" and Note 33 to the financial statements. For details as to the possible implications of the new directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses", see Note 1 Y (3) to the financial statements.

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.

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Income from credit card clearing operations is attributed to the corporate banking segment and to the middle market banking segment.

Net income of the segment in 2008 amounted to NIS 215 million compared with NIS 232 million in 2007, a decrease of 7.3%. Disregarding certain components (see hereunder), net income would have amounted to NIS 219 million in 2008, compared with NIS 170 million in 2007, an increase of 28.8%.

The return on equity in 2008, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 27.5%, compared with 34.0% in 2007. Disregarding certain components (see hereunder), the return on equity would have been 28.1% in 2008, compared with 24.9% in 2007.

Provision for doubtful debts in this segment amounted in 2008 to NIS 156 million, compared with NIS 128 million in 2007, an increase of 21.9%.

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

	Domestic operations					
	Banking and finance	Credit cards	Capital market	Construction and real estate	Mortgage	Total
	For the year ended December 31, 2008					
Income from financing activities before provision for doubtful debts						
- From external sources	949	13	3	126	69	1,160
- Intersegmental	(228)	1	-	(59)	(37)	(323)
Total income from financial activity	721	14	3	67	32	837
Operating and other income	336	102	29	16	2	485
Total Income	1,057	116	32	83	34	1,322
Provision for doubtful debts	133	-	-	24	(1)	156
Operating and other expenses	689	77	34	20	9	829
Operating Income (loss) before taxes	235	39	(2)	39	26	337
Provision for taxes on operating income	81	11	(1)	14	9	114
Net (loss) income	154	20	(1)	25	17	215
Net income disregarding certain components	159	18	-	25	17	219
Return on equity (percentage)	25.1	88.5	-	39.3	20.2	27.5
Return on equity disregarding certain components (percentage)	26.1	79.2	-	39.9	20.2	28.1
Average Assets	11,553	239	3	1,535	1,318	14,648
Average Liabilities	11,034	1,197	-	666	122	13,019
Average Risk-assets	9,422	356	3	965	1,281	12,027
Average assets of provident and mutual funds	-	-	45	-	-	45
Average customers' securities	-	-	5,008	-	-	5,008
Average other assets under management	-	-	309	-	-	309
Components of income from financial activities:						
Margin from credit activity	546	14	-	51	33	644
Margin from deposits activity	127	-	-	8	-	135
Other	48	-	3	8	(1)	58
Income from financing activities before provision for doubtful debts	721	14	3	67	32	837

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

	Domestic operations					
	Banking and finance	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 external sources	765	16	3	89	33	906
- Intersegmental	(127)	-	-	(25)	(10)	(162)
Total income from financial activity	638	16	3	64	23	744
Operating and other income	291	68	45	14	2	420
Total Income	929	84	48	78	25	1,164
Provision for doubtful debts	107	-	-	13	8	128
Operating and other expenses	632	60	36	17	8	753
Operating Income (loss) before taxes	190	24	12	48	9	283
Provision for taxes on operating income	66	10	5	18	2	101
Net income	124	10	62	30	6	232
Net income disregarding certain components[1]	117	9	7	31	6	170
Return on equity (percentage)	23.0	46.1	-	52.3	9.5	34.0
Return on equity disregarding certain components[1] (percentage)	21.7	45.3	-	51.8	9.5	24.9
Average Assets	9,465	237	4	1,441	1,013	12,160
Average Liabilities	9,154	1,179	-	595	217	11,145
Average Risk-assets	8,271	320	4	893	1,017	10,505
Average assets of provident and mutual funds	-	-	1,861	-	-	1,861
Average customers' securities	-	-	4,748	-	-	4,748
Average other assets under management	-	-	300	-	-	300
Components of income from financial activities:						
Margin from credit activity	486	16	-	52	26	580
Margin from deposits activity	116	-	-	7	-	123
Other	36	-	3	5	(3)	41
Income (loss) from financing activities before provision for doubtful debts	638	16	3	64	23	744

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 1,840 (of which 328 are managerial positions) 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 1,617 poisitions in 2007, a decrease of 13.8%.

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').

REGIONAL CREDIT CENTERS

As stated, handling the business activity of customers having a credit facility exceeding NIS 500 thousand, is carried out at the regional credit centers. These centers are manned by teams of officers specializing in the credit field.

As at the end of 2008, five credit centers in a nation wide distribution are in operation: 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 28 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.

For details as to the legislation regarding bank commissions and its implications, see above.

For details as to the possible implications of the new directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses", see Note 1 Y (3) to the financial statements.

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 also includes customers of IDB New York's corporate banking segment.

REVIEW OF DEVELOPMENTS IN THE BUSINESS SECTOR IN 2008

The GDP grew in 2008 by 4.0% compared to 2007, this concurrently with a growth of 4.4% in the business product. Notwithstanding, a slowdown trend has been noticed during the year which continued to intensify. The business product grew in the second half of the year at an annualized rate of 1%, compared to 5.8% in the first half of the year and to 6.2% in 2007. The economic situation deteriorated significantly in the fourth quarter of 2008, a fact that was reflected in a 0.5% decline in the GDP and a 1.6% decline in the business product (changes in annualized terms).

The slowdown in 2008 typified all applications. Following are the principal development courses in 2008:

- Private consumption grew by 3.9% following a growth of 6.7% in 2007. a marked slowdown was recorded in the consumption of durable goods (a growth of 8.1% in 2008, compared to 18.6% in 2007), this alongside a slowdown in current consumption (a growth of 3.4% compared to 5.5% in 2007). The per capita private consumption grew in 2008 by 2% (4.8% in 2007).
- Investment in fixed assets increased by a rate of 5.1%, compared to an increase of 15.5% in 2007. Particularly prominent was the slowdown in investments by economic sectors - from a growth of 19% in 2007, down to 5.5% in 2008.
- A slowdown was also recorded in the export of goods and services, from a growth of 8.5% in 2007 down to 3.0% in 2008. The slowdown in exports stems from the sharp decline in the export of diamonds, at a rate of 25.6%, this alongside a certain slowdown in exports excluding diamonds (from a growth rate of 9.5% in 2007 down to 8% in 2008).
- The slowdown in economic activity was reflected in a sharp slowdown in the import of goods and services, excluding defense imports which increased in 2008 by 2.3% in contrast to an increase of 12.4% in 2007. Imports have also been effected by the sharp drop in the import of diamonds, though a slowdown was also recorded in respect of other components.

According to a company survey performed by the Bank of Israel, a marked decline in the activity of all sectors that had been reviewed took place in the last quarter of 2008. Furthermore, all sectors expect a continued moderate activity, while the construction, services and hotel sectors expect an intensified decline in activity.

DEVELOPMENTS IN CREDIT TO THE BUSINESS SECTOR

Credit to the business sector declined in 2008 by a real-term rate of 3.9%, compared to a growth at the rate of 11.2% in 2007 and at the rate of 9% in each of the years 2005-2006. The decline in credit to the business sector is the result of a 25% decline in the credit from institutional entities that was partly offset by an expansion in credit by foreign residents, at the rate of 5.4%, and by bank credit, at the rate of 3.7% (the growth rates stated in this section are computed on the basis of data net of the CPI effect).

The slowdown in the credit from institutional entities began in the second half of 2007, with the outbreak of the credit crisis, and turned into a regression at the beginning of 2008, which continued to intensify. Thus, the credit from institutional entities was reduced in the last quarter of 2008 at an annualized rate of 15.8%, in continuation of the decline of 8.5% in the third quarter of the year. As stated, the the credit from institutional entities declined by a yearly total of 25% compared to a yearly growth of 30% in the years 2006-2007.

The sharp decline in the the credit from institutional entities in the second half of 2008, was affected by a significant decline in the issue of corporate bonds and by a sharp decline in the value of these bonds stated at market prices. The standstill in the raising of capital by means of corporate bonds spanned most of the companies in the market and is a function of the significant increase in related risks, including doubts as to certain companies' ability to service the debt.

And indeed, the volume of fundraising by means of corporate bonds decreased in the fourth quarter of 2008 to NIS 1.2 billion, out of NIS 22 billions raised during the whole year. The volume of bond issues during 2008 was about one quarter of its

volume in 2007, about NIS 82 billion. Some 40% of the corporate bonds issued in 2008 were issued by banks.
On the other hand, 2008 saw a growth in bank credit to the business sector at a rate of 3.7%, in continuation to a 2.6% growth in 2007, and a regression prior to that.
As a result, the weight of bank credit out of total credit to the business sector grew for the first time from 51.3% in 2007 to 55.3% in 2008, following several years of consecutive decline.

DEVELOPMENTS IN SEGMENT MARKETS

Changes occurring during 2008 in the business environment of a large part of the customers belonging to this segment, as a result of their exposure to various aspects of the global financial crisis. The effect of the crisis on the customers of this segment was reflected primarily in the following three areas:

- **Decline in the supply of financing resources**
  - Reduction in the volume of credit granted to Israeli companies by the financial system abroad;
  - A significant reduction in the volume of funds raised on the capital in Israel and abroad;
  - The need on the part of leveraged corporations with a heavy debt load in the years 2009-2010, to recycle their debt;
  - The adoption by local banks of a selective policy in approving new credit due to the increased risk level of borrowers on the local and foreign markets, and the need to present a capital adequacy level of at least 12% by the end of 2009.

  Most of the customers that had been affected by the increased restriction in supply of financing sources are the large holding corporations operating abroad and on the local market, which in the past used to recycle their debt on the capital market as well as customers of the real estate sector most of whose operations were located abroad.
- **Decline in the value of financial and non-financial assets**
  - A decline in value of most of the financial assets owned by borrowers and serving as collateral for bank loans;
  - A decline in value of housing, office and commercial properties in various areas in the United States and Europe.

  Most of the customers affected by the fall in value of securities and real estate assets are holding and other companies active in these fields.
- **Decline in non-financial activities**
  - A significant decline in demand for products of Israeli exporters of the hi-tech industries (primarily in the field of semi-conductors) and in the traditional industries (textiles, metal, paper and plastics) diamonds and the sea freight industry, mainly due to the expected significant decline in growth rates and trading of the developed markets;
  - A decline in the volume of operations of export oriented local customers, which has contributed to a drop in the operating profit margin, including the application of a policy reducing investments in fixed assets;
  - A decline of the local market demand for goods and services of companies in the commercial, industrial and services sectors.

  Customers that have been significantly affected by the decline in local demand are importers of motor vehicles, leasing companies, electronic components importers, cosmetics and fashion brands importers, investment houses, contractors of luxury apartments and diamond industry traders.

ANTICIPATED DEVELOPMENTS IN THE SEGMENT'S MARKETS

Activity of the business sector is expected to fall in 2009, affecting most of the industrial, commercial and services sectors. According to the Bank of Israel's forecasts, the business product is expected to fall by 2.5% in 2009 compared to a growth of 4.4% in 2008.

Following are the principal forecasted developments:

- A decline in the export of goods and services due to the slowdown in international trade and the decline in demand on the part of developed markets, mostly for products of the hi-tech industry, the more traditional industries and diamonds;
- The decline in use of resources is expected to lead to a decline in the import of goods and services;
- The decline in exports coupled with difficulties in raising funds, are expected to lead to a decline in investments in the economic sectors;
- The continued decline in private consumption of households as a result of the growth in unemployment rates and a decline in the consumption desire of the population against the background of the damaged "personal wealth effect" (the decline of the capital market and the decrease in interest rates on financial assets);
- A slower growth rate than in the past in the offer of financing resources by the banking industry, concurrently with the growth in demand for credit on the part of the business sector due to the decline in cash generated by internal accumulation, the need for resources for the recycling of debts and/or self-acquisition of bonds as an alternative to the finance granted in the past by off banking financing resources and a decline in the offer of financing resources on the part of the local and foreign banks operating in the domestic market. Contending with the liquidity distress of the business sector will require joint deployment by the banks and the financial institutions for the recycling of a part of the debts with due dates in the years 2009-2010, estimated as having reasonable prospects of repayment in the future;
- The continued trend of increasing the credit margins by the banking industry, due to an increase in the sector's customers' risk profile, alongside the increasing cost of financing resources to the banks and the need to improve the liquidity level and capital adequacy;
- A decline in operating profit margins and in corporations' repayment ability due to the decline in the volume of production, inventories, increased restrictions on the offer of financing resources and the volatility in exchange rates.

The above said is considered a forward looking statement. The above reflects the evaluation of the Bank's management keeping in mind the information available to it at date of preparation of the financial statements, with respect to the state of the economy and of the global economy, as discussed above in this Section and in the Chapters "The global economic crisis", "Main developments in the Israeli economy" and "Principal economic developments in January-March 2009". The above stated may not materialize on the one hand, and alternatively, a more acute slowdown in economic activity may occur, in the event that the level of demand will significantly decline as a result of a deterioration in the political/security situation, an addtional significant decline in the supply of financing resources in financial markets abroad and on the local market, a considerable slowdown in the growth rate to the extent of prolonged recession conditions developing in the global markets and other macro economic developments over which the Bank has no 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 Commissioner of Restrictive Trade Practices, 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.
As from April 1, 2008 the Bank has been computing 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.
As of December 31, 2008 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.
The limitation on "related parties". Proper Banking Management Directive No. 312 imposes a restriction on the granting of credit to all "persons related to the bank", as defined in the Directive, so that it would not exceed 10% of the equity of the bank. The indebtedness of each component of the controlling interest shall not exceed the product of multiplying his proportionate share in the controlling interest by 10% of the equity of the bank.
In September 2006, the Bank received the Supervisor of Banks` guideline of in this matter, according to which for the purpose of the said Directive, the credit restriction relating to the individuals making up the group will be as follows: Mr. Edgar M. Bronfman – 3.86% of the equity of the Bank, Mr. Matthew Bronfman – 0.78% of the equity of the Bank, Mr. Adam R. Bronfman – 0.39% of the equity of the Bank, Ms. Holly B. Lev – 0.39% of the equity of the Bank, Mr. Michael Rubinoff – 0.2% of the equity of the Bank, Mr. Philip Milstein – 0.39% of the equity of the Bank and Mr. Rubin Schron – 4.0% of the equity of the Bank.
As of December 31, 2008, there were no deviations from the said limitations.
Basel II. 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

Income from credit card clearing operations is attributed to the corporate banking segment and to the middle market banking segment.
Income from financing operations amounted to NIS 1,001 million in 2008, compared to NIS 940 million, an increase of 6.5%. This increase stems from two contrasting developments. On the one hand, a 13% increase in the average credit portfolio resulting from the expansion of credit, mostly due to a number of large credit transactions in the fields of acquisition of means of control and financing infrastructure, and on the other hand, a decline in the financial margin.
Net income of the segment in 2008 amounted to NIS 321 million compared with NIS 356 million in 2007, a decrease of 9.8%. Disregarding certain components, net income would have amounted to NIS 327 million in 2008 compared with NIS 348 million in 2007, an increase of 6.0%. The decline in net earnings resulted mainly from the increase in the provision for doubtful debts and in operating expenses, which was partly offset by the increase of income from financing operations.
The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 9.7% in 2008, compared with 13.9% in 2007. Disregarding certain components, the return on equity would have been 9.9% in 2008, compared with 13.5% in 2007.
Provision for doubtful debts in this segment amounted in 2008 to NIS 233 million compared with NIS 60 million in 2007, an increase of 288.3%. The increase in provision for doubtful debts was the result of the deterioration in the repayment ability of borrowers in most economic sectors that became apparent as from the second half of the year.

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

	Domestic operations					International operations			
	Banking and finance	Credit cards	Capital market	Construction and real estate	Total	Banking and finance	Construction and real estate	Total	Total
	For the year ended December 31, 2008								
Income from financing activities before provision for doubtful debts									
- From external sources	960	10	3	690	1,663	54	19	73	1,736
- Intersegmental	(434)	-	(1)	(420)	(855)	120	-	120	(735)
Total income from financial activity	526	10	2	270	808	174	19	193	1,001
Operating and other income	140	106	26	18	290	95	2	97	387
Total Income	666	116	28	288	1,098	269	21	290	1,388
Provision for doubtful debts	97	-	-	121	218	12	3	15	233
Operating and other expenses	410	79	30	74	593	104	9	113	706
Operating Income (loss) before taxes	159	37	(2)	93	287	153	9	162	449
Provision for taxes on operating income	56	9	(2)	31	94	19	3	22	116
Net income	103	17	(1)	62	181	134	6	140	321
Net income disregarding certain components[1]	110	14	(1)	63	186	135	6	141	327
Return on equity (percentage)	5.7	218.8	-	6.0	6.4	33.5	9.7	30.2	9.7
Return on equity disregarding certain components[1] (percentage)	6.1	179.4	-	6.1	6.5	33.7	9.7	30.4	9.9
Average Assets	26,082	316	14	10,294	36,706	5,049	978	6,027	42,733
Average Liabilities	13,352	1,554	1	2,136	17,043	2,634	-	2,634	19,677
Average Risk-assets	27,883	121	13	15,814	43,831	6,146	978	7,124	50,955
Average assets of provident and mutual funds	-	-	372	-	372	-	-	-	372
Average customers' securities	-	-	59,817	-	59,817	-	-	-	59,817
Average other assets under management	-	-	256	-	256	-	-	-	256
Components of income from financial activities:									
Margin from credit activity	392	10	1	187	590	142	16	158	748
Margin from deposits activity	57	-	-	7	64	31	-	31	95
Other	77	-	1	76	154	1	3	4	158
Income from financing activities before provision for doubtful debts	526	10	2	270	808	174	19	193	1,001

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

	Domestic operations					International operations			
	Banking and finance	Credit cards	Capital market	Construction and real estate	Total	Banking and finance	Construction and real estate	Total	Total
	For the year ended December 31, 2007								
Income from financing activities before provision for doubtful debts									
- From external sources	552	12	-	497	1,061	174	21	195	1,256
- Intersegmental	(102)	-	1	(201)	(302)	(14)	-	(14)	(316)
Total income from financial activity	450	12	1	296	759	160	21	181	940
Operating and other income	149	80	41	14	284	22	4	26	310
Total Income	599	92	42	310	1,043	182	25	207	1,250
Provision for doubtful debts	7	-	-	42	49	8	3	11	60
Operating and other expenses	346	67	23	70	506	100	10	110	616
Operating Income (loss) before taxes	246	25	19	198	488	74	12	86	574
Provision for taxes on operating income	87	11	7	74	179	37	2	39	218
Net income	159	9	16	125	309	37	10	47	356
Net income disregarding certain components[1]	150	9	12	124	295	43	10	53	348
Return on equity (percentage)	11.6	116.6	-	16.0	14.3	10.8	15.8	11.5	13.9
Return on equity disregarding certain components[1] (percentage)	11.1	116.5	-	15.8	13.7	11.9	15.8	12.5	13.5
Average Assets	22,175	313	25	8,563	31,076	5,801	945	6,746	37,822
Average Liabilities	9,340	1,529	3	2,495	13,367	4,634	3	4,637	18,004
Average Risk-assets	20,888	121	24	12,040	33,073	5,501	966	6,467	39,540
Average assets of provident and mutual funds	-	-	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 financial activities:									
Margin from credit activity	362	12	-	189	563	130	18	148	711
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	12	1	296	759	160	21	181	940

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 1,332 (of which 329 are managerial positions), 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 1,006 positions in 2007, an increase of 32.4%. 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.

SERVICE TO SEGMENT CUSTOMERS

The business segment enjoys professional banking services provided by the Corporate Division. In 2008, 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.

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 Finanacing Department, which operates within the framework of the real estate 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, implemented financing transactions for customers. Since January 2009, the company is not taking on any new transactions.

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. The branch's operations were reorganized during 2008, which at the beginning of 2009 was turned into a branch designated to serve the business customer. The branch's retail customer service has been transferred to a new retail business branch opened in the vicinity. Renovations carried out at the branch are expected to be completed in the course of 2009, adapting the premises to the branch's new work format.

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. 2008 was characterized by the continued acceleration of the import and export activities in the market, particularly in the first three quarters of the year. According to the data of the Central Bureau of Statistics, the import of goods (excluding services and diamonds) recorded a growth of 19.9% as compared with 2007 and the export of goods (excluding services and diamonds) recorded a growth of 16.3% as compared with the year 2007.

Import transactions made through the Bank increased in 2008 by 41.25% (excluding securities and diamonds) compared with 2007.

An increase of 28% was recorded in export transaction at the Bank in 2008 compared with 2007.

These rates are significantly higher than the growth rates of the Israeli economy's import and export activities in that period.

It should be noted that starting with the fourth quarter of 2008, a significant decline was recorded in export and import of goods, following the intensified slowdown in world trade and a decline in private consumption of households

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 2008, 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 2008 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 2009.

Technological improvements. Since the beginning of 2008, the system allows direct import payments operations and transfers of foreign currency by means of the Internet system. Starting in January 2009, the foreign trade services on the Internet have been expanded and the system also allows customers to open letters of credit for imports and making payments regarding import documents for collection.

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. In addition, the Bank has succeeded in the course of the past year to attract a noteworthy number of quality large customers, whose business with the Bank contributed to the increase in the volume of operations in this segment.

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 has been used for the expansion of their activity abroad mostly backed-up by local collateral.

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 while taking into account the overall indebtedness of the customer, including in the off-banking market;
- 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 Commissioner of Restrictive Trade Practices' instruction in this issue, see "Consortium agreements for the granting of credit" 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 leverage policy which includes the use of bank financing sources together with use of off-banking means of finance.

As from the middle of 2007, and more intensely in 2008, against the background of the capital market crisis, a marked decline has been noticed in the ability to raise funds from off-banking sources, a fact that increased the dependence of customers of this segment on credit that may be obtained from the banking industry.

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.

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.
As a result of the capital market weakness, the business sector's ability to raise alternative credit on the off-banking market has been significantly reduced.
Wherever the possibility to raise funds on the capital market exists, off-banking finance serves as an alternative financing resource, primarily for the long and medium term credit products, thus contributing to the reduction in the volume of this kind of credit in the credit portfolio reflecting the activity of this 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. It should be noted that competition on the part of the foreign banks has declined with the development of the world financial crisis.
The level of competition on the part of institutional bodies also increased until recently, mainly insurance companies and pension funds, which established off-banking credit departments.
The increased competition between the banks in 2008 stemmed mostly from the improved capital adequacy in prior years.
The increased competition between banks, which during 2008 contributed to the real term increase in the volume of banking credit alongside the decrease in issuance of corporate bonds, brought about, for the first time after a long period, an increase in the share of bank finance out of the total financing resources available to corporate customers.
Starting with the second half of 2008, a continuous process of significant increase in financial spreads and operating commissions has existed, typifying the segment. This is the result of the increase in customers' credit risk levels as well as the difficulty experienced by the banking industry in raising financing resources on the capital market at credit spreads that had been customary in the past.

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 the first three quarters of 2008 on the background of the many transactions carried out in this field. The Bank participated in these transactions and even led several such transactions. A marked slowdown in this type of activity has been noticed since the last quarter of 2008.

TARGETS AND BUSINESS STRATEGY

- Improving the quality of service, while moving to an overall view of customer needs and providing overall solutions;
- Moderate and controlled increase in business credit;
- Attracting new quality customers and intensifying activity with existing customers;
- Intensifying the control, supervision and monitoring processes over extraordinary developments in customers' risk profiles;
- A selective and cautious examination of new credit applications, primarily regarding matters of recycling or self-acquisition of outstanding bonds;
- Evaluations in respect of the sale/reduction of risk assets;
- Improving the quality of the Bank's credit portfolio;
- The application of a selective sectorial policy in financing customers;
- Preparation for the implementation of the "Basel II" provisions;
- Continued improvement of the technological infrastructure supporting the identification, measurement, analysis and control of various risks, focusing on credit and operational risks.
- Determination of a risk credit policy in the matter of environmental protection;
- Preparation for the handling of delinquent debts.

THE CORPORATE BANKING SEGMENT AT MERCANTILE DISCOUNT BANK

The handling of customers of the corporate banking segment at the Mercantile Discount Bank is the responsibility of the Corporate Division, which includes three sub-units: the corporate department responsible for the large corporate customers; the commercial department responsible for large commercial customers; and the construction projects financing department responsible for entrepreneurial real estate segment companies.
An organizational change was effected on January 1, 2009, whereby the operations of the commercial department were merged with those of the corporate department creating a corporate department. In addition the Corporate Division established a real estate department taking care of all real estate companies conducting business with the Mercantile discount Bank which includes the operations of the building projects finance department.
For details as to the possible implications of the new directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses", see Note 1 C to the condensed financial statements.
For details as to the possible implications of the new directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses", see Note 1 Y to the financial statements.

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 customers of IDB New York's commercial banking segment.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Income from financing operations amounted to NIS 624 million, compared to NIS 723 million, a decrease of 13.7%. The decline in income stemmed mainly from the decline in volume of activity.

The income of the segment in 2008 amounted to NIS 159 million compared with NIS 106 million in 2007, an increase of 50.0%. Disregarding certain components, the loss would have amounted to NIS 165 million in 2008 compared with an income of NIS 84 million in 2007, an incease of 96.4%.

The return on equity in 2008, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 10.8% in 2008 compared with 7.1% in 2007. Disregarding certain components, the return on equity would have been 11.3% in 2008 compared with 5.6% in 2007.

Provision for doubtful debts in this segment amounted in 2008 to NIS 198 million, compared with NIS 124 million in 2007, an increase of 59.7%. The increase in the provision for doubtful debts stemmed from industry and services sectors, construction and real estate industries.

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

	Domestic operations						International operations			
	Banking and finance	Credit cards	Capital market	Construction and real estate	Mortgage	Total	Banking and finance	Construction and real estate	Total	Total
	For the year ended December 31, 2008									
Income from financing activities before provision for doubtful debts										
- From external sources	532	3	1	117	7	660	124	14	138	798
- Intersegmental	(269)	-	-	(58)	(5)	(332)	110	48	158	(174)
Total income from financial activity	263	3	1	59	2	328	234	62	296	624
Operating and other income	105	33	20	13	1	172	153	29	182	354
Total Income	368	36	21	72	3	500	387	91	478	978
Provision for doubtful debts	146	-	-	13	6	165	14	19	33	198
Operating and other expenses	346	25	18	22	-	411	172	50	222	633
Operating Income (loss) before taxes	(124)	11	3	37	(3)	(76)	201	22	223	147
Provision for taxes on operating income	(51)	2	1	13	(1)	(36)	20	1	21	(15)
Net income	(73)	6	2	24	(2)	(43)	181	21	202	159
Net income disregarding certain components[(1)]	(68)	5	2	24	(2)	(39)	182	22	204	165
Return on equity (percentage)	(13.4)	81.9	0.0	15.9	(19.4)	(5.8)	38.5	7.6	27.5	10.8
Return on equity disregarding certain components[(1)] (percentage)	(12.5)	69.0	0.0	16.1	(19.4)	(5.2)	38.9	7.8	27.7	11.3
Average Assets	8,754	112	1	2,032	149	11,048	6,189	2,697	8,886	19,934
Average Liabilities	4,702	324	-	439	-	5,465	2,256	1,558	3,814	9,279
Average Risk-assets	8,474	119	1	2,492	143	11,229	7,235	4,034	11,269	22,498
Average assets of provident and mutual funds	-	-	193	-	-	193	-	-	-	193
Average customers' securities	-	-	9,510	-	-	9,510	-	-	-	9,510
Average other assets under management	924	-	533	-	-	1,457	-	-	-	1,457
Components of income from financial activities:										
Margin from credit activity	194	3	-	44	1	242	189	58	247	489
Margin from deposits activity	33	-	-	3	-	36	45	2	47	83
Other	36	-	1	12	1	50	-	2	2	52
Income from financing activities before provision for doubtful debts	263	3	1	59	2	328	234	62	296	624

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 finance	Credit cards	Capital market	Construction and real estate	Mortgage	Total	Banking and finance	Construction and real estate	Total	Total
	For the year ended December 31, 2007									
Income from financing activities before provision for doubtful debts										
- From external sources	668	5	2	126	38	839	240	158	398	1,237
- Intersegmental	(391)	(1)	-	(59)	(26)	(477)	2	(39)	(37)	(514)
Total income from financial activity	277	4	2	67	12	362	242	119	361	723
Operating and other income	114	26	26	11	2	179	30	20	50	229
Total Income	391	30	28	78	14	541	272	139	411	952
Provision for doubtful debts	100	-	-	10	(1)	109	9	6	15	124
Operating and other expenses	341	21	14	23	1	400	217	89	306	706
Operating Income (loss) before taxes	(50)	9	14	45	14	32	46	44	90	122
Provision for taxes on operating income	(25)	3	6	17	4	5	21	17	38	43
Net income	(25)	4	37	28	10	54	25	27	52	106
Net income disregarding certain components[1]	(31)	4	8	27	10	18	35	31	66	84
Return on equity (percentage)	(4.6)	50.5	0.0	18.4	29.4	7.2	5.6	9.4	7.1	7.1
Return on equity disregarding certain components[1] (percentage)	(5.7)	50.1	0.0	18.3	29.4	2.5	7.7	10.6	8.8	5.6
Average Assets	9,395	111	1	1,971	545	12,023	5,477	3,692	9,169	21,192
Average Liabilities	5,869	308	-	411	-	6,588	6,697	824	7,521	14,109
Average Risk-assets	8,508	109	1	2,389	519	11,526	6,973	4,347	11,320	22,846
Average assets of provident and mutual funds	-	-	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 financial activities:										
Margin from credit activity	213	4	-	50	9	276	151	103	254	530
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	4	2	67	12	362	242	119	361	723

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 1,120 (of which 299 are managerial positions), 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 1,306 positions in 2007, a decrease of 14.2%.

SERVICE TO SEGMENT CUSTOMERS

The commercial banking segment enjoys professional banking services provided through the Commercial Department in 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, which are located at the business centers, while assisted by the branch layout.

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").

DEVELOPMENTS IN THE SEGMENT'S MARKETS

Since the second half of 2008, activity in the sector's environment has deteriorated, reflected in the increase in the segment's customers' risk profile, generally constituting companies with a medium to low scale of operations.

Following are the main developments:

- A decrease in the volume of demand on the local and foreign markets, against the background of the slowdown in local private consumption and in the volume of international trade;
- A decline in the scale of operations of the segment's customers reflected in the decrease in volume of production and inventory levels, with erosion in operating profit margins;
- Difficulties in obtaining credit from the banking industry for the continued support of the proper current operations, alongside the decline in availability of off-banking financing sources;
- As a result of the increase in the risk profile of segment customers and the declining competition against the off-banking market, the credit spreads and operating commissions have increased.

For details as to the possible implications of the new directive in the matter of "measurement and disclosure of delinquent debts, credit risk and provision for credit losses", see Note 1 Y (3) to the financial statements.

PRIVATE BANKING SEGMENT

SEGMENT CUSTOMERS

This segment includes, as part of the Bank's domestic operations customers of the Bank's Retails Division (individuals and corporations), who maintain their accounts at 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 and the London branch of medium and high wealth and all the activity of IDB (Swiss) Bank and the private banking customer activity at IDB New York, including all the operations of the subsidiary Discount Bank Latin America.

STRUCTURE OF SEGMENT

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, acording 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.

STRATEGIC EMPHASES

In the international private banking arena emphasis is placed on initiated professional and specialized service, to wealthy customers, 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 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 2008 amounted to NIS 173 million compared with NIS 43 million in 2007, an increase of 302.3%. Disregarding certain components (see hereunder), net income would have amounted to NIS 177 million in 2008 compared with NIS 35 million in 2007, an increase of 405.7%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 61.2% in 2008 compared with 16.9% in 2007. Disregarding certain components (see hereunder), the return on equity would have been 62.4% in 2008 compared with 14.0% in 2007.

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

	Domestic operations			International operations			
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	Total
	For the year ended December 31, 2008						
Income from financing activities before provision for doubtful debts							
- From external sources	(58)	1	(57)	452	-	452	395
- Intersegmental	165	-	165	(223)	-	(223)	(58)
Total income from financial activity	107	1	108	229	-	229	337
Operating and other income	38	38	76	135	62	197	273
Total Income	145	39	184	364	62	426	610
Provision for doubtful debts	-	-	-	7	-	7	7
Operating and other expenses	128	36	164	204	39	243	407
Operating Income (loss) before taxes	17	3	20	153	23	176	196
Provision for taxes on operating income	11	2	13	9	1	10	23
Net income	6	1	7	144	22	166	173
Net income disregarding certain components[(1)]	7	2	9	146	22	168	177
Return on equity (percentage)	10.7	-	13.2	65.3	0.0	75.1	61.2
Return on equity disregarding certain components[(1)] (percentage)	12.4	-	15.3	66.2	0.0	76.1	62.4
Average Assets	1,631	6	1,637	2,909	-	2,909	4,546
Average Liabilities	18,982	-	18,982	15,875	-	15,875	34,857
Average Risk-assets	1,382	6	1,388	2,985	-	2,985	4,373
Average assets of provident and mutual funds	-	294	294	-	-	-	294
Average customers' securities	-	8,105	8,105	-	7,928	7,928	16,033
Average other assets under management	(0)	1,081	1,081	115	-	115	1,196
Components of income from financial activities:							
Margin from credit activity	22	-	22	67	-	67	89
Margin from deposits activity	99	-	99	162	-	162	261
Other	(14)	1	(13)	-	-	-	(13)
Income from financing activities before provision for doubtful debts	107	1	108	229	-	229	337

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

	Domestic operations			International operations			
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	Total
	For the year ended December 31, 2007						
Income from financing activities before provision for doubtful debts							
- From external sources	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 (loss) before taxes	21	14	35	20	13	33	68
Provision for taxes on operating income	7	6	13	22	3	25	38
Net income	14	21	35	(2)	10	8	43
Net income disregarding certain components[1]	9	9	18	6	11	17	35
Return on equity (percentage)	43.5	0.0	109.7	(0.8)	0.0	3.4	16.9
Return on equity disregarding certain components[1] (percentage)	32.5	0.0	59.0	2.7	0.0	7.5	14.0
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	-	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 financial activities:							
Margin from credit 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

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 606 (of which 164 are managerial positions), including positions of employees directly related to the segment and positions of staff members whose salaries are

attributed to the segment compared with 542 positions in 2007, an increase of 11.8%. 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 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 2008, 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 Department also acts towards involvement in Jewish communities abroad, while maintaining close relations with local organizations. 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.

DEVELOPMENT IN THE SEGMENT'S MARKETS AND COMPETITION

Customers of the private banking segment are exposed to a variety of financial investment products.

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.

For details as to the legislation regarding bank commissions and its implications, see above.

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 activity with the dealing room). These activities are mainly comprised of for their own account operations of the Bank, Mercantile Discount Bank and IDB New York 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 investments made by the subsidiary Israel Discount Capital Markets and Investments ("DCMI") and by the Bank directly.

DEVELOPMENT IN THE SEGMENT

Developments in the "nostro" portfolio. For details regarding the Bank's "nostro" portfolio and developments therein, including particulars concerning the impairment of available-for-sale securities and concerning the Bank's investments in asset-backed securities, see above "Securities" under "Development of assets and liabilities" and Note 3 to the financial statements.

Banks within the Palestinian Authority. For details regarding the cessation of representation services and clearing transfers from the Gaza Strip, see "Prohibition of money laundering and prohibition of financing of terror" under "Legislation and supervision" hereunder.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net loss of the segment, in 2008 amounted to NIS 651 million compared with NIS 128 million in 2007. Disregarding certain components (see hereunder), the net loss would have amounted to NIS 446 million in 2008 compared with NIS 14 million in 2007.

Total revenues amounted in 2008 to a negative amount of NIS 329 million, of which a negative amount of NIS 23 million from domestic activity, compared with NIS 381 million in 2007, of which NIS 108 million from domestic activitiy, and they include three major components:

1. Earnings from operations in the "Nostro" portfolio in Israel in the amount of NIS 71 million, of which NIS 34 million from earnings on the sale of securities and from adjustments to fair value of trading securities, compared with NIS 58 million "Nostro" earnings in 2007, of which NIS 48 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 94 million in 2008, compared with a net loss of NIS 50 million in 2007.
3. Net loss on international operations in the amount of NIS 306 million, compared to earnings in the amount of NIS 273 million in 2007.

The return on equity in 2008, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was a negative rate of 38.8% in 2008, compared with a negative rate of 5.6% in 2007. Disregarding certain components (see hereunder), the return on equity would have reached a negative rate of 26.6% in 2008, compared with a negative rate of 0.6% in 2007.

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, 2008			For the year ended December 31, 2007		
Income from financing activities before provision for doubtful debts	44	1	45	110	246	356
Operating and other income	(67)	(307)	(374)	(2)	27	25
Total Income	(23)	(306)	(329)	108	273	381
Provision for doubtful debts	-	10	10	1	6	7
Operating and other expenses	422	77	499	430	80	510
Operating Income (loss) before taxes	(445)	(393)	(838)	(323)	187	(136)
Net income	(279)	(372)	(651)	(171)	43	(128)
Net income disregarding certain components[1]	(221)	(225)	(446)	(60)	46	(14)
Return on equity (percentage)	(21.1)	(109.0)	(38.8)	(9.4)	8.9	(5.6)
Return on equity disregarding certain components[1] (percentage)	(16.7)	(67.6)	(26.6)	(3.3)	9.7	(0.6)
Average Assets	42,098	15,854	57,952	45,754	19,351	65,105
Average Liabilities	13,768	10,455	24,223	14,829	6,531	21,360
Average Risk-assets	9,082	5,493	14,575	10,680	7,252	17,932

HUMAN CAPITAL

In 2008, the average number of positions in the segment amounted to 942 (of which 182 are managerial positions), 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 895 position in domestic operations, compared with 862 positions as aforementioned in 2007, an increase of 9.3%.

TEL AVIV TREASURY

A global treasury unit was established at the headquarter offices in Tel Aviv in the course of 2007, which is intended to implement the group management strategy and within its framework will concentrate all the dealing room operations and the asset and liability management of the Bank. Cooperation between the Group companies and the Bank in the areas of liquidity management and capital management was strengthened in the course of 2008.

Dealing room. The 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.

As part of the reorganization carried out by the Bank all dealing room operations in foreign and Israeli securities, foreign currencies and corporations are concentrated in one place. The objective of the change is to provide the customer an

array of all commercial services he requires under one roof. Alongside the improved level of service to the customer, this move creates a synergy between all areas of trade at the Bank, savings in costs and elimination of duplicity of processes, infrastructure and manpower. As part of the change, the Middle Office Unit and the Back Office Unit will serve all Bank customers who transact business in financial instruments and on the capital market.

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.

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.

Risk and liability management. The main areas of activity in the management of assets and liabilities are the management of capital, liquidity, exposure to base and interest risks inherent in the balance sheet, management of the available-for-sale securities portfolio, management of the financial spread and determination of transfer prices.

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 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. For further details, see "Operations in the capital market" under "Further details as to activity in certain products" hereunder. "Reform in the structure of the capital market and in the activity of the banks and other players in the capital field" under "Legislation and supervision" hereunder.

BUSINESS STRATEGY AND TARGETS

The strategic plan of the finance division for the coming years includes the continued absorption of the global treasury strategy, which was formed in 2007, with a view of professionally concentrating the activity in assets and liabilities and activity of dealing rooms of the comprehensive Group (in Israel, New York and Switzerland).

And this, mainly in the areas of capital management, liquidity management, exposure to base and interest risks management and management of the "nostro" securities portfolio.

Furthermore, in 2009 the Bank plans to convene a Group assets and liabilities committee ("GALCO"), for risk management at a Group level and for the promotion of cooperation between the dealing rooms of the Group, both on the business level and the technological level.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 undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd. (hereinafter: "DCMI"), as well as direct investments by the Bank itself.

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, 2008, the amount of the Bank's investment in non-financial corporations was less than the amount of the above restriction.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

The loss of the sub segment in 2008 amounted to NIS 196 million, compared with an income of NIS 19 million in 2007. Disregarding certain components (see hereunder), the loss would have amounted to NIS 75 million in 2008, compared with an income of NIS 20 million in 2007.

The return on equity in 2008, calculated on the capital allocated to the sub-segment on the basis of the average balance of sub segment risk assets reached a negative rate of 249.3% in 2008, compared with 29.9% in 2007. Disregarding certain components (see hereunder), the return on equity would have reached a negative rate of 96.2% in 2008, compared with 31.5% in 2007.

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

	For the year ended December 31	
	2008	2007
Income from financing activities before provision for doubtful debts	(55)	(36)
Operating and other income	(32)	32
Total Income	(87)	(4)
Operating and other expenses	4	4
Operating Income (loss) before taxes	(91)	(8)
Bank's share in operating income of affiliated	(115)	21
Net income	(196)	19
Net income disregarding certain components[1]	(75)	20
Return on equity (percentage)	(249.3)	29.9
Return on equity disregarding certain certain components[1] (percentage)	(96.2)	31.5
Average Assets	1,206	958
Average Liabilities	684	248
Average Risk-assets	1,206	958

HUMAN CAPITAL

In 2008, 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, similar to 2007.

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.** The activity 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.

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 DCMI 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 comitments in the fund reached US$16 million, of which US$13.3 million had already been invested by December 31, 2008. 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 comitments is due to reach US$8.1 million. As of December 31, 2008, 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 the dissolution process which has begun in accordance with the partnership agreement.

Vertex Israel II Venture Capital Fund. The size of the fund is US$160 million, and DCMI's share in the investment comitments in the fund is due to reach US$15 million. As of December 31, 2008, DCMI had invested the full amount to which it is committed.

Vertex Israel III Fund. This funds size is US$150 million, and DCMI's share will reach US$13.5 million. As of December 31, 2008, DCMI had invested an amoun of US$7.8 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, 2008, DCMI had invested an amount of US$9.6 million in this fund.

FIMI Opportunity II Fund. The Fund reaches a total of approximately US$293 million. DCMI's share in the investment comitments in the fund will reach US$50 million, of which an amount of US$36.9 million has been invested up to December 31, 2008.

FITE - First Israel Turnaround Enterprise Fund. The size of the fund is US$129 million, and DCMI's share in the investment comitments in the fund is due to reach US$12.5 million. Up to December 31, 2008, the Bank had invested US$3.1 million in the fund. The outstanding commitment for investment in the Fund has been transferred to FIMI Opportunity IV Fund, which began operations at the beginning of 2008 (see below).

FIMI Opportunity IV Fund. The volume of the Fund is approximately US$509 million. DCMI's share in the investment commitments in the Fund amounts to US$50 million. US$7.3 million have been invested in the Fund until December 31, 2008, including the outstanding investment commitment transferred from the FITE Fund (see above).

Golden Gate Bridge Fund. The fund 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 2008.

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, 2008 DCMI had invested an amount of US$3.2 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 2006 and 2008, the fund's volume reached US$46 million. DCMI's share is due to reach US$17.8 million, of which US$13.9 million had been invested by the end of 2008.

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$3.5 million had been invested by the end of 2008.

Edmond de Rothschild Europporties Fund. This fund is a member of the Rothschild Group. The size of the fund is Euro 100 million. During 2008, DCMI committed to invest Euro 11.3 million in this fund. As of December 31, 2008, Euro 8.9 million was invested.

Investment in Apax VII Fund. DCMI committed to invest Euro 7.4 million in the Fund, which amounts to Euro 10 billion. The Fund is a European private equity fund in the Apax Group, and is expected to operate mainly in Europe. Until December 31, 2008, DCMI invested an amount of €3.2 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, 2008 DCMI invested a total of US$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 at inception directed its investments towards real estate projects in India and China. Following the global crisis, the fund has changed its investment policy and now focuses on investments in the USA and Canada. The expected volume of the fund is US$110 million. Up until December 31, 2008, DCMI invested US$1.8 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, 2008, DCMI invested an amount of €4.1 million in the said Fund.

Fortissimo Fund II. In October 2008, DCMI committed to invest US$20 million in this fund. The fund is a "turn around" fund for technology based developed companies. The scope of the fund amounts to US$100 million. Up to December 31, 2008 DCMI invested an amount of US$2 million in the Fund.

The outstanding balance of DCMI's investments in venture capital funds and in private equity funds amounted on December 13, 2008 to US$116.7million. As of that date, the balance of DCMI's investment commitments amounted to US$118.9 million.

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$22.7

million, of which US$18.6 million had been invested by December 31, 2008.

Furthermore, Mercantile Discount Bank is committed to investments in five venture capital funds. As of December 31, 2008, the investment of Mercantile Discount Bank in these funds amounted to US$3.5 million. As of December 31, 2008, the maximum commitment for the future investments in these funds amended to US$0.6 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 (Kesher) 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 subject to the commitment of the Mayer Group to make a parallel investment an amount of up to Euro 160 million in Mayer Real Estate and an amount of up to Euro 120 million in Mayer Europe. Until December 31, 2008, DCMI invested €9.7 million in Mayer Real Estate Ltd. and an amount of €1.4 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.

The investment in the said companies entitles DCMI to an equity interest of 20% and to the right to appoint one of five Directors in each of these companies.

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 Esate 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 relatied to the trading, leasing, rental etc. of private vehicles in Europe.

As from the third quarter of 2008, Mayer Europe did not make any investments and to the best knowledge of DCMI and the Bank, Mayer Europe does not intend to make any additional investments.

The principal investment in Mayer Real Estate is in respect of the holdings in Habbas Star, a Dutch Reit owning income generating real estate in Western Europe.

Investment in "KFS". On December 30, 2007, DCMI Kardan Financial Services BV (hereinafter: "KFS") and Kardan NV (hereinafter: "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 Bank provided KFS with a credit facility of up to €225 million. The credit is provided in installments, for various periods and subject to compliance with certain conditions as determined in the agreement between the parties. The balance of credit provided by the Bank as of December 31, 2008, amounted to €236.2 million. A significant part of the credit is secured by collateral that is not related to the activities of KFS or to the areas in which it operates.

The valuation of KFS was updated in November 2008, according to which, the updated value of the company amounts to €451 million, compared to €505 million following the acquisition of Discount Group's holdings in the company, a decrease of 11%.

The investment has been reduced in the financial statements as of September 30, 2008, in accordance with the said valuation. The effect of this reduction, net of the current amortization of the excess of cost (in the amount of NIS 15 million) in the period since acquisition of the holdings in this company, amounted to NIS 10 million.

The original investment in KFS amounted to NIS 316 million.

On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of it holdings in the shares of KFS in consideration for €38.5 million. This amount is to be paid as follows: An amount of €30 million will be paid upon signing the agreement and an amount of €8.5 million is payable at the end of seven years from date of the agreement, without interest. In view of the above, Discount Capital Markets adjusted the value of this investment on its books to the value of the sale consideration. In total, an amount of NIS 85 million was recorded in 2008 in respect of impairment

of this investment. At the same time, DCMI signed an option agreement for the purchase of 5% of the share capital of KFS by way of an issue of shares. The Option is exercisable within six years from date of signing the agreement, at an exercise price of €386 million together with interest of 5% per annum to accumulate as from the third year since the signing of the agreement (subject to adjustments specified in the agreement). The option is exercisable at any time within the said period of six years, unless this period is shortened following the listing for trade of the KFS shares or another event of their sale (as these are specified in the option agreement). If and when DCMI exercises the option, then it will be entitled to rights including a "tag along" right in the case of sale of a controlling interest by Karden and the right to participate in future allotments of shares. The shares of DCMI are also subject to the right of first refusal by Karden, and all subject and in accordance with the terms prescribed in the option agreement.

At this stage, being cautious, the Bank did not take into account, in computing the provision for impairment, the economic value attributed to the option and the matter is to be examined as part of the preparation of the financial statements for the first quarter of 2009, in which the sale will be recognized.

In addition to the above, the Bank has approved a new credit facility to the Karden Group in amounts exceeding the said consideration amount.

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 46.2 million.

In July 2007, DCMI signed an agreement for the acquisition of control in Menif, in consideration for an immaterial amount. Under this agreement DCMI committed to provide additional guarantees with respect to construction projects, to replace the guarantees given by the seller (an additional facility of US$17.3 million, of which an amount of NIS 33 million had already been granted).

Consummation of the transaction was 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 negotiated with the Seller as to the amendment for the purchase of his rights in Menif.

An amendment to the share purchase agreement was signed in August 2008, subject to the fulfillment of several conditions by September 7, 2008 and subject to obtaining the approval of the Bank of Israel and the Antitrust Commissioner until December 15, 2008. Subsequent to this date, each of the parties is entitled to terminate the agreement. As of a date proximate to date of issue of these financial statements, all conditional provisos in the agreement had been fulfilled, with the exception of the approval of the Bank of Israel which is still pending.

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 was expected to engage in initiation of rental real estate projects in Eastern Europe. In May 2007, Europort issued bonds to the public in a total amount of NIS 57 million, to finance its operations. According to Europort's financial statements for 2008, it had began promoting one project in Eastern Europe, however, it is uncertain whether Europort will be able to raise additional finance for the continuation of the project.

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 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 78% of the adult population in Israel uses credit cards as an instrument of payment, the Israeli consumer holding on an average of 2 credit cards. ICC also estimates that as of December 31, 2008, approximately 6 million credit cards were issued in Israel (of which, according to ICC's data, 80% 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.

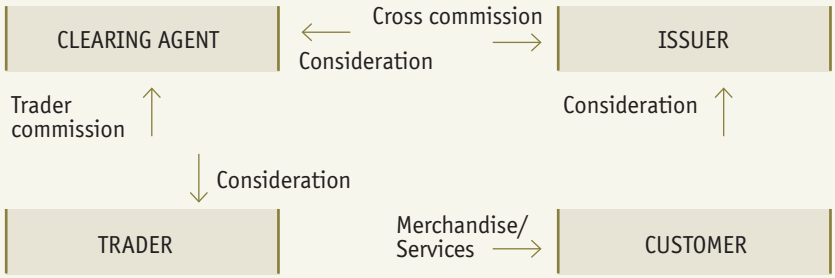
Accordingly, customers can conduct transactions with a large number of traders and traders can sell their goods or services to a large number of customers.

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 directly issues, markets and operates credit cards of the "VISA", "Diners" and "MasterCard" types, valid in Israel and abroad, and also has joint issue agreements with banks that participate in the arrangement.

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 (hereinafter - "off-banking cards"). 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 discounting credit card slips, advancing payments in respect of transactions made and the granting of loans on account of future payments to traders with whom ICC has clearing agreements.

Possible changes in the business environment. The outcome of the global financial crisis only had a partial effect on the financial results of ICC, particularly in the fourth quarter of the year. The Bank and ICC believe that with the progress of the crisis, it will have implications on the credit card industry in Israel, which will be reflected in declining turnover of credit card transactions and in an increase in loss rates.

Following are quantitative data regarding the activity of ICC:

Number of valid cards[3]				
	As of December 31,			
	2008		2007	
	The total number of cards	Of which: active cards	The total number of cards	Of which: active cards
	in thousands			
Bank cards[1]	993	842	960	829
Off-banking cards[2]	506	401	446	360
Total	1,499	1,243	1,406	1,189

Transactions turnover[4]		
	For the year ended December 31,	
	2008	2007
	in NIS millions	
Bank cards	32,917	30,918
Off-banking cards	8,365	7,705
Total	41,282	38,623

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.
(5) "Active card" - a credit card through which at least one transaction was made in the last quarter.

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 60,000 traders and marketing chains in Israel enable purchases through credit cards.

Net income from the operations in 2008 amounted to NIS 234 million, compared with NIS 120 million in 2007, an increase of 95.0%. Disregarding certain components (see hereunder), net income would have amounted to NIS 143 million in 2008, compared with NIS 118 million in 2007, an increase of 21.2%.

The return on equity was 55.8% in 2008, calculated on the capital allocated to the operations on the basis of the average balance of the operations risk assets, compared with 32.5% in 2007. Disregarding certain components (see hereunder), the return on equity would have been 34.1% in 2008, compared with 32.0% in 2007.

Provision for doubtful debts amounted in 2008 to NIS 51 million, compared with NIS 41 in 2007, an increase of 24.4%.

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

	Domestic operations				
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
	For the year ended December 31, 2008				
Income from financing activities before provision for doubtful debts					
- From external sources	222	13	10	3	248
- Intersegmental	(59)	1	-	-	(58)
Total income from financial activity	163	14	10	3	190
Operating and other income	699	102	106	33	940
Total Income	862	116	116	36	1,130
Provision for doubtful debts	51	-	-	-	51
Operating and other expenses	481	77	79	25	662
Operating Income (loss) before taxes	330	39	37	11	417
Provision for taxes on operating income	84	11	9	2	106
Net income	191	20	17	6	234
Net income disregarding certain components[1]	106	18	14	5	143
Return on equity (percentage)	50.4	88.5	218.8	81.9	55.8
Return on equity disregarding certain components[1] (percentage)	28.1	79.2	179.4	69.0	34.1
Average Assets	6,948	239	316	112	7,615
Average Liabilities	833	1,197	1,554	324	3,908
Average Risk-assets	5,858	356	121	119	6,454
Components of income from financial activities:					
Margin from credit activity	160	14	10	3	187
Other	3	-	-	-	3
Income from financing activities before provision for doubtful debts	163	14	10	3	190

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

	Domestic operations				
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
	For the year ended December 31, 2007				
Income from financing activities before provision for doubtful debts					
- From external sources	184	16	12	5	217
- Intersegmental	(55)	-	-	(1)	(56)
Total income from financial activity	129	16	12	4	161
Operating and other income	580	68	80	26	754
Total Income	709	84	92	30	915
Provision for doubtful debts	41	-	-	-	41
Operating and other expenses	437	60	67	21	585
Operating Income (loss) before taxes	231	24	25	9	289
Provision for taxes on operating income	91	10	11	3	115
Net income	97	10	9	4	120
Net income disregarding certain components[1]	96	9	9	4	118
Return on equity (percentage)	29.2	46.1	116.6	50.5	32.5
Return on equity disregarding certain components[1] (percentage)	28.8	45.3	116.5	50.1	32.0
Average Assets	6,027	237	313	111	6,688
Average Liabilities	699	1,179	1,529	308	3,715
Average Risk-assets	5,123	320	121	109	5,673
Components of income from financial activities:					
Margin from credit activity	126	16	12	4	158
Other	3	-	-	-	3
Income from financing activities before provision for doubtful debts	129	16	12	4	161

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 including various directives issued by the Supervisor of Banks.

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 applied 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. The steps that ICC is required to perform following the application of the Order prolong the process of enrolling 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, 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.

Credit Cards Law Amendment, 1986. In August the credit card law was amended. The amendment came into effect in December 2008. Within the framework of the amendment, Section 10 of the Law, dealing with default on a deferred payment transaction has, among other things, been expanded to also apply to cash transactions, and this Section has also now been applied automatically to cases where the issuer receives notice of bankruptcy of the trader. In addition, the dates prescribed by the Law for crediting the customer have been shortened and the protection granted to a holder of a credit card in case of misuse has been expanded. Furthermore, the amendment entitles customers to instruct the credit card company to immediately stop charging them with respect to standing payment orders by means of the card.

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.

In the wake of the said Inter-ministerial Committee and a private Bill which followed it, the Ministry of Finance issued in April 2008 a law memorandum, the principal provisions thereof are:

- A requirement to obtain a license from the Governor of the Bank of Israel in order to perform the clearing of charge cards transactions;

- The Supervisor of Banks shall be authorized to determine that a clearing agent, who together with its subsidiaries and parent company, cleared at least 20% of the total amount of transactions or of the total number of transactions effected in Israel in a calendar year, shall be considered a "major clearing agent", and to compel such major clearing agent to enter into a cross clearing agreement with credit card issuers for the clearing of cards issued by them;
- The Supervisor of Banks shall be authorized to determine that an issuer who, together with its subsidiaries and parent company, issued at least 10% of the number of credit cards issued in Israel in a calendar year, shall be considered a "major issuer", and to compel such major issuer to enter into a cross clearing agreement with clearing agents for the clearing of cards issued by it;
- The cross commission will be considered a controllable commission under the Banking Law (Service to customer);
- Various provisions of the Banking Ordinance shall apply to the holder of a clearing license.

ICC and the Bank are of the opinion that at this stage it is not possible to evaluate the impact of the law, if passed, on the credit card activity.

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 issuence 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. ICC completed in 2007 the preparations for the issuance of the "smart cards", and began issuing them in 2008, though on a limited scale at this stage.

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 four years to complete. During 2008, ICC made progress with the examination process, and it expects to reach a decision in the course of 2009.

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. ICC also engages in providing discounting services to traders, by discounting installment transaction vouchers as well as regular transaction vouchers.

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 and MasterCard credit cards and Diners credit cards (through Diners, exclusively);
- **IsraCard,** which clears IsraCard (exclusively), "American Express" (exclusively), MasterCard and Visa;
- **LeumiCard,** which clears VISA and MasterCard 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 ofLeumiCard) 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 (for further details see below).

DEVELOPMENTS IN THE SEGMENT IN 2008

A joint issuance agreement with Mizrahi-Tefahot Bank. On November 18, 2008, ICC and Diners signed an agreement with Mizrahi-Tefahot Bank for the joint issuance of VISA, MasterCard and Diners Club credit cards, including Mizrahi-Tefahot branded cards, and for determining operating arrangements and providing services by ICC and/or Diners for credit cards issued by them and distributed by Mizrahi-Tefahot Bank to its customers. This agreement replaces the

agreement between the parties dated July 26, 1995, as amended.

The agreement is for a period of five years from date of signature. In the event that the option for the purchase of ICC shares described hereunder is exercised or redeemed, the period of the agreement will be extended to ten years from date of signature. The agreement period will be extended by additional periods of two years, unless a notice in writing is given by one party to the other, six months prior to the end of each period or additional period, of its reluctance to further extend the period of the agreement.

The grant of an option to Mizrahi-Tefahot Bank to purchase up to 10% of ICC's share capital. Within the framework of the joint issuance agreement described above, Mizrahi-Tefahot Bank was granted an option to purchase from ICC, by way of a share issue, up to 121,978 ordinary shares in ICC, comprising at date of the agreement, 10% of the fully diluted ordinary share capital of ICC. The amount of shares allotted may be higher in the event that prior to the exercise of the option, ICC will issue shares at a price reflecting a value lower than market, in accordance with the formula determined in the agreement. Furthermore, the number of shares may vary respectively, in the event that ICC decides to carry out a reverse split of its ordinary shares into shares having a higher par value or to split its ordinary shares into shares having a lower par value, or decides to distribute bonus shares, all this from date of signing the agreement and until a date prior to the exercise date of the option.

The option is exercisable in one lot no later than five years from date of the agreement (or, under certain circumstances, during a slightly longer period) at any time after the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers reaches the minimum amount stated in the agreement. The number of ordinary shares to be allotted within the framework of the exercise of the option shall be computed according to a formula determined in the agreement, which is effected by the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers and to the increase in volume of transactions on the bank credit card market in Israel.

In consideration for the exercise of the option, Mizrahi-Tefahot Bank will pay an exercise price in accordance with a formula determined in the agreement, which reflects ICC's present company value and is effected by the net accumulated earnings of ICC in the last four calendar quarters ending prior to the date of the agreement, less the contribution to the profitability to ICC of the cards issued to customers of Mizrahi-Tefahot Bank, as well as subject to a profit multiplier of 12 and certain additional adjustments.

The option may be converted into a cash payment to Mizrahi-Tefahot Bank, if difficulties arise in the exercise of the option by way of allotment of ICC shares, as stated, or if ICC elects to redeem the option in consideration for a payment. Redemption of the option shall be effected by a payment computed according to a formula determined in the agreement, which reflects the future company value of ICC and is subject to the net earnings of ICC (excluding nonrecurring items and capital gains/losses) in the last four calendar quarter ending prior to the date of notice of exercise and a profit multiplier of 12 (or a multiplier derived from the value of ICC on the market, if it is listed for trade prior to the date of exercise of the option, but not higher than a multiplier of 14) and net of the exercise price as stated. The amount to be paid for the redemption of the option shall not exceed an amount of between NIS 85 and NIS 100 million (such maximum amount shall be determined on the basis of the volume of the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers in the three calendar months preceding the notice of redemption).

The agreement is subject to all regulatory requirements under any law, if such exist.

Public share issue by VISA International. VISA International decided in 2007 on a structural change and the offer of its shares to the public. The public offering of shares on the Stock Exchange in the United States was effected in the first quarter of 2008. ICC is a member of the VISA Europe organization, which remained a not-for-profit organization. VISA Europe received part of the proceeds of the share issue of VISA International. VISA Europe has distributed the

proceeds to member companies of the organization, including the Bank and ICC.

On October 17, 2008, the special meeting of shareholders and the Board of Directors of Visa Europe approved the final distribution of the proceeds of the securities offering. Accordingly the Bank received a cash amount of approximately US$4.4 million as well as 54.6 thousand shares of Visa Inc. On the said date ICC received a cash amount of US$16 million as well as 201 thousand shares. The said shares are locked-up until March 25, 2011. Income in a total amount of NIS110 million, as above, was recognized in the last quarter of 2008.

Transfer of ownership in Diners International. In April 2008, Citibank informed that a transaction had been signed for the sale of Diners International shares to the credit card company of Discover Financial Services (hereinafter: "Discover"). This acquisition will increase the share of Discover in the international and U.S. credit card market. Discover is a credit card company with a well known and leading brand name in the U.S. financial market. The transaction was completed in July 2008. The said transaction has had no effect upon the activity of Diners Club Israel Ltd.

A joint issuance agreement between ICC and the Bank. As of date of approval of the financial statements, ICC and the Bank are conducting negotiations regarding the change in the agreement conditions.

MATERIAL AGREEMENTS

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. At this stage, the "YOU Club" activity has not reached the level specified 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. On October 31, 2006 the Antitrust Court issued a provisional permit for the agreement. As part of the preliminary hearing of the opposing motions the Antitrust Court ruled on November 11, 2007, to appoint an expert whose task 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 Court has decided that the expert shall perform the examination in accordance with the methodology determined in previous proceedings to which the Bank and ICC were parties, the expert being appointed and supervised by the Antitrust Authority. On September 25, 2008, the Commissioner with the consent of all the parties, applied for an extension of 60 days, until the end of December 2008, for submitting the expert's interim report.

On July 6, 2008, the Commissioner approved the request for extension until the end of February 2009 of the temporary permit to the agreement, submitted by the credit card companies and the banks as shareholders of the credit card companies.

On July 9, 2008, the Antitrust Court extended the validity temporary permit until February 28, 2009. The Court dismissed the motion of the Opponents for retroactive compensation and determined that the difference between the rates of commission specified in the temporary permit and the rates of commission to be determined by the Court at the end of the proceedings may be taken into consideration by the Court in giving its ruling as regards the terms for approval of the continued existence of the arrangement.

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

In accordance with the Court's ruling of January 12, 2009, ICC, the Bank and the First International Bank informed the Court on February 11, 2009 of their intention to interrogate the Expert with respect to his opinion concerning the computation of the issuer commission rate.

On January 28, 2009, the three credit card companies and the banks owning shares therein, submitted a motion for the extension of the validity of the provisional permit until April 30, 2009. and the provisional permit has been extended accordingly.

Joint enterprise 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. In January 2008, the Antitrust Commissioner's approval was received and in February 2008 this activity went into operation as a club within ICC.

DEVELOPMENTS IN THE SEGMENT IN 2009

Acquisition of factoring operations. On January 5, 2009, ICC signed an agreement for the purchase of the factoring operations of Psagot Factoring Finance Company in consideration for NIS 1 million. The purchased operations will be conducted under a new company (hereinafter: "ICC Factoring") jointly owned by ICC (57%) and Psagot Factoring Finance (25%). According to the agreement, ICC will provide ICC Factoring with a credit facility in an amount not to exceed NIS 200 million.

Consummation of the transaction is subject to certain conditions precedent, including the obtaining of regulatory

approvals, as stated in the agreement.

At the end of three years from date of consummation of the transaction and at the end of four years from that date, ICC will have the right to purchase within twelve months, the full interest of Psagot Factoring Finance in the joint company in accordance with an exercise formula (hereinafter: "the Call option"). To the extent that the Call option is not exercised, then at the end of five years from date of consummation, Psagot Factoring Finance will have the right to obligate ICC within twelve months to buy its full share in the joint company (hereinafter: "the Put option").

The said acquisition will provide ICC with a direct entry into the factoring market, thus expanding its operations in the off-banking business credit market.

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 VISA International Service Association, 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 Diners Club International Ltd., and for the operating of issuance and clearing services of Diners credit cards in Israel. In March 2007 an agreement was signed between Diners and Diners International, entitling Diners to sole rights in Israel until 2017.

ICC also serves as the Principal Member in MasterCard International Inc., 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 acquired ICC's shares in E.R.N. (20%), a company engaged in providing assurance of the payment of checks on the basis of a technology developed by its shareholders.

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.

TREND OF EVENTS AND DEVELOPMENTS IN THE MACRO-ECONOMIC ENVIRONMENT

Capital market. The real estate market in the United States deteriorated in the course of 2008 drawing after it the global banking industry. The deterioration reached crisis levels which had endangered the financial systems around the world and created uncertainty and an economic crisis in all sectors of economic activity around the world. Sharp drops in prices were registered on world capital markets.

Sharp drops in prices of securities was especially marked in the second half of 2008, stemming from the intensifying world financial crisis, the collapse of international financial institutions and the apprehension of intensified global recession. Despite the formation of emergency plans by various governments designed to curb the financial crisis, the reduction in interest rates, the strengthening of the U.S. dollar and the sharp drop in oil prices, the sharp drops in world leading share indices continued.

Israel's economic situation was in comparatively better, from many aspects, such as: economic growth, budget and balance of payments. However, in spite of positive data of the Israeli economy, the Tel Aviv Stock Exchanged experienced steep drops in securities prices, similar to other markets around the world.

The decline in prices resulted from a number of factors: firstly, the Israeli economy is oriented towards exports and other international operations; therefore the global crisis has an effect on the Israeli exporters. Furthermore, corporations engaged in the export of raw materials or which are related to commodity prices are affected to a large extent by the decline in commodity prices in the world that occurred during the year. Secondly, foreign investors effected realizations of their investments in the Israeli capital market. Thirdly, the crisis affecting the banking industry in the world also unsettled to a certain extent the public's confidence in the Israeli banking industry, among other things, in view of the exposure of banks in Israel to banks around the world and to complex financial products issued by various banks around the world.

Noticeable drops in prices in the said period were recorded in the Real Estate-15 Index, which dropped by 79.7%, in the Tel-Tech Index, which dropped by 64.0%, in the Finance-15 Index, which dropped by 56.2%, in the Ta-Banks Index, which dropped by 55.9%, in the Tel-Div 20 Index, which dropped by 53.7%, in the TA-100 Index, which dropped by 51.1% and in the Ma'of Index, which dropped by 46.1%.

The mutual funds market. The mutual funds market shrank in the course of 2008 by NIS 9.65 billion, from a market value level of NIS120.6 billion in December 2007 to a level of NIS 110.95 billion in December 2008, a decrease of 8.0%. During 2008, withdrawals were recorded in all types of mutual funds with the exception of the monetary mutual funds.

Assets of the monetary mutual funds rose in the said period by NIS 28.3 billion, assets of the equity funds fell by NIS 4.0 billion, assets of the bonds funds fell by NIS 26.3 billion, assets of the shekel funds fell by NIS 2.8 billion, assets of funds specializing in overseas investments fell by NIS 4.7 billion and the assets of the remaining mutual funds fell by NIS 66 million.

The provident fund market. The provident fund market sustained in 2008 a negative return at an average rate of 17.8%. This decline stems mostly from the steep drops in the various indices of the stock market in the second half of 2008. According to data published by the Capital Market Division at the Ministry of Finance, it appears that the assets of all the provident funds at the end of 2008 amounted to NIS 218,383 million, compared to NIS 278,388 million at the end of 2007, a decrease of NIS 60 billion (21.5%).

Furthermore, according to data published by the Capital Market Division at the Ministry of Finance Provident funds of the "Provident and Personal Severance Pay Funds" class had in 2008 a net negative accumulation in the amount of NIS 7,728 million. This compared to a net negative accumulation of NIS 534 million in 2007, 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 Provident Funds Law (see hereunder).

The basket certificate market. From data published by the Tel Aviv Stock Exchange, it appears that the accelerated development trend of the indices products market continued in 2008, during which 140 new series were added, similarly to the number of series in the previous year. 55 of the new series are basket certificates of equity and bond indices of various types and 85 are cover options for shares traded abroad, foreign share indices and commodity cover options.

At the end of 2008, the number of indices products traded on the Tel Aviv Stock Exchange stood at about 350 basket certificates, of which 269 basket certificates on 12 domestic indices and 60 basket certificates on international indices, 75 cover options and 6 commodity baskets.

The value of public holdings of basket certificates in November dropped to NIS 23 billion, after reaching a record high of NIS 30 billion in August and compared to NIS 26 billion at the beginning of the year.

The daily trading turnover in equity indices basket certificates amounted to NIS 380 million, and in bond indices basket certificates to NIS 200 million, comprising about 20% of the trading turnover in equity and corporation bonds securities.

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

The main restrictions that effected 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.

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 tow 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.

In August 2008, the Ministry of Finance published a law memorandum for the amendment of the law regulating the investment consulting business, the marketing of investments and the management of investment portfolios. Within the framework of the memorandum it is proposed, inter-alia, to include the basket certificates within the definition of

a financial asset, so that whoever has an "affinity" to basket certificates (within the meaning of this term in the law) shall not be permitted to act as an investment consultant.

If the said amendment is approved, the Bank will have to act towards severing its ties with companies issuing basket certificates and/or sell its holdings therein, until the year 2013. To the best of the Bank's knowledge, the proposed amendment has not yet been published as a Bill in the Official Gazette.

LEGISLATION AND REGULATION AMENDMENTS CONCERNING PENSION SAVINGS

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 starting with 2008 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 stated, as part of the updating of the strategic focus points for 2009, it has been decided to halt the growth in non-financial investments.

New regulations concerning mutual funds. In November 2007 a series of Regulations under the Mutual Investment Trust Law, 1994, was published in which come 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".

For details regarding a proposal for further amendment of the Regulations, designed to remove obstructions concerning the development of the monetary funds, under "Legislation and Supervision" below.

New regulation regarding investment consulting. The directive of the Securities Authority regarding the duty of an investment consultant to acquaint himself with and understand the needs of the customer when discussing his investments and guidelines come into effect in January 2008. The directive details and expands 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 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, will enable providing improved service to customers in the field of investment consulting. However, the process of becoming acquainted with the customer's needs in accordance with the new directive, while making use of the computerized system, is longer and more complex than in the past. This not infrequently, is burdensome for on the customer as well as for the consultant providing the service.

In the course of 2008 the Bank made preparations for the implementation of the new Regulations regarding the documentation of discussions concerning investment consultation, which were issued at the end of 2007 and 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 computer system installed, as stated, at the Bank and at Mercantile Discount Bank, has been adapted to the requirements of the new Regulations and provides a detailed documentation of the minutes of each consultation discussion. However, even from this aspect, the implication of the new Regulation, among other things, is the extension of the amount

of time devoted to each consultation, a fact that is burdensome both for the customer and for the consultant.
In February 2009, the Securities Authority issued two circular letters concerning the measurement and remuneration of investment consultants at the banks, and the duty of such consultants to keep updated. The Bank and Mercantile Discount Bank generally act in accordance with the requirements of the said letters, and following their publication, supervision and monitoring of their implementation will be tightened.

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in 2008 amounted to NIS 17 million, compared with NIS 648 million in 2007. Disregarding certain components the income would have amounted to NIS 22 million in 2008, compared with NIS 130 million in 2007.

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

	Domestic operations						International operations:	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the year ended December 31, 2008							
Income from financing activities before provision for doubtful debts								
- From external sources	12	3	3	1	1	20	-	20
- Intersegmental	-	-	(1)	-	-	(1)	-	(1)
Total income from financial activity	12	3	2	1	1	19	-	19
Operating and other income	212	29	26	20	38	325	62	387
Total Income	224	32	28	21	39	344	62	406
Operating and other expenses	219	34	30	18	36	337	39	376
Operating Income (loss) before taxes	5	(2)	(2)	3	3	7	23	30
Provision for taxes on operating income	11	(1)	(2)	1	2	11	1	12
Net income	(6)	(1)	(1)	2	1	(5)	22	17
Net income disregarding certain components[1]	(3)	-	(1)	2	2	-	22	22
Average Assets	7	3	14	1	6	31	-	31
Average Liabilities	-	-	1	-	-	1	-	1
Average Risk-assets	7	3	13	1	6	30	-	30
Average assets of provident and mutual funds	50	45	372	193	294	954	-	954
Average customers' securities	27,488	5,008	59,817	9,510	8,105	109,928	7,928	117,856
Average other assets under management	1,389	309	256	533	1,081	3,568	-	3,568

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

	Domestic operations						International operations:	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the year ended December 31, 2007							
Income from financing activities before provision for doubtful debts								
- From external sources	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 (loss) 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]	83	7	12	8	9	119	11	130
Average Assets	10	4	25	1	8	48	-	48
Average Liabilities	-	-	3	-	-	3	-	3
Average Risk-assets	10	4	24	1	8	47	-	47
Average assets of provident and mutual funds	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	100,502
Average other assets under management	1,423	300	152	555	615	3,045	-	3,045

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS:

Securities. On December 31, 2008, the balance of securities held for customers amounted to NIS 73.8 billion, including NIS 8.7 billion of non-marketable securities, compared to NIS 102.3 billion as at December 31, 2007, including NIS 10 billion of non-marketable securities, a decrease of 27.9%. For details as to income from security activities, see Note 24 to the financial statements.

In addition, the balance of securities held on behalf of customers at the Mercantile Discount Bank as of December 31, 2008, amounted to NIS 8.6 billion, a decrease of 13.3%, compared with December 31, 2007.

Investment portfolio management. On December 31, 2008, Tachlit was managing 1,463 investment portfolios, which together were valued at approximately NIS 2,174 million, as compared to 1,623 portfolios valued in total at

approximately NIS 2,375 million as at December 31, 2007. The above data point to a decrease of 9.9% in the number of portfolios managed and to a decrease of approximately 8.5% in the monetary value of the managed portfolios.

In addition, Mercantile Discount Bank, through a subsidiary of that bank, manages investment portfolios for its customers. On December 31, 2008 the total monetary value of managed portfolios was approximately NIS 1,373 million, a decrease of approximately 3.4% in comparison to December 31, 2007.

Basket certificates. The companies of the Michael Davies Group, in which Tachlit Investment House Ltd. has (directly and indirectly) a 20% equity interest, expanded their activities and issued additional basket certificates in 2008. The total position held by Tachlit in basket certificates amounted, at the end of 2008, to NIS 7,667 million, compared with NIS 7,227 million at the end of 2007, an increase of 6.1%.

Pension advisory services. As stated, 2008 was the first year in which the Bank provided pension advisory services to its customers. As from the start of operations in March 2008 and until the end of the year, advisory services were provided to some 20 thousand customers. The accumulation of customer assets, to whom advice has been provided, amounted to NIS 3.2 billion, in the said period.

DEVELOPMENTS IN THE OPERATIONS

The sale of capital market operations. In June 2007, the transaction for the sale of the provident fund operations was consummated. Concurrently with the consummation of the transaction, agreements were signed between the Bank and subsidiaries of Clal Insurance Company Ltd. for the distribution, operation and services to members. As stated, the net gain to the Bank from the sale of the provident fund activity amounted to NIS 384 million and was recognized in the 2007 financial statements under "Net income from extraordinary items, net of taxes". For further details, see Note 6 E to the financial statements.

The transaction for the sale of Kahal was consummated in July 2007. At consummation date, agreements were signed between the Bank, Kahal - Employee Training Fund Ltd. 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 in the 2007 financial statements 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.

It should be noted that as part of the reform concerning bank charges, banks were prohibited, for the most part, from charging commissions in respect of the purchase and sale of mutual fund units.

Pension consulting services. The process of transferring control over the provident funds of the employees to the Bank's employee committee at the Bank was completed during the first quarter of 2008. 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.

In the months of March to December 2008, the Bank provided to thousands of customers pension consulting services

as regards provident funds and pension funds and further education funds through a network of pension consultants located in the various Bank branches. The Bank is carrying out comprehensive preparations for the provision of this service, which included, inter-alia, the recruitment and training of professional manpower for the pension consulting field, the establishment of computer systems supporting the advisory and distribution services of the pension products and the signing of distribution agreements with pension products suppliers, all under the concept that the pension consulting field has strategic and business importance to the Discount Bank Group.

As part of the pension consulting supporting layout, a designated module has been established within the Bank systems for the management of relations with pension consulting potential customers, starting with establishing the initial connection with the customer (whether initiated by the Bank or by the customer) and continuing with the customer coming to the branch for a meeting with the pension consultant. A reporting module has also been developed for the control, and monitoring of the performance at the level of consultant/branch/region and the Bank as a whole.

As stated above, The Bank has engaged in distribution agreements with most of the operators in the pension market for the purpose of distributing further training funds, provident funds and pension funds managed by them. The Bank is obliged to engage with all suppliers of pension products (of the provident funds and pension funds that do not comprise insurance products, as well as further training funds) who are interested to do so, in distribution agreements for products managed by them in consideration for a distribution commission of a rate and payment terms identical to those of an identical service. The rate of the distribution commission is determined in regulations and is payable in respect of the pension assets (which are not insurance products) of customers who had received consulting services from the Bank in respect of products for which the Bank has distribution agreements with companies managing these products. The distribution commission generally amounts to 0.25% of the assets to which the advisory services apply.

Pension advisory services are being offered both to Bank customers and to non-customers through the Bank's branches and its investment centers located all over the country.

In the wake of the present financial crisis, public awareness of the importance of pension planning has grown and accordingly the demand for pension advisory services at the Bank branches has grown significantly.

Concurrently, the crisis caused many customers to take a decision and transfer the provident fund management to another investment channel or to another management company, and in certain cases even to withdraw their funds.

As a result of the fact that no uniform protocol for communicating data and no central clearing house for the transfer of funds exist as yet, many complaints are received from customers regarding delays in performing transfer operations. These complaints are brought to the knowledge of the management companies and are monitored by the Bank.

Presentation of new services having a leading value in the capital market. As part of the Bank's operations in the capital market field, the Bank offers its customers the services of Green Bull Company, in which the Bank holds a 20% equity interest. Green Bull specializes in global investment portfolio management and offers the "family office" service. which 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.

Imposition of a civil fine following an audit performed at "Tachlit". In a letter dated March 30, 2008, the Securities Authority informed Tachlit Investment House Ltd. (hereinafter:"Tachlit") that following an audit of the company performed by it in August 2007, it intends to impose on Tachlit a civil fine of NIS 90,000, concerning three ostensible violations of Section 26(a) of the Law regulating the engagement in investment consulting, in investment marketing and investment portfolio management, 1995. Tachlit has submitted its arguments regarding the requirement for a

fine in writing. In a letter dated November 5, 2008, Tachlit was informed that the Chairman of the Israeli Securities Authority had dismissed the company's arguments and imposed a fine in the amount of NIS 90,000 on it.
In addition, Tachlit was required to correct the deficiencies and violations found by the audit and provide the Securities Authority with reports as to the action taken by it to correct such deficiencies. Tachlit has rectified the deficiencies and has provided the required reports to the Authority.

Request by the Securities Authority for information regarding investment consulting activity at the Bank. At the end of the first quarter of 2008, the Securities Authority requested the Bank to present documents and data regarding the investment consulting activity at the Bank as well as documents and data concerning several purchase transactions of monetary mutual funds and basket certificates made on behalf of customers of the Bank. To the best of the Bank's knowledge, the said requests were made as part of an across the board audit which is being performed by the Securities Authority at banks regarding investment consulting operations.
Following this, details were requested regarding Tachlit and regarding companies issuing basket certificates of the Michael Davis Group, with which Tachlit is connected. To the best the Bank's knowledge details have also been requested from the basket certificates companies. Furthermore, the Bank was requested to provide additional details regarding the activity of investments consultants and the transactions made by them on behalf of customers, both with and without consulting, involving Dollar and Euro monetary funds and basket certificates monitoring the Dollar and Euro exchange rates, while differentiating between the certificates issued by companies of the Michael Davis Group connected with Tachlit and the Bank Group, and certificates of other issuers.
Following this, the bank has prepared and presented to the Israel Securities Authority in July 2008 a work plan for the control and supervision over the consulting activity regarding basket certificates at the Bank. The plan was designed to ensure that the consulting services offered in this field are provided at a proper professional level while diligently following the provisions of the law and the Bank's procedures. The Bank acts in accordance with the plan.

Approach by the Restrictive Trade Practices Authority. In a letter dated July 10, 2008, the Restrictive Trade Practices Authority informed that it is studying the extent of entry by banks into the pension consulting market, and requested the Bank to provide data regarding the pension consulting services actually provided by the Bank. The Bank has delivered the requested data to the Authority.

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" in the Section "The retails sector - General" in the Chapter "Activity of the Group according to principle segments of operation" above.
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.

CAPITAL MARKET SERVICES

The Bank provides its customers with an array of investment consulting services, securities trading and operating in Israel and abroad. These are offered to private customers, institutional customers and capital market operators. The Bank offers varied services, which include: equity securities activity in Israel and abroad, bonds (including convertible bonds), short-term Government loans (MAKAM), options, foreign currency, structured deposits, basket certificates,

derivatives in Israel and abroad, securities offerings and lending of securities, as well as providing professional and objective investment consulting regarding securities and financial assets.

The Bank has engaged in distribution agreements with most of the companies managing mutual funds in Israel in order to distribute their mutual funds to Bank customers. The Bank earns a distribution commission in respect of the holdings by Bank customers of units in these mutual funds, in accordance with Regulations issued in the matter. In addition, the Bank is also at the preliminary stages of preparing to sign distribution agreements with foreign mutual funds managers, once they are permitted by law to offer units of funds managed by them in Israel.

Some of the Bank's customers maintain securities portfolios managed by various portfolio managers operating through the Bank, including through the subsidiary Tachlit Investment House.

Since March 2008, the Bank also provides pension advisory services. For this purpose, the Bank has entered into distribution agreements with most of the entities operating in the pension market, distributing further training funds, provident funds and pension funds managed by them (for further details see above).

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.

In the course of 2008 and at the beginning of 2009, all the banks, including the two largest banks, began operating in this field. The gradual entry of the two largest banks into operations in the pension advisory services field, subject to the limitations imposed on them as discussed above, is expected to bring about development in this market on the one hand and to increase competition on the other.

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;
- Continued cultivation and distinction of the status of the investment consultant;

CAPITAL MARKET ACTIVITY OF MERCANTILE DISCOUNT BANK

Pension advisory services. The Commissioner of the Capital Market, Insurance and Savings, permitted Mercantile Discount Bank and the Bank 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 permition, Mercantile Discount Bank 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 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 option, as detailed in the agreement.

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 19c19 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 in 2007 under "Net income from extraordinary items, net of taxes".

Mercantile Discount Bank's share in the earning of Hadas Mercantile Provident Funds amounted in 2008 to NIS 3 million, compared to a loss of NIS 0.5 million in 2007.

The income of Mercantile Discount Bank from provident fund management, amounted to NIS 26 million in 2007.

Concurrently with the completion of the sale of the provident fund operations, Mercantile Discount Bank has completed the relevant preperations required to enter activity in the field of pension advisory services. The said preparations included the preparation of a business plan; recruitment and training of consultants and pension advisors; development of computer systems designed to provide support for pension consulting and the distribution of pension products, in cooperation with the Bank; the preparation of the appropriate legal infrastructure (consultation agreements, procedures, etc.); The setting-up of consultation stations at most of the Mercantile Discount Bank branches and regional consultation centers providing solutions for customers of other branches; formation of business and operation support units; the signing of 22 distribution agreements with producers of pension products.

On June 12, 2008, Mercantile Discount Bank obtained a pension consultant license. Mercantile Discount Bank launched its pension advisory services in the second half of 2008, in two stages: in the first stage these services were offered in 18 of its branches, followed by another 40 branches. During this period, Mercantile Discount Bank provided pension advisory services to approximately 1,000 customers, whose portfolio of pension assets amounts to NIS 170 million. Whereas the operations in this field are still at their preliminary stages, Mercantile Discount Bank did not show material earnings from this service in 2008.

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, in IDB New York and the London branch 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. Activity in the construction and real estate sector slowed down in 2008. The volume of investments in residential construction dropped at the rate of 3.5%, compared to an increase of 2.9% in 2007. Non-residential construction and other construction work dropped at the rate of 2%, compared to an increase of 11.4% in 2007.

The following developments occurred in the various operating segments in 2008:

Residential construction. A decline at the rate of 6.9% in the number of new residential units sold by private entrepreneurs compared to 2007.

- About 42% of the residential units sold were in the central region (excluding Tel Aviv), which experience an increase of 1.7% in the volume of sales of new apartments compared to the corresponding period last year;
- The Haifa region and the Judea and Samaria region were the two single regions which recorded an increase of 2.2% and 43.1%, respectively, compared to the corresponding period last year;
- At of the end of 2008, the inventory of new apartments constructed by private entrepreneur was 10% lower compared to the end of 2007.

Luxury apartments. A significant downward trend in demand on the part of foreign residents and local investors was noticed, in particular in the Jerusalem and Tel Aviv areas, accompanied by a drop in prices.

Income generating real-estate - office buildings. A slowdown in demand for office space was noticed in demand areas in Tel Aviv and the central region, mainly on the part of institutional entities. Notwithstanding, for the time being, relative stability in prices and rates of return is noticed as a result of a shortage in available rental space.

Income generating real-estate - commercial buildings. Stability in demand for quality commercial properties was noticed in demand areas in the center of Israel and in peripheral areas, mainly involving shopping malls and open shopping centers, on the part of institutional entities and private investors, accompanied by stability in prices.

Real-estate activity abroad. A marked decrease is noticed in the investment activity of Israeli corporations in entrepreneurial and income generating real estate abroad due to the following developments:

- Decrease in financing resources available to the real estate corporations on the financial markets abroad;
- Increased selectivity on the part of the local banks in granting finance to leveraged real estate companies operating abroad;
- The need to provide shareholders' equity at higher rates compared to previous years, for financing investments in real estate;
- A decline in the value of properties in certain areas in the USA, Britain, Euro -block countries, Central and Eastern Europe and in Russia.

DEVELOPMENTS IN THE CREDIT MARKET

A significant decline occurred in 2008 in the volume of fundraising in the sector. The standstill in the issues of corporation bonds involved all real estate companies in the market and stemmed from the significant increase in returns against the background of the deterioration in the risk profile which characterized their business environment in Israel and abroad, the high leverage and heavy debt burden, particularly in the years 2009-2010.

Starting with the second half of 2008, there was nearly a sharp decline in the availability of financing resources belonging to the off-banking system, a fact which made real estate companies highly dependent on financing resources from the local banking industry in supporting their current operations. The deterioration in the risk profile of customers and the adoption of a restraining and selective credit policy by the local banking industry caused an increase in credit spreads and commission rates.

As from the middle of 2008 share prices of real estate corporations in Israel, USA and Europe declined sharply accompanied by a decline in multipliers and a decline in market value compared to net asset value.

EXPECTED DEVELOPMENTS IN THE SECTOR'S MARKETS IN THE FIRST HALF OF 2009

A slowdown in the activity of the construction industry is expected in 2009, particularly as a result of the decline in demand for residential properties and income generating real estate in demand areas in central Israel.

Following are the expected developments in the various operating segments:

Residential construction. A decline in the level of demand on the part of those wishing to improve housing conditions coupled by a moderate decline in prices as a result of the continuous trend of reduced inventories of new apartments held by private entrepreneurs, mainly in demand areas in central Israel.

Luxury apartments. The continued decline in demand on the part of foreign and local residents for luxury apartments, mainly in Tel Aviv and Jerusalem coupled with a drop in prices.

Income generating property - office space. A decline in demand for office space in demand areas in central Israel on the part of institutional investors, coupled by a certain decline in prices as a result of shortage in office space in these areas. The continued movement of tenants to offices outside of the circle of expensive office space in the greater Tel Aviv area is possible.

Income generating property - commercial space. A decline in demand for commercial property and its prices as a result of market saturation and a relatively high sensitivity of the sector to the slowdown in private consumption.

Infrastructure. The volume of investments in this sector will be largely affected by the completion of various regulatory procedures and is dependent on the availability of long-term finance resources in appreciable amounts, as required by the scope of these projects.

Financing of foreign operations. A significant decline in the volume of investments by Israeli real estate companies in entrepreneurial and income generating real estate abroad, due to the slowdown in the supply of available finance in Israel and overseas, a decline in the value of properties in certain markets and the apprehension that this trend would spread to additional markets. On the other hand, the continued grown of investments in South East Asia is possible.

The above information comprises a forward looking statement. The above reflects the evaluation of the Bank's management while keeping in mind the information available to it at date of preparation of the financial statements, as discussed above in this Section and based on publications of various entities, such as the Central Bureau of Statistics, the Ministry of Housing, the Bank of Israel and others. The information may not materialize if the decline in the level of domestic demand will continue and/or intensify as a result of a deterioration in the political/security situation, a significant decline reaching a complete freeze in the availability of financing resources on the financial markets in Israel and abroad, intensified recession conditions in the global markets, continued fluctuations in interest and exchange rates globally and in the Israeli economy and other developments in macro economic conditions that are not under the Bank's control.

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;
- A most selective review of credit applications by real estate corporations seeking to recycle or acquire their own corporate bonds;
- The allocation of credit facilities in respect of construction projects will be conditional upon the provision of a minimum amount of initial capital by entrepreneurs and upon minimum profitability rates of the projects;

The preferred areas for granting of credit facilities:

- Residential construction in central Israel and in demand areas;
- Residential construction in peripheral areas in a selective manner and only to experienced and financially sound contractors, or which are guaranteed by owners who are financially sound;
- 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 for medium-term financing needs;
- 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.

SCALE OF OPERATIONS AND NET INCOME

General. In view of the slow recovery in this sector in 2007, 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 2008 amounted to NIS 138 million compared to income of NIS 220 million in 2007, a decrease of 37.3%. Disregarding certain components, net income would have amounted to NIS 140 million in 2008 compared with NIS 223 million in 2007, a decrease of 37.2%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 8.7% in 2008 compared to a rate of 16.5% in 2007. Disregarding certain components, the return on equity would have been 8.9% in 2008 compared with 16.5% in 2007.

Provision for doubtful debts amounted in 2008 to NIS 180 million compared with NIS 74 in 2007, an increase of 143.2%.

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

	Domestic operations				International operatins			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
	For the year ended December 31, 2008							
Income from financing activities before provision for doubtful debts								
- From external sources	126	690	117	933	14	19	33	966
- Intersegmental	(59)	(420)	(58)	(537)	48	-	48	(489)
Total income from financial activity	67	270	59	396	62	19	81	477
Operating and other income	16	18	13	47	29	2	31	78
Total Income	83	288	72	443	91	21	112	555
Provision for doubtful debts	24	121	13	158	19	3	22	180
Operating and other expenses	20	74	22	116	50	9	59	175
Operating Income (loss) before taxes	39	93	37	169	22	9	31	200
Provision for taxes on operating income	14	31	13	58	1	3	4	62
Net income	25	62	24	111	21	6	27	138
Net income disregarding certain components[1]	25	63	24	112	22	6	28	140
Return on equity (percentage)	39.3	6.0	15.9	8.9	7.6	9.7	8.3	8.7
Return on equity disregarding certain components[1] (percentage)	39.9	6.1	16.1	8.9	7.8	9.7	8.6	8.9
Average Assets	1,535	10,294	2,032	13,861	2,697	978	3,675	17,536
Average Liabilities	666	2,136	439	3,241	1,558	-	1,558	4,799
Average Risk-assets	965	15,814	2,492	19,271	4,034	978	5,012	24,283
Components of income from financial activities:								
Margin from credit activity	51	187	44	282	58	16	74	356
Margin from depo sits activity	8	7	3	18	2	-	2	20
Other	8	76	12	96	2	3	5	101
Income from financing activities before provision for doubtful debts	67	270	59	396	62	19	81	477

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

	Domestic operations				International operatins			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
	For the year ended December 31, 2007							
Income from financing activities before provision for doubtful debts								
- From external sources	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	14	14	11	39	20	4	24	63
Total Income	78	310	78	466	139	25	164	630
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	48	198	45	291	44	12	56	347
Provision for taxes on operating income	18	74	17	109	17	2	19	128
Net income	30	125	28	183	27	10	37	220
Net income disregarding certain components[1]	31	124	27	182	31	10	41	223
Return on equity (percentage)	52.3	16.0	18.4	18.4	9.4	15.8	10.7	16.5
Return on equity disregarding certain components[1] (percentage)	51.8	15.8	18.3	18.3	10.6	15.8	11.9	16.5
Average Assets	1,441	8,563	1,971	11,975	3,692	945	4,637	16,612
Average Liabilities	595	2,495	411	3,501	824	3	827	4,328
Average Risk-assets	893	12,040	2,389	15,322	4,347	966	5,313	20,635
Components of income from financial activities:								
Margin from credit activity	52	189	50	291	103	18	121	412
Margin from depo sits 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

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, 2008 amounted to 19.02% (17.8% at the end of 2007).

Legislation and regulation in the matter of securing the investments of residential units purchasers. For details regarding amendments to 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, and on the subject of the letter of guarantee, see under "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:

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).

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

Customers of the sector 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 maximum rate of exposure of the Bank in financing the sector.

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.
Starting with the second half of 2007, the availability of off-banking financing resources has declined significantly against the background of the crisis involving the financial markets. The halt in alternative financing resources, creates high dependence of customers on the local banking industry in obtaining financing resources to support their current operations.

STRUCTURE OF THE COMPETITION PREVAILING IN THE OPERATIONS AND CHANGES THEREIN

Most of the competition involving this activity takes place within the local banking industry. In times when equity and bonds can be raised on the capital market, the off-banking finance serves as an alternative resource for long-term financing required, generally, for construction and/or acquisition of income generating assets in Israel or abroad or as capital financing the construction of real estate projects abroad.
Competition with local and overseas banks exists with respect to the financing of infrastructure projects.
Some institutional entities (insurance companies and pension funds) extend guarantees to apartment purchasers, in accordance with relevant provisions of the Sales Law (Apartments).

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 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 from the second half of 2007.

The volume of credit granted by mortgage banks in 2008, excluding credit out of State funds, reached an amount of NIS 34,313 million, excluding internal refinancing, compared to NIS 28,198 million in 2007, an increase of 22%.

The downwards trend in the volume of credit granted out of State funds continued in 2008, reaching NIS 1,337 million (including standing loans and conditional grants in the amount of NIS 0.3 billion), compared to NIS 1,938 million in 2007 (including standing loans and conditional grants in the amount of NIS 0.2 billion), a decline of 33%.

The volume of housing loans out of bank funds granted by the mortgage banks in 2008, reached an amount of NIS 30,163 million, excluding internal refinancing, in compared to NIS 24,527 million in 2007, an increase of 23.0%.

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.

Loans financing the purchase or construction of commercial property. Loans intended for the purchase or construction of property for commercial uses.

Suppoting activity - 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, which were subsequently also fixed in legislation.

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.

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. The insurance agency sustained operating losses in the first years of operation. In 2008, the insurance agency's income amounted to NIS 928 thousand.

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 2008, the volume of housing loans granted amounted to NIS 4,427 million, compared to NIS 3,041 million in 2007, an increase of 45.6%. The above amount includes some NIS 119 million of loans recycled in 2008, compared to NIS 106 million in 2007, an increase of 12.3%. The impressive growth in housing loans granted is the direct result of the mortgage marketing campaign (see hereunder).

Net income from the operations in 2008 amounted to NIS 37 million, compared with NIS 40 million in 2007, an increase of 7.5%. Disregarding certain components (see hereunder), net income would have amounted to NIS 37 million in 2008, compared with NIS 40 million in 2007, a decrease of 7.5%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 4.7%% in 2008, compared with 6.5% in 2007. Disregarding certain components (see hereunder), the return on equity would have been 4.7% in 2008, compared with 6.5% in 2007.

Provision for doubtful debts in 2008 to NIS 5 million, compared with NIS 17 in 2007, a decrease of 70.6%.

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, 2008			
Income from financing activities before provision for doubtful debts				
- From external sources	195	69	7	271
- Intersegmental	(80)	(37)	(5)	(122)
Total income from financial activity	115	32	2	149
Operating and other income	50	2	1	53
Total Income	165	34	3	202
Provision for doubtful debts	-	(1)	6	5
Operating and other expenses	126	9	-	135
Operating income (loss) before taxes	39	26	(3)	62
Provision for taxes on operating income	16	9	(1)	24
Net income	22	17	(2)	37
Net income disregarding certain components[1]	22	17	(2)	37
Return on equity (percentage)	3.3	20.2	(19.4)	4.7
Return on equity disregarding certain components[1] (percentage)	3.3	20.2	(19.4)	4.7
Average Assets	12,959	1,318	149	14,426
Average Liabilities	2,070	122	-	2,192
Average Risk-assets	10,573	1,281	143	11,997
Average other assets under management	2,022	-	-	2,022
Components of income from financial activities:				
Margin from credit activity	99	33	1	133
Other	16	(1)	1	16
Income from financing activities before provision for doubtful debts	115	32	2	149

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, 2007			
Income from financing activities before provision for doubtful debts				
- From external sources	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 (loss) before taxes	32	9	14	55
Provision for taxes on operating income	4	2	4	10
Net income	24	6	10	40
Net income disregarding certain components[1]	24	6	10	40
Return on equity (percentage)	4.7	9.5	29.4	6.5
Return on equity disregarding certain components[1] (percentage)	4.7	9.5	29.4	6.5
Average Assets	10,519	1,013	545	12,077
Average Liabilities	2,401	217	-	2,618
Average Risk-assets	7,923	1,017	519	9,459
Average other assets under management	2,130	-	-	2,130
Components of income from financial activities:				
Margin from credit activity	85	26	9	120
Other	22	(3)	3	22
Income from financing activities before provision for doubtful debts	107	23	12	142

LEGISLATIVE RESTRICTIONS

Capital adequacy limitation. Whereas the activity within the framework of Discount Layout (see below) is conducted by Discount Mortgage Bank, it may be hampered by the capital adequacy limitation of this bank.

The ratio of capital to risk assets of Discount Mortgage Bank at December 31, 2008, reached a rate of 10.8%.

The Board of Directors of Discount Mortgage Bank resolved that the ratio of capital to risk assets of that bank shall not fall below 10%. In August 2008, the Board of Directors of Discount Mortgage Bank approved a temporary decrease in the capital ratio determined as above until the completion of the proceedings for the issue of tier II capital, which were in progress.

On September 21, 2008, Discount Mortgage Bank issued a non-marketable debt note in the amount of NIS 250 million. The Supervisor of Banks recognized this capital note as tier II capital, subject to the provisions of Proper Banking Management Directive No. 311. In the first stage only an amount of NIS 184 million, that exhausted the limitation of the tier II capital (50% of the tier II capital), was recognized as part of Discount Mortgage Bank's tier II capital. The

Balance of NIS 66 million had been recognized as tier II capital in January 2009, following a reduction in the tier II capital that will take place in that month. As stated, following the abovementioned issue, Discount Mortgage Bank has fully exhausted the tier II capital limitation.

In view of the capital requirements dictated by the accelerated development rate of Discount Mortgage Bank's business, an examination has been made in cooperation with the Bank regarding the increase of Discount Mortgage Bank's tier I capital, and as an additional layer, regarding the increase of its tier II capital.

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, 2008, the said rate at Discount Mortgage Bank amounted to 1.69%, and the provision required in this respect amounted to NIS 0.7 million.

Amendment to the Execution Law in the matter of alternative housing. For particulars regarding the amendment of this Law, see below under "Legislation and supervision". This amendment to the Law is expected to have a material effect on the housing loan market and on the banks operating in this market. The Bank believes that this Law will have a material effect on income from mortgage loan activity.

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 five branches (Tel Aviv, a VIP branch operating within the main branch in Tel Aviv, Haifa, the Diamond Exchange in Ramat Gan and Modi'in) and through 67 counters located inside branches of Israel Discount Bank Ltd. or in their vicinity. During 2009, Discount Mortgage Bank intends to study the location, disposition and efficiency of the branches.

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, Ministry of Defense, 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.

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 and the 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 2008 - 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.

The success of the advertising campaign was greater than anticipated. 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 2007 was 5.6%, increased significantly following the new layout. Discount Mortgage Bank's market share reached 12.6% in 2008, compared with 10.6% in 2007. 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 2008 amounted to NIS 3,459.1 million. The total credit for housing purposes granted outside the framework of the "Discount layout" in the said period amounted to NIS 345.3 million. The total deposits made by the Bank within the framework of the "Discount layout" amounted to NIS 3,397.3 million in 2008.

	CPI linked	Non-linked	Foreign currency linked	Total
		(in NIS millions)		
"Discount layout" housing loans	2,157.0	1,300.1	2.0	3,459.1
Non-"Discount layout" housing loans	171.0	160.6	13.6	345.2
Deposits provided by the Bank	2,145.4	1,249.9	2.0	3,397.3

An amount of NIS 61.8 million was deposited at the beginning of January 2009, of which NIS 11.6 million in the CPI linked segment and NIS 50.2 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 3.73% in 2008. 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 4.06% in 2008.

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 is also limited. In February 2007, the Board of Directors of Discount Mortgage Bank approved the "Sky" Project, which objective was the upgrading of the existing information systems.

The total investment in the project amounted as of December 31, 2008, to NIS 15 million. For details regarding the engagement of Discount Mortgage Bank with the Bank for receiving computer services, see "Main future projects" in "Information and computer systems" in the Chapter "Fixed assets installations"

DEVELOPMENTS IN THE SEGMENT

Mortgages secured by EMI Ltd. Discount Mortgage Bank allowed the granting of mortgages at a high financing ratio where such mortgages were secured by guarantees of EMI Ltd. On September 16, 2008, following the reduction in the rating of AIG - EMI's parent company - "Midroog" reduced EMI's rating from AAA to A2. On November 1, 2008, Midroog raised EMI's rating to Aa2 with a negative horizon. Ma'alot, which in September 2008 had also lowered EMI's credit rating from AAA to A+, has not yet made any change to the said rating. In view of the above, EMI is no longer considered a "recognized insurance company", within the meaning of this term in Proper Banking Management Directive No. 311, dealing with the minimum capital ratio. On September 17, 2008, Discount Mortgage Bank stopped issuing approvals for new loans secured by EMI guarantees. Discount Mortgage Bank allows the utilization in full of loan amounts approved prior to September 16, 2008.

On October 29, 2008, the Supervisor of Banks informed that as from the financial statements as of December 31, 2008, and so long as EMIS's rating remains unchanged, banking corporations will have to weight the housing loans secured by EMI at the rate of 100% instead of the 50% rate used up to then. The outstanding housing loans of Discount Mortgage Bank secured by EMI as of December 31, 2008, amount to NIS 2.1 billion, including an amount of NIS 0.2 billion in loans repayable to the extent of collection, which are not the responsibility of Discount Mortgage Bank.

The total credit insured under this insurance arrangement as of December 31, 2008, amounts to NIS 580 million.

Discount Mortgage Bank has already implemented the said directive in advance in its financial statements as of September 30, 2008.

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 was set 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 arrangement letter, 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%.

As on December 31, 2008, the calculated rate of exposure of the Bank with respect to overseas extensions stood at 31.47%, as compared to a rate of 33.69% on December 31, 2007.

The decline as from the beginning of the year, in the rate of exposure to the foreign extensions was influenced mainly by the appreciation of the NIS as against the U.S. Dollar and the British Pound Sterling as well as from the increase in the capital amount serving in the computation.

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.

At the end of August 2008, the Supervisor of Banks issued a new guideline in the matter of exposure of a banking corporation to the activity of overseas extensions. The guideline states that the Board of Directors of a banking corporation which operates or intends to operate through overseas extensions must discuss and approve a comprehensive policy statement regarding the activities of overseas extensions. Within the framework of the said statement of policy, the Board of the banking corporation is required, among other things, to determine a restriction or a set of restrictions as to the exposure regarding the activities of overseas extensions, which should reflect the risk appetite applying to the operations of the overseas extensions, on condition that the principal part of the operations of the banking corporation and the banking group is located in Israel.

Banking corporations were requested to prepare for the implementation of the new guideline no later than the end of

February 2009. The restriction applied in the past pursuant to the Regulatory Letter mentioned above, shall be cancelled concurrently with the approval of the exposure restriction by the Board of the banking corporation.

The Bank is studying the new guideline and is preparing for its implementation. In the middle of February 2009, the Bank received a letter from the Supervisor of Banks, according to which the implementation of the guideline has been deferred to the end of May 2009. Until such date the Bank has to follow the arrangement letter.

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 2008 amounted to NIS 137 million, compared with NIS 152 million in 2007.

Disregarding certain components, net income would have amounted to NIS 289 million in 2008, compared with NIS 184 million in 2007, an increase of 57.1%.

The return on equity, calculated on the capital allocated to the international operations on the basis of the average balance of segment risk assets, was 7.8% in 2008, compared with 8.2% in 2007. Disregarding certain components, the return on equity would have been 16.5% in 2008, compared with 9.9% in 2007.

Provision for doubtful debts amounted in 2008 to NIS 65 million, compared with NIS 38 in 2007, an increase of 71.1%.

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

	Households	Corporate Banking	Middle Market Banking	Private Banking	Other Financial Management	Total
	For the year ended December 31, 2008					
Income from financing activities before provision for doubtful debts	2	193	296	229	1	721
Operating and other income	-	97	182	197	(307)	169
Total Income	2	290	478	426	(306)	890
Provision for doubtful debts	-	15	33	7	10	65
Operating and other expenses	1	113	222	243	77	656
Operating Income (loss) before taxes	1	162	223	176	(393)	169
Provision for taxes on operating income	-	22	21	10	(21)	32
Net income	1	140	202	166	(372)	137
Net income disregarding certain components[(1)]	1	141	204	168	(225)	289
Return on equity (percentage)	7.0	30.2	27.5	75.1	(109.0)	7.8
Return on equity disregarding certain components[(1)] (percentage)	7.0	30.4	27.7	76.1	(67.6)	16.5
Average Assets	117	6,027	8,886	2,909	15,854	33,793
Average Liabilities	-	2,634	3,814	15,875	10,455	32,778
Average Risk-assets	117	7,124	11,269	2,985	5,493	26,988

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

	Households	Corporate Banking	Middle Market Banking	Private Banking	Other 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 (loss) 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	66	17	46	184
Return on equity (percentage)	16.6	11.5	7.1	3.4	8.9	8.2
Return on equity disregarding certain components[1] (percentage)	16.6	12.5	8.8	7.5	9.7	9.9
Average Assets	207	6,746	9,169	2,857	19,351	38,330
Average Liabilities	74	4,637	7,521	18,610	6,531	37,373
Average Risk-assets	207	6,467	11,320	3,205	7,252	28,451

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. As part of the steps taken by the Bank for expanding its operations in Switzerland, the Bank completed on June 20, 2008 the transaction for the purchase of the shares of Arzi Bank in Zurich, Switzerland. This bank was purchased in return for SFR41 million (approximately NIS 133 million) and soon thereafter the merger between Arzi Bank and the subsidiary IDB (Swiss) Bank (formerly: Israel Discount Bank (Switzerland) SA) was completed. IDB (Swiss) Bank is considering the allocation of the excess of cost of the purchase over the equity value of the Arzi Bank shares totaled NIS 82 million. The excess of cost, as stated, was written down in 2008 by an amount of NIS 16 million.

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 Bancorp. Concurrently it has been decided to appoint Ms. Alexandra Lebenthal as President of the company It should be noted that at that time Ms. Lebenthal 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 Lebenthal 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. Lebenthal.

Sale of a part of the leasing portfolio. IDB New York entered into an agreement with another financial institution for the sale of US$89.1 million of IDB Leasing's portfolio. The transaction was effected in two parts in the months of September and October 2008. A total profit on this transaction of US$1.7 million was recognized in the financial statements as of December 31, 2008.

The global financial crisis. For details regarding the global financial crisis, see under "The global economic crisis" and "Principal economic developments in October and November 2008".

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. 2008 witnessed the continuing growth of assets of customers of IDB (Swiss) Bank, a wholly owned subsidiary of the Bank. IDB (Swiss) Bank, located in Geneva and which also operates a branch in Zurich (formerly Arzi Bank, which has been merged, as stated) 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 October 2008, a representative office of IDB (Swiss) Bank began operations in Israel. According to the permit granted by the Governor for the use of the word "bank" in the name of the representative office in Israel, this office may not conduct any banking business and may only provide information, promote the business activities of IDB (Swiss) Bank in Israel and provide service relating to the submission of an application for opening a customer account in a foreign country.

In addition, the Bank maintains a representative office in France (Paris).

United States. IDB New York ("IDB Bank") continues to be the largest of the Israeli banks operating overseas. This bank maintains two branches in New York, one branch in Florida (up to February 27, 2009 two branches were in operation), 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 and Israel.

SERVICES AND PRINCIPAL PRODUCTS OF IDB BANK

Credit - IDB Bank provides financing to a variety of U.S. based corporations and also, at times, to the principals of these privately held companies.

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. This activity 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.

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 64% 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 - 2008 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 57%, 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 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. Notwithstanding, in view of the situation in the markets, IDB New York's exposure to these markets has decreased.

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, 2008, amounted to NIS 9.0 billion, compared with NIS 8.0 billion on December 31, 2007.

Following is the distribution of net income (loss) by main operating segments (in NIS millions):

	Contribution to Group's results		Contribution Disregarding the effects of coverage of investment[1]	
	2008	2007	2008	2007
Banking Activity:				
Commercial banks:				
In Israel - the Bank (including branches overseas)	(14)	415	(39)	228
- Mercantile Discount Bank	149	166	149	166
- First International Bank	43	[2]25	43	[2]25
Overseas - Bank offices	55	(60)	80	(127)
Discount Mortgage Bank	27	22	27	22
Other Activities:				
Israel Credit Cards	191	87	191	87
Other financial services	(196)	52	(196)	52
Total operating (gain) loss	255	707	255	707
Income (loss) from extraordinary operations	(10)	558	(10)	558
Net gain (loss)	245	1,265	245	1,265

(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 U.S. 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 2008, the shekel was revalued in real terms as against the U.S. dollar by 1.1%, compared with an appreciation of 9.0% in 2007. In 2008, the shekel was devalued in real terms against the Swiss Franc by 4.2%, compared with a revaluation of 1.3% in 2007. The said revaluation resulted in an increase in the Bank's net operating income after tax in Israel by NIS 25 million, compared with an increase of NIS 186 million in net operating income in 2007. Concurrently, there was a decrease/increase in the positive contribution by overseas extensions to the results of the Bank.

(2) Including a provision for tax in respect of the Bank's share in the earnings of the First International Bank, in the amount of NIS 130 million (see Note 6 F to the financial statements).

MAIN INVESTEE COMPANIES

At the end of 2008, 21.9% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 22.7% were assets of overseas consolidated companies and branches. The contribution to the net results by the consolidated companies in Israel totalled NIS 174 million in 2008 (in 2007 the contribution totalled NIS 382 million). The contribution to the net results by overseas consolidated companies totaled an income of NIS 55 million in 2008 (in 2007 the contribution totalled in a loss of NIS 60 million), and the contribution to the net results by affiliated companies totalled NIS 40 million in 2008 (in 2007 the contribution totalled NIS 96 million).

The total contribution by both domestic and overseas investees companies to the net results of the Bank amounted to NIS 269 million in 2008, compared with NIS 418 million in 2007, a decrease of 35.6%.

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 2008, would have been NIS 294 million, compared with 604 million in 2007, a decrease of 51.3%.

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 2008 amounted to US$9,450 million, compared with US$9,136 million at the end of 2007, an increase of 3.4%.

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 2008 was US$3,937 million, compared with US$3,758 million at the end of 2007, an increase of 4.8%.

Total deposits stood at US$6,205 million as at the end of 2008, compared with US$6,412 million at the end of 2007, a decrease of 0.6%.

Shareholder's equity totalled US$624 million at the end of 2008, compared with US$631 million at the end of 2007, a decrease of 1.1%.

The ratio of capital to risk assets was 12.1% as at December 31, 2008, compared with 11% at December 31, 2007. In December 2008, IDB New York issued to the Bank a subordinated capital note in the amount of US$75 million.

Net income in 2008 totalled US$35 million, compared with US$38 million in the preceding year, a decrease of 7.9%. The decrease in net earnings was affected by a decerase of US$49 million in non financing income, which was partly offset as a result of an increase of US$24 million in financing income, net of provisions, from a decrease of US$14 million in non financing expenses, and from a decrease of US$8 million in the tax expense.

As a result of the financial crisis in the United States, IDB New York had to record a provision for impairment in value of an other than temporary nature in the amount of US$59.7 million, in respect of securities held in the available for sale portfolio.

Return on equity was 5.5% in 2008, compared with 6.3% in 2007.

The contribution of the Bank's investment in Bancorp to the net results of the Bank reached an amount of NIS 65 million in 2008 (after deducting a provision for additional taxes of NIS 25 million that applies to the Bank in Israel), compared with a loss of NIS 61 million in 2007 (after deducting provision for additional taxes of NIS 21 million that applies to the Bank in Israel).

The said contribution is comprised of Bancorp's net income in 2008 (after deducting the provision for tax as aforesaid) of NIS 98 million disregarding exchange rate differentials on the investment of NIS 33 million, compared with net income of NIS 159 million (after deducting a provision for taxes as aforesaid) and disregarding exchange rate differentials on the investment of NIS 220 million in 2007.

Alongside the exchange rate differentials on the said investment, the Bank in Israel recorded financing expenses in 2008 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 15.4.

INVESTIGATION REGARDING PROHIBITION ON MONEY LAUNDERING

The New York County District Attorney's Office conducted investigations in 2005 involving 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").

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 abovesaid and committed to act insofar as possible to ensure fulfillment of the abovementioned liabilities.

Concurrently and additionally, on December 15, 2005 IDB New York reached a compromise arrangement with the District Attorney for the State of New York regarding cessation of the 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.

Changes in composition of management and Board of Directors of IDB New York. In February 2006 the Board of Directors of the Bank appointed Mr. Reuven Spiegel as President and CEO of IDB New York, in place of Mr. Arie Sheer. 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 accordaing to the determined timetable. 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.

Most of the required actions have been completed and IDB New York continues the process of strengthening the controls and procedures.

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, US$13.3 million in 2007 and to an additional US$3.5 million in 2008.

IDB New York has tightened the controls and procedures relating to compliance, and it believes that no additional material costs in this respect are expected in 2009.

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 the years 2006 and 2007, 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.

Further developments. 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 Lebenthal, 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 U.S. law applying to the investigated transactions and provided guidelines to the independent Counsel engaged by the Bank to examine the arguments raised by Mr. Len Grunstein regarding the examination report (see above). Furthermore, the committee received reports from the internal auditor of the Bank regarding his audit findings in New York and among other things, has guided him to examine the activity of the Board of Directors of IDB New York and its committees.

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

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

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

(6) 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 Raubinoff 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 U.S. 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, following 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 tenant company paid IDB New York interest in respect of the delay in the payment of rent.

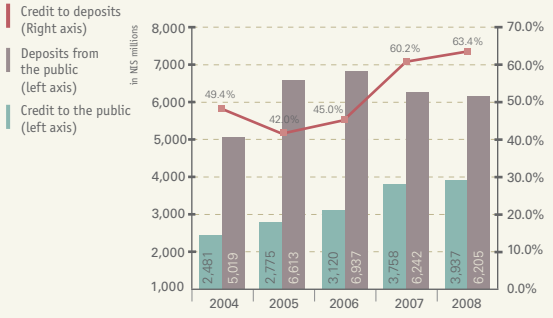
Furthermore, according to the recommendations of the report, an opinion of an independent appraiser was sought out and received with respect to the appropriate amount of rent as of the date of the examination report. In view of the opinion of the assessor, IDB New York negotiated to change the rental 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 by the authorized organs at the Bank as an entitled transaction. For further details, see Note 22 I (1) to ght financial statements.

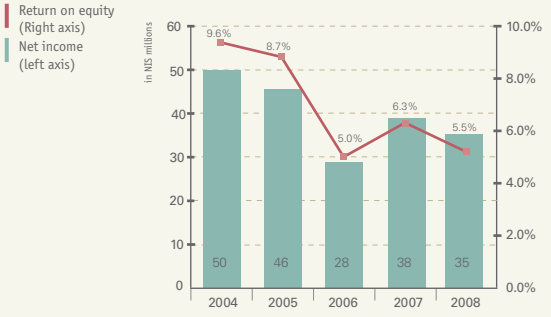
(10) In February 2008, the recommendations of the ad-hoc committee on the New York issues were presented to the Board of Directors. The committee recommended that part of the transactions that had been examined by it should be examined according to the rules approved within the framework of Discount Group's "Corporate Governance" code. 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. The Bank is acting to implement the recommendations, Including within the framework of a company governance code for the Discount Group, as detailed in the Section "Miscellaneous" below.

(11) In March 2009, Mr. Len Grunstein the former Chairman of the Board of IDB New York, approached IDB New York with a request for the payment of remuneration (including salary, severance pay and expenses), in respect of himself and another individual, in respect of his period of office as Chairman of the Board. In his approach, Mr. Grunstein did not specify the amount requested by him nor the mechanism for its calculation.

BANCORP. – DEVELOPMENT OF CREDIT AND DEPOSITS



BANCORP. – NET INCOME AND 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 2008, Mercantile Discount Bank operated through 71 branches, compared with 70 branches in 2007.

Total assets at the end of 2008 amounted to NIS 20,384 million, compared with NIS 18,860 million at the end of 2007, an increase of 8.1%.

Total credit granted to the public at the end of 2008 was NIS 14,326 million, compared with NIS 13,027 million at the end of 2007, an increase of 10.0%.

Total deposits from the public at the end of 2008 amounted to NIS 17,037 million, compared with NIS 15,736 million at the end of 2007, an increase of 8.3%.

Shareholder's equity at the end of 2008 amounted to NIS 1,479 million, compared with NIS 1,363 million at the end of 2007, an increase of 8.5%.

The ratio of capital to risk assets was 12.7% as at December 31, 2008, compared with 13.2% as at December 31, 2007.

Net income was NIS 148 million in 2008, compared with NIS 214 million in 2007, a decrease of 30.8%.

The principal factors affecting the business results of Mercantile Discount Bank in 2008, as compared with 2007:

an increase in the income from financing activities before provision for doubtful debts (an increase of NIS 44 million, 6.9%); an increase in the provision for doubtful debts (an increase of NIS 26 million, 26.8%); a decrease in operating and other income (a decerase of NIS 13 million, 3.8%); an increase in operating and other expenses (an increase of NIS 34 million, 5.5%) and a decrease in earnings from extraordinary operations in the amount of NIS 48 million, mainly due to the sale of the provident funds activities in 2007.

The increase in financing income stems mostly from the contribution of the non-linked Shekel segment, resulting from an increase in volume of operations. The said increase was offset by a decrease in other financing income, net, due mostly to losses of NIS 22 million charged to the income statement in respect of adjustment to fair value of certain bonds that had been classified as losses of an other than temporary nature.

The increase in the specific provision for doubtful debts in the amount of NIS 25 million, derives mainly from the increase in provisions in respect of a small number of customers, whose business declined, including additional provisions in respect of a large customer in the construction business, which encountered financial difficulties, following a compromise agreement signed by Mercantile Discount Bank during 2008 with the special manager appointed to manage the business of that customer.

The increase in operating expenses stems from an increase of 16.9% in other expenses, mainly due to an increase in legal expenses and expenses in respect of other professional services.

Return on shareholders' equity in 2008 was 10.3%, compared with 17.2% in 2007.

Conviction of a former employee on charges of money laundering prohibition violations. Following an investigation conducted by the police in 2006, regarding suspicions of violation of the Prohibition of Money Laundering Law, an indictment has been served against an employee of the Ramla Branch of Mercantile Discount Bank (who had been suspended even during the course of the investigation). In October 2008, the said former employee was found guilty on his own admission, within the framework of a plea bargain, and was sentenced to imprisonment.

Police investigation into a client. Mercantile Discount Bank has recently received notice of an investigation being conducted by the Israeli Police regarding a customer whose business had collapsed. Several employees of Mercantile Discount Bank have been interrogated by the police in this respect, including a member of management of this bank. Managements of the Bank and of Mercantile Discount Bank have no knowledge of the suspicions being investigated or of the progress of the investigation and accordingly, they are unable to assess the results of this investigation or its implications on Mercantile Discount Bank, if at all.

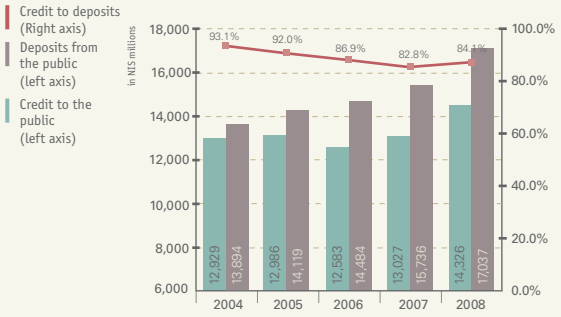
For details regarding a third party notice filed by the Arab Bank, see Note 19 C 15.4 to the financial statements. Regarding a motion to approve a lawsuit filed, among others, against Mercantile Discount Bank and against the Bank as a class action suit, in the matter of payments received in respect of attachments effected by the Judgment Execution

Office through the magnetic media, see Note 19 C 14.8 to the financial statements. For details regarding the motion to approve a lawsuit filed against Mercantile Discount Bank as a class action suit, in the matter of the delayed crediting of foreign currency amounts transferred from banks abroad, see Note 19 C 14.12.

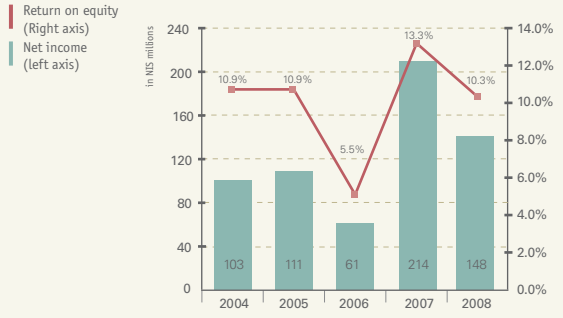
For details regarding a request to approve an action as a class action filed, among others, against Mercantile Discount Bank and the Bank, regarding payments received in respect of foreclosures executed through magnetic media, see Note 19 C item 14.8 to the financial statements.

See Note 19 C to the financial statements, articles 14.2 and 14.4 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, that had been rejected.

MERCANTILE – DEVELOPMENT OF CREDIT AND DEPOSITS



MERCANTILE – NET INCOME AND RETURN ON EQUITY



DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank is a subsidiary of the Bank. As of December 31, 2008, 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 G to the financial statements).

Discount Mortgage Bank operates through two main branches (Tel-Aviv and Haifa), a VIP branch in Tel Aviv, two independent branches (the Stock Exchange Branch in Ramat-Gan and the Modi'een Branch) and through 68 counters located all over the country within branches of the Bank or adjacent to them (compared with 57 counters and branches at the end of 2007). 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 2008 amounted to NIS 14,296.2 million, compared with NIS 11,503.1 million at the end of 2007, an increase of 24.3%.

Total credit granted to the public amounted at the end of 2008 to NIS 13,742.1 million, compared with NIS 11,200.2 million at the end of 2007, an increase of 22.7%.

Shareholder's equity amounted to NIS 899.1 million at the end of 2008, compared with NIS 870.7 million at the end of 2007, an increase of 3.2%.

Net income totalled NIS 28.4 million in 2008, compared with NIS 26.2 million in 2007, an increase of 8.3%.

The business results of Discount Mortgage Bank for 2008, were affected, inter-alia, by an increase in income from financing activity (an amount of NIS 2.9 million, 2.3%), by a decrease in the provision for doubtful debts (an amount of NIS 27.2 million, 77.2%), by an increase in operating and other expenses (an amount of NIS 11.1 million, 9.7%), most of which in respect of payroll expenses and from an increase in the tax expense (an increase of NIS 17.6 million compared with 2007).

Return on shareholders' equity in 2008 was 3.4%, compared with 3.0% in 2007.

The ratio of capital to risk assets was 10.9% as at December 31, 2008, compared with 10.6% as at December 2007.
The Contribution of the Bank's investment in Discount Mortgage Bank to the net results of the Bank totalled NIS 27.4 million in 2008, compared with NIS 22.5 million in 2007, an increase of 21.8%.
See Note 19 C article 14.6 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 article 15.2 in the matter of insuring property for amounts exceeding its reinstatement value.

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, 2008, the Bank held 26.4% of its share capital and 11.1% of its voting rights.
Net earnings amounted in 2008 to NIS 161 million, in comparison with NIS 744 million in 2007, a decrease of 78.4%.
The Bank's share in the net income of FIBI in 2008 totalled NIS 43 million, compared with NIS 67 million in 2007. The amount for 2007 is presented net of a provision for taxes of NIS 130 million (see hereunder).
Return on shareholders' equity in 2008 was 2.9%, compared with 14.6% in 2007.
The ratio of capital to risk assets stood at 12.3% on December 31, 2008, compared with 11.5% at the end of 2007.
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 is 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 therely may change.
This was preceded by an approach by 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 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 FIBI is the one using the equity basis method.

On January 22, 2008, the Restrictive Trade Practices Authority informed the Bank that the 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 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 Restrictive Trade Practices Authority, it has been decided to arrange a meeting between the parties prior to the Bank submitting its response to the subject at hand. The meeting has not yet taken place, and the Bank has not as yet responded addressing the substance of the approach by the Restrictive Trade Practices Authority. 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 FIBI, and the Restrictive Trade Practices 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 in FIBI, 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 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 up to and including the financial statements as of September 30, 2007, that the investment in shares of FIBI would be a long-term one and therefore no provision for taxes had been recorded in them 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 recorded in the financial statements as of December 31, 2007 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.

The Supervisor of Banks held negotiating with the Bank and with FIBI and its controlling shareholder with a view to arrive at a solution between the parties. Direct meetings between the parties have taken place in the third quarter of 2008 with a view to arrive at a solution, as stated.

Various issues and possibilities have been discussed in this respect. The structure of the capital of FIBI, the arrangements between the bank and its controlling shareholders as well as the Bank's holdings in FIBI are among the issues being discussed. At this stage no arrangement has been formalized and the ideas introduces were preliminary and premature.

Pursuant to FIBI's request and its controlling shareholder and against the background of the crisis in the financial markets in general and the uncertainty existing in the Israeli capital market in particular, negotiations between the parties have been brought to a halt.

An opinion in the matter of the provision for impairment in value. For details regarding an opinion received by the Bank according to which the recoverable value of the investment does not fall below the equity value of the investment see Note 6 F to the financial statements. The valuation is available via the MAGNA site on the Israel Securities Authority website and via the MAYA site on the Tel Aviv Stock Exchange website.

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.

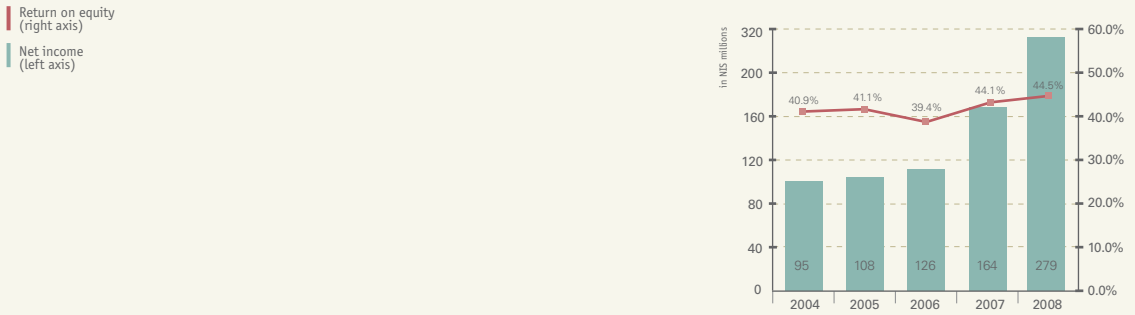
Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2008, the Bank owned 71.8% of the equity and 79.0% of the voting rights in ICC (for details as to the acquisition of the control in ICC, see Note 34 A to the financial statements). ICC issues and operates "VISA", "Diners" and "MasterCard" credit cards.

Total assets amounted, at the end of 2008, to NIS 7,615 million, compared with NIS 6,750 million at the end of 2007, an increase of 12.8%.

Total capital resources amounted, at the end of 2008, to NIS 802 million, compared with NIS 519 at the end of 2007. In 2007, ICC distributed to its shareholders a dividend amounting to NIS 110 million.

The ratio of equity to risk assets at December 31, 2008, was 19.3%, compared with 14.6% at the end of 2007.
ICC's Board of Directors has determined a capital ratio target that shall not fall below 15% until the end of 2009, and accordingly resolved not to distribute a dividend until this target is reached. After this goal is attained ICC will not distribute a dividend that would cause the capital ratio to fall below 15.5%.
In view of the above decision, the Bank cancelled the provision for taxes in respect of its share in ICC's earnings not yet distributed in the amount of NIS 20 million.
Total income amounted in 2008 to NIS 1,118 million, compared with NIS 946 million in 2007, an increase of 18.2%.
Net income amounted in 2008 to NIS 279 million, compared with NIS 184 million in 2007, an increase of 51.6%.
Return on equity reached 44.5% in 2008, compared with 44.1% in 2007.
The contribution of the Bank's investment in ICC to the net results of the Bank in 2008, amounted to NIS 189 million, compared with NIS 87 million in 2007.
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.

ICC – NET INCOME AND RETURN ON EQUITY



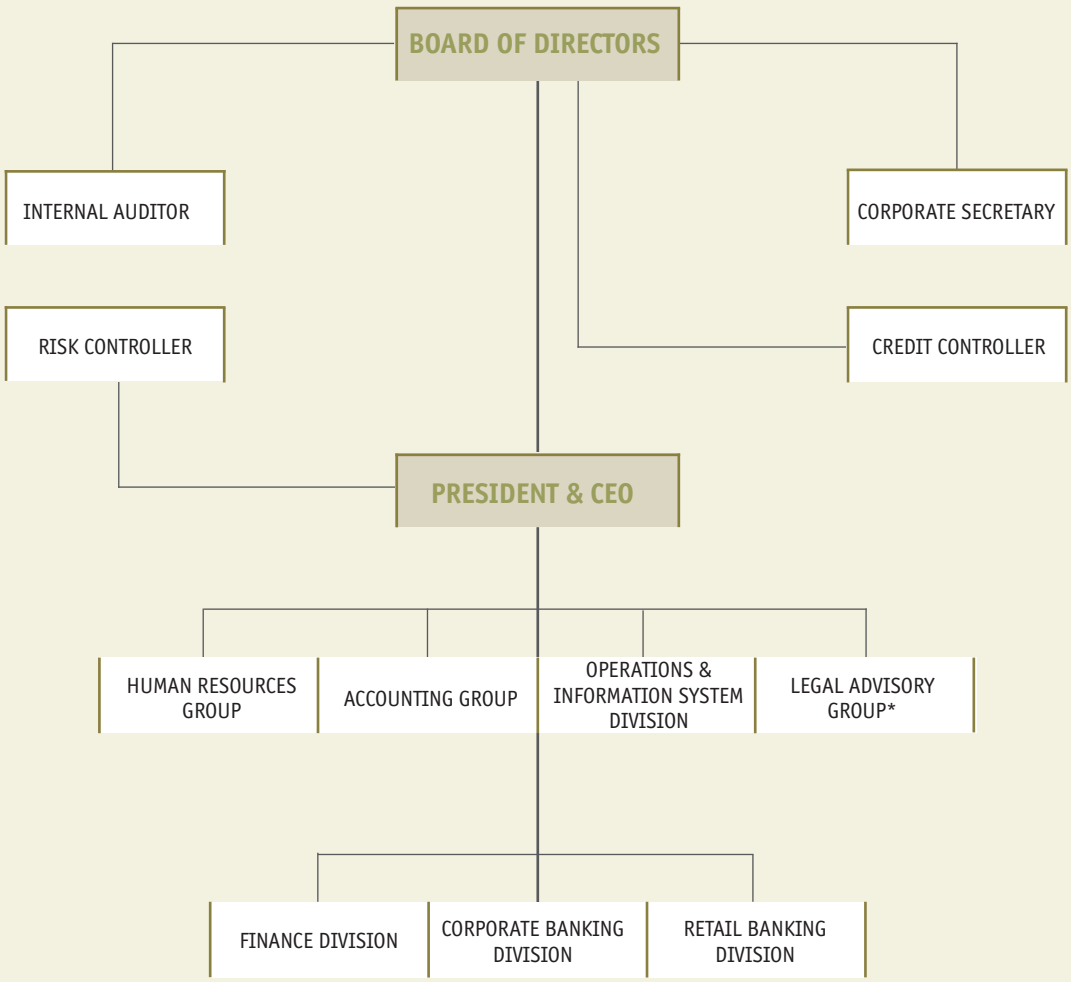
ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

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, 2008 amounted to NIS 723 million, compared with NIS 733 million at the end of 2007, a decrease of 1.4%.
The loss in 2008 amounted to NIS 191 million, compared with net income of NIS 11 million in 2007. The loss stems primarily from write-offs and provisions for impairment of investments in the amount of NIS 150 million and from financing expenses.
As a result of the loss, DCMI's ratio of capital to risk assets, as at December 31, 2008, decreased below the required minimum. In December 2008, the Bank and DCMI settled the matter.
Contribution of the Bank's investment in DCMI to the Bank's results amounted in 2008 to a loss of NIS 191 million, compared to income in the amount of NIS 8 million in 2007 (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 2008, DCMI, through a subsidiary, participated in 5 public offerings of securities (all of which with no underwriting)

with a total volume of approximately NIS 2.7 billion (23 public offerings with a total of approximately NIS 6.7 billion in 2007), and in one placement of securities with a volume of approximately NIS 0.1 billion (8 private placements with a total volume of approximately NIS 2.7 billion in 2007). Of the said issues in 2008, public issues of a total amount of NIS 1,967 million and one private placement of an amount of NIS 135.5 million, were issued made by the Discount Group. As to an indictment filed against DCMI and against two of its former employees, see Note 19 C 15.3 to the financial statements.

HUMAN RESOURCES

ORGANIZATIONAL STRUCTURE CHART



* Subordinated to the Legal Advisory Group are , inter-alia, the Bank's Compliance Officer and Officer in charge of money laundering prohibition matters, appointed under the provisions of the prohibition of money laundering law and the secondary legislation under it.

A CHANGE IN THE ORGANIZATIONAL STRUCTURE

The Bank's Board of Directors, in its meeting of November 30, 2008, approved the plan for a change in the Bank's organizational structure.

The objectives of the change are maximizing efficiency as part of the implementation of the long range strategic program, reduced labor costs, concentration of specialization and increased customer focused. The change is expected to take place during the coming months.

The principal changes include:

A. Dissolution of the Marketing and Strategic Planning Division and the Customer Assets Division, and a respective reduction in the number of management members;
B. Merger of the investment consulting field and the pension consulting field under the Retail Banking Division;
C. Transfer of the trading and securities operations to the Finance Division;
D. Subjecting the Strategy Group directly to the President and CEO;
E. Transfer of responsibility for foreign operations to the Corporate Banking Division;
F. Transfer of all the logistics units to the Operations and Information Sysems Division.

The reorganization, in addition to changes made and to be made in the computer group (see above "Information and computer systems") is expected to reduce the Bank's labor force, in the course of 2009, by about 300 employees, this following a significant reduction in the labor force since March 2008, which reached 400 employees by the end of 2008 (a reduction of 253 employees between December 2007 and December 2008).

The efficiency program in the computer field is to also continue in 2010.

The above information is considered a forward looking statement, which reflects the plans of the Bank's management at date of publication of this Report. These plans may not materialize in case of delays occurring in the shutdown date of the Unisys computer, changes in the scope and order of preference of assignments in the field of information systems in view of changes in regulation and urgent business requirements, which may bring about changes in the preparation or the ability to carry out the Bank's existing plans as of date of publication of this Report.

LABOR FORCE AND PAYROLL COSTS

There were 6,227 employees in full-time positions in the Bank in Israel (not includeing the Bank's branches abroad) at the end of 2008, compared with 6,400 at the end of 2007, a decrease of 2.7%.

The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas branches) rose in 2008 and amounted to 6,282, as compared to 5,875 in 2007, an increase of 407 employees on a monthly average, 6.9%.

There were 10,426 full-time positions in the Group in Israel and abroad at the end of 2008, compared with 10,402 at the end of 2007, an increase of 0.2%.

The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2008, was 10,382, compared with 9,710 at the end of 2007, an increase of 6.9%.

Following or the labor force data of the Group and the Bank, in terms of positions[1]:

	As of December 31		Monthly average in	
	2008	2007	2008	2007
The Bank in Israel	6,227	6,400	6,282	5,875
Domestic subsidiaries	3,296	3,050	3,183	2,912
Group total in Israel	9,523	9,450	9,465	8,787
Overseas branches	35	37	37	35
Overseas subsidiaries	868	915	880	888
Group total overseas	903	952	917	923
Group total overseas and Israel	10,426	10,402	10,382	9,710

(1) Position - Full-time position, including specific overtime hours, hours worked by subcontractor employees and others.

Following are details of he cost per position, in NIS thousand:

	2008	2007	Change in%
The annual average direct cost per employee position in the Bank in Israel	198	221	(10.4)
The total annual average cost per employee position in the Bank in Israel, not including voluntary early retirement expenses	322	321	0.3
The average annual overall payroll cost per employee of the Group in Israel and abroad	299	312	(4.2)

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, 2008, there were 3,875 tenured employees in the Bank (December 31, 2007: 3,813 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, 2008, there were 2,033 temporary employees in the Bank (December 31, 2007: 1,729 temporary employees). The increased employment of temporary employees derives mostly from the implementation of the Manpower Companies Law. Furthermore, in accordance with an agreement between the Bank and the employees' representatives signed in 2002, 265 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, 2007: 244 computer 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).

On February 1, 2009, the Bank signed an agreement with the representative committee of the employees enabling the Bank to employ, with the consent of the committee, and for an indeterminate period of time, persons who completed seven years of temporary employment with the Bank, at terms similar to those applying to them as temporary employees.

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, 2008, the Bank employed, in practice, 66 personnel (including members of management) under personal employment agreements (December 31, 2007: 65 employees engaged under personal contracts).

In addition, the Bank acquires services of manpower company employees and software houses.

As of December 31, 2008, 71 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, 2007: 524 manpower company personnel). The decrease in the number of manpower companies' employees stems from completion of the implementation of the Manpower Companies Law, namely, non-employment of staff through manpower companies for periods exceeding nine months.

As of December 31, 2008, 947 software house personnel were employed in the Bank. These employees are engaged mainly in software development tasks (as of December 31, 2007: 1,114 software house personnel).

Following is a summary of employment data in the various categories and the changes therein compared to the end of 2007:

Employees	Tenured employees, personal contracts and members of management	Temporary employees	Manpower companies	Software house	Total
December 2007	3,878	1,729	524	1,114	7,245
December 2008	3,941	2,033	71	947	6,992
Difference	63	304	(453)	(167)	(253)
Positions					
December 2007	4,009	1,841	300	1,251	7,401
December 2008	4,051	1,955	31	946	6,983
Difference	42	114	(269)	(305)	(418)

* Includes positions detailed in the Bank's human resources data: 250 in December 2007 and 190 in December 2008.

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.

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.

On February 1, 2009, the Bank signed an agreement with the representative committee of the employees enabling the Bank to employ, with the consent of the committee, and for an indeterminate period of time, persons who completed seven years of temporary employment with the Bank, at terms similar to those applying to them as temporary employees.

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.

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.

The salary of employees employed under various personal or temporary agreements, and who earn at least a total monthly wage of NIS 10 thousand, was reduced by 5.5% for a period of twelve months starting February 2009, without affecting the level of salary for social benefits purposes. Employees of the managerial level, agreed, with the consent of the managers' representative committee, to forego the "13th month" salary for 2009, where under certain circumstances, the reinstatement of 40% thereof will be considered at the beginning of 2010. Employees of the clerical level, agreed, with the consent of the clerks' representative committee, to forego the pay for five vacation days as well as the Jewish New Year gift.

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. As at December 31, 2008, the staff of the managerial grade numbered 1,179 (December 31, 2007: 1,148 employees).

OFFICERS AND SENIOR MANAGEMENT MEMBERS GROUP OF THE BANK

Members of this group of employees are subject to a prior notice period larger them 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. For details regarding an award plan for members of management, see Note 16 to the financial statememts. 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 plan for 2008.

Award in respect of 2008. The Board of Directors of the Bank decided to grant employees of the Bank a special award in respect of 2008 equal to one half of a monthly salary.

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, held by the Bank and extended from time to time.

RETIREMENT OF EMPLOYEES

In the years 2000-2008, 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.

86 employees retired during 2008, of which 28 took early retirement. 172 employees retired during 2007, of which 103 employees took early retirement. 262 employees retired during 2006, of which 205 employees took early retirement. In total, 1,627 employees retired from the Bank in the period 2000-2008, of which 1,101 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.
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 three managerial training courses:
- Training reserves for position appointments (junior management, intermediate management and senior management levels);
- 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;
- Professional training adapted to the needs of managers in the various divisions (corporate division, finance division and operations department);
- Personal development is achieved by a variety of methods designed to improve qualifications, evaluation and feedback:
  - Personal counseling upon a manager's entry into a new position;
  - Sociometry and emotional intelligence as part of executive training;
  - "Reporter evaluation" (evaluation of managers by their staff) and self-evaluation (by the manager) as well as a complementary process of personal counseling feedback for the manager, as the initiation of a coaching process.
    A process of "reporter evaluation" was conducted during 2008 with regards to unit managers in the Corporate Division and at the headquarters of the Retail Division. A coaching program has also been completed with regards to regional managers, their deputies and all of the Bank's branch managers.
- Improving professionalism and preservation of the professionals -
  Recruitment of and designing a manpower mix with a "desirable" profile, framing and integrating career courses and training and preservation programs of core banking duties: structuring and implementing development courses for investment consultants, structuring a development course for economists in the asset field and a general effort for the strengthening the professionalism of tellers as salespersons providing promotional service to the customer.

- Development on the organic level -

  Implementation of a multi-disciplinary approach for development on the basis of the "custom made" principle; namely, a basket of organizational and personal development activities designed for the unique needs of the organic unit, designated professional teams and/or professional groups (based on occupation and/or hierarchy grading) from the aspect of organizational consulting, service, training and organizational culture. The activity basket is the product of a comprehensive organizational survey.

  In 2008, organizational consulting was introduced as accompaniment of the organizational change in the Tel Aviv Main Branch, the business centers and as part of the establishment of new concept branches, as well as professionals in the Information Technology Group.

IMPROVEMENT OF SERVICE

Discount Bank is in the midst of a multi-annual effort for the integration of a culture that sees the customer experience as the center of the organizational endeavor. 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 a positive service experience.

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.

During 2008 the Bank developed and integrated a language and rules designed to serve as "business culture at Discount Bank". A comprehensive effort was undertaken with regards to training in this field, measurement and drawing conclusions at the branches.

Measurement of service quality. The bank is performing a process of measuring the service quality at the business units. The measurement products are brought to the attention of the managers and comprise a managerial tool for improving the service quality at their units.

The Bank is studying the customers' reaction and is implementing a process of studying the complaints, drawing conclusions and their integration.

INFORMATION MANAGEMENT

Information management constitutes an important layer in the management of employee professionalism, influences the quality of service at the Bank and forms a part of the work procedures therein.

Information management is designed to provide an answer to several central challenges:

- Accumulation of professional knowledge, its preservation and its reuse;
- Knowledge sharing by all relevant factors in the organization;
- Turning covert knowledge into overt knowledge;
- Directing the required information to the user in the shortest possible time;
- Improving performance and attaining business goals.
- Shortening of reaction time and the transfer of required knowledge in the fastest and most efficient manner;

The organizational portal on the Intranet system at Discount Bank comprises a central tool in Information management. Dozens of substance experts currently maintain information communities and information sites. These sites and communities are connected to the core business activities and to central organizational processes, thereby supporting raising the level of employee professionalism and customer satisfaction. A prominent example is the establishment in 2008 of a designated content area in the portal dealing with the issue of pension consulting.

Statistical data indicate broad use by the employees of the information management tools, which enable beneficial sharing of professional and organizational knowledge.

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.

The development of tools and framework for operational needs is performed while emphasizing aspects of cost saving and efficiency.

The Bank's information management activity in 2008 focused on the establishment of information communities in the organizational portal and their upgrading. Resources have been invested in improvements and organizing the content at the sites, in order to make them user friendly.

In addition, the activity of the organizational forum of leaders of information communities - the forum for information sharing regarding methodology and tools, has continued alongside studying developments in this field at other organizations in Israel.

ORGANIZATIONAL CULTURE

The Discount code of ethics. The Bank's code of ethics was formed by an internal team of employees and managers from all parts of the organization. The code is based on five basic values of Discount Bank humane banking vision of: the love of humanity, professionalism, integrity, initiative and commitment.

Integration of the Bank's code of ethics was launched at a designated management workshop, which instigated a set of discussions at management, division headquarters, layouts and unit levels. The process of integrating the code in the organization was intensified in 2008, lead by managers according to the management chain.

As part of the long term integration of the code of ethics in the daily existence of the organization, relevant tutorials have been integrated into the employee training track, starting with the teller course, through service teams and with additional focus, in the development programs for managers at the Bank.

A member of management, head of the Bank's Human Resources Group has been put in charge of ethics at Discount.

Initiative. Within the framework of forming an innovative organizational culture that includes initiative and creativity at all levels of activity at the Bank, the following projects were conducted in 2008:

- "Development of enterprise and creativity" - training a chosen group of highly motivated young employees with entrepreneurial abilities for the purpose of serving as "innovative engines" in the organization.
- "Headquarter initiative" competition - promotion and execution of projects beneficial to the profitability of the Bank, its customers, employees, the community and the environment, focusing on initiative and professionalism. Over 80 business enterprises have been submitted as part of the competition, including these that promoting the quality of the Bank's management and human resources.

  It should be noted that the winning team donated the prize money in favor of the activities of the chosen enterprise.

Intra-organizational communication - "Taking you personally". The Bank is investing in the development of open

and two-sided communication with its employees, within the framework of realizing the promise of "taking you personally" with respect to both external and internal customers. The intra-organizational communication layout is designed to strengthen the employees feelings of kinship and commitment, while cooperating and providing answers to their questions and expectations.

In order to sense the employees' state of mind, challenges and questions, the Bank conducted in 2008 meetings at various levels, discussion groups and feedback processes, including:

- A round table - meeting of the CEO with the Bank's "distinguished service team";
- Monthly tours - visits of management members at field units accompanied by senior managers from their headquarters;
- Intra-organizational surveys.

With a view of broadening employees' knowledge and understanding as to the total activities of the Bank and in order to deliver organizational messages, a variety of communication lines were also used during 2008, including: Senior Forum - a quarterly meeting led by the CEO; "Morning magazine" - a weekly television newscast presenting subjects standing at the core of the Bank's endeavor; Employee portal (Intranet) and more.

Measurement and evaluation. In 2008 resources were invested in improving the measurement and evaluation tools, with a view of creating an infrastructure for an objective and relative measurement of production, creating true differentiation and instigating action.

TRAINING

In 2008, the staff at the Bank received a widespread response to their professional requirements through extensive and focused training and guidance.

The knowledge gaps in various areas were filled in during the year according to the identification of needs conducted at the various units. Among other things, an answer has been provided for training needs derived from regulatory instructions that have effect on the banking industry and/or consumer instructions such as the Commissions Law.

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.

In the course of 2008 strategic moves at the Bank were addressed at the training level, including:

- Training of staff from the branch layout and from headquarter units for conducting the extraction of operational activities from the branches and transferring it to the Operational Group;
- Continued preparation for providing services to state employees, by means of a comprehensive update of the auxiliary set for dealing with State employees and teaching personnel;
- Continued preparation by the Bank for providing pension advisory services, through the training of a group of investment consultants towards examinations conducted by the Ministry of Finance entitling a pension consultant certificate.

A special effort was undertaken this year to complete knowledge gaps and specialization of those engaged in the granting of credit.

As part of improving professionalism, the process of training investment consultants also continued this year. Four new courses were developed joining the other courses required for the consecutive training of investment consultants within the framework of their careers at the Bank.

An additional population which was focused on as regards training was the service teams at the branches. A new course was established for the training of tellers for work in the service teams.

With respect to retail banking, a training program was formed, based on the integration of managing the relations

with the customer around life cycle events and significant events. As part of this training the staff was given tools and expertise for managing service and sales with a customer focused approach and a performance support system was studied and integrated.

In addition intensive support was given to 11 focus branches for attracting State employees and to designated branches in the various regions. Within this framework branch managers were given support in task and personnel management areas, as well as support to bankers in the field during meetings with customers and the conduct of initiated connection with the customer.

Furthermore, tutorials were prepared with respect to three editions of software launched in 2008. Inter-bank transfers, banker drafts and standing orders. Training was also provided to headquarter units regarding these matters.

The number of training days in 2008 reached 31,157 compared with 40,830 training days in 2007. This data indicates a decline of 23%. The decline derives mainly from the fact that in 2007 extensive training was conducted on the subject of State employees, pension consulting and new tellers.

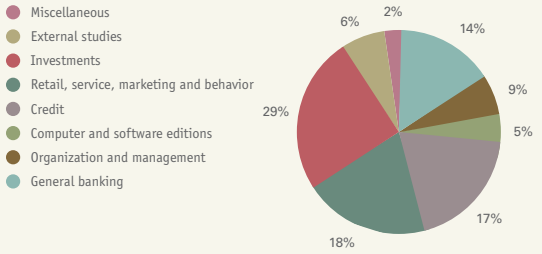
The data regarding the number of trading days relate to actual training days on the College premises, and do not reflect individual study activity that was widely implemented with respect to all subjects and sectors.

Investment in training. The Bank's investments in training and in the development of human resources amounted to NIS 20.1 million in 2008, compared with NIS 19.7 million in 2007. 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.

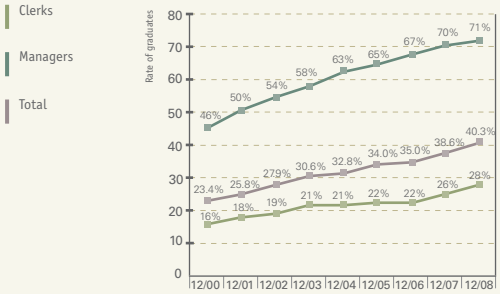
Furthermore, for the purpose of conducting the training, the Bank appoints mentors and training partners who are Bank employees and who, in addition to their regular work, assist in training and in the preparation of training material. The cost in this respect in not included in the above amount.

The increase in the expense in 2008 in comparison to 2007, derives mainly from the intensified process of integrating the code of ethics code at Discount Bank, enhancement of the intra-organizational communication channels, and conducting a comprehensive process of personal coaching all along the managerial line in the branches layout and among the managers at the business headquarter units.

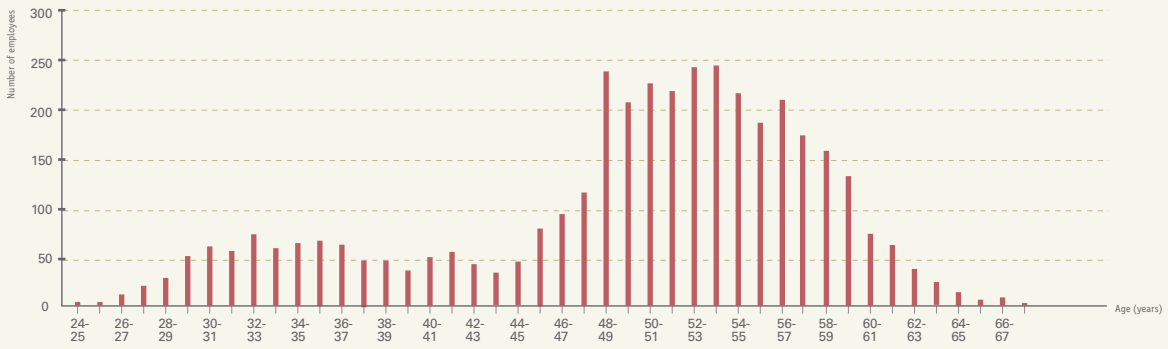
TRAINING DAYS BY TOPICS



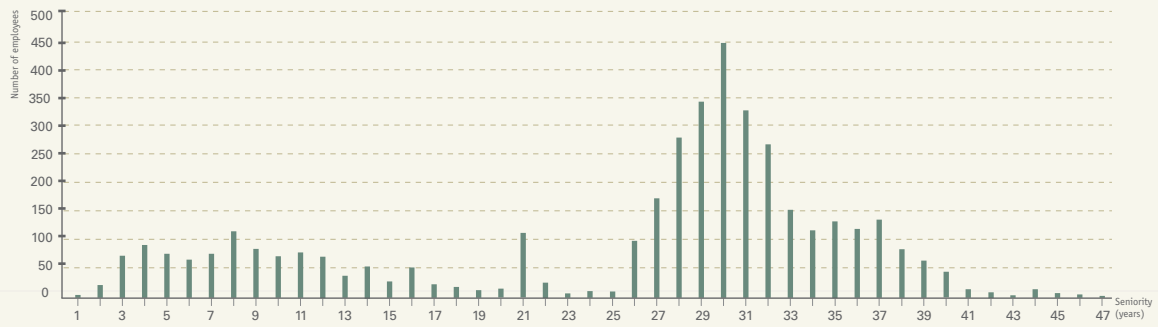
THE RATE OF UNIVERSITY GRADUATES ACCORDING TO GRADE



DISTRIBUTION OF TENURED EMPLOYEES BY AGE – DECEMBER 2008



DISTRIBUTION OF TENURED EMPLOYEES BY SENIORITY - WORK FORCE AT DECEMBER 2008



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 Arrangement (Temporary Provision) Law, 1993, (hereinafter - "the Bank Shares 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. For additional details see "The Bank Shares Arrangement Law" hereunder.

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 was given an option to purchase from the state a further 25% of the outstanding capital of the Bank and of the voting rights therein which expired at the end of 2008.

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.

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-Schron 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-Schron 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.

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.

According to information received by the Bank, the loan has been repaid, with the exception of a negligible amount which is in dispute. The parties are negotiating this issue, including the matter of releasing the Bank shares pledged in favor of the State to secure the loan.

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).

In the event that the option to purchase a further 245,159,802 shares would have been exercised, the Buyers would have had to 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 had been set at 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 was exercisable by the Buyers or either of them in accordance with the ratio of their holdings of the controlling interest. As stated above, the option exercise period terminated on December 31, 2008, and the option expired unexercised.

The agreement specified an additional consideration, which the Buyers might have been required to pay to the State, in an amount of up to NIS 156 million, which had been conditional on the cumulative return on the shareholders' equity of the Bank in the period beginning on October 1, 2004 and ending on September 30, 2008, as well as terms of settlement of such consideration. The conditions for the payment of the additional consideration did not materialize.

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 the to Edgar M. Bronfman, Matthew 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 int 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 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 mae, 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 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. Rubin Schron, Matthew Bronfman and Michael Rubinoff were permitted to hold a higher share of the right to participate in the earnings of the Bank, in accordance with the terms of the cooperation agreement between members of the Group.

   (b) The Group's members shall at all times hold the control and means of control in the Bank in the percentages and manner st 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 Banking Law (Legislation), 1981, (hereinafter: "Banking Law (Legislation)), 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 paragraph 4 and 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 Banking Law (Legislation).

   (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 indentical 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 ration 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.

For details regarding the amendment of the permit granted by the Governor and the approval of the Supervisor of banks for the amendment of the agreement for the sale of a core of control in the bank, see below "Instituting the cooperation as from January 1, 2009 and thereafter".

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 whereto 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. (regarding the amendment of the provisions of the agreement concerning this matter following the termination of the support period and the expiration of the option, see under Section "Instituting the cooperation arrangements between the Buyers and the Government as from January 1, 2009 onwards" hereunder).
- 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. (this provision is still in effect, even after the amendment of the agreement, as stated under the Section "Instituting the cooperation arrangements between the Buyers and the Government as from January 1, 2009 onwards" hereunder).
- 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 Arrangement Law. (Regarding the provisions of this law, see the "Bank Shares Arrangement Law" below) (this provision has come to an end following the termination of the support period and the expiration of the option).

- 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, 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, 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 money 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 Government pledged that during the restriction period it will not sell Bank shares by way of a private sale, not according to terms of a Prospectus, to a single investor or a group of investors acting, to the best of its knowledge, in unison, in an amount exceeding 4.9% of the issued share capital of the Bank (together with prior holdings of that/those investor/investors, to the extent of the Government's knowledge), without the consent of the Buyers. No limitation is to apply to the sale of Bank shares by the Government in the course of trading on the Stock Exchange, and the Government shall not be restricted in exercising its right under the agreement to participate in the sale of shares by the Buyers or to include a sale of shares it owns in a public offering of shares made by the Bank.
- 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 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 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 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 Arrangement Law, with regard to the restriction of the exercise of the voting rights of the Government.

INSTITUTING THE COOPERATION ARRANGEMENTS BETWEEN THE BUYERS AND THE GOVERNMENT AS FROM JANUARY 1, 2009 ONWARDS

As stated above, according to the agreement for the sale of the controlling interest in the Bank, the exercise period of the option given by the State of Israel to the Bronfman-Schron Group for the purchase of 25% of the Bank's shares held by the State, terminated on December 31, 2008. On this date the Support Period determined in the Agreement also expired.

Following previous notices delivered to the Bank regarding provisional extensions of the terms specified in the agreement, in everything connected to the exercise of voting rights attached to the shares of the Bank held by the Government and to the shares of the Bank owned by the Buyers, including provisions regarding the voting in general meetings of shareholders of the Bank and regarding the appointment of Directors of the Bank.

On February 15, 2009, the Bank received notice with respect to an amendment of the agreement for the sale of the controlling interest in the Bank. This amendment relates to the provisions of Section 11 of the agreement with respect to the appointment of Directors at the Bank (which are described above in the Section "Arrangements with regard to cooperation between the Buyers and the Government in respect of holding shares of the Bank and exercising control of the Bank").

According to the amendment, the arrangements regarding the appointment of Directors in the Bank shall also apply in the period from February 16, 2009 until February 15, 2010 (hereinafter: "period of agreement"), subject to the following changes: so long as the Government holds at least 10% of the Bank's issued capital, the members of the Bank's Board of Directors, at any time, shall number at least 5 Directors, the identity of whom shall be determined by representatives of the Government, and not more than 8 Directors suggested for election by the Purchasers. In the event that the rate of holdings by the Government in the Bank's issued share capital shall fall below 10% during the period of agreement, the number of Directors suggested by the Purchasers shall not exceed 11, while the number of Directors whose identity is to be determined by representatives of the Government, will be 2. In addition, the identity of candidates suggested to act as outside Directors on the Bank's Board, shall for the first time during the period of agreement, in February 2009, be determined by the Purchasers and thereafter by the Government representatives, and so on and so forth. The parties shall also act towards the appointment of an additional Director in the Bank, whose identity will be determined by Government representatives, so that the total number of members of the Bank's Board of Directors will reach 15.

Each of the parties may terminate the said amendment by way of a notice in writing to the other party 15 days in advance. Nothing in the contents of the amendment to the sale agreement shall in any way limit the rights of the State of Israel and of M.I. Holdings Ltd. with respect to the sale of Bank shares held by the State.

All other terms of the agreement remain unchanged, and accordingly, other provisions regarding the cooperation during the supporting period (as described above in the Section "Arrangements with regard to cooperation between the Buyers and the Government in respect of holding shares of the Bank and exercising control of the Bank"), have come to an end.

The Bank was further informed that following of the said amendment to the agreement, the permit granted to the Buyers on January 29, 2006, by the Governor of the Bank of Israel for the control and the holdings of means of control in the Bank, was amended on February 9, 2009, in a manner that allows the Buyers to permanently cooperate with the Government of Israel with respect to operating the control in the Bank, in accordance with the sale agreement as amended, to be approved in writing in advance by the Supervisor of Banks. The amendment to the permit further clarifies that extending the period of the agreement itself shall not require receipt in advance of an approval, and notice thereof shall be given to the Supervisor of Banks in writing within seven days of the date on which the period of the agreement was extended.

The Bank was also notified that in accordance with that stated in the amendment to the permit, the Supervisor of Banks approved on February 9, 2009, the said amendment to the agreement for the sale of the controlling interest in the Bank. The said notice clarified that nothing in the above detracts from the right of any of the parties to disagree with the continuation of the effect of the said stipulations (in whole or in part) subsequently to January 15, 2009, and nothing in the above limits in any way the Government or M.I. Properties from selling their shares in the Bank.
Representatives of the Buyers further informed that the parties are negotiating a further extension of the cooperation between them and its scope.
According to the information given to the Bank, the Supervisor clarified in February 2009, in response to an approach by the Bronfman Group, that he will allow the controlling group to appoint an observer on its behalf to the Board of Directors of the Bank, and that the restrictions applying to a Director of the Bank will also apply to the observer.

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").
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. To the best of the Bank's knowledge, no amendment has been made to the cooperation agreement following the amendment of the agreement for the sale of the controlling interest in the Bank of February 2009, as detailed under "Instituting the cooperation arrangements between the Buyers and the Government as from January 1, 2009 onwards" above.

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 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. Matthew 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.

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 its possession.

On March 12, 2009, the Bank Shares Arrangement Instruction (Temporary Provision) (Appointment of other committees and the period of their tenure), 2009, were published in the Official Gazette, according to which, the public body shall appoint a committee in the matter of the Bank's shares for an additional period of three years, however, the committee's term of office shall be terminated prior to the end of this period if the Government's holdings in the Bank's shares will fall below 10%. Accordingly, the Bank's shares committee has been reappointed.

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.

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"). On February 7, 2005, the Audit Committee of the Bank and the Board of Directors of the Bank approved the Bank joining the Agreement. On April 5, 2005, the General Meeting of Shareholders of the Bank approved the Bank joining the Employees Agreement. The Finance Committee also approved the Employee Agreement.

The Employees Agreement was 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.

The Employees Agreement determined, among other things, that 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 Employees Agreement further determined that 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.

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, (hereinafter: "the Mercantile Employees Agreement"). 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. The Mercantile Employees Agreement was 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 Mercantile Employees Agreement determined, among other things, that 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.

REPAYMENT OF THE STATE'S DEBT WITH RESPECT TO THE AWARD TO EMPLOYEES

An agreement with the employees stated, among other things, that the employees are to receive from the Government an amount of NIS 120 million in consideration for the waiver of their right to acquire the Bank's shares at a discount (hereinafter: "State's award to employees"). It was also provided that the employees will receive from the Bank an amount of NIS 130 million (hereinafter: "Bank's award to the employees").

It should be noted that in a conversation held between the President and CEO of the Bank and the Deputy Accountant General at the Ministry of Finance, it has been clarified to the Bank that the amount of the Bank's award to the employees (an amount of NIS 130 million, as stated), reflects the overall cost to the Bank as the employer of the said employees.

It is further noted that the approvals granted by the Audit Committee, the Board of Directors and the General Meeting

of Shareholders for the attachment of the Bank to the agreement with the employees, emphasized that the total cost (cost to the employer) to be borne by the Bank shall be NIS 130 million (and should not exceed this amount).

The agreement with the employees provided that the State's award to the employees and the Bank's award to the employees (hereinafter: "the total award") shall be an amount of NIS 250 million. The total award is to be paid to the employees subject to the closing of the agreement for the sale of the controlling interest in the Bank, on the following dates: (1) an amount of NIS 205 million payable during September 2005 or soon after the closing, the later of the two; (2) an amount of NIS 45 million payable no later than at the end of three years from the date of closing or proximate to the date of exercise of the option granted to the Buyers, in the event that the Buyers choose to exercise their right to acquire the option shares in full or in part, at an earlier date (hereinafter: "the deferred payment").

In the first quarter of 2006, soon after the closing of the agreement for the sale of the controlling interest in the Bank, the Bank and its relevant subsidiaries paid the total award agreed upon in the employee agreement. Thus the rights of the employees for an award in accordance with the agreement with the employee agreement.

The total cost of the award, including related expenses (payroll VAT and National Insurance contributions) amounted to NIS 305 million. In view of the above stated ,the award to be paid by the State will amount to to NIS 175 million, of which an amount of NIS 120 million was paid to the Bank in March 2006. The balance of the State of Israel debt to the Bank with respect to the award to Discount Bank employees amounts therefore to NIS 55 million and its payment is due on February 1, 2009.

According to information relayed to the Bank, concurrently with the signing of the agreement for the sale of a controlling interest in the Bank, an agreement was signed between the Bronfman-Schran Group (hereinafter: "the Buyers") and the Government, regarding interim financing of the deferred payment component of the State's award to the employees, in respect of that part of the option not exercised by the Buyers. According to the said arrangement, in the event that the Buyers will not exercise the option in full, as actually happened, they will have to finance the deferred payment (an amount of NIS 45 million - see above). The repayment of the interim finance is as follows: at any date on which the State will sell shares of the Bank, it will pay the Buyers a proportion of the consideration received by it based on the ratio of the number of shares sold by it to the number of option shares not exercised. The balance is repayable at the end of eight years.

According to information communicated to the Bank, in conversations held between the State and the Buyers at the beginning of 2009, the State agreed to waive the loan which the Buyers were obliged to grant to it on February 1, 2009, as stated above, subject to the following conditions:

- The Bank shall agree to defer the date of repayment by the State of Israel of the deferred payment for a period of a few months (with possible extension) in consideration for the payment of interest (see hereunder). This in order to enable the Accountant General at the Ministry of Finance to budget the repayment of the debt to the Bank;
- The Buyers will pay to the State an amount equal to the amount of interest paid to the Bank by the State in respect of the delay in repayment of the deferred payment;
- The Buyers will pay to the State the value of the benefit inherent in the interim finance they committed to provide to the State in respect of the deferred payment.

The authorized organs of the Bank approved towards the end of January 2009, the entry into an agreement of the Bank with the State of Israel for the granting of a loan in an amount equal to the amount of the debt of the State to the Bank, under accepted commercial terms.

Soon afterwards, the Bank submitted to the Accountant General an agreement in this respect signed by the Bank. In response, the Bank was informed by a representative of the State that in view of personnel changes in the Department

of the Accountant General, the State requires a short respite to study the matter.
As of date of publication of the financial statements, the said debt has not yet been repaid and the agreement in its respect has not been signed.
On March 1, 2009, the Accountant General requested the Bank for a confirmation certified by the auditors of the Bank as to the amount paid to the employees and details regarding the taxes applying to this payment.

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 an on its own behalf (for example: investment consulting and customer portfolio management, pension consultating, 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.

For further details regarding Standards amendment and the preparations made by the Bank with respect to the reform of the structure of the capital market in Israel see "Operations in the Capital Market" under "Further details regarding activity in certain products".

Additional legislation initiatives. During the year, the Ministry of Finance and the Securities Authority prompted a comprehensive amendment of the Mutual Investment Trusts Law, 1994, that will allow the offering of participation units in foreign mutual funds in Israel. Also published in July 2008, was the Bill for the amendment of the Law regulating the engagement in investment consultation, in marketing investments and in investment portfolio management, 1995, which would allow foreigners qualified to provide investment consultation, investment marketing and investment portfolio management in their country of origin, to also provide these services in Israel without a license requirement, provided the terms to be fixed in the Law are fulfilled. It is further proposed to expand the list of entities to which consulting services or investment marketing may be provided without a license, to also include, among other things, private customers having a large investment portfolio (NIS 15 million and over) as well as other amendments.

In August 2008, the Ministry of Finance published a law memorandum for the amendment of the law regulating the investment consulting business, the marketing of investments and the management of investment portfolios. Within the framework of the memorandum it is proposed, inter-alia, to include the basket certificates within the definition of a financial asset, so that whoever has an "affinity" to basket certificates (within the meaning of this term in the law) shall not be permitted to act as an investment consultant. If the said amendment is approved, the Bank will have to act towards severing its ties with companies issuing basket certificates and/or sell its holdings therein, until the year 2013.

The Ministry of Finance and the Securities Authority also acted towards the end of 2008 for the amendment of the Mutual Investment Trusts Regulations in order to remove obstacles regarding the continued development of the monetary funds. Among other things, it is proposed to expand the possibilities offered to the monetary funds to invest in commercial papers intended to provide short-term off-banking credit to corporations. It is further proposed to

mitigate the provisions as to the rate and type of deposits that these funds may invest in. All this with the objective of improving he yield potential of these funds and their attraction in relation to the alternative of a direct investment in bank deposits.

LEGISLATION AND ARRANGEMENTS REGARDING BANKING COMMISSIONS

In resent 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, which includes a parliamentary commission of inquiry that submitted a draft report in 2007.

Amendment of the Banking Law (Service to customer). The Amendment of the Banking Law (Service to customer) 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 replaced 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.

Following the enactment of the Law, the Governor of the Bank of Israel published on January 8, 2008, the Banking Rules (Service to customer)(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. Following this, the following amendments have been published in the Official Gazette: Amendment to the Banking Rules (Service to customer) (Fair disclosure and the delivery of documents), amendments to the said rules regarding commissions, update to the schedule of services under control and the maximum prices fixed in respect thereto and circular letters concerning clarifications with respect to the implementation of the price lists and the new rules.

The new list of charges issued following the amendment of the Law and secondary legislation enacted in its wake, came into effect in July 2008.

An amendment to the Banking Rules (Service to customer) (Commissions) effective as from September 1, 2008, was published on August 26, 2008. According to this amendment, an apartment building representative committee shall be considered an individual, and accordingly shall no longer be charged with the ledger commission charged to

small businesses (as defined in the Rules); senior citizens, the handicapped and customers who do not have a cash withdrawal card shall be entitled to 4 teller transactions per month at a price of direct channel transaction; as well as each transaction by way of a service box being considered as a direct channel transaction.

For further details regarding the new Law and its implications on commission income see "Activities of the Group according to principal segments of operation" under "Retails sector - Household segment".

As stated there, even after the amendment of the law has come into effect, public criticism addressed at the banking industry and the Supervisor of Banks has not subsided and additional private Bills were tabled proposing to impose further limitations on the level of commissions, their types and the population to which they would apply, etc. It was also proposed to change the mechanism for fixing the commissions and the supervision over them, and proposals requiring the banks to pay interest on customer current account credit balances were renewed. The Bank estimates that some of these proposals, the promotion of which has not progressed due, among other things, to the dissolution of the previous Knesset, will be tabled again with the renewal of the work of the Knesset following the presentation of the new Government. It is also expected that new proposals will be tabled regarding these matters. At this stage it is not yet possible to evaluate whether additional legislation and regulatory changes relating to banking services, commissions and/or interest in their respect will take effect and what the applicable arrangements will be, if any, and how these may affect the banking services consumption habits of customers. Accordingly, it is not yet possible to assess the implications this might have upon the Bank's results of operations in the future.

REFORM OF THE EXECUTION LAW

In November 2008, a comprehensive amendment to the Execution Law, 1967, was published. The amendment will come into effect in May 2009.

The Amendment to the Law, laid down, inter-alia, provisions with respect to the duty to provide protection by way of alternative housing arrangements, which would secure, in the case of foreclosure of mortgaged housing property and eviction of the borrower, financial assistance for alternative housing. The financial assistance would be in an amount enabling the borrower to rent a residential unit in his area of residence, that would suit his requirements and those of his family residing with him, for a limited period of 18 months. Under special circumstances the Chief Execution Officer has the authority to shorten or extend this period. The expenses incurred with respect to alternative housing will be considered as part of the debt and will be collectible from the borrower. The said protection will also apply to mortgage bills signed prior to the Law taking effect, which included a proviso that the alternative housing protection shall not apply, if the borrower is able to prove to the Chief Execution Officer that his right to alternative housing and the meaning of his waiver thereof had not been clearly explained to him by the bank.

The Bank and its relevant subsidiaries believe that the said Amendment is expected to have a material effect upon the housing loan markets in Israel as well as on the banks operating in this market, and it is being affected by the volatility inherent in exchange rates, interest rates and by the indices relevant to the option bought or written by the Bank. The volatility data of the dollar/Shekel exchange rate and of foreign currency to foreign currency exchange rate are determined by the Bank's dealing room in accordance with the money markets and are supervised by the middle office, being compared with several sources of information.

The Amendment further stipulates that the Chief Execution Officer is authorized to order banks to provide information as to borrower rights regarding the banking corporation, valid bank guarantees issued at his request and loans granted to him.

Additional legislation initiatives. During the year, the Ministry of Finance and the Securities Authority prompted

a comprehensive amendment of the Mutual Investment Trusts Law,. This will requires preparation for providing the required information by technological means.

In addition, according to the Amendment, an application for an attachment order in respect of alimony shall be submitted once a year and the order will be renewed every month without the submission of a new application being submitted, where in the Regulations (enacted by law) a mechanism will be established whereby the Execution Office will issue a new order every month, which will update the amount of the attachment and will cancel the previous order. Banks will be entitled to a payment of only NIS 7 in respect of all the periodic order issued under one request.

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 have prepared for the implementation of this Directive.

Two amendments to the sales Law were published in April 2008, that came into effect in October 2008. The amended Law 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 Banks 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.
At the same time, in April 2008, the Supervisor of Bank issued a binding directive to all banking corporations regarding the uniform version of the letter of guarantee, which came into effect on June 1, 2008.
According to the uniform 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.

PROHIBITION OF MONEY LAUNDERING AND PROHIBITION OF THE FINANCING OF ERROR 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 or 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, 2005 (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 knowing that such a person is active in terror activities or has been declared as such (according to a procedure determined in the Law) or effects a transaction in assets being aware of the fact that it may promote or finance the execution of terror activities, or remunerate in respect of the execution of terror activities - 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 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 have been implemented within six or nine months, and the Supervisor of Banks was authorized to extend, in certain circumstances, 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 continued 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.

To date, no notice has been received as to the completion of the process.

It should be noted that soon after the said resolution had been adopted by the Board, the Bank discontinued all those services and operations that are not related to the Bank of Israel Clearing House. In this respect, among other things, Israeli Shekel transfers to the Gaza Strip have been discontinued as well as foreign currency transfers to and from abroad and Automatic Bank Services transfers to Gaza.

Due to the period of time that had passed, the Board of the Bank repeated its instruction to Management to inform the Bank of Israel Clearing House and the relevant banks as to the discontinuation of representative services provided by the Bank to the said banks and branches. Accordingly, the Bank of Israel and the relevant banks were notified that the provision of representation services will cease on December 15, 2008, and Banking Clearing Center transfers from the Gaza Strip.

All banking activity with the Gaza Strip was stopped in January 2009, including the clearing of checks, transfer of funds in Israeli and foreign currency, electronic clearing of documents, and clearing through the Central Banking Clearing performed by the Bank Clearing Center. Mercantile Discount Bank has acted in a similar manner.

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.

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. On April 17, 2008, the Bank submitted its response in writing regarding the request for the imposition of the sanction. On July 13, 2008, an oral hearing took place before the Committee. Following the hearing the Bank submitted to the Sanctions Committee, on July 31, 2008 a supplements letter to the various matters raised during the hearing. The Bank believes that to the extent that sanctions would be imposed on it, these would not be in material amounts. In the course of September 2008, the Bank responded to the Commission's request for further details regarding one of the issues raised during the hearing.

On November 2, 2008, the Bank received notice of the decision of the Committee form the Imposition of Financial Sanctions to impose upon the Bank a monetary sanction in the amount of NIS 3.7 million. It should be noted that the Bank has been taking effective and operative actions to rectify the deficiencies and prevent their recurrence.

For details regarding the conviction of a former employee of Mercantile Discount Bank on offences under the Prohibition of Money Laundering Law, see above "Mercantile Discount Bank Ltd." under "Main investees 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" above.

PROHIBITION OF INVESTMENT IN CORPORATIONS MAINTAINING RELATIONS WITH IRAN LAW-2008

The said Law was published on April 8, 2008 intended at preventing Israeli financial institutions from investing in entities that maintain "material business relations" with Iran. The definition in the Law of a "financial institution" also includes a banking corporation.

The Law prohibits investments in entities that maintain material business relations with Iran, to be included in a "list" that will be published under the law. The law defines "investment" as also including loans for a predetermined period exceeding five years in an amount exceeding 5% of the equity capital of the borrowing corporate.

Where the investment had been made prior to the inclusion of the corporation in the list, the financial institute must sell its holdings within a specified period, though it is not obliged to require repayment of a loan that had been granted to a corporation prior to its inclusion in the list.

The Law assigns criminal liability in respect of effecting such an investment in violation of its provisions on the financial

institution as well as on the general manager and active manager of the financial institution, or on a senior executive in charge of that area at the head office, such offence being subject to imprisonment of up to one year.
The Law came into effect upon its publication; however it's implementation is conditional upon the "list" which has not yet been published. The Bank believes that the effect of this Law will not be material.

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.

EXEMPTION FROM A BINDING ARRANGEMENT WITH RESPECT TO THE HOLDING AND JOINT ACTIVITY WITHIN THE FRAMEWORK OF ABC AND CBC

Background. 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. (hereinafter: "ABS") and Bank Clearing Center Ltd. (hereinafter: "BCC"). 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.

Re-examination of the exemption in the course of 2007-2008. 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.

Renewal of the exemption from a binding arrangement in 2008. Following a new and comprehensive examination the Antitrust Commissioner decided, on November 5, 2008, to grant a conditional exemption from a binding arrangement in respect of the arrangement regarding the joint holdings and operations of the five large banks in ABS and CBC. The exemption is in effect for three years from date of the Commissioner's decision.

The exemption reiterates the conditions determined in the past and in addition stipulates that interested parties in the Bank and or members of management of the Bank and/or executives in charge of trading, accounting and/or retail operations at the Bank may not act as directors of ABS and CBC. Furthermore, anyone appointed as director of ABS or of CBC, prior to accepting office, must sign an undertaking to uphold the conditions of the exemption.

As part of the conditions of the exemption, SBA is permitted to act towards establishing an overseas backup site for the banking industry's data, which would provide backup services to any bank in Israel wishing to receive such service.

CONSORTIUM AGREEMENTS FOR THE GRANTING OF CREDIT

On August 18, 2002, following the cancellation of the "principles of conduct" document mentioned above, 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:

Joining 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 then 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.

Arrangement concerning consortium agreements for the granting of credit between banks and insurance companies. 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.

Extension of the arrangement concerning consortium agreements for the granting of credit between banks. On January 5, 2009, the Antitrust Authority informed bank managements that the Commissioner is conducting a re-examination of the terms for the joining together of banks in a credit consortium, and meanwhile has extended for six months as from January 5, 2009, the effect of the terms determined in her letter of March 8, 2007 (mentioned above).

LEGISLATIVE AND REGULATORY PROPOSALS WITH RESPECT TO THE PROTECTION OF THE ENVIRONMENT

During the past two years 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, and in October 2008, a draft circular in this matter was distributed. For further details, see "Environmental risks" under "Exposure to risks and risk management" above.
Concurrently, various legislative and regulatory initiatives were brought up 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. Also distributed during the year was a memorandum of a Government Bill in this respect. It should be noted that several laws regarding the environment were passed during the year, the effect of which on the banking industry is not expected to be material. The Bank believes that legislation and arrangement initiatives regarding the environment, both governmental and private, are expected to continue also in the future.

ABUNDANCE OF LEGISLATION INITIATIVES

The year 2008, 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 2008 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, and the decisions taken within the authority of the Antitrust Commissioner.
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. The Bank expects that this state of affairs will also continue in the future. See above also, "Regulation risks" under "Exposure to risks and risk management".

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, 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. For details regarding the credit risk management at the Bank, including details in respect of "Credit exposure to foreign financial institutions" and "Credit risk in respect of leveraged finance" see "Exposure to Risks and Risk Management" above.
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 (3) 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 U.S. 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 U.S. 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 U.S. principle, however it is vital to bring into account in this respect the difference in the characteristics of the U.S. reality in comparison to Israeli reality, and the difficulties that arise as a result.

The U.S. 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 U.S. 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 noted 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.

IMPAIRMENT OF AVAILABLE FOR SALE SECURITIES

According to directives and guidelines issued by the Supervisor of Banks and to accepted accounting principles applying to banking corporations, unrealized gains or losses on adjustment to fair value of available for sale securities, net of the tax effect, are directly recorded as a separate item in shareholders' equity and are taken to the income statement in certain cases, including upon realization of the securities. Unrealized losses reflected as a capital reserve are losses of a temporary nature only. Other than temporary losses are taken directly to the statement of income.

The Bank's management is therefore required to examine and evaluate the nature of losses accumulated in respect of the said securities.

For the purpose of determining the nature of losses accumulated in respect of securities as above, managements of the Bank and/or of the relevant subsidiaries, base themselves on the security's various characteristics on which losses have been accumulated and on the company that had issued this security, such as: the rating of the security, the rate of impairment of the security in relation to its cost and the duration in which the fair value of the security was lower than its cost, the financial condition of the issuer and so forth. For further details, see above "Details regarding impairment in value of available for sale securities" under "Financial management segment".

The said characteristics and assessments are to a large extent subject to subjective judgment and accordingly changes in assessments and the assumptions and features upon which they are based may have an effect upon the financial statements.

ASSESSMENT OF THE FAIR VALUE OF SECURITIES

Securities, excluding bonds held to maturity, are stated in the balance sheet at fair value, except for shares and options in respect of which fair value is not readily available, which are stated at cost.

Differences between the fair value and the stated cost of securities available for sale, are recognized in a capital reserve.

The market value of securities traded on an active market and which have a market price, represents their fair value. The stated fair value relating to securities which are not traded on an active market and which do not have a market price, is a calculated fair value as explained hereunder.

The fair value of bonds issued by foreign banks and financial institutions is based on price quotations by international providers of securities prices that are independent of the Bank, and independent of the issuing entities as well as the marketing entities. These providers are leading international companies that provide price quotation and evaluation services to hundreds of leading financial institutions around the world. For control purposes the middle office performs crosschecks of securities prices, as received from the provider with those published by the Bloomberg system (financial data system) and with quotations by brokers that are not the issuers of the securities. Whenever differences arise between the valuation of the provider and prices quoted by Bloomberg and/or brokers, the matter is brought before the control committee, which decides as to the fair value of the security.

Calculation of fair value of Israeli currency non-marketable securities is performed by the present value of future cash flows method, on the basis of the discount rate received from an interest rate company. For control purposes, the middle office performs, to the extent possible, tests which compare the resultant fair value amount with prices of other marketable securities of the same issuer or similar securities traded on the market.

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. Where the derivative financial instruments are traded on an active market and have a market value, then the market value represents their fair value.

Where the derivative financial instruments are not traded on an active market and do not have a market value, then the fair value is assessed using pricing models, which take into account the risks inherent in the instrument, such as: the present value of future cash flows expected to be received from the instrument, the Black and Scholes model, etc.

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, for the most part, upon the Black and Scholes Model, and it is being affected by the volatility inherent in exchange rates, interest rates and by the indices relevant to the option bought or written by the Bank. The volatility data of the dollar/Shekel exchange rate and of foreign currency to foreign currency exchange rate are determined by the Bank's dealing room in accordance with the money markets and are supervised by the middle office, being compared with several sources of information.

Establishing the model to be used in computing the fair value of derivative financial instruments the scope of activity therein is material, the pricing methodology and the computation of fair value amount, is the responsibility of the middle office, serving as a factor independent of the business units that execute the transactions (hereinafter: "the factor responsible for determining fair value"), by using designated systems (hereinafter: "process of determining fair value"). The process of determining fair value is validated and verified by the department in charge of evaluation of market and liquidity risks at the Risk Management Department, which functions at a suitable professional level and serves as a factor independent of the factor responsible for determining fair value. Validating the said process includes an examination of the compatibility of the model to the type of instrument in question, the fairness and reasonableness of the parameters used in determining fair value, the reasonableness of the resultant fair value amounts, sample examinations of the computations, etc. Validating the models used for the computation of fair value is performed at least once a year, or whenever a material change takes place in the process of determining fair value. The validation process, which primarily includes reasonableness tests, is performed once in every quarter.

An interface exists for transmitting the results of the validation and verification processes between the middle office and the department in charge of evaluation of market and liquidity risks. In case of a dispute between these factors, the issue is brought before the control committee (a committee in the Corporate Division in which representatives of the Accounting Group participate).

Note 20 to the financial statements presents comprehensive data regarding the Bank's activity in derivative financial instruments as well as information as to the fair value of such instruments, according to type of instrument.

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.

Following are details regarding the fair value of financial assets and financial liabilities measured in the balance sheet and/or in the statement of income according to fair value, while distinguishing between instruments, the fair value thereof is determined by quoted prices in an active market and other, on a consolidated basis as at December 31, 2008 (in NIS millions):

	Quoted prices in an active market	Other
Assets		
Trading securities	2,033	-
Available-for-sale securities	12,242	15,343
Debitory balances in respect of derivative financial instruments	90	3,432
Liabilities		
Creditory balances in respect of derivative financial instruments	149	4,157

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, 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 16 million, while a decrease of 1% in the discount rate would result in an increase in liabilities in the amount of approximately NIS 17 million.

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 TAXES

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 R 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

As aforementioned, on September 15, 2008, the Lehman Brothers Group (hereinafter: "Lehman Group"). At that time, the Bank and IDB New York held Lehman Group's holding company's bonds. Furthermore, the Bank manages various accounts of Lehman Group companies, some of which are for their customers.

On September 18, 2008, at the request of Bank Leumi, a temporary comprehensive attachment order was issued with respect to assets and rights existing in the Lehman Group accounts with the Bank in an amount of up to NIS 370 million. On October 6, 2008, Bank Leumi filed a petition for approval of the attachment. The Bank has submitted a defense brief.

On November 17, 2008, the Bank served three companies of the Lehman Group with a notice of setoff in respect of all assets and money held by the Group with the Bank as regards all the Group's debts to the Bank, except for accounts managed on behalf of Lehman Group customers.

On March 12, 2009, the Tel Aviv District Court ruled a compromise agreement reached between the Bank and Bank Leumi, to have effect of a Court verdict. According to this agreement, the attachment on assets of the Lehman Brothers companies held by the Bank, executed by Bank Leumi will be approved, subject to the priority rights of the Bank in these assets deriving from the right of set-off to which the Bank is entitled.

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN 2008

1. 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 an two other banks.

   The plaintiffs alleged 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.

   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 assessed 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 amounted to NIS 50 million.

   On June 26, 2008, the Plaintiffs filed for permission to withdraw from the action. The Court assented to their request and accordingly the action and request to approve it as a class action were struck off.

2. **Additional motion to the High Court of Justice.** On February 13, 2008, Yahav Bank filed a (second) motion with the High Court of Justice 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 argued 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.

   On May 22, 2008, the Court dismissed the motion. In view of consent given by the Minister of Finance and the Accountant General, the Court ruled that Yahav Bank would be permitted to withhold payments from salaries of State employees with respect to savings deposits and loans dated prior to March 31, 2008, the period of which is definite and their final date of repayment is known, this without charging any commission ("zero margin") and subject to the approval of the employees.

   The High Court of Justice dismissed in its ruling Yahav Bank's claims, according to which the Accountant General is unjustifiably discriminating it in comparison to the Bank. The Court decided that a material difference distinguishes the Bank from Yahav Bank in that he Bank was successful in the tender and thereby assumed various commitments, such differentiation justifies the right awarded to the Bank to withhold amounts from State employees' salaries.

For details regarding significant legal proceedings concluded at the beginning of 2009, see Note 19 C to the financial statements, articles 14.2, 14.4 and 14.12.

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. On March 19, 2008, following an investigation conducted since 2004 by the Antitrust Authority, within the framework of which many documents and computer material had been seized and Bank employees interrogated, including a member of management, the Authority informed the Bank that in view of the investigation findings, the Antitrust

Commissioner is studying the possibility of applying the authority conferred on her by law and determine that binding arrangements had existed between Bank Hapoalim Ltd., Bank Leumi Ltd., Mizrahi-Tefahot Bank, the First International Bank Ltd. and the Bank (hereinafter: "the banks"), in the matter of communicating information regarding to commissions ("the considered determination"). The Bank was given a chance to submit its position in writing to the Commissioner before she takes a decision whether to make use of the said authority.

In September 2008, the Bank submitted to the Commissioner its position in writing within the framework of hearing, in which the Bank presented in great detail the factual and legal reasons supporting its argument that there is no place for the Commissioner to make use of her authority to determine that a binding arrangement had in fact existed.

On January 11, 2009, the Authority called a meeting in which it raised the possibility of forming an "agreed upon order", that will include the payment to the Treasury of an amount of NIS 290 million, to be divided among the banks, so that Bank Hapoalim Ltd., Bank Leumi Ltd. and the Bank will pay an amount of NIS 80 million each, the First International Bank Ltd. will pay NIS 30 million and United Mizrahi-Tefahot Bank will pay NIS 20 million. In addition to the monetary payment, the Commissioner suggested that the agreed upon order shall include agreed upon restrictions on the communication of information between the banks and the mapping of all cooperation arrangements between them and their regularization.

On February 4, 2009, the Bank informed the Authority that it rejects the said suggestion for an "agreed upon order".

The Antitrust Authority's decision with respect to the considered determination has not yet been given.

3. 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.
4. 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".
5. For details regarding a Bank of Israel audit in the matter of the implementation of the Prohibition of Money Laundering Law and the imposition of monetary sanctions committee, see above "Prohibition of Money Laundering and the Financing of Terror" in the Chapter "Legislation and supervision".
6. For details regarding a civil fine imposed on Tachlit Investment House following an audit by the Securities Authority, see "Operations in the capital market" hereunder under "Further details as to activity in certain products".
7. For details regarding the Securities Authority's request for information regarding investment consulting activity in general and basket certificates in particular, see "Operations in the capital market" hereunder under "Further details as to activity in certain products".
8. For details regarding the conviction of a former employee of Mercantile Discount Bank on offences under the Prohibition of Money Laundering Law, see above "Mercantile Discount Bank Ltd." under "Main investees companies".
9. For details regarding an investigation being performed by the Israeli Police with respect to a customer whose business had collapsed, see above "Mercantile Discount Bank Ltd." under "Main investees companies".

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 Arrangement (Temporary Provision) Law, 1993. The said agreement has been amended several time with the consent of the parties.

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 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 will 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". "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 ICC since March 1, 2008.

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.

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 according to the Internal Audit Law, 1992, according to the Banking Rules (Internal Audit) 1992 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 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 Director's 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

(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.

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 121.9 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	69.7
Investee companies in Israel audited by the internal auditor of the Bank (including outsourcing and overhead)	13.4
Investee companies in Israel where the audit (including outsourcing and overhead) is performed by an independent internal auditor	20.7
Investee companies abroad where the audit (including overhead) is performed by an independent internal auditor	18.1
Total	121.9

Performance of the audit. The internal audit is carried out according to the provisions of the Internal Audit Law, 1992, 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 2007, submitted on February 25, 2008, and discussed by the Audit Committee on March 24, 2008.
- Annual report on the activities of the internal audit in 2007, submitted on February 26, 2008, and discussed by the Audit Committee on April 28, 2008 and by the Board of Directors on June 16, 2008.
- Report on the activities of the internal audit in the first quarter of 2008, submitted on May 12, 2008, and discussed by the Audit Committee on June 29, 2008.
- Report on the activities of the internal audit in the second quarter of 2008, submitted on August 7, 2008, and discussed by the Audit Committee on September 25, 2008.
- Report on the activities of the internal audit in the third quarter of 2008, submitted on November 16, 2008, and discussed by the Audit Committee on December 24, 2008.
- Report on the activities of the internal audit in the fourth quarter of 2008, submitted on Febuary 8, 2009, and discussed by the Audit Committee on March 29, 2009.

The annual report on the activities of the internal audit department in 2008, was presented on March 4, 2009, and has not yet been discussed.

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 setout 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 WITH 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 within the framework of the "Lema'an" Project - Discount Employees for the Community continued during 2008, 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, infirm 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 2008 in the culture and arts field, providing sponsorship and donations.

The total volume of activities of Discount group in 2008, including the Lema'an Project, amounted to NIS 6,901 thousand, compared with NIS 6,272 thousand in 2007. In addition, the Bank has borne the cost of the staff of the social responsibility unit and the cost of additional entities at the Bank who were directly engaged with various issues of social responsibility, as part of their working hours, in a total amount of NIS 532 thousand in 2008, compared to NIS 1,007 thousand in 2007.

In 2008, 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 2008, the following are noteworthy to the following associations: Yad Ezer Lachaver, Warm Home for Children requiring Artificial Respiration, Yad Sarah, Chimes, Ilan, Akim, 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 2008, 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:

Discount in aid of the South. As from the beginning of the IDF's military operation in Gaza "Operation Cast Lead", the Bank's social responsibility unit contacted Discount Bank branches in the South in order to help out in various arising scenarios. Gift packages were sent to the injured hospitalized at the Barzilai Medical Center in Ashkelon and Soroka University Medical Center in Beer-Sheva. Sets of warm undergarments were sent to servicemen fighting with Squadron 916, fostered by the Bank.

Internet site building course at the "Hadassa Youth" youth village. The course is tutored by employees of the Bank's Operation and Information System's Division. 15 pupils from grades 9 to 11 at the village school participate in the project which began in 2008 and will continue in 2009.

Hanukkah events at volunteering venues. Bank employees conducted Chanukah parties at dozens of centers in which they work as volunteers; children clubs, senior citizen clubs, schools, hospitals, etc.

"Adopt a combat soldier" Project. Discount Bank continued its support to 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.

Bazaar for items produced by the handicapped. This is the second consecutive year in which, towards the Jewish New Year and Passover holidays, the Bank assists in setting up a bazaar (on the Bank's permises) at which Bank employees can buy items created by members of the IDF rehabilitation center and other associations employing handicapped persons ("Gvanim", "Chimes", "Cheletz" chool in Holon and others).

"Discount Fund" at the "Ezra LeMarpe" Association. The Bank continued its support of the Fund, whose goal is to offer financial assistance, for the second year running. Applications with respect to difficult cases are referred to the Association for examination of the case and its various aspects. Where the case is found deserving of assistance it is awarded out of the Fund.

Adoption of a Hostel for battered women in Rishon Le'Tzion. The staff of the Bank's Human Resources Department has begun voluntary activity at the battered women's hostel in Rishon Le'Tzion. The first activity took place towards the Pentecost (Shavu'ot) Holiday as a joint activity of the women and their children and the staff of the Department.

Assistance to needy families towards the Jewish New Year and Passover holidays. In line with the Bank's tradition, the Bank rallied once again to assist needy families. The Bank has purchased charged food cards in the value of NIS 250 each, and Bank employees distributed them directly to needy families, in coordination with the welfare departments of municipalities and local authorities, within the boundaries of which the Bank operate branches.

In the reported year, the distribution included, in addition to needy families, also needy IDF servicemen, families of the "Discount Heznek" project participants and additional families from the Haifa area in conjunction with Haifa Radio.

Enrolling Bank employees for volunteer work among Holocaust survivors. As part of the cooperation with the "Latet" Organization, about 90 Bank employees enrolled as volunteers assisting Holocaust survivors. Assistance includes a monthly visit to the survivor's home and food and medication coupon distributions.

Assistance in establishing a hostel for Holocaust survivors in Haifa. Financial assistance and volunteer work for the "Yad Ezer Lachaver" Asssociation in Haifa in establishing a hostel for Holocaust survivors.

Assistance in setting up a library for the Ben Shemen Youth Village. As part of the voluntary work done by the staff of the Bank's Operations and Information Systems Division at the Ben Shemen Youth Village, assistance was provided in setting up a reading library for the Ben Shemen children. The Division's staff holds "story time" at the library for the children of the Village.

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.

INVOLVEMENT IN AND CONTRIBUTION TO THE COMMUNITY BY THE PRINCIPAL SUBSIDIARIES

Following are descriptions of several prominent projects carried out by the principal subsidiaries:

Dreamnight at the Zoo. This is an international social project, originating in the Rotterdam Zoo in Holland in 1996, and operating today in some 23 countries around the world over. Zoos that have joined the project open their gates at

no entrance fee for a special evening. ICC has undertaken to lead this project in Israel, this being its flag project. In the years 2007-2008, hundreds of "AKIM Israel" National Association for the Habilitation of the Mentally Handicapped in Israel members and their families enjoyed the events of "Dreamnight at the Zoo".

Social credit card. In February 2008, ICC launched the first social credit card in Israel, whereby for every transaction made by the customer using this card, ICC makes a donation to a benevolent association.

A start-up project in the Arab sector. In 2008, Mercantile Discount Bank launched an educational project jointly with "Sprint for the Future" Association, within the framework of which this bank granted 60 scholarships for studies at academic institutions to Arab sector students who were found deserving of these scholarships, in return for their commitment to contribute time to community work The cost of this project amounted to NIS 0.5 million in 2008.

"Adopt a combat soldier" Project. Discount Mortgage Bank has also joined the project, adopting Regiment 405 of the Artillery Corps. Accordingly, Discount Mortgage Bank is committed to make an annual donation of NIS 100 thousand for three years, starting with 2007. In addition to the monetary contribution, Discount Mortgage Bank employees participate in special events held by the Regiment and support the activities of the Regiment and its servicemen.

"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 Heznek" Project. At the practical experience stage, the Bank presented a challenge to the students: the production of an advertising campaign for the "Discount Heznek" 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. Alagem 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 Startup" 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. 96 scholarships were granted in 2008.

"Discount start-up" Annual Event. Ten youths, graduates of the "Discount start-up" Program were awarded scholarships for academic studies by the late Nissim Alagem Fund as part of the event held in February 2008.

In addition all the art works collected within the framework of the "Artist Wall" project were sold at the said event (as

noted, within the framework of the "Artist Wall" project, the Bank offered its branches all over the country as a venue for artists to present their work to the public. The Bank purchased one work out of each exhibit and each artist also contributed one work). Part of the art works were purchased by the Bank for its art collection. The consideration for the sale of the works together with additional contributions collected at the event will be used to award additional scholarships to graduates of the "Discount start-up" Project.

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

"MA'ALEH" RATING FOR 2008

In June 2008, Ma'aleh published its rating for 2008. As accepted globally, the rating includes for the first time three categories: platinum, gold and silver. Israel Discount Bank was among the ten companies granted platinum status (highest category).

Ma'aleh rates the leading public and private corporations in the market, based upon their social responsibility characteristics.

The rating evaluates the corporations in five areas: business ethics, human rights and work environment, involvement in the community, environmental protection and corporate governance.

60 companies participated in the rating in 2008, the total financial turnover of which comprised 41% of the economy's business product.

"THE MARCH OF THE LIVING"

In April 2008, 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 90 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 80 of the Bank's staff is expected to participate in 2009 in the "March of the Living".

ARTS

"The Discount Bank Collection - Selected acquisitions" exhibit. On March 1, 2008, this exhibit was opened in the Ashdod Museum of Art. The exhibit presents 86 works of art to the public combining contemporary Israeli art with works of the leading artists representing the best of Israeli art, being a part of the Bank's collection since the sixties. The exhibit is on show for six months and is supported by the Bank and by additional companies in the Discount Group.

"Or Yarok" - Helmet exhibit. The Bank supported the production of an exhibition of helmets designed by various artists. Income from the sale of the helmets was donated to the "Or Yarok" Association.

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.

An exhibit of the artist Tsahi Kirshon was presented on the occasion of the Jewish Holiday of Tu Be'shvat, at the entrance lobby of Discount Tower. His works were sculptured out of tree roots.

On the occasion of Independence Day, an exhibition of the works of the artist David Meital, named "Twenty in Sixty" was presented at the MatsArt Gallery.

The Discount Museum website. The art collection of the bank is considered on of the qualit 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

SPONSORSHIPS

During 2008, the Bank granted sponsorship to entities and activities promoting social, health, sporting, cultural, artistic and educational and business goals.

CULTURAL, ARTISTIC AND EDUCATIONAL SPONSORSHIPS

Sponsorship was granted to the Tel Aviv-Yaffo **"Well Houses" preservation** exhibition held in February 2008, at the Boulevard Gallery, presenting works by Tel Aviv University's Conservation Studio, Uri Levine, Limor Edri and Dani Karavan.

Theatronetto. The 2008 Theatronetto festival too place in Tel Aviv in April, during which dozens of one man shows were presented at various venues in the city.

Jazz Festival at the Caesarea Port. For the fourth year running the Bank has provided sponsorship to this Festival that was held in June, with the participation of the leading New Orleans jazz ensembles.

Carta Publishing House. Sponsorship was granted to the publication of the book "All these 60 years of Israel" written by Ilan Kfir, Danny Dor and Moshe Milner. The book describes all the formative events in the history of the State. A CD is attached to the book documenting the scenes and voices relating to the State.

A retrospective exhibition of the artist Avraham Naton, was opened on April 10, 2008, in the framework of which the Bank sponsored the publication of a catalogue documenting the legacy of the artist, who was one of the leading artists of the "New Horizons" Group and was an active member of the Painters Association.

The Carmiel Dance Festival. Sponsorship was granted to the international dance festival which took place in Carmiel with the participation of Israeli and foreign dance groups.

SPORTS SPONSORSHIPS

Israel Athletics Association. Sponsorship was granted to the Israeli Athletics Championship that took place at the Hadar Yosef Stadium in July 2008.

HEALTH SPONSORSHIPS

An international convention on the subject of **Jewish medical ethics** held in Lucerne, Switzerland at the beginning of March 2008.

A convention on the subject of **Autism along Lifespan**, held at the Edmond and Lily Safra Children's Hospital at Tel Hashomer.

Rotary Association. Sponsorship of a fund raising event in aid of special needs children, which took place on June

12, 2008 in Ramat-Gan.

An international convention on the subject of chronic artificial respiration. Within the framework of the 70th anniversary of the Re'ut Association, an international convention was held in June 2008 on the subject of chronic artificial respiration.

ENVIRONMENTAL PROTECTION, SCIENCE, AND BUSINESS SPONSORSHIPS

The business and environment convention. Sponsorship was granted to a convention held in January 2008 at the Tel Aviv Convention Center, on the subject of durable economic growth, environmental regulation, green technology and environmental management.

The Aravah research and development convention. Sponsorship was granted to a convention held in February 2008, in which the region's research and development achievements were presented. This year, the convention focused on the emphasis of the connection between durable agriculture development and problems and achievements concerning the subject of water in the desert.

The Israeli Chamber of Information System Analysts. Sponsorship was granted to the annual convention of the Institute held in March 2008.

The Herzliya Conference. Sponsorship was granted to the conference held in January 2008, on the subject of the balance of Israel's national security in its 60th year of existence.

AUDITORS' REMUNERATION[(1)(2)]

Below are particulars of the remuneration that was paid to the auditors (in NIS thousands):

	Consolidated		The Bank	
	For the year ended December 31			
	2008	2007	2008	2007
For Auditing[(3)]:				
To the joint auditors	17,676	*12,953	7,637	4,482
For Other Services:				
Audit related services[(4)]:				
To the joint auditors	1,155	*3,246	911	2,867
Taxation Services[(5)]:				
To the joint auditors	3,957	*3,625	1,323	921
Other Services:				
To the joint auditors	552	2,080	458	1,045
Total	5,664	8,951	2,692	4,833
Total Auditors' Remuneration	23,340	21,904	10,329	9,315

* Reclassified.

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. As from the middle of 2008 also includes audit – internal control over financial reporting (SOX 404).
(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.

REMUNERATION OF INTERESTED PARTIES AND SENIOR OFFICERS AND TRANSACTIONS WITH CONTROLLING SHAREHOLDERS

REMUNERATION OF INTERESTED PARTIES AND SENIOR OFFICERS

Name	Position	Extent of position	Rate of holdings in the corporation's capital	Salary*	Awards*	Employer's payments and provisions	Supplemental reserve(2)	Total payroll, awards and employer's provisions	Share based payment(3)	Total	Loans granted under regular terms
						in NIS thousands					
Shlomo Zohar	Chairman of the Board	100%	0.02%	2,270	2,314	954	19	5,557	3,251	8,808	-
Giora Offer	President and CEO of the Bank	100%	0.02%	2,345	2,314	1,154	367	6,180	3,251	9,431	-
Jacob Tennenbaum	President and CEO of Mercantile Discount Bank	100%	-	1,622	1,500	828	22	3,972	-	3,972	-
Reuven Shpiegel	President and CEO of IDB New York	100%	-	2,794	-	1,036	-	3,830	-	3,830	-
Boaz Chechik	President and CEO of ICC	100%	-	1,323	2,475	(337)	93	3,554	-	3,554	-
Eli Hoter	Senior Executive Vice President, Head of Marketing and Strategic Planning Division	100%	-	998	1,170	293	40	2,501	629	3,130	19
Israel David	Senior Executive Vice President, Head of Retail Banking Division	100%	-	1,051	-	354	163	1,568	1,542	3,110	-
Noam Hanegbi	Senior Executive Vice President, Head of Information Systems Division	100%	-	1,028	-	229	43	1,300	1,542	2,842	-
Shlomo Pitchon	Senior Executive Vice President, Internal Auditor	100%	(4)-	1,016	-	340	173	1,529	1,285	2,814	111

* The amounts of the remuneration are in cost terms to the Bank (do not include VAT on payroll).

(1) Including an adaptation award, severance and provident pay, further education fund, vacation pay and National Insurance contributions.

(2) Supplementing reserves in respect of salary related expenses due to changes in remuneration

(3) The expense was computed on the basis of the value determined on date of grant of the options. As of now, the options are deep "outside the money".

(4) Mr. Pitchon holds shares of the Bank in a negligible amount of NIS 21,583 par value.

Notes:

(a) In determining the remuneration and awards, the following factors have, among other things, been taken into consideration: the scope of the Bank's business, its proportionate share of the banking industry, the rate of return on capital and the contribution of the Officer to the operations and profitability of the Bank as well as the duties assumed by him.

(b) The terms applying to senior officers in respect of their personal bank accounts held at the Bank, including all the operations therein, are similar to those granted to all other employees, and generally such terms are not preferable to those applying to regular customers of their kind whose operations are of a similar volume

(c) Remuneration of all types is included in the item "Payroll and related expenses" in the financial statements.The total benefits granted to officers of the Bank represent a negligible amount.

(d) The Directors of the Bank, excluding the Chairman, are entitled to remuneration which is in line with accepted practice and payable according to the Companies Regulations (Rules regarding remuneration and expenses to an external director), 2000, as detailed in Note 22 Q to the financial statements.

Furthermore, Dr. Sharir serves also as director of the subsidiary Israel Discount Capital Markets and Investments and is entitled to remuneration which is in line with accepted practice, being identical to the remuneration paid by that subsidiary to other directors who are not senior executives of the Bank.

(e) For details regarding insurance, exemption and indemnification of directors and other senior executives, see Note 19C (10) (k) and (l) to the financial statements.

Mr. Shlomo Zohar, Chairman of the Board of Directors, serves in this office since January 31, 2006. Mr. Zohar is engaged under a personal engagement agreement. His term of office terminates of February 5, 2011. For details regarding the terms of engagement of Mr. Zohar, including his entitlement to an award and to retirement benefits, see Note 22 H to the financial statements. For details regarding Mr. Zohar's stock option plan, see Note 13 D (2) to the financial statements. Mr. Zohar informed that he foregoes 10% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. Giora Offer, the President and CEO of the Bank has been employed since March 2, 2001. Mr. Offer is employed under a personal agreement. According to the updated employment agreement, his period of office will terminate on February 1, 2011, following which the agreement will be automatically renewed each time for a period of one year. For details regarding the terms of employment of Mr. Offer, including his entitlement to an award and to retirement benefits, see Note 22 H to the financial statements. For details regarding Mr. Offer's stock option plan, see Note 13 D (2) to the financial statements. Mr. Offer informed that he foregoes 10% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. Jacob Tennenbaum. The President and CEO of the subsidiary Mercantile Discount Bank (hereinafter: "Mercantile") is employed under a personal employment agreement. The period of employment is a determined period of five years ending in July 2011. Subsequent to that date (and provided the employment is not terminated prior to this date by either of the parties), the employment agreement shall continue in effect for an indeterminate period until Mr. Tennenbaum reaches retirement age, during which period either of the parties is entitled to terminate the agreement giving a prior notice of six months. In the event that Mercantile decides to terminate the employment of Mr. Tennenbaum in the course of the determined period, then Mercantile is obligated to pay to Mr. Tennebaum until the end of the determined period, his full salary including the related benefits or his full salary excluding the related benefits but with the addition of 15%, as elected by Mercantile. Mr. Tennenbaum shall be prohibited from competing against Mercantile during a period of three month following the termination of employment, unless otherwise agreed by the parties. Mr. Tennebaum is

entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits as determined by law, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. Tennenbaum is entitled under the agreement to severance payment in accordance with the law. In addition, he is entitled to a special award upon termination of his employment (whether by Mercantile or by himself), as follows: if termination of employment occurs within the five year determined period he is entitled to an award equal to a six months salary; if termination of employment occurs after six years he is entitled to an award equal to a nine months salary; if termination of employment occurs after seven years he is entitled to an award equal to a twelve months salary. Alternatively, if his employment is terminated following the sale of Mercantile, transfer of the control thereof or merger thereof, Mr. Tennenbaum will be entitled to a special award of twelve months salary. In the event that Mercantile offers shares to the public, within the framework of which shares and/or share options will be allotted to employees, then Mr. Tennenbaum will be entitled to a similar allotment at rates and under terms to be decided by Mercantile's board of directors considering his office as President and CEO.

Mr. Reuven Spiegel, President and CEO of IDB New York, is employed by the subsidiary under a personal agreement. The period of employment is until June 30, 2012, following which the agreement will be automatically renewed each time for a period of one year which may be terminated by either of the parties with a prior notice of six months. In the event that the subsidiary elects to terminate Mr. Spiegel's employment prior to June 2012, the subsidiary will have to pay his salary until that date. In any event, upon termination of his employment, Mr. Spiegel is entitled to a payment equal to one year salary. Mr. Spiegel's monthly salary is reviewed by IDB New York every year and may be updated at the end of each year in accordance with the rise in the consumer price index in the US. Mr. Spiegel is entitled to social benefits (National Insurance contributions, pension within the framework of the pension plans in effect at the subsidiary, at the rate of 1.5% per each year of employment, on condition that he completes at least five years of employment), as well as to life assurance, medical care and loss of work ability. Mr. Spiegel, as the other members of management of IDB New York, is entitled to an annual award on condition that IDB New York reaches 80% of the forecasted annual earnings in accordance with the annual work plan, in addition, a long-term remuneration plan for management members exists, whereby an additional award is paid for attaining the profitability target for three consecutive years. Mr. Spiegel has committed not to compete against the subsidiary in the United States only for a period of six months following termination of office. IDB New York provides Mr. Spiegel with an appropriate motor vehicle and is also entitled to an annual home leave in Israel.

Mr. Boaz Chechik, President and CEO of the subsidiary ICC, is employed under a personal agreement, for an indeterminable period, which may be terminated by either of the parties with a prior notice of four months. The non-competition period fixed in the agreement is three months from date of termination of office, unless otherwise agreed by the parties. Mr.Chechik's salary is linked to the CPI, where in case of a decrease in the CPI, the salary will remain unchanged until the rise in the CPI offsets the decline. Mr. Chechik is entitled to vacation pay, sick leave, recreation payment, an appropriate motor vehicle, social benefits (severance pay, provident payments, loss of work ability and further education fund) as well as other benefits. According to the agreement, upon termination of office, Mr. Chechik is entitled to severance pay according to the law. According to the terms of the original agreement with Mr. Chechik, he was entitled to a special retirement award equal to three months salary. During 2008, the agreement was amended whereby the monthly salary was increased and a mechanism was established for an annual award and a special award in the years 2008 to 2011. If Mr. Chechik's office will terminate in the course of any of the said years, he would be entitled to a proportionate part of the annual award in respect of the year of termination. The annual award would be equal to an amount not to exceed 20 monthly salaries (hereinafter: "the ceiling of the overall award"), and shall be paid only in a year in which

the financial statements will reflect net earnings. The annual award will be computed on the basis of five indices described in the amendment to the agreement, each index being attributed a part of the ceiling of the overall award. In addition, a minimum objective, a target objective and a maximum objective were established. Attaining the minimum objective entitles to 30% of the annual award ceiling of the relevant index, attaining the target objective entitles to 60% of the annual award ceiling of that index, and attaining the maximum objective entitles to the full annual award ceiling of that index. If the result reached in a certain year of entitlement falls below the minimum objective in respect of any of the indices, then the difference will be offset against the result of the particular index in the following year of entitlement. However, if the result reached in a certain year of entitlement is in excess of the maximum objective in respect of any of the indices, then the difference will be added to the result of the particular index in the following year of entitlement. Results that fall between the minimum objective and the target objective or the target objective and the maximum objective, will grant entitlement to a proportionate annual award in accordance with the place of the result (on a straight line) between the two objectives. The indices are: the rate of increase in net earnings; the growth in market share; the rate of growth in the number of valid and active off-banking credit cards; the rate of growth of income from electronic trading; the rate of growth in financing income from the net granting of credit, less provisions for doubtful debts. The Special award is in respect of the entire period (2008-2011) and it shall be paid according to one of the following alternatives: if the shares of ICC are listed for trading, Mr. Chechik will be granted the option to receive, at no consideration, ordinary shares of ICC comprising 0.14% of the issued and paid-up share capital of the company, on a fully diluted basis. The right to this share will vest in full at no consideration, at the end of four years (namely: on December 31, 2011), provided Mr. Chechik is still employed by ICC at that time.

So long as the shares of ICC are not listed for trade, Mr. Chechik will be entitled to a deferred award, accumulated in each year, payable on December 31, 2011, provided Mr. Chechik is still employed by ICC at that time, and if until that date the ICC shares are not listed for trade. The amount of the deferred special award will be equal to one half of the total annual awards to which Mr. Chechik would be entitled in respect of the years 2008 to 2011.

In addition, Mr. Chechik is entitled to a special award in respect of foreign operations conducted by ICC (Properties) Ltd., in accordance with the remuneration plan for senior employees of ICC. According to the said plan, in the event of a public issue of shares or a sale to a third party of at least 25% of the equity interest in ICC (Properties) Ltd. and also in the event of sale, merger or reorganization of the said company into another company or the sale of most of its assets, Mr. Chechik will be entitled to an award equaling 4% of the betterment of ICC (Properties) Ltd., computed on the basis of a formula specified in the agreement, and everything in the period until the end of 2011, which may be shortened by ICC.

Mr. Israel David, employed by the Bank as Senior Executive Vice President and Head of the Retail Banking Division. Mr. David is employed under a personal employment agreement for an indeterminate period, which either of the parties may terminate giving a prior notice of four months. According to the agreement, Mr. David is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. His salary is linked to the CPI, and in the event of the CPI falling, his salary will not change until such time that the rise in the CPI offsets the rate of the fall The salary of Mr. David has been updated as from April 2008.

Mr. David is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. David is entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. David is among management members entitled to awards according to the award plan, as stated in Note 16 G to the financial statements as well as to option warrants in accordance with

the option plan for senior executives at the Bank, as detailed in Note 13 D (1) to the financial statements.
Mr. David informed that he foregoes 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. Eli Hoter, was employed at the Bank until January 31, 2009. In his last office he served as senior executive vice president, head of the Marketing and Strategic Planning Division. Mr. Hoter was employed under a personal agreement, for an indeterminable period, which may be terminated by either of the parties with a prior notice of four months. The non-competition period fixed in the agreement was six months from date of termination of office, unless otherwise agreed by the parties. Mr. Hoter's salary was linked to the CPI, where in case of a decrease in the CPI, the salary will remain unchanged until the rise in the CPI offsets the decline. Mr. Hoter was entitled to vacation pay, sick leave, recreation payment, an appropriate motor vehicle, social benefits (severance pay, provident payments, loss of work ability and further education fund) as well as other benefits. According to the agreement, upon termination of office, Mr. Hoter was entitled to severance pay according to the law, as well as a retirement award equal to three months salary. Mr. Hoter is included among management members entitled to awards in accordance with the award plan, as detailed in Note 16 G to the financial statements and to option warrants in accordance with senior officers' option plan, as detailed in Note 13 D (1) to the financial statements. In actual fact, the Audit Committee and the Board of Directors approved a retirement award to Mr. Hoter equal to nine months salary over and above the amounts to which he was entitled according to the personal agreement with him, as detailed in the immediate report dated November 30, 2008 (reference No. 2008-1-338235)

Mr. Noam Hanegbi, employed by the Bank as Senior Executive Vice President and Head of the Operations and Information Systems Division. Mr. Hanegbi is employed under a personal employment agreement for an indeterminate period, which either of the parties may terminate giving a prior notice of four months. According to the agreement, Mr. Hanegbi is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. His salary is linked to the CPI, and in the event of the CPI falling, his salary will not change until such time that the rise in the CPI offsets the rate of the fall. Mr. Hanegbi is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. Hanegbi is entitled to severance payment in accordance with the law as well as to a retirement award equal to three months salary. Mr. Hanegbi is among management members entitled to awards according to the award plan, as stated in Note 16 G to the financial statements as well as to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 D (1) to the financial statements.
Mr. Hanegbi informed that he foregoes 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. Shlomo Pitchon, employed by the Bank as Senior executive Vice President and acts as the Internal Auditor. Mr. Pitchon is employed under a personal employment agreement for an indeterminate period, which either of the parties may terminate giving a prior notice of six months. According to the agreement, Mr. Pitchon is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. His salary is linked to the CPI, and in the event of the CPI falling, his salary will not change until such time that the rise in the CPI offsets the rate of the fall. Mr. Pitchon is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. Pitchon is entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. Pitchon is among

management members entitled to awards according to the award plan, as stated in Note 16 G to the financial statements as well as to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 D (1) to the financial statements.

Mr. Pitchon informed that he foregoes 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting with February 2009.

TRANSACTIONS WITH CONTROLLING SHAREHOLDERS.

NEGLIGIBLE TRANSACTIONS

The Amendment of the Securities Regulations (Periodic and Immediate Reports), 1970, (hereinafter: "the Amendment") came into effect on August 6, 2008. Pursuant to this Amendment, a reporting corporation is required , among other things, to submit an immediate report with respect to "details regarding a transaction with the controlling shareholder, or in which the controlling shareholder has a personal interest in its approval, including principal details of the transaction or of the engagement, details of the Organ approving the transaction and a summary of the grounds for its approval; in this Section - "transaction" - excluding a transaction where other transactions of its kind, have been determined as negligible in the most recent financial statements".

The term "negligible transaction" originates in Regulation 64(3) of the Securities Regulations (Preparation of Annual Financial Statements), 1993 (hereinafter: "financial statements regulations") which deals with disclosure in financial statements of transactions of the corporation with an interested party therein. This Regulation determined the extent of the disclosure which is required regarding such transactions, and it also grants an exemption from providing the disclosure where a negligible transaction is involved.

Whereas the financial statements regulations do not apply to banks, where instead directives of the Supervisor of Banks as to preparation of financial statements apply, the Union of Banks referred to the Israel Securities Authority the question as to how the instruction regarding a "negligible transaction" should apply to banks. In its reply to the Union of Banks dated August 6, 2008, the Israel Securities Authority informed that it will not interfere in cases where no disclosure will be given in an immediate report to banking transactions that do not constitute extraordinary transactions, as defined in Section 1 to the Companies Law, provided the following are fulfilled:

- The upcoming quarterly financial statements (and thereafter the periodic statements) shall include a general description of the transactions, their characteristics and the criteria determined for defining the transactions as negligible or as such that are not extraordinary, providing details of the facts, reasons and explanations for such determinations;
- The audit committee of the corporation is to establish criteria for determining a transaction as unusual or negligible;
- Within the framework of describing the engagement with a controlling shareholder as regards office and employment, a general description shall be included as to his financing transactions with the bank (if any) and their characteristics.

Criteria for determining a transaction as unusual or negligible. The Audit Committee of the Board decided on August 24, 2008, as follows:

Definition of a "banking transaction" - any transaction will be considered a banking transaction if it involves the granting of credit of any, including the granting of guarantees, letters of documentary credits, documentary credit, etc. as well as any transaction or act involving a monetary or financial asset, which a bank performs on behalf of its customers during the ordinary course of business of a banking corporation (such as: securities, foreign currency, future

contracts, derivative financial instruments, marketable papers, pension products, etc.) and this whether as a dealer or as an agent, representative ,trustee or guardian, as well as any act of accepting deposits, the payment of checks, collection of monies, money exchange, the transfer of money, payment system management, maintaining customer accounts, providing advisory, marketing or brokerage services to customers and any other action that a bank performs for its customers to the extent that these are permitted to the bank under the Banking Law (Licensing), 1981.

Definition of "ordinary course of business" - the performance of a banking transaction or a transaction which is the outcome of a bank's ordinary course of business or a related action (such as: the renting of premises, purchase of equipment or obtaining services for the purpose of a bank's undertaking of current operations).

The way in which "market terms" are to be examined in respect of banking operations - the terms will be judges by comparing the relevant transaction and the terms relating to it (interest, collateral, commissions charged etc.) to the terms according to which other customers examined the bank, having similar characteristics, and who are not related parties, execute transactions or operations of the same kind and of similar volume and under the same circumstances, as is the practice in examined transactions with related parties in accordance with Proper Bank Management Directive No. 312.

Determination of a quantitative minimal benchmark under which a transaction is considered as negligible - A debt transaction (credit, guarantees etc.) - a transaction to which the indebtedness limitation of related parties applies and which was approved in accordance with the directives of the Supervisor of Banks, is considered a negligible transaction because the indebtedness limitation and the specified mode of approval were designed to ensure that the volume of indebtedness of related parties to a bank in relation to the volume of indebtedness of customers who are not controlling shareholders, will be negligible. For details regarding the actual restriction relating to the individuals forming the controlling interest of the Bank, see above "Legislative restrictions, regulations and special constraints applicable to the segment" in the Section "The corporate segment" in the Chapter "Legislative restrictions, regulations and special constraints applicable to the segment". However, in the event that such an indebtedness is classified as a problematic debt (as this term is defined in Proper Banking Management Directive No.314) then until such classification is withdrawn, additional credit or guarantees granted or an extension of an existing transaction or changes in its terms, shall not be considered a "negligible transaction".

As to corporations where the shareholder is considered an "interest party" (and not a controlling shareholder), or where he has some other personal interest in transactions with such corporations, but where the indebtedness involved in these transactions is not taken into consideration for the purpose of limitation on indebtedness according to directives and guidelines of the Supervisor of Banks - an indebtedness of a volume of up to 1% of the total credit granted to the public in the consolidated balance sheet shall be considered a "negligible transaction".

A temporary deviation from such a volume for a period not exceeding 30 days shall not require the reclassification of a transaction as a "negligible transaction".

A Banking transaction that is not an indebtedness transaction - a transaction with the controlling shareholder or with a corporation under his control shall be considered "negligible" if its volume (in case of a single transaction or a number of transactions per year) does not exceed 0.1% of total consolidated assets of the bank.

A transaction with a corporation in which the controlling shareholder has an interest but does not control it, or where the bank's controlling shareholder has some other personal interest therein, shall be considered as "negligible" " if its volume (in case of a single transaction or several transactions per year) does not exceed 0.3% of total consolidated assets of the bank.

Other transactions made in a bank's ordinary course of business:

1. The purchase of retail products from a controlling shareholder, from companies under his control or from companies in which he is an interested party - an engagement in an agreement to purchase retail products in the ordinary

course of business and at market terms, in a volume that does not exceed NIS 2.5 million per transaction, or NIS 15 million per year, is considered a "negligible transaction". The said amount of NIS 15 million per year shall not apply to separate transactions each of which amounts to less than NIS 25,000.

2. The purchase of services from a controlling shareholder, from companies under his control or from companies in which he is an interested party - the purchase of services in the ordinary course of business and at market terms, in a volume that does not exceed NIS 2.5 million per year, is considered a "negligible transaction".
3. Rental of property from a controlling shareholder, from companies under his control or from companies in which he is an interested party - rental of property in the ordinary course of business and at market terms, where the annual rental expense for each property does not exceed 5% of the total rental expense in the consolidated balance sheet and the total rental fees paid to the controlling shareholders or companies, as stated, in respect of property rentals do not exceed 15% of the rental expenses in the consolidated balance sheet, is considered a "negligible transaction".

With respect to the transactions mentioned in subsections (1) to (3) above - a controlling shareholder, including a next of kin.

Market terms with respect to transactions mention ed in items 1-2 above shall be judged in relation to transactions of the same kind made by a bank with suppliers. In cases where a bank does not have transactions of the same kind, market terms shall be examined in relation to transactions of the same kind effected on the market, and to the extent possible in the financial sector. Market terms with respect to rental transactions, as stated in section (3) above, shall be examined in comparison to prices of rental transactions made regarding the same property or in the same area, as the case may be.

4. Covering the expenses of controlling shareholders' participation in representative events and customer conventions of a bank its subsidiary companies, at their invitation, and all at a volume not exceeding US$100,000 per year, is considered a "negligible transaction".

As of date of publication of the financial statements, negotiations are being held between the Securities Authority, the banks and the Union of Banks regarding the various issues relating to the subject of negligible transactions and other transactions that are not exceptional.

For details regarding transactions with the controlling shareholders or in which the controlling shareholders have an interest, see Note 22 I and N and Note 19 C (10) (k) and (l) to the financial statements, as well as "Repayment of the State's debt in respect of the award to employees" under "Control of the Bank" above.

CONTROLS AND PROCEDURES

Disclosure controls and procedures. 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, 2008, 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.

Internal control over financial reporting. 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 were 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 According Oversight Board (PCAOB). Everything in accordance with the provisions of Section 404 of the U.S. Sarbanes Oxley Act and the directives issued by the SEC under it.

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 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.

It should be mentioned in this respect that on September 28, 2008, the Bank of Israel issued Proper Banking Management Directive No. 309, which requires bank managements to comply with the following requirements: assuring the establishment of controls and procedures regarding disclosure and internal control over financial reporting; evaluation of the effectiveness of the controls and procedures as to disclosure at the end of each quarter; evaluation of the internal control on the financial reporting at the end of each year, as well as evaluation at the end of each quarter of the changes that have occurred in internal control during the quarter, which have had or might have had a material effect on the internal control over financial reporting.

The Bank is implementing the instructions starting with the financial statements as of December 31, 2008. For the purpose of implementing the instructions, the Bank, jointly with its banking subsidiaries in Israel, has engaged an independent consulting company to assist in carrying out the project.

Within this framework, relevant employees of the Bank have participated in training courses and tutorials, business processes at the Bank that have implications upon the financial statements have been reviewed, existing controls in each of such processes have been documented and the "residual exposure" of the Bank to "financial statements risks" in the said processes has been evaluated. At the end of the said survey and documentation, comprehensive examinations have been performed in order to evaluate the level of effectiveness of internal control.

In addition, jointly with its banking subsidiaries in Israel, the Bank acquired at the end of 2007, a designated information system to contain all the assembled information regarding the business processes that had been reviewed, as above, including: description of the process, possible risks existing in the process, controls existing in respect of the process, and the rating of the residual exposure considering the existing controls. This system is to serve in the future as the central tool in implementing the instructions and in performing the ongoing monitoring of the effectiveness of controls over financial reporting.

Based on the findings of the said examination of the effectiveness of internal control, Management of the Bank together with the President and CEO and the Chief Accountant of the Bank have assessed the effectiveness of controls in the reported period over the financial reporting of the Bank.

On the basis of this assessment, the President and Chief Accountant of the Bank arrived at the conclusion that as of the end of the reported period, the controls and procedures regarding financial reporting are effective in order to: record, process, conclude and report the information included in the annual financial statements, in accordance with the public reporting instructions of the Supervisor of Banks and on the date prescribed by these instructions.

Furthermore, during the fourth quarter ended on December 31, 2008, no change has occurred in the internal control of the Bank over financial reporting, which materially affected, or is reasonably expected to materially affect, the internal control of the Bank over financial reporting.

The layout of internal control over financial reporting of the Bank had also been audited by the independent auditors of the Bank and found to be effective.

The opinion of the independent auditors on internal control, in the format determined by the Bank of Israel, is included in these financial statements after the Reports of the Board of Directors and Management regarding the internal control over financial reporting.

MISCELLANEOUS

DISCLOSURE REGARDING THE PROCESS OF APPROVAL OF THE FINANCIAL STATEMENTS

General. On April 27, 2008, the Supervisor of Banks issued a provisional directive in the matter of "Disclosure in the Directors' Report regarding the Process of Approval of the Financial Statements". The directive adopts the guidelines of the Securities Authority on the subject issued in July 2007. According to the directive, banks must include in their quarterly and annual Directors' Reports information as to the process of approval of the financial statements.

Overall control at the Bank. The Board of Directors of the Bank is the organ entrusted with the overall control at the Bank. The Board has appointed the Financial Statements Committee as the entity entrusted on its behalf with the supervision, control and guidance of the process of the approval of the Bank's financial statements, and this Committee, at the conclusion of its work, submits its recommendations regarding the approval of the financial statements to the Board. The Financial Statements Committee is comprised of six Directors, five of whom have accounting and financial expertise, as follows: Mr. Shlomo Zohar - Chairman of the Board; Mr. Itshak Forer - Chairman of the Financial Statements Committee; Mr. Ilan Biran; Mr. Ben-Zion Granit, Prof. Ben Zion Zilberfarb; Mr. Eilon Aish and Mr. Zvi Streigold.

Process of approval of the interim financial statements. Approval of the financial statements includes the following stages and organs:

Disclosure Committee. As part of the implementation of the Bank of Israel directives in the matter of disclosure in the financial statements, which are based on Section 302 of the Sarbanes Oxley Act (see hereunder), the Bank has formed a Disclosure Committee headed by the President and CEO with the participation of the following management members: Mr. Joseph Beressi, Senior Executive Vice President - Chief Accountant; Ms. Esther Deutsch, Executive Vice President - Legal Adviser and Legal Risks Manager; Ms. Dorit Bensimon, Executive Vice President - Head of the Finance Division and Risk Manager of the Bank; Mr. Ehud Arnon, Executive Vice President - Head of the Corporate Division and Credit Risk Manager; Mr. Noam Hanegbi, Senior Executive Vice President - Head of Operations and Information Systems Division. The Bank's Corporate Secretary and other entities at the Bank are also invited to attend the meetings of the Committee. The Internal Auditor and the Bank's independent auditors are also invited to attend the meetings of the Disclosure Committee as observers. The Committee convenes once in every quarter (or more if required) and discusses material disclosure matters in accordance with principles determined within the framework of the disclosure policy adopted by the Board of the Bank.

Financial Statements Committee. As stated, this Committee discusses the draft of the Bank's financial statements, and submits its recommendations in the matter to the Board. The Committee also discusses the Bank's financial statements on a stand alone basis (not consolidated).

Prior to the discussions by the Committee, the draft financial statements are provided to the Committee members for review together with additional documents intended to assist them in understanding and analyzing the financial statements, as well as extensive details regarding problematic debts and provisions for doubtful debts. The Financial Statements Committee discusses the statements in detail with the participation of senior officers related to financial reporting (the President and CEO, the Chief Accountant and other entities at the Bank, where required). The independent auditors are invited to attend the meetings as observers.

As part of the discussions, the Chief Accountand reports to the Committee on matters related to the financial statements or matters that might have an impact on the financial statements, such as new regulatory requirements that have been published or which are expected to be published.

The Committee is authorized to discuss and decide on the disclosure of critical accounting policies.

Within the framework of discussing the financial statements, the Committee also discusses cases of borrowers where the recommended provisions in respect to their debt to the Bank exceed the amount determined by the Board, and recommends to the Board the provision to be made in their respect.

The Financial Statements Committee as well as the Audit Committee of the Board is also informed (if required) of significant deficiencies and weaknesses found in the formation or implementation of the internal control over financial reporting, and of fraud, if any, in which the management of the Bank or other employees playing a significant role in the internal control over financial reporting are involved.

The independent auditors report findings, if any, that came up during their audit of the financial statements as well as other matters which, in their opinion, should be brought to the attention of the Committee members.

At the conclusion of the discussion, the Financial Statements Committee presents its recommendations to the Board with respect to the approval of the financial statements, prior to the discussion which the Board will be holding in the matter.

The Board of Directors of the Bank. Following the discussions by the Financial Statements Committee, an additional discussion regarding the approval of the financial statements is held by the full plenum of the Board. Prior to the meeting, the Directors receive an amended draft of the financial statements (which include the recommendations and

decisions of the Financial Statements Committee) together with the documents provided to the members of the Financial Statements Committee for their discussion of the financial statements.
Senior officers involved in financial reporting are also asked to attend the full meeting of the Board are (the President and CEO, the Chief Accountant and other officers where required), as well as the Internal Auditor and the independent auditors of the Bank attending as observers.
The discussion includes a review of the financial statements by the President and CEO and by the Chief Accountant, and a report concerning the adoption of the recommendations of the Financial Statements Committee.
The independent auditors report any findings of their audit of the financial statements as well as other matters which, in their opinion, should be brought to the attention of the Board members.
During the discussion, Board members refer to management questions and requests for clarifications regarding items that have been included (or should have been included) in the financial statements to others involved in the financial reporting. At the end of the discussion, subject to satisfactory answers on the part of management, the Board approves the financial statements.

"CORPORATE 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 "Corporate 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; supervision by the Board of Directors of the Bank over Group companies; 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 August 2007, the Bank's Board of Directors adopted a legal opinion rendered by a prominent legal expert, according to which, transactions between the Bank's interested parties and its subsidiaries shall be approved in accordance with procedures prescribed by the Israeli law relating to approval of transactions with the Bank itself.
As part of the implementation of the plan for adoption of a corporate governance code, the Bank is acting towards the formation of procedures designed to regularize the activities of the Board of Directors and its committees, approval of interested party transactions as well as work processes involving subsidiaries. Once the development of the procedures is completed, they will be presented to the Board of Directors for approval.

BANK OF ISRAEL CIRCULAR REGARDING "GUIDELINES AND CLARIFICATIONS WITH RESPECT TO INTERNAL CONTROL OVER THE FAIR VALUE ASSESSMENT OF FINANCIAL INSTRUMENTS, MEASUREMENT OF FAIR VALUE AND DISCLOSURE REGARDING THE PROCESS OF DETERMINING FAIR VALUE"

On December 18, 2008, the Bank of Israel published a circular regarding "Guidelines and clarifications with respect to internal control over the fair value assessment of financial instruments, measurement of fair value and disclosure regarding the process of determining fair value" (hereinafter: "fair value guideline" or "the guideline"). Prior to the issue of the circular, a draft of this circular was distributed in November 2008.
The guideline refers to all instruments measured according to their fair value in the balance sheet and/or statement of income, such as: securities, derivative instruments and other financial instruments.
As a weakness point, which in certain circumstances may be considered a material weakness requiring disclosure in the

annual report in accordance with the SOX 404 requirements, the guideline notes the, sometimes absolute reliance, on prices received from third parties or from companies quoting fair value of financial instruments, without understanding the assumptions at the base of the method of computation of the price and the risks inherent therein. This may bring about cases where securities, derivative instruments and other financial instruments are measured in the balance sheet and/or the statement of income according to fair value, despite the absence of a process which allows the determination of fair value at a reasonable level of assurance in accordance with the public reporting instructions.

Accordingly, the guideline prescribes the principle that regarding financial instruments in respect of which a process of computing fair value is used, control mechanisms are to be applied, including: review of the models used for computing fair value, validation, verification of the computations, performing reviews and reasonableness examinations, in order to ensure that the fair values presented in the balance sheet and/or the statement of income are stated at a reasonable degree of assurance.

In consequence of the implementation of the requirements of the guideline, cases where fair value computations are accepted "as is" from a quotation company/service bureau or model will no longer be possible, unless they undergo control procedures while exercising proper judgment.

The guideline further prescribes that the requirements included therein must be applied as from the financial statements for the year 2008 onwards.

The Bank has begun preparations even prior the draft guideline became binding. The Bank and its principal subsidiaries have completed the preparations for the full implementation of the guideline within the framework of the annual financial statements for 2008.

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 - Serving 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 Personal and social Responsibility Committee, Chairman of the Ad Hoc Committee for Pricing the Raising of Upper Tier II Capital, Chairman of the Ad Hoc Committee for Pricing the Raising of Hybrid Tier I Capital, Chairman of the Insurance and Property Committee, and as member of the Overseas Operations Committee (until February 19, 2009), Financial Statements Committee, the Computer Committee and the Risk Management Committee.

Has financial and accounting expertise as well as professional qualifications.

Mr. Zohar is a Certified Public Accountant having academic education - Bachelors in Economics and Accounting from the Bar-Ilan University and Masters in Business Administration (specializing in accounting and finance) from McGill University, Montreal, Canada.

Serves as Chairman of the Boards of Mercantile Discount Bank Ltd., Israel Discount Capital Markets & Investments Ltd., Israel Credit Cards Ltd. Director and Deputy Chairman of Israel Discount Bank of New York. Director of Discount Bancorp Inc. and S. Zohar Consulting & Management Ltd.

Served as Chairman of the Board of The Provident Fund of the Staff of Israel Discount Bank (until March 26, 2008), and as

Director of 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 Real Estate Ltd. (until May 2004), Mitzpeh Kinneret Hotel Ltd. (until March 2004).

Betzalel Eiger - Serving as director of the Bank since January 31, 2006. Member of the Credit Committee, member of the Ad Hoc Committee for Pricing the Raising of Upper Tier II Capital, member of the Ad Hoc Committee for Pricing the Raising of Hybrid Tier I Capital. Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation and has financial and accounting expertise as well as professional qualification.

Mr. Eiger has academic education - Bachelors and Masters 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., as Chairman of the Board of Ortam Sahar Engineering Ltd. and as Director of Comsec Ltd. Served as Outside Director in Adanim Mortgage Bank Ltd. (until January 2006), as CEO of Giron-Development and Building Ltd. (until March 2005).

Ilan Biran - Serving as director of the Bank since October 29, 2008. Member of the Audit Committee, Credit Committee, Computer Committee and Financial Statements Committee (since February 9, 2009). Member of the Ad Hoc Committee for Pricing the Raising of Upper Tier II Capital (since February 9, 2009). Acts as an Outside Director under the Companies Law, 1999. Has accounting and financial expertise as well as professional qualifications.

Mr. Biran has an academic education - Bachelors in Economics and Business Administration from Bar-Ilan University and holder of a diploma/strategic studies in strategy and economics from Georgetown University, Washington DC.

Serves as Chairman of the Board of Rafael Advanced Defense Systems Ltd., Chairman, management Committee, Kinneret College on the Sea of Galilee (R.A). Venture Partner Consultant, The Challenge Fund - Etgar L.P. Served as Chairman of the Board of DBS Satellite Services (1998) Ltd. (2004-2006) and of Beit Shemesh Engines Holdings (1997) Ltd. (2006 -2007), and as Director in Delta Three Israel Ltd. (until November 1, 2008) as Director and Chairman of the Strategic Committee of Israel Aircraft Industries Ltd. (2005-2007), as Director and member of the Finance Committee of Netafim Ltd. (2004 - 2007), as Director of Massad Bank Ltd. (2005-2007) and as a consultant at Al Cielo Ltd. (2006-2007.)

Ben-Zion Granit - Serving as Director of the Bank since January 31, 2006. Member of the Audit Committee, the Financial Statements Committee, Overseas Operations Committee (since February 19, 2009) and the Computer Committee.

Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation 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.

Mr. Granit is a Management Consultant. Member of the Audit Committee, The Friends of Kaplan Medical Center .Served as member of management of Ilan - Israeli Association for Handicapped Children (until 2009) and he was a voluntary consultant of Nitzan Association (until 2009). Served as a voluntary consultant of the Rehovot Community center Company (until 2006)/ 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.

Prof. Ben-Zion Zilberfarb - Serving as Director of the Bank since January 31, 2006. Chairman of the Risk Management Committee and member of the Credit Committee, Financial Statements Committee. Member of the Ad Hoc Committee for Pricing the Raising of Upper Tier II Capital (since February 19 2009), the Insurance and Property Committee and

the Ad Hoc Committee for Pricing the Raising of Hybrid Tier I Capital.
Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation and has financial and accounting expertise as well as professional qualification.
Prof. Zilberfarb has an academic education - Bachelors in Economics and Business Administration and Masters in Economics from Bar-Ilan University, Ph.D 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 Delek Group Ltd., Direct capital Investments Ltd., Perrigo Company (a U.S. corporation) and as a 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 Brimag Digital Age Ltd. (until December 7, 2008), Fundtech Ltd. (until end of December 2007), of Clal Finance Provident and Education Fund Ltd. (until April 2006) and of Partner Communications Company Ltd. (until February 2006).
Jorge Zafran - Serving as Director of the Bank since January 31, 2006. Chairman of the Overseas Operations Committee (since February 19, 2009. Prior there to, Member of the Committee), Member of the Audit Committee. Has professional qualifications.
Mr. Zafran has an academic education - Masters 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).
Dr. Arie Ovadia - Serving as Director of the Bank since October 29, 2008. Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation. Has accounting and financial exerpertise as well as professional qualifications.
Dr. Ovadia has an academic education - Bachelors in Economics and Accounting and Masters in Business Administration from Tel Aviv University and a Ph.D. in Economics from the University of Pennsylvania USA.
Managing Partner, Shamrock Israel Growth Fund Advisors Ltd., Chairman, Giron - Development and Building Ltd., Destiny Holdings (1993) Ltd., Teva Naot - Distribution Ltd., Naot Footwear Agricultural Cooperative Association Enterprise Ltd., Nadlan.com.Israel Ltd., Peer Stream Ltd. Director, Shamrock - Cinema City Ltd., Destiny Investments (1993) Ltd., Destiny Properties (1991) Ltd., Israel Petrochemical Enterprises Ltd., Hadar Givun Investments Ltd., Strauss Group Ltd., Scailex Corporation Ltd., Elron Electronic Industries Ltd., Compugen Ltd., Carmel Olefins Limited, Polar Investments Ltd., Intercure Ltd., I. Q. S. Shalev Ltd., I.Q.S Hydraulics Ltd., Maxtech Technologies Ltd., Maxtech Communication Networks Ltd., Mantisvision Ltd., Paycard Ltd., Viryanet Ltd., Adsmarket G.M. Ltd., Telem Finance Solutions Ltd., A.O. Adav Consultants Ltd., A.O. Adav Consulting and Management (2007) Ltd., Anatz Consultants Ltd., Benjamin Ovadia Consultants (2007) Ltd., G.A. Tech Ltd. Lecturer at the College of Management founded by the Union of Clerks.
Served as member of the Advisory Board of Shamrock Israel Growth Fund Advisors Ltd. (2003- 4/2008), as Chairman of the Board of Exatend Ltd. (2005-2007), NVR Labs Ltd. (18/4/2000- 8/2008), Techtium Ltd. (until 2007), Peninsula Finances Ltd. 14/3/2007-7/2008), Israel Phoenix Insurance Company Ltd. (18/9/2003-31/3/2006). As Director at Israel Discount Bank Ltd. (7/1998-7/2006), Hadar Ltd. (until 2005), Mehadrin Ltd. (14/7/2002-19/4/2007), Tadiran Communications Ltd. (10/11/1999-23/8/2005), Participations in Properties in Israel Ltd. (until 2004) and as an Outside Director in Orda Print Industries Ltd. (until 2004).
Ilan (Eilon) Aish - Serving as Director of the Bank since November 1, 2008. Chairman of the Audit Committee (since

February 24, 2009. Prior there to Member of the committee), Member of the Credit Committee, Financial Statements Committee, the Ad Hoc Committee for Pricing the Raising of Upper Tier II Capital, Overseas Operations Committee and the Risk Management Committee.

Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation. Has accounting and financial expertise as well as professional qualifications.

Mr. Aish is a Certified Public Accountant having academic education - Bachelors in Economics and Accounting from Tel Aviv University.

Serves as Joint Managing Director, Harvest Capital Markets Ltd. Director, Harisha Tuff Lanka (Private) Limited.

Served as Chairman General Partner of Tuff L.P. (until 12/2008), Chairman of the Board of Tuff Merom Golan (2000) Ltd. (until 12/2008), as Outside Director and Chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd. (12/2003-9/2007), as Outside Director and Chairman of the Risk Management Committee of Mercantile Discount Bank Ltd. (11/2000-10/2006), as Director of Golan Fine Crafts (1977) Ltd. (7/2005-8/2005), Ilran Holdings Ltd. (in voluntary liquidation) (4/1998-4/2004). Liquidator in the voluntary liquidation of Amnar Underwriting and Issuance Ltd. (2004), and as a consulting partner in the accounting firm of Goldstein, Sabu, Tevet (2001-2004).

Itshak Forer - Serving as Director of the Bank since December 18, 2007. Chairman of the Financial Statements Committee, member of the Personal and social Responsibility Committee and the Risk Management Committee.

Has financial and accounting expertise as well as professional qualifications.

Mr. Forer is a Certified Public Accountant having an academic education - B.Sc 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. and Otzar Hityashvuth Hayehudim B.M.

Served as a Member of the advisory Committee of Tamir Fishman Investments Ltd.(4/2007-4/2008). Until March 31, 2007, Mr. Forer served as Chairman of the accounting firm of Ernst & Young Israel (Kost Forer Gabbay and Kasierer) and Managing Partner of the accounting firm of Ernst & Young Israel (Kost Forer Gabbay and Kasierer) in the years 1979 - 2000. Fulfilled various duties in this Firm since 1959.

Dr. Dafna Schwartz - Serving as Director of the Bank since December 27, 2007. Member of the Credit Committee, Risk Management Committee and the Overseas Operations Committee. Serves as an Outside Director according to Instruction 301 of the Proper Conduct of Business Regulation and has financial and accounting expertise as well as professional qualifications.

Dr. Schwartz has an academic education - Bachelors in Economics (Statistics) from the Tel Aviv University, Masters (MSc) in Agricultural Economics and Management, and PhD in Economics from the Hebrew University, Jerusalem.

Serves as an economic and business consultant. A faculty member at the Department of Business Administration, Guilford Glazer School of Business and Management, Ben Gurion University: Head of the MBA Specialization (Magama) in Entrepreneurship and High-Tech Management, and Director, Bengis Center for Entrepreneurship and High-Tech Management. Serves as an Outside Director of Oil Refineries Ltd. and Giron-Development and Building Ltd. and Strauss Group Ltd. (since 12/6/2008).

Served as Director of Rotem Industries Ltd. (2/2002-11/2008), 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 Yitzhak Ltd. (until May 2004).

Zvi Streigold - Serving as Director of the Bank since January 31, 2006. Member of the Credit committee, Audit Committee, Personal and social Responsibility Committee, Financial Statements Committee, Computer Committee and Insurance and Property Committee (since February 19, 2009). Serves as an Outside Director according to Instruction

301 of the Proper Conduct of Business Regulation and has professional qualifications.

Mr. Streigold is a lawyer with an LL.B. Degree from the Tel Aviv University He also studied economics there without graduating.

Mr. Streigold 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).

Dr. Yitzhak Sharir - Serving as director of the Bank since December 24, 2006. member of the Computer Committee, Personal and social Responsibility Committee and Overseas 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., chairman of the Board of Revolutionaire Ltd. (since September 2007) and Director of Israel Discount Capital Markets & Investments Ltd. (since April 3, 2008). Served as Chairmen of the borad of Lia Chocolate Gourmet Ltd. (16/4/2008-25/9/2008), President and CEO of Sapiens International Corporation NV (11/2000-11/2005).

Prof. Eytan Sheshinski - Serving as Director of the Bank since January 31, 2006. Member of the Risk Management Committee and the Personal and social Responsibility Committee. Has professional qualifications.

Prof. Sheshinski 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).

Edith Lusky - Serving as Director of the Bank since March 25, 2009. Serves as member of the Audit Committee, Overseas Operations Committee, Insurance and Property Committee, Risk Management Committee and the Personal and social Responsibility Committee.

Serves as an Outside Director in accordance with the Companies Law, 1999. Has financial and accounting expertise and professional qualifications.

Ms. Lusky has a Bachelor in Economics and statistic and Masters Degrees in Economics from the Tel Aviv University.

Ms. Lusky served as senior executive vice president and member of management of Union Bank of Israel Ltd. (2/2004-31/12/2008), Vice President and CEO of Mishcan Bank, a subsidiary of Bank Hapoalim Ltd. (3/2001-2/2004). Igud Leasing Ltd. (3/2007-12/2008), Igudim Insurance Agency (1995) Ltd. (9/2005-12/2008), Igudim Ltd. (9/2005-12/2008), Livluv Insurance Agency (1993) Ltd. (2/2004-12/2008), Bitan Investment and Mortgage Company Ltd. (3/2001-2/2004).

DETAILS REGARDING MEMBERS OF MANAGEMENT

Giora Offer - Serving as President and CEO of the Bank since March 2, 2001.

Mr. Offer has an academic education - Bachelors in Economics and Masters in Industrial Management from the Negev Ben Gurion University, Beer Sheva.

Mr. Offer serves as Chairman (temporary) of Discount Bancorp Inc. (Director since April 18, 2001, Chairman since April 13, 2007), Chairman of the Board of IDB (Swiss) Bank Ltd. (The Former name until June 2008 was: Israel Discount Bank (Switzerland) SA), Director of Israel Discount Bank of New York. Served as Chairman of the Board of Israel Credit Cards Ltd. (until March 2006).

Ehud Arnon - Serving as Executive Vice President Head of the Corporate Banking Division of the Bank since May 13, 2007.

Mr. Arnon has an academic education - Bachelors in Social Sciences - Economics and International Relations and Masters 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).

Served as manager of the business wing and member of management of the Israeli branch of HSBC Bank PlC (2001-12/5/2007), Director of Beyachad Fund (2006-1/1/2009).

Dorit Bensimon - Serving as Executive Vice President Head of Finance Division and as the Bank's Chief Risk Manager since April 2, 2006.

Ms. Bensimon has an academic education - Bachelors in Social Sciences - Economics and General Studies and Masters in Business Administration (specializing in finance) from the Hebrew University, Jerusalem.

Serves as Chairperson of the Board of Discount Manpikim Ltd. (since April 10, 2006) and Chairperson of the Board of Bet Lamed Dalit Ltd. (since January 23, 2007).

Served as Director of Manpikim - Financial Operation Ltd. (until 1/6/2008 when the company was voluntarily dissolved), Discount Reinsurance International Limited, Guernsey (2006-12/3/2008), Director of Ma'alot - The Israel Rating Company Ltd. (17/4/2006-15/11/2007) (The current name of the company is: M.H.L.D.N. Ltd.) and General Manager of Gmulot and Head of the provident funds asset management unit at Bank Hapoalim Ltd. (2/2001-1/2006).

Joseph Beressi - Serving as Senior Executive Vice President, Comptroller - Chief Accounting Officer and Head of the Accounting of the Bank since April 1, 2000.

Mr Beressi is a Certified Public Accountant and has an academic education - Bachelors in Accounting and Economics from the Tel Aviv University.

Serves as 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).

Served as Chairman of the Board of Discount Gemel Ltd. (until December 28, 2008).

Amnon Gideon - Serving as Executive Vice President Head of the Human Resources of the Bank since March 1, 2006.

Mr. Gideon has an academic education - Bachelors in Political Science and Psychology from Bar-Ilan University, and MA-HRM studies in Human Resources Management (has not graduated) from 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 (15/3/2006-30/1/2008) (until 29/7/2007 the name of the company was: Discount Management of Provident Fund Ltd.) and as VP Human Resources at Partner Communications Company Ltd. (2001 to the beginning of 2006).

Israel David - Serving as Senior Executive Vice President, Head of the Retail Banking Division at the Bank since February 1, 2002.

Mr. David has an academic education - Bachelors in Economics from the Negev Ben Gurion University, Beer Sheva and Masters in Business Administration from the Bar-Ilan University. He has also taken a course in management and guidance at the Bar-Ilan University.

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 Israel Ltd.

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 (2/2002-3/2006).

Esther Deutsch - Serving as Executive Vice President, Legal Adviser and Head of the Legal Advisory layout of the Bank as since June 1, 2006.

Ms. Deutsch is a lawyer having an academic education - LL.B. from the Hebrew University, Jerusalem.

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).

Served as Manager of the Legal Department of the Bank (2000-6/2006).

Noam Hanegbi - Serving as Senior Executive Vice President, Head of the Operations and Information Systems Division of the Bank since November 15, 2000.

Mr Hanegbi has an academic education - Bachelors in Economics and Computer Sciences from the Bar-Ilan University.

Served as Director of Diners Club Israel Ltd. (until December 2006).

Serves as Chairman of the Board and General Managing Director of Badal Computer and Management Services Ltd., Chairman of the Board of Discount Gemel Ltd. (since December 28, 2008), Nidbach Real Estate and Investments Ltd. (since February 1, 2009. Prior there to serve as Director). Director of Mercantile Discount Bank Ltd., Israel Credit cards Ltd. Acts as member of the Computer Committee of the Tel Aviv Stock Exchange (since December 2001).

Served as chairman of the Board of Banking Clearing Center Ltd. (1/7/2007-3/2009) (Director since November 2000), Automatic Bank Services Ltd. (1/7/2007-3/2009) (Director since November 2000). Director of Diners Club Israel Ltd. (until December 2006).

Shlomo Pitchon - Serving as Senior Executive Vice President and Internal Auditor of the Bank since 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 - Bachelors 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, Bachelors in Economics and Accounting and Masters in Business Administration (specializing in accounting and finance).

A partner in the accounting firm of Zohar, Zohar & Co., CPA (Isr) (1980 to December 2005). 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 a director and as vice chairman of the board of directors of Israel Discount Bank of New York, and as director, Discount Bancorp Inc.

Mr. Zohar serves as a member of the Financial Statements Committee.

Betzalel Eiger - Bachelors in business administration, Masters in business administration (specializing in finance).

Chairman of the Board of Directors and CEO of Dorea Investments and Development Ltd. and Liberty Properties Ltd., public companies traded on the Tel-Aviv Stock Exchange as well as Chaiman of the Board of Ortam Sahar Engineering Ltd. and Director in Comsec Ltd., public companies as well.

Served as Outside Director in Adanim Mortgage Bank Ltd. (December 2001 until January 2006). Served as Director in Neot Aviv Ltd. (1987 to September 2003). Served as CEO of Giron - Development and Building Ltd. (May 2002 to March 2005). From 1979 to 1994 held various positions in Bank Leumi Le Israel B.M, including as a member of various credit committees of Bank Leumi Le Israel B.M. His experience includes analysis of financial statements.

Ilan Biran - Bachelors in Economics and Business Administration and holder of a diploma/strategic studies in strategy and economics.

Serves as Chairman of the Board of Rafael Advanced Defense Systems Ltd., Chairman, manager committee Kinneret College on the Sea of Galilee (R.A). Venture Partner Consultant, The Challenge Fund - Etgar L.P.

Serves as Director General of the Ministry of Defense (1996-1999) and Bezeq the Israel Telecomunications Corp. Ltd. (1999-2003).

Served as Chairman of the Boards of DBS Satellite Services (1998) Ltd. (2004-2006) and of Beit Shemesh Engines Holdings (1997) Ltd. (2006 - 2007), and as Director in Delta three Israel Ltd. (until November 1, 2008) as Director and Chairman of the Strategic Committee of Israel Aircraft Industries Ltd. (2005-2007), as Director and member of the Finance Committee of Netafim Ltd. (2004-2007), as Director of Massad Bank Ltd. (2005-2007) and as a consultant at Al Cielo Ltd. (2006-2007.)

Mr. Biran serves as member of the Audit Committee and the Financial Statements Committee.

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. ("Union Bank") 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). In additinon he 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 - Bachelors in Economics and Business Administration and Masters 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 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 Company (including a tenure as chairman of the audit committee). Served as Chairman of the Board of Directors of Karnit (1998-2002) and of Eurotrade Bank Ltd. (2000-2001).
Served as director of the Economic Planning Authority (1982-1985) and as Director General of the Ministry of Finance (1998-1999).
Partner Communications Company Ltd. reported him as having financial expertise under the U.S. Securities Regulations. As a member of the audit committees of Fundtech Ltd. and of Partner Communications Company 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.
Dr. Arie Ovadia - Bachelors in Economics, Masters in Business Administration and Ph.D. in Economics. Consultant to companies on economic matters.
Serves as Chairman of the Board and as Director Giron - Development and Construction Ltd., Peer Stream Ltd.
Director of Strauss Group Ltd, Israel Petrochemical Industries Ltd., Carmel Olefins Ltd., Polar Investments Ltd., Elron Electronic Industries Ltd. Scailex Corporation Ltd.
Served as member of the Israel Securities Authority (1981-1996) and member of the Israeli Accounting Standards Institute (1998-2001). In the years 1996-1999 acted as President and CEO of Dubek Ltd.
Served as Chairman of the Board of Israel Phoenix Insurance Company Ltd. As Director of Dubek Ltd., Koor Industries Ltd., Participations in Properties in Israel Ltd., Tadiran Communications Ltd., Hadar Ltd., Mehadrin Ltd., and as an Outside Director in Orda Print Industries Ltd.
In addition acted as Director of Israel Discount Bank Ltd. (7/1998-7/2006).
Ilan (Eilon) Aish - Certified Public Accountant, Bachelors in Economics and Accounting.
Serves as Joint Managing Director, Harvest Capital Markets Ltd. Director, Harisha Tuff Lanka (Private) Limited.
Served as a partner in the accounting firm of Yigal Brightman & Co. (1984-1992) and in the accounting firm of Vulcan, Weinberg, Aish & Co. (1993-2000) and as consulting partner in the accounting firm of Goldstein, Sabu, Tevet (2001-2004).
Served as Outside Director and chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd. (12/2003-9/2007), and as Outside Director and chairman of the Risk Management Committee of Mercantile Discount Bank Ltd. (11/2000-10/2006). In addition acted as Director of Golan Fine Crafts (1977) Ltd. (7/2005-8/2005), Ilran

Holdings Ltd. (in voluntary liquidation) (4/1998-4/2004). Chairman and General Partner in Tuff Industries (4/2002-12/2008) and as Chairman of the Board of Tuff Merom Golan (2000) Ltd. (4/2002-12/2008).

Also served as General Manager, Director and Liquidator in the voluntary liquidation of Amnar Underwriting and Issuance Ltd. (4/1998-4/2004).

Mr. Aish serves as member of the Audit Committee (as Chairman since 24/2/2009) and of the Financial Statements Committee.

Itshak Forer - Certified Public Accountant having an academic education - B.Sc Economics From 1959 to March 31, 2007, served in various positions with the accounting firm of Ernst & Young Israel (Kost Forer Gabbay & Kassierer): auditor (1959-1962); partner (1962-1979); managing partner (1979-1999); chairman (2000-2007). Serves as director of Otzar Hityashvuth Hayehudim B.M. 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 - Bachelors in Economics (Statistics), Masters (MSc) in Agricultural Economics and Management, and PhD in Economics from the Hebrew University, Jerusalem.

Serves as a faculty member at the Department of Business Administration, Guilford Glazer School of Business and Management, Ben Gurion University: Head of the MBA Specialization (Magama) in Entrepreneurship and High-Tech Management, and Director, Bengis Center for Entrepreneurship and High-Tech Management and as economic and business consultant in Israel and abroad.

Serves as an Outside Ddirector of the following companies: Oil Refineries Ltd., Giron - Development and Buildings Ltd. and Strauss Group Ltd.

Also served in the past as director of Rotem Industries Ltd. (2/2002-11/2008), The Phoenix Holdings Ltd. (8/2003-2/2007), The Phoenix Insurance Company Ltd. (5/2006-12/2007), Israel Discount Bank Ltd. (1995-2002) and Bezeq the Israel Telecommunication Corp. Ltd. (1997-2000).

Edith Lusky - Bachelors degree in Economics and Statistics and Masters in Economics.

Senior vice president and member of management of Union Bank of Israel Ltd. (2004-2008). Her areas of responsibility were: Head of the retail, customer assets and advisory services department, Head of the retails banking and risk management department and in addition in charge of marketing, advertising and mortgages.

President and CEO of Mishcan Bank, a subsidiary of Bank Hapoalim Ltd. (2001-2004).

Manager of the direct banking wing at Bank Hapoalim Ltd. (11/1995-3/2001). Her responsibilities were: establishment and marketing the Bank's internet sites, establishment and management of "Poalim Direct" - the bank's telephone centers, responsibility for self-service machines and automatic branches.

Ms. Lusky serves as member of the Audit Committee.

CHANGES IN THE BOARD OF DIRECTORS AND MANAGEMENT

CHANGES IN THE BOARD OF DIRECTORS

On September 23, 2008, Mr. Ittamar Givton ended his service as a director and on September 25, 2008, Mr. Joseph Singer ended his service as a director. On February 24, 2009, Ms. Tsippi Samet ended her service as a director.

The Chairman and members of the Board wish to thank the directors whose term has come to an end for their activity and contribution to the Bank during their period of office.

The Annual General Meeting of Shareholders convened on October 29, 2008, decided to appoint as directors of the Bank Mr. Ilan Biran, effective from October 29, 2008, and Dr. Arie Ovadia, effective from October 29, 2008, as well as Mr. Ilan (Eilon) Aish, effective from November 1, 2008. At an extraordinary meeting held on March 25, 2009, it was resolved to appoint Ms. Edith Lusky as director of the Bank effective from March 25, 2009.

CHANGES IN MANAGEMENT

Mr. Eli Hoter, Senior Executive Vice President and Head of the Marketing and Strategic Planning Division, retired from the Bank on January 31, 2009.

The Board of Directors, the President and CEO and Management wish to thank Mr. Hoter for his work and contribution in his years of service at the Bank.

MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

In 2008, the Board of Directors held 35 meetings. In addition, 88 meetings of committees of the Board of Directors were held.

The Board of Directors wishes to thank the President & CEO, 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, 2009

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

REPORTED AMOUNTS

	As at December 31				
	2008	2007	2006	2005	2004
	In NIS millions				
Assets					
Cash and deposits with banks	21,554	19,850	25,100	20,586	17,751
Securities	31,535	37,278	38,977	42,226	40,099
Securities borrowed or purchased under resale agreements	25	346	-	-	-
Credit granted to the public	116,800	101,899	90,097	87,778	81,254
Credit granted to the Government	1,491	374	324	92	271
Investments in affiliated companies	1,900	2,008	1,367	1,478	1,258
Buildings and equipment	3,039	2,780	2,614	2,268	1,978
Other assets	5,904	*4,184	4,044	4,292	3,666
Total assets	182,248	168,719	162,523	158,720	146,277
Liabilities and Shareholders' Equity					
Deposits from the public	139,232	130,518	130,517	130,285	121,982
Deposits from banks	4,555	5,072	8,099	6,518	4,806
Deposits from the Government	206	125	119	136	127
Securities loaned or sold under buy-back arrangements	7,194	5,895	-	-	-
Subordinated capital notes	9,373	7,437	6,302	5,342	4,809
Other liabilities	12,665	*10,321	9,119	9,254	7,718
Total liabilities	173,225	159,368	154,156	151,535	139,442
Minority interest	226	147	402	467	449
Shareholders` equity	8,797	9,204	7,965	6,718	6,386
Total liabilities and shareholders` equity	182,248	168,719	162,523	158,720	146,277

* Reclassified.

SCHEDULE B - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

REPORTED AMOUNTS

	As at December 31				
	2008	2007	2006	2005	2004
	in NIS millions				
Financing Income					
Income from financing activities before provision for doubtful debts	4,127	4,225	3,790	3,697	3,473
Provision for doubtful debts	780	447	570	691	880
Income from financing activities after provision for doubtful debts	3,347	3,778	3,220	3,006	2,593
Operating and other Income					
Operating commissions	2,339	*2,214	1,911	1,863	1,776
Net income on investment in shares	51	58	65	3	103
Other income	100	*300	383	540	352
Total operating and other income	2,490	2,572	2,359	2,406	2,231
Operating and other Expenses					
Salaries and related expenses	3,106	3,030	3,202	2,967	2,564
Maintenance and depreciation of buildings and equipment	910	819	679	670	634
Other expenses	1,249	1,217	1,139	1,092	830
Total operating and other expenses	5,265	5,066	5,020	4,729	4,028
Operating income before taxes	572	1,284	559	683	796
Provision for taxes on operating income	169	566	350	324	342
Operating income after taxes	403	718	209	359	454
Bank's share in operating income (loss) net of tax effect of affiliated companies	(70)	45	188	174	135
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(78)	(56)	(82)	(75)	(56)
Net operating income	255	707	315	458	533
Net cumulative effect as of the beginning of the year of change in accounting	-	-	-	(4)	(1)
Net income, before extraordinary income (loss) after taxes	255	707	315	454	532
Cancellation of provision for impairment in value of investment in affiliated companies	-	-	173	-	-
Net income (loss) from extraordinary items, net of taxes	(10)	558	348	4	24
Net income	245	1,265	836	458	556
Earnings per share of NIS 0.1 (in NIS)[(1)]:					
Net operating income	0.26	0.72	0.32	0.47	0.54
Net income (loss) from extraordinary items, net of taxes[(1)]	(0.01)	0.57	0.53	-	0.03
Net income	0.25	1.29	0.85	0.47	0.57
Total number of shares used for the above computation (in thousands)	980,639	980,639	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 and December 31, 2004: Including net cumulative effect as of the beginning of the year of change in accounting.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1]

REPORTED AMOUNTS

	2008				2007			
			Rate of income (expense)				Rate 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]	67,372	3,990	5.92		*60,149	*3,657	6.08	
Effect of derivatives:[3]								
Hedging derivatives	46	1			65	2		
Embedded derivatives and ALM	50,310	3,035			29,566	910		
Total assets	117,733	7,026		5.97	89,780	4,569		5.09
Liabilities[5]	(64,985)	(1,785)	(2.75)		(57,918)	(1,693)	(2.92)	
Effect of derivatives:[3]								
Hedging derivatives	(46)	(8)			(66)	-		
Embedded derivatives and ALM	(48,243)	(2,842)			(28,146)	(884)		
Total liabilities	(113,274)	(4,635)		(4.09)	(86,130)	(2,577)		(2.99)
Interest margin			3.17	1.88			3.16	2.10
Israeli Currency Linked to the CPI:								
Assets[4][5]	25,558	2,312	9.05		*21,598	*1,718	7.95	
Effect of derivatives:[3]								
Embedded derivatives and ALM	429	22			655	30		
Total assets	25,987	2,334		8.98	22,253	1,748		7.86
Liabilities[5]	(19,117)	(1,568)	(8.20)		(18,727)	(1,274)	(6.80)	
Effect of derivatives:[3]								
Embedded derivatives and ALM	(4,715)	(471)			(1,574)	(109)		
Total liabilities	(23,832)	(2,039)		(8.56)	(20,301)	(1,383)		(6.81)
Interest margin			0.85	0.42			1.15	1.05

* Reclassified.
For footnotes see page 306.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1]

REPORTED AMOUNTS

	2008				2007			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Foreign Currency:[6]								
Assets[4][5]	64,806	1,611	2.49		*73,446	(1,033)	(1.41)	
Effect of derivatives:[3]								
Hedging derivatives	959	(50)			755	(110)		
Embedded derivatives and ALM	39,555	531			40,365	(848)		
Total assets	104,320	2,092		1.99	114,566	(1,991)		(1.74)
Liabilities[5]	(68,483)	242	0.35		(73,529)	2,724	3.70	
Effect of derivatives:[3]								
Hedging derivatives	(982)	(47)			(753)	114		
Embedded derivatives and ALM	(37,337)	(910)			(40,818)	672		
Total liabilities	(106,802)	(715)		(0.67)	(115,100)	3,510		3.05
Interest margin			2.84	1.32			2.29	1.31

* Reclassified.
For footnotes see page 306.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2008				2007			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated finacning income[4][5]	157,736	7,913	5.02		155,193	4,342	2.80	
Effect of derivatives:[3]								
Hedging derivatives	1,005	(49)			820	(108)		
Embedded derivatives and ALM	90,294	3,588			70,586	92		
Total assets	249,035	11,452		4.6	226,599	4,326		1.91
Monetary liabilities which generated financing expenses[5]	(152,585)	(3,111)	(2.04)		(150,174)	(243)	(0.16)	
Effect of derivatives:[3]								
Hedging derivatives	(1,028)	(55)			(819)	114		
Embedded derivatives and ALM	(90,295)	(4,223)			(70,538)	(321)		
Total liabilities	(243,908)	(7,395)		(3.03)	(221,531)	(450)		(0.20)
Interest margin			2.98	1.57			2.64	1.71
In respect of options		(109)				(75)		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives)[3]		27				89		
Commissions on financing operations and other financing income[7]		208				363		
Other financing expenses		(62)				(28)		
Income from financing activities before provision for doubtful debts		4,127				4,225		
Provision for doubtful debts (including general and supplemental provisions)		(780)				(447)		
Income from financing activities after provision for doubtful debts		3,347				3,778		

* Reclassified.
For footnotes see next page.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2008	2007
	Average balance[2]	Average balance[2]
	in NIS millions	
Total:		
Monetary assets which generated financing income[4][5]	157,736	155,193
Assets related to derivative instruments[8]	2,301	1,325
Other monetary assets[5]	2,954	*3,357
General and supplemental provisions for doubtful debts	(594)	(609)
Total monetary assets	162,397	159,266
Total:		
Monetary liabilities which generated financing expenses[5]	(152,585)	(150,174)
Liabilities related to derivative instruments[8]	(2,819)	(1,384)
Other monetary liabilities[5]	(4,046)	(4,552)
Total monetary liabilities	(159,450)	(156,110)
Surplus of monetary assets over monetary liabilities	2,947	3,156
Non-monetary assets	6,639	5,898
Non-monetary liabilities	(324)	(192)
Total capital resources	9,262	8,862

* Reclassified.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).
(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.
(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.
(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities, included in shareholders equity under other cumulative comprehensive income, in the item "Adjustments for the presentation of available-for-sale securities at fair value" (including in respect of bonds transferred from the available-for-sale portfolio to the bonds held to maturity portfolio), 2008 - NIS ? million in the non-linked segment, NIS ? million in the CPI linked segment and NIS ? million in the foreign currency segment; 2007 - NIS (192) million in the non-linke segment, NIS (14) million in the CPI linked segment and NIS 84 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" - RATES OF FINANCING INCOME AND EXPENSES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2008				2007			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	in US$ millions		%		in US$ millions		%	
Foreign Currency - Nominal in US$[6]*								
Assets[4][5]	17,886	904	5.05		17,839	1,021	5.72	
Effect of derivatives:[3]								
Hedging derivatives	277	(18)			187	(17)		
Embedded derivatives and ALM	11,204	504			10,003	400		
Total Assets	29,367	1,390		4.73	28,029	1,404		5.01
Liabilities[5]	(18,961)	(518)	(2.73)		(17,938)	(721)	(4.02)	
Effect of derivatives:[3]								
Hedging derivatives	(286)	(7)			(187)	18		
Embedded derivatives and ALM	(10,622)	(515)			(10,069)	(386)		
Total liabilities	(29,869)	(1,040)		(3.48)	(28,194)	(1,089)		(3.86)
Interest margin		350	2.32	1.25		315	1.70	1.15

* Nominal Israeli Shekel amounts translated to US$ Dollars at the representative rate of exchange.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances (except for the non-linked Israeli currency segment in respect of which the average balances are computed based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts).

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities (including bonds transferred from the available-for-sale to the held-to-maturity portfolios) 2008 - in amount of US$? million 2007 - in the amount of US$ 20 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, 2008

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	56,570	4,997	2,603	2,295
Total liabilities	54,908	5,561	7,083	2,133
Difference	1,662	(564)	(4,480)	162
Effect of forward transactions and special commitments	926	(425)	1,298	863
Options	(133)	25	86	15
Exposure to changes in interest rates in the segment	2,455	(964)	(3,096)	1,040
Cumulative exposure in the segment	2,455	1,491	(1,605)	(565)
Israeli Currency Linked to the CPI				
Total assets	500	788	3,574	7,586
Total liabilities	431	905	2,502	6,852
Difference	69	(117)	1,072	734
Effect of forward transactions and special commitments	-	(21)	(807)	(804)
Options	-	-	-	262
Exposure to changes in interest rates in the segment	69	(138)	265	192
Cumulative exposure in the segment	69	(69)	196	388
Foreigh Currency**				
Total assets	29,893	20,798	13,493	4,053
Total liabilities	35,581	19,203	9,593	3,253
Difference	(5,688)	1,595	3,900	800
Effect of forward transactions and special commitments	127	74	(84)	757
Options	133	(25)	(86)	(277)
Exposure to changes in interest rates in the segment	(5,428)	1,644	3,730	1,280
Cumulative exposure in the segment	(5,428)	(3,784)	(54)	1,226
Overall Exposure to Changes in Interest Rates				
Total assets***	86,963	26,583	19,670	13,934
Outstanding debt deriving from credit card transactions****				
Total balance sheet assets	86,963	26,583	19,670	13,934
Total liabilities***	90,920	25,669	19,178	12,238
Creditors in respect of credit card activity****				
Total balance sheet liabilities	90,920	25,669	19,178	12,238
Difference	(3,957)	914	492	1,696
Effect of forward transactions and special commitments	1,053	(372)	407	816
Exposure to changes in interest rates in the segment	(2,904)	542	899	2,512
Cumulative exposure in the segment	(2,904)	(2,362)	(1,463)	1,049

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.

								31.12.2007	
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	Rate of return %	Average duration in years
1,078	3,023	640	(16)	1,170	72,360	4.31	0.64	6.00	0.71
815	2,159	309	18	120	73,106	2.85	0.50	3.01	0.41
263	864	331	(34)	1,050	(746)	1.46	0.14	2.99	0.30
403	668	126	-	-	3,859				
(79)	92	188	-	-	194				
587	1,624	645	(34)	1,050	3,307				
22	1,646	2,291	2,257	3,307	-				
4,842	6,877	2,627	153	114	27,061	4.59	4.63	5.08	4.61
3,477	5,159	1,462	-	83	20,871	3.98	4.09	4.30	4.11
1,365	1,718	1,165	153	31	6,190	0.61	0.54	0.78	0.50
(1,303)	(1,990)	(498)	-	-	(5,423)	-	-	-	-
-	2	-	-	-	264	-	-	-	-
62	(270)	667	153	31	1,031	-	-	-	-
450	180	847	1,000	1,031	-	-	-	-	-
1,282	1,069	421	-	1,171	72,180	6.11	0.57	5.08	1.35
3,629	3,630	89	-	98	75,076	3.34	0.85	3.34	0.23
(2,347)	(2,561)	332	-	1,073	(2,896)	2.77	(0.28)	1.74	1.12
648	678	(636)	-	-	1,564	-	-	-	-
79	(94)	(188)	-	-	(458)	-	-	-	-
(1,620)	(1,977)	(492)	-	1,073	(1,790)	-	-	-	-
(394)	(2,371)	(2,863)	(2,863)	(1,790)	-	-	-	-	-
7,202	10,969	3,688	137	9,111	178,257	-	1.25	-	1.56
					3,991				
7,202	10,969	3,688	137	9,111	182,248				
7,921	10,948	1,860	18	482	169,234	-	1.10	-	0.77
					3,991				
7,921	10,948	1,860	18	482	173,225				
(719)	21	1,828	119	8,629	9,023	-	0.15	-	0.79
(252)	(644)	(1,008)	-	-	-	-	-	-	-
(971)	(623)	820	119	8,629	9,023	-	-	-	-
78	(545)	275	394	9,023	-	-	-	-	-

* 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.

SCHEDULE E - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS

REPORTED AMOUNTS (IN NIS MILLIONS)

	December 31, 2008				
	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	891	260	1,151	1	64
Industry	14,111	8,585	22,696	121	1,136
Construction and real estate	14,816	10,204	25,020	155	2,923
Electricity and water	1,010	509	1,519	-	2
Commerce	9,615	3,646	13,261	54	413
Hotels, hotel services and food	1,974	321	2,295	50	775
Transportation and storage	3,408	278	3,686	12	79
Communications and computer services	2,661	620	3,281	7	436
Financial services	8,749	3,127	11,876	28	727
Other business services	6,735	3,432	10,167	105	434
Public and community services	1,523	872	2,395	4	195
Private individuals - housing loans	14,095	728	14,823	3	419
Private individuals - other loans	15,477	17,994	33,471	139	683
Total	95,065	50,576	145,641	679	8,286
Less a deposit abroad linked to the credit risk of the borrower	(59)	-	(59)	-	-
Total	95,006	50,576	145,582	679	8,286
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements[4]	239	34	273	4	105
Local authorities[5]	217	119	336	-	9
2. Lending Activity Outside of Israel					
Agriculture	70	1	71	-	-
Industry	3,727	3,210	6,937	15	206
Construction and real estate	7,828	1,880	9,708	28	551
Electricity and water	356	472	828	-	-
Commerce	4,640	2,451	7,091	43	205
Hotels, hotel services and food	1,231	127	1,358	3	12
Transportation and storage	683	866	1,549	-	53
Communications and computer services	91	8	99	-	4
Financial services	3,982	1,051	5,033	(9)	23
Other business services	2,600	1,372	3,972	11	71
Public and community services	59	10	69	-	-
Private individuals - housing loans	18	-	18	-	-
Private individuals - other loans	1,108	1,271	2,379	4	19
Total	26,393	12,719	39,112	95	1,144

Footnotes:
(1) Credit to the public of NIS 117,407 million, investments in bonds c, assets relating to derivative instrumentsof NIS 3,017 million, created with the public of NIS 975 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)

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	236	1,033	(3)	43
Industry	12,581	8,844	21,425	76	967
Construction and real estate	12,854	11,383	24,237	92	2,417
Electricity and water	1,003	121	1,124	-	2
Commerce	8,138	3,664	11,802	52	396
Hotels, hotel services and food	2,111	387	2,498	28	898
Transportation and storage	3,453	587	4,040	10	91
Communications and computer services	2,334	689	3,023	8	443
Financial services	8,005	3,135	11,140	5	166
Other business services	6,094	3,057	9,151	22	344
Public and community services	1,595	986	2,581	9	183
Private individuals - housing loans	11,149	649	11,798	10	425
Private individuals - other loans	13,259	10,647	23,906	123	590
Total	83,373	44,385	127,758	432	6,965
Less a deposit abroad linked to the credit risk of the borrower	(59)	-	(59)	-	-
Total	83,314	44,385	127,699	432	6,965
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements[4]	409	141	550	3	113
Local authorities[5]	197	160	357	-	12
2. Lending Activity Outside of Israel					
Agriculture	28	-	28	-	-
Industry	4,048	2,656	6,704	12	149
Construction and real estate	6,606	2,106	8,712	4	107
Electricity and water	79	123	202	-	-
Commerce	4,175	3,723	7,898	(11)	130
Hotels, hotel services and food	724	101	825	-	-
Transportation and storage	113	19	132	-	-
Communications and computer services	154	13	167	-	25
Financial services	3,816	1,041	4,857	10	64
Other business services	1,943	1,566	3,509	12	83
Public and community services	79	40	119	-	-
Private individuals - housing loans	35	-	35	-	-
Private individuals - other loans	1,019	630	1,649	-	7
Total	22,819	12,018	34,837	27	565

* Reciassified.

Footnotes:

(1) Credit to the public of NIS 102,487 million, investments in bonds c, assets relating to derivative instrumentsof NIS 3,199 million, 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.

APPENDIX "F" - EXPOSURE TO FOREIGN COUNTRIES (ON A CONSOLIDATED BASIS)[1]

REPORTED AMOUNTS

NIS millions

A. Information regarding the total exposure to foreign countries and to countries where the total exposure to each country amounts to over 1% of total consolidated assets or over 20% of shareholders' equity, the lower of the two.

	December 31, 2008		
	Balance sheet exposure		
	Across the border balance sheet exposure		
The Country	To governments[3]	To banks	to Others
United state	252	2,133	2,053
United kingdom	-	866	381
Netherlands	-	69	2,729
Other	15	4,367	2,770
Total exposure to foreign countries	267	7,435	7,933
Total exposure to LDC countries	4	615	836

Notes:
1. Based on the final risk, net of the effect of guarantees and liquid collateral .
2. Credit risk of off-balance sheet financial instruments as computed for the purpose of borrower indebtedness limitations.
3. Governments, official institutions and central banks.
4. Outstanding problematic debts, net of debts secured by collateral that are deductible for the purpose of borrower and group of borrowers indebtedness limitation, excluding off-balance sheet risk components.

The item "Total LDC countries" includes the total exposure to countries defined as less developed countries (LDC) in Proper Banking Management Directive No. 313 regarding "Additional provision for doubtful debts".

Balance sheet exposure to a foreign country includes across the border balance sheet exposure and balance sheet exposure of overseas extensions of the banking corporation to local resident customers, across the border balance sheet exposure includes balance sheet exposure of the banking corporation offices in Israel to residents of a foreign country and the balance sheet exposure of the overseas extensions of the banking corporation to customers who are not residents of the co extension is located

Balance sheet exposure of extensions of the banking corporations in a foreign country to local resident customers includes the balance sheet exposure of extensions of the banking corporation in that foreign country to residents of that country, net of the extensions (deduction of liabilities should not exceed the amount of exposure).

B. There is no exposure to countries the amount of exposure in respect of each amounts to between 0.75% and 1% of total consolidated assets or between 15% and 20% of shareholders' equity, whichever is lower

C. Information regarding exposure to foreign countries having liquidity problems (IN NIS MILLIONS)

	Balance sheet exposure						
	Iceland	Ukraine	Argentina	Latvia	Romania	Kazakhstan	Total
Balance at December 31, 2007	50	12	29	11	6	137	245
Changes in 2008	(42)	(11)	1	(7)	2	(69)	(126)
Balance at December 31, 2008	8	1	30	4	8	68	119

December 31, 2008								
Balance sheet exposure					Off-balance sheet exposure[2]		Balance sheet exposure across the border	
Balance sheet exposure to local resident customers of extensions of a banking corporation in a foreign country								
Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities	Total balance sheet exposure	Outstanding problematic debts[4]	Total off-balance sheet exposure*	Of which problematic off-balance sheet credit risk*	Due up to one year	Due over one year
31,477	16,957	14,520	18,958	797	8,479	-	2,673	1,765
1,823	239	1,584	2,831	23	1,082	-	864	383
-	-	-	2,798	-	472	-	580	2,218
1,097	1,097	-	7,152	59	1,303	34	4,340	2,812
34,397	18,293	16,104	31,739	879	11,336	34	8,457	7,178
989	989	-	1,455	24	351	-	815	640

SCHEDULE G - CONDENSED CONSOLIDATED BALANCE SHEET FOR END OF EACH QUARTER - MULTI QUARTER DATA

REPORTED AMOUNTS

	2008				2007			
Quarter	4	3	2	1	4	3	2	1
	In NIS millions							
Assets								
Cash and deposits with banks	21,554	*16,094	*14,440	*17,323	19,850	23,238	26,135	24,021
Securities	31,535	29,860	34,679	36,711	37,278	40,343	39,825	39,627
Securities borrowed or purchased under resale agreements	25	119	2	5	346	375	488	149
Credit granted to the public	116,800	*113,461	*107,191	*103,654	101,899	96,911	95,000	90,789
Credit granted to the Government	1,491	1,496	1,448	1,414	374	12	25	17
Investments in affiliated companies	1,900	1,960	2,025	2,000	2,008	1,527	1,450	1,464
Buildings and equipment	3,039	2,909	2,908	2,855	2,780	2,715	2,678	2,645
Other assets	5,904	5,129	4,849	5,809	*4,184	*4,600	*4,405	*3,882
Total assets	182,248	171,028	167,542	169,771	168,719	169,721	170,006	162,594
Liabilities and Shareholders' Equity								
Deposits from the public	139,232	*127,686	*126,945	*127,969	130,518	129,555	133,189	126,852
Deposits from banks	4,555	4,733	4,395	5,145	5,072	7,530	8,157	9,548
Deposits from the Government	206	*193	*169	*140	125	124	123	96
Securities loaned or sold under buy-back arrangements	7,194	8,175	6,668	6,994	5,895	6,273	2,768	1,953
Subordinated capital notes	9,373	9,538	8,473	8,245	7,437	6,730	6,614	6,432
Other liabilities	12,665	11,737	11,460	11,923	*10,321	*10,205	*10,167	*9,057
Total liabilities	173,225	162,062	158,110	160,416	159,368	160,417	161,018	153,938
Minority' interest	226	194	177	161	147	136	120	418
Shareholders' equity	8,797	8,772	9,255	9,194	9,204	9,168	8,868	8,238
Total liabilities and shareholders' equity	182,248	171,028	167,542	169,771	168,719	169,721	170,006	162,594

* Reclassified.

SCHEDULE H - CONDENSED CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA

REPORTED AMOUNTS

	2008			
Quarter	4	3	2	1
	In NIS millions			
Financing Income				
Income from financing activities before provision for doubtful debts	873	1,057	1,132	1,065
Provision for doubtful debts	366	182	139	93
Profit from financing activities after provision for doubtful debts	507	875	993	972
Operating and other Income				
Operating commissions	609	624	538	568
Net income (loss) from investment in shares	94	(36)	23	(30)
Other income	23	29	28	20
Total operating and other income	726	617	589	558
Operating and other Expenses				
Salaries and related expenses	865	733	649	859
Maintenance and depreciation of buildings and equipment	239	240	215	216
Other expenses	345	319	306	279
Total operating and other expenses	1,449	1,292	1,170	1,354
Operating income (loss) before taxes	(216)	200	412	176
Provision for taxes (tax savings) on operating income	(228)	65	199	133
Operating income after taxes	12	135	213	43
Bank's share in operating income (loss) net of tax effect of affiliated companies	(96)	(8)	24	10
Minority interest in the operating income after taxes of consolidated companies	(31)	(17)	(15)	(15)
Net operating income	(115)	110	222	38
Net loss from extraordinary items, net of taxes	(6)	-	(1)	(3)
Net income	(121)	110	221	35
Earnings per share of NIS 0.1 (in NIS):				
Net operating income	(0.12)	0.11	0.23	0.04
Net income from extraordinary items, net of taxes	-	-	-	-
Net income	(0.12)	0.11	0.23	0.04
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

	2007			
Quarter	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
Income from financing activities after provision for doubtful debts	990	1,104	758	926
Operating and other Income				
Operating commissions	*584	560	540	*530
Net income (loss) on investment in shares	(16)	20	4	50
Other income	*58	42	131	*69
Total operating and other income	626	622	675	649
Operating 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 operating and other 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 (loss) net of tax effect of affiliated companies	(99)	56	47	41
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(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 (losses) 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	0.00
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

* Reclassified.

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, 2008 (hereinafter: "the Report");
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations, changes in shareholders' equity and cash flows of the Bank as of, and for, the periods presented in this report;
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting (as defined in the public reporting instructions regarding "Directors' Report"), 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accepted accounting principles and directives and guidelines of the Supervisor of Banks;
   (c) Evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (d) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred 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, 2009

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, 2008 (hereinafter: "the Report");
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations, changes in shareholders' equity and cash flows of the Bank as of, and for, the periods presented in this report;
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting (as defined in the public reporting instructions regarding "Directors' Report"), 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accepted accounting principles and directives and guidelines of the Supervisor of Banks;
   (c) Evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (d) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred 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, 2009

REPORT OF THE DIRECTORS AND MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Management of Israel Discount Bank Ltd. (hereinafter – "the Bank") are responsible for establishing and maintaining effective internal control over financial reporting (as defined in the public reporting instructions regarding "Directors' Report"). The internal control system of the Bank has been designed to provide reasonable assurance to the Board of Directors and Management regarding the preparation and the fair presentation of financial statements published in accordance with generally accepted accounting principles in Israel and directives and guidelines of the Supervisor of Banks. Regardless of the quality of their level of design, all internal control systems have inherent limitations. Therefore, even if these systems are determined effective, they can provide only a reasonable degree of assurance regarding the preparation and presentation of the financial report.

Management, under the supervision of the Board of Directors, maintains a comprehensive system of controls intended to ensure that transactions are made in accordance with authorization of Management, assets are protected and the accounting records are reliable. In addition, Management, under the supervision of the Board of Directors, takes the necessary actions to ensure that communication and information channels are effective and monitor performance, including performance of internal control procedures.

Management, under the supervision of the Board of Directors, assessed the effectiveness of the Bank's internal control over financial reporting as of December 31, 2008, based on the framework set forth in the Internal Control model of the Committee Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, Management believes that as of December 31, 2008, the Bank's internal control over financial reporting is effective.

The effectiveness of the Bank's internal control over financial reporting as of December 31, 2008 has been audited by the independent auditors of the Bank, Messrs. Somekh Chaikin and Ziv Haft, Certified Public Accountants, as stated in their report presented on page 323, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as of December 31, 2008.

	Shlomo Zohar Chairman of the	Giora Offer President and	Joseph Beressi Senior Executive Vice President,
March 31,2009	Board of Directors	Chief Executive Officer	Chief Accountant

FINANCIAL STATMENTS

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Somekh Chaikin

ZIV HAFT

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD. - INTERNAL CONTROL OVER FINANCIAL REPORTING

We have audited the internal control over financial reporting of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Bank's Board of Directors and Management are responsible for maintaining effective internal control over financial reporting and for their assessment of the effectiveness of internal control over financial reporting, included in the accompanying Directors' and Management's reports on internal control over financial reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States), as adopted by the Supervisor of Banks. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

The internal control of a bank over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and directives and guidelines of the Supervisor of Banks. The internal control of a bank over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and directives and guidelines of the Supervisor of Banks, and that receipts and expenditures of the bank are being made only in accordance with authorizations of management and directors of the bank; (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective material control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with accepted auditing standards in Israel, 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, the accompanying balance sheets of the Bank as of December 31, 2008 and 2007 and the consolidated balance sheets as of such dates and the related statements of income, statement of changes in shareholders' equity and statements of cash flows - of the Bank and consolidated – for each of the years in the three-year period ended on December 31, 2008, and our report dated March 31, 2009, expressed an unqualified opinion on these financial statements.

Somekh Chaikin
Certified Public Accountants (Isr.)

Ziv Haft
Certified Public Accountants (Isr.)

March 31, 2009

BDO ZIV HAFT is a member of BDO.

Somekh Chaikin, a partnership registered under the Israel Partnership Ordinance, is a member of KPMG International a Swiss cooperative.

Somekh Chaikin

ZIV HAFT

AUDITORS' REPORT TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD. - ANNUAL FINANCIAL STATEMENTS

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, 2008 and December 31, 2007, 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, 2008. 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 280 million and NIS 424 million at December 31, 2008 and 2007, respectively, and the share of the Bank in their results is a loss of NIS 124 million, an income of NIS 25 million and an income of NIS 5 million, for the years ended December 31, 2008, 2007 and 20006, respectively. 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 in Israel, including those prescribed under the Israeli Auditors' Regulations (Auditor's Mode of Performance), 1973 and certain auditing standards applied in the audit of banking corporations as determined by directives and guidelines of the Supervisor of Banks. 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 all material respects, the financial position - of the Bank and consolidated - as at December 31, 2008 and 2007, 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, 2008, according to generally accepted accounting principles in Israel (Israeli GAAP). Furthermore, in our opinion, the abovementioned financial statements were prepared in accordance with the directives and guidelines of the Supervisor of Banks.

Without qualifying our above 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 items 15.6 and 15.7 concerning motion to approve certain lawsuits as class action suits and to item 15.4 as regards a third party notice served against the Bank and some of its subsidiary companies.

We have also audited in accordance with standards prescribed by the Public Company Accounting Oversight Board (United States), as adopted by the Supervisor of Banks, the internal control of the Bank over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report dated March 31, 2009, expressed an unqualified opinion.

Somekh Chaikin
Certified Public Accountants (Isr.)

Ziv Haft
Certified Public Accountants (Isr.)

March 31, 2009

BDO ZIV HAFT is a member of BDO.

Somekh Chaikin, a partnership registered under the Israel Partnership Ordinance, is a member of KPMG International a Swiss cooperative.

BALANCE SHEET AS AT DECEMBER 31

REPORTED AMOUNTS

		Consolidated		The Bank	
	Notes	2008	2007	2008	2007
		In NIS millions			
Assets					
Cash and deposits with banks	2	21,554	19,850	26,130	24,234
Securities	15,3	31,535	37,278	13,248	17,545
Securities borrowed or purchased under resale agreements		25	346	25	346
Credit granted to the public	4	116,800	101,899	69,283	59,574
Credit granted to Governments	5	1,491	374	1,461	363
Investment in investee companies (consolidated – affiliated companies)	6	1,900	2,008	8,978	7,980
Buildings and equipment	7	3,039	2,780	2,364	2,141
Other assets	8	5,904	*4,184	4,079	*2,442
Total assets		182,248	168,719	125,695	114,625
Liabilities and Shareholders' Equity					
Deposits from the public	9	139,232	130,518	102,341	92,630
Deposits from banks	10	4,555	5,072	2,923	3,041
Deposits from the Government		206	125	128	37
Securities loaned or sold under buy-back arrangements		7,194	5,895	-	-
Subordinated capital notes	11	9,373	7,437	3,588	3,837
Other liabilities	12	12,665	*10,321	7,791	*5,876
Total liabilities		173,225	159,368	116,771	105,421
Minority interest		226	147	-	-
Shareholders' equity	13	8,797	9,204	8,797	9,204
Total liabilities and shareholders' equity		182,248	168,719	125,568	114,625

* 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, 2009

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

		Consolidated		
	Notes	2008	2007	2006
		In NIS millions		
Financing Income				
Income from financing activities before provision for doubtful debts	23	4,127	4,225	3,790
Provision for doubtful debts	1i, 4c	780	447	570
Income from financing activities after provision for doubtful debts		3,447	3,778	3,220
Operating and other Income				
Operating commissions	24	2,339	*2,214	1,911
Net income on investment in shares	25	51	58	65
Other income	26	100	*300	383
Total operating and other income		2,490	2,572	2,359
Operating and other Expenses				
Salaries and related expenses	27	3,106	3,030	3,202
Maintenance and depreciation of buildings and equipment		910	819	679
Other expenses	28	1,249	1,217	1,139
Total operating and other expenses		5,265	5,066	5,020
Operating income before taxes		572	1,284	559
Provision for taxes on operating income	29	169	566	350
Operating income after taxes		403	718	209
Bank's share in operating income (loss) net of tax effect of affiliated companies	6b	(70)	45	188
Minority interest, after taxes, in the operating income of consolidated subsidiaries		(78)	(56)	(82)
Net operating income		255	707	315
Reversal of provision for impairment in value of investment in affiliated company.	6f	-	-	173
Net income (loss) from extraordinary items, net of taxes	30	(10)	558	348
Net income		245	1,265	836
Earnings per share of NIS 0.1 (in NIS)	1s, 13, 35			
Net operating income		0.26	0.72	0.32
Net income (loss) from extraordinary items, net of taxes[(1)]		(0.01)	0.57	0.53
Net income		0.25	1.29	0.85
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.
The notes to the financial statements are an integral part thereof.

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

REPORTED AMOUNTS

		The Bank		
	Notes	2008	2007	2006
		in NIS millions		
Financing Income				
Income from financing activities before provision for doubtful debts	23	2,564	2,692	2,423
Provision for doubtful debts	1i,4c	547	245	377
Income from financing activities after provision for doubtful debts		2,017	2,447	2,046
Operating and other Income				
Operating commissions	24	1,101	1,054	903
Net income (loss) on investment in shares	25	(2)	13	44
Other income	26	105	260	279
Total operating and other income		1,204	1,327	1,226
Operating and other Expenses				
Salaries and related expenses	27	2,043	1,975	2,082
Maintenance and depreciation of buildings and equipment		628	557	452
Other expenses	28	614	586	540
Total operating and other expenses		3,285	3,118	3,074
Operating income before taxes		(64)	656	198
Provision for taxes (tax savings) on operating income	29	(50)	241	103
Operating income after taxes		(14)	415	95
Bank's share in operating income net of tax effect of investee companies	6b	269	292	220
Net operating income		255	707	315
Reversal of provision for impairment in value of investment in affiliated company.		-	-	173
Net income (loss) from extraordinary items, net of taxes	30	(10)	558	348
Net income		245	1,265	836

The notes to the financial statements are an integral part thereof.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

REPORTED AMOUNTS

	Capital reserves			
	Share capital	Share premium	Benefit in respect of equity based compensation transactions	Other capital reserves
	in NIS millions			
Balance at December 31, 2005	658	2,939	-	37
Changes in 2006:				
Initial application of an accounting standard by an affiliated company	-	-	-	-
Net 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	8	212
Changes in 2007:				
Net 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	35	212
Changes in 2008:				
Initial application of IFRS in affiliated companies	-	-	-	-
Initial application of new accounting principles in a subsidiary abroad	-	-	-	-
Net Income for the year	-	-	-	-
Dividend	-	-	-	-
Benefit in respect of equity based compensation transactions	-	-	15	-
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, 2008	658	2,939	50	212

* Reclassified.
Footnotes:
(1) Translation adjustments of foreign autonomous units, primarily from a consolidated subsidiary Israel Discount Bank of New York in amount of NIS 231 million, which was treated until December 31, 1994, in the financial statements of the Bank as autonomous unit. Accordingly this item included the financing sources of this investment and the related tax effect until that date.
(2) Including an amount of NIS 2,704 million that is not available for distribution.

The notes to the financial statements are an integral part thereof.

Total share capital and reserves	Other cumulative comprehensive income (loss)			Retained earnings[2]	Total shareholders' equity
	Adjustments for presentation of available for sale securities at fair value	Translation adjustments[1]	Net gains (losses) on cash flow hedging		
		in NIS millions			
3,634	18	(229)	(1)	3,296	6,718
-	-	-	-	1	1
-	-	-	-	836	836
175	-	-	-	-	175
8	-	-	-	-	8
-	*409	-	-	-	409
-	*17	-	-	-	17
-	(195)	-	-	-	(195)
-	-	(4)	-	-	(4)
3,817	249	(233)	(1)	4,133	7,965
-	-	-	-	1,265	1,265
27	-	-	-	-	27
-	8	-	-	-	8
-	(90)	-	-	-	(90)
-	30	-	-	-	30
-	-	(1)	-	-	(1)
3,844	197	(234)	(1)	5,398	9,204
-	-	-	-	1	1
-	-	-	-	(4)	(4)
-	-	-	-	245	245
-	-	-	-	(250)	(250)
15	-	-	-	-	15
-	(873)	-	-	-	(873)
-	249	-	-	-	249
-	231	-	-	-	231
-	-	(21)	-	-	(21)
3,859	(196)	(255)	(1)	5,390	8,797

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Cash Flows from Operating Activities						
Net income for the year	245	1,265	836	245	1,265	836
Adjustments necessary to present cash flows from operations:						
Bank's share in undistributed loss of investee companies (consolidated - affiliated companies)	73	(79)	(319)	(272)	(415)	(322)
Minority interest in income of consolidated subsidiaries	78	56	82	-	-	-
Depreciation of buildings and equipment	417	350	275	308	254	190
Amortization of goodwill	50	32	11	-	-	-
Financial statements translation adjustments	21	-	-	-	-	-
Provision for decline in value of securities held for investment	76	46	7	76	44	-
Provision for doubtful debts	838	553	642	602	348	447
Loss (gain) on sale of available-for-sale securities	121	(67)	-	(91)	(33)	(35)
Realized and non realized loss (gain) from adjustment to fair value of trading securities	65	47	(33)	41	40	(25)
Gain on realization of investments	-	-	(376)	-	-	(417)
Benefit with respect to the allotment of options	15	27	8	15	27	8
Provision for impairment in value of buildings	11	10	4	11	8	4
Gain (loss) on sale of buildings and equipment	11	9	(2)	5	4	(2)
Dividend from Visa Europe	(33)	-	-	(7)	-	-
Net deferred taxes	(415)	281	106	(209)	240	86
Severance pay – decrease (increase) in excess of deposits over the provision	307	(18)	43	240	(5)	9
Inflation adjustment component of investing and financing activities	967	2,581	1,376	303	263	254
Changes in Balance Sheet Items:						
Other assets, net	(1,585)	(473)	315	(1,728)	(792)	355
Other liabilities, net	2,559	1,201	(331)	2,084	1,006	(452)
Net Cash Flows from Operating Activities	3,821	5,821	2,644	1,623	2,254	936

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

REPORTED AMOUNTS

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(640)	(834)	(2,134)	-	-	-
Proceeds from redemption of held-to-maturity bonds	1,820	1,823	2,722	-	-	-
Acquisition of available-for-sale securities	(15,676)	(19,120)	(17,313)	(2,733)	(5,659)	(4,679)
Proceeds from sale of available-for-sale securities	17,093	13,482	15,298	5,225	1,530	1,684
Proceeds from redemption of available-for-sale securities	1,120	3,989	4,334	870	3,207	4,093
Net deposits with banks	51	756	(805)	(4,081)	(1,188)	(36)
Trading securities, net	941	(20)	(362)	663	43	(541)
Net credit granted to the public	(15,962)	(11,976)	(3,132)	(10,527)	(8,038)	(2,871)
Net credit granted to the Government	(1,117)	(50)	(232)	(1,099)	(51)	(224)
Net on securities borrowed or purchased under resale agreements	321	(346)	-	321	(346)	-
Additional investment in investee companies	(29)	(738)	153	(956)	(756)	757
Proceeds, net, from sale of investments in previously consolidated subsidiaries (annex B)	-	-	508	-	-	-
Acquisition of buildings and equipment	(679)	(565)	(644)	(526)	(403)	(548)
Proceeds from sale of buildings and equipment	6	18	14	4	18	10
Decrease in cash due to initially consolidated companies (annex A)	(50)	-	-	-	-	-
Net Cash Flows from Asset Transactions	(12,801)	(13,581)	(1,593)	(12,839)	(11,643)	(2,355)
Cash Flows From Liability and Capital Transactions:						
Net deposits from the public	8,790	(317)	281	9,862	7,603	4,477
Net deposits from banks	(516)	(3,028)	1,581	(118)	(2,485)	2,556
Net deposits from the Government	81	6	(17)	91	32	(5)
Net securities loaned or sold under buy-back arrangements	1,299	5,895	-	-	-	-
Payment for fixed assets purchased on credit	-	-	(13)	-	-	(13)
Issuance of subordinated capital notes	2,131	1,446	1,485	151	297	807
Redemption of bonds and subordinated capital notes	(800)	(737)	(729)	(705)	(637)	(639)
The State's bonus to the employees (privatization)	-	-	128	-	-	98
Dividend paid to shareholders	(250)	-	-	(250)	-	-
Dividend paid to minority interests in consolidated subsidiaries	-	-	(58)	-	-	-
Net cash flows from liability and capital transactions	10,735	3,265	2,658	9,031	4,810	7,281
Increase (decrease) in cash	1,755	(4,495)	3,709	(2,185)	(4,579)	5,862
Cash balance at beginning of year (see Note 2)	17,313	21,808	18,099	14,436	19,015	13,153
Cash balance at end of year (see Note 2)	19,068	17,313	21,808	12,251	14,436	19,015

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

	2008	2007	2006
		In NIS millions	
Assets and liabilities at acquisition date of consolidated subsidiaries:			
Assets (excluding cash in the amount of NIS 83 million)	52	-	-
Liabilities	(84)	-	-
Goodwill	82	-	-
Total decrease in cash due to initially consolidated companies	50	-	-

Annex B - Proceeds from sale of investments in previously consolidated subsidiaries

	2008	2007	2006
		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

	2008	2007	2006
		In NIS millions	
The Bank:			
Purchase of fixed assets	28	3	15
Lending of securities	216	(416)	132
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	28	4	16
Lending of securities	252	(381)	156
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 generally accepted accounting principles applying to banking corporations in Israel and 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.

B. FINANCIAL STATEMENTS IN REPORTED AMOUNTS

1) **General.** 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. 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 financial reporting in accordance with the Standard, as from January 1, 2004.

2) **Definitions.** In these financial statements -

- "Adjusted amounts" - Amounts in nominal (historical) terms as adjusted for changes in the general purchasing power of the Israeli currency, in accordance with the provisions of the Opinions of the Institute of Certified Public Accountants in Israel;
- "Reported amounts" - 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.
- "Cost" - cost in reported amounts.

3) 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:

(a) 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.

(b) 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.

C. 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		
	2008	2007	2006	2008	2007	2006
				%	%	%
CPI (in points):						
Balance sheet month (December index)	110.4	106.4	102.9	3.8	3.4	(0.1)
Known at balance sheet month (November index)	110.5	105.8	102.9	4.5	2.8	(0.3)
Representative exchange rate (in NIS) at the balance sheet date of the:						
U.S. Dollar	3.802	3.846	4.225	(1.1)	(9.0)	(8.2)
Euro	5.297	5.659	5.564	(6.4)	1.7	2.2

D. CONVERSION OF FINANCIAL STATEMENTS OF EXTENSIONS ABROAD

In these financial statements "extensions abroad" - consolidated subsidiaries and branches abroad.

Up to the year 1994, foreign subsidiaries were considered autonomous units, and the conversion differences with respect to the investment herein 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"). Up until December 31, 2007 the Bank implemented that Standart. 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. 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.

According to Accounting Standard No. 20, the excess cost of acquisition of investment in an investee company over the acquiring company's share in the fair value of its identifiable assets (including intangibles), less the fair value of its identifiable liabilities (net of related taxes) constitutes goodwill. The allocation of the excess of cost to an acquired intangible asset shall be made only where such asset complies with the definition of an intangible asset in accordance with criteria specified in the Standard. In the event that a negative goodwill (excess of fair value over cost of acquisition) is created upon acquisition, it should be recognized immediately in the statement of income and should no longer be amortized systematically. Positive goodwill and intangible assets having an indeterminate lifespan are not to be amortized.

E. PRINCIPLES OF CONSOLIDATION AND THE IMPLEMENTATION OF THE EQUITY METHOD

1) **Definitions.** 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

"Affiliated companies" - companies, other than consolidated subsidiaries, the investment in which is included on the equity basis.

"Investee companies" - consolidated subsidiaries or affiliated companies.

2) **Principles of consolidation.** The consolidated financial statements include the financial statements of the Bank and those of its consolidated subsidiaries. Intercompany balances and transactions between the consolidated companies are annuled 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.

3) **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 of the acquired company. Excess of cost not attributed as above (goodwill) is amortized at an annual rate of 10%.

4) **Accounting Standard No. 20 (Amended).** The Bank implements the provisions of Accounting Standard No. 20 (amended) "Accounting Treatment of Goodwill and Intangible Assets on Acquisition of Investee companies", as adopted by the Supervisor of Banks. 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.

According to Accounting Standard No. 20, the excess cost of acquisition of investment in an investee company over the acquiring company's share in the fair value of its identifiable assets (including intangibles), less the fair value of its identifiable liabilities (net of related taxes) constitutes goodwill. The allocation of the excess of cost to an acquired intangible asset shall be made only where such asset complies with the definition of an intangible asset in accordance with criteria specified in the Standard. In the event that a negative goodwill (excess of fair value over cost of acquisition) is created upon acquisition, it should be recognized immediately in the statement of income and should no longer be amortized systematically. Positive goodwill and intangible assets having an indeterminate lifespan are not to be amortized.

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 from, thus the amortization of goodwill shell 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 6 K hereunder).

F. 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. Bonds are stated at cost with the addition of accumulated linkage differences or exchange differences and interest, as well as the premium or discount component created upon acquisition and not yet amortized, and net of a provision for impairment which is not 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.

(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 less a provision for impairment in value not of a temporary nature which is recorded in the statement of income. 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.

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. See also the change in public reporting requirements, as detailed in item G hereunder.
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 and its relevant subsidiaries examine, in accordance with generally accepted accounting principles applying to banking corporations, whether the impairment of securities is of an other than temporary nature.

   The review is based on the following considerations:
   - The ratio of loss to cost/depreciated cost;
   - The period in which the fair value of the security is lower than its cost;
   - The rate of yield to redemption in the case of bonds;
   - The credit rating of the security, including changes in its rating;
   - In the case of shares - events of reduction due to the distribution of dividends or its cancellation;
   - In the case of bonds - adherence by the issuer to the timely payments of principal and interest.
   - Relating the impairment in value to the deterioration in the financial position of the issuer, or to the change in general market condition;
   - The intent and ability of the Bank or its relevant subsidiary to continue holding the securities until such time that the expected recovery of the fair value of the securities occurs.
   - The intention and ability of the Bank or of the relevant subsidiary to continue holding the securities for a long enough period allowing the recovery of the security to its original cost.

G. PUBLIC REPORTING REQUIREMENTS REGARDING TRANSFERS AND SERVICES RELATING TO FINANCIAL ASSETS AND SETTLEMENT OF LIABILITIES.

In May 2006 the Supervisor of Banks published a memorandum amending the public reporting requirements regarding "transfers and services relating to financial assets and settlement of liabilities". The requirements stated in the memorandum adopt the measurement and disclosure principles stated in FAS 140, accounting principles for transfer and services relating to financial assets and settlement of liabilities, for differentiation between transfers of financial assets recorded as sale and between other transfers.

Accordingly, the principle was adopted according to which a transferred financial asset will be included in the balance sheet of the controlling party, whether the transferor or the recipient of the asset. In this regard, the provisions detail determinations for control relating to reacquisition transactions, securities' lending, issuance of debentures against proceeds from future cash flow, sale and participation in loans.

The Bank implements the amendments to the public reporting requirements regarding securities' lending transactions, reacquisition of securities, issuance of debentures in respect of financial assets, other transfers of financial assets, provision of services for financial assets

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

and settlement of liabilities, implemented after December 31, 2006.

H. 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.
3) 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.
4) 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.
5) 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			
	2008	2007	2008	2007
General provision	0.17%	0.19%	0.18%	0.20%
Supplemental provision	0.17%	0.16%	0.14%	0.13%

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.

6) 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.
7) 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.
8) 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 (3) below.

I. BUILDINGS AND EQUIPMENT

1) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2) 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 U.S. 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 ("Ofek Project") development costs are being amortized over a period of seven years.

3) **Accounting Standard No. 27.** The Bank implements the provisions of Accounting Standard No. 27 "Fixed assets", as adopted by the Supervisor of Banks. 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 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 begun on January 1, 2007 and thereafter.

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.

J. 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 in the consolidated balance sheet are not stated in amounts which exceed their recoverable 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.

K. 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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. Gain or loss on a derivative instrument not designated as a hedging instrument is recognized in the income statement as incurred.

For further details see Note 20 hereunder.

L. FINANCIAL INSTRUMENTS - DISCLOSURE AND PRESENTATION

The Bank implements Accounting Standard No. 22 - "Financial instruments: 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 shoud 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.

M. 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".

N. INTANGIBLE ASSETS

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 U.S. Accounting Standard No.141 (FAS 141) shall also implement the provisions of Sections 33-43 of the Standard.
- The balance of excess cost not attributed to balance sheet items, shall be deducted from equity for the purpose of calculating the equity to risk assets ratio. A banking corporation that would adopt an early implementation in full of FAS No.141 should refer to the Supervisor for specific guidelines in this matter.
- The cost of software recognized as an intangible asset is to be reflected in the item "Property and equipment".

The Supervisor also determined that sections of the Standard that include terms defined in the instructions of the Supervisor of Banks shall not apply, and that sections referring to Standards which have not as yet been adopted by the Supervisor of Banks shall not be adopted, and that sections which instituted changes from the International Standard as detailed in Annex "B" to the Standard, shall not apply.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

O. 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.

P. 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 (f) above; with respect to the provision for doubtful debts - see (h) above; with respect to derivative financial instruments - see (k) below.

Sale and leaseback transactions are presented in the financial statements in accordance with International Accounting Standard (IAS) 17.

Q. EMPLOYEE BENEFITS

Liabilities in respect of employee rights are covered by appropriate provisions. For further details see note 16 hereunder.

R. 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 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 L) 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) 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

S. CONTINGENT LIABILITIES

The accounting treatment of outstanding legal actions is in accordance with the provisions of the U.S. 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.

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.

T. 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.

U. 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.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

V. 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.

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

(1) Effective January 1, 2008, the subsidiary IDB New York (Hereinafter: "IDBNY") adopted the U.S. accounting standard FAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities". (Hereinafter: "FAS 159"). Upon adoption of FAS 159, IDB New York transferred municipal bonds with a carrying value of US$41.4 million and a fair value of US$42.8 million, from held to maturity securities to the trading portfolio. The cumulative effect for adopting FAS 159, totalling US$780 thousand (approximately NIS 3 million), after taxes, was reflected directly as an increase of the retained earnings in shareholders' equity. The said securities have been subsequently sold at a negligible profit.

(2) The subsidiary IDB New York adopted EITF Issue No. 06-04, "Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements", as of January 1, 2008. The Task Force reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. Upon adoption of EITF 06-04, IDB New York reduced equity by US$1.7 million (approximately NIS 6 million), through a reduction in retained earnings.

(3) On January 1, 2008, the Bank's subsidiary IDBNY adopted FAS No. 157, Fair Value Measurements ("FAS No. 157"). The standard defines, among other things, fair value; establishes a consistent framework for measuring fair value; and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis.

FAS No. 157 clarifies that fair value is an "exit" price, representing the amount that would be received when selling an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value is thus a market based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, FAS No. 157 establishes a three tier fair value hierarchy, which prioritizes the inputs to valuation techniques used to measuring fair value as follows:

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Level 1 - Inputs which are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Inputs which are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Including quoted prices in markets that are not considered to be active.
- Level 3 - Inputs which are unobservable and significant to the fair value measurement.

	Fair value measurements at December 31, 2008 using			
	Quoted prices in active markets for identical Assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	Dollars in thousands			
Assets:				
Trading account securities, at fair value	9,762	33,072	-	42,834
Available for sale securities at fair value	5,398	3,479,156	32,523	3,517,077
Unrealized gain on derivatives	344	13,029	-	13,373
Liabilities:				
Unrealized loss on derivatives	299	15,026	-	15,255

Fair value is based upon quoted market prices when available. If listed prices or quotes are not available fair value is based upon internally developed models that primarily use market based or independently sourced market parameters as inputs, including, but not limited to, yield curves, interest rates, equity or debt prices, and credit curves. In addition to market information, models also incorporate transaction details, such as maturity and cash flow assumptions.

IDBNY reviews and updates the fair value hierarchy classifications on a quarterly basis. Changes from one quarter to the next that are related to the observability of inputs to a fair value measurement may result in a reclassification from one hierarchy level to another.

A description of the methods and significant assumptions utilized in estimating the fair value of available for sale securities follows:

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and exchange traded securities.

If quoted market prices are not available for the specific security, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Such securities would generally be classified within Level 2 of the valuation hierarchy and include such instruments as mortgage related securities, corporate bonds, preferred stock, and municipal securities.

In certain cases where there is limited activity or less transparency around inputs used for the valuation, securities are classified within Level 3 of the valuation hierarchy. In valuing certain collateralized mortgage and debt obligations and high yield debt securities, the determination of fair value may require benchmarking to similar instruments or analyzing default and recovery rates. For collateralized debt obligations (CDOs), external price information is not available. Therefore CDOs are valued using market standard models to model the specific collateral composition and cash flow structure of each deal. Key inputs to the model consist of market spread data for each credit rating, collateral type, and other relevant contractual features.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while IDBNY believes its valuation methods are appropriate and consistent with those of other market participants the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result

in a different estimate of fair value at the reporting date.

(4) **Accounting Standard No. 13 (amended).** The Israel Accounting Standards Board issued in May 2007 Accounting Standard No. 13 (amended) regarding "The effect of changes in foreign currency exchange rates" (hereinafter: "the Standard"), which deals with the determination of the functional currency of an entity or of foreign operations of an entity, with the translation of transactions effected in foreign currency, with the translation of financial statements of foreign operations, as well as with the translation of the functional currency into the reporting currency. The Standard applies to financial statements for the period beginning on January 1, 2008 and thereafter.

According to this Standard, the term "reporting currency" has been replaced by two terms: "functional currency" and "reporting currency". "Functional currency" has been defined as the currency best reflecting the economic environment in which the entity operates and its transactions. When preparing the financial statements, each entity - whether it is an autonomous entity, an entity having foreign operations (as a parent company), or foreign operations (such as a subsidiary or a foreign branch) - shall determine its functional currency according to criteria designed to identify the currency of the principal economic environment in which the entity operates. The "reporting currency" is defined as the currency in which the financial statements are denominated.

This Standard does not apply to cash flows deriving from transactions in foreign currency or to the translation of cash flows of foreign operations. This Statement is to be prepared in accordance with the provisions of Opinion No. 51 of the Institute of Certified Public Accountants in Israel relating to the Statement of Cash Flows.

The provisions of the Standard are to be applied retroactively by way of a restatement of the comparative data for prior periods.

On August 18, 2008, the Supervisor of Banks published guidelines regarding the manner of adoption of the amendment by banking corporations, according to which the Standard is to apply to banking corporations as from January 1, 2008. The Supervisor clarified that, as a general rule, a foreign banking extension of a banking corporation, which had been classified by the banking corporation as a "long arm" (in accordance with Standard 13 dated October 2001, which the reporting directives had adopted), shall be classified in accordance with the amended standard 13 (dated May 2007) as a foreign operation the functional currency thereof is identical to the functional currency of the banking corporation. The classification of a new foreign banking extension as an extension the functional currency of which is different from the functional currency of the banking corporation shall be subject to a prior approval by the Supervisor of Banks.

In view of the above, the initial implementation of the Standard did not have a material effect upon the Bank's 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.

(1) **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 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

(2) **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.

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 shuld be adopted by banking corporations.

(3) **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 in this matter with those applying to banks in the United states, and among other things, it is based on U.S. accounting principles and on the directives of the bank regulatory authorities in the U.S. 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 waver, 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

- The directives regarding accounting erasure of problematic debts were tightened, inter alia, the draft directives in this regard determine as follows:
  (a) 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.
  (b) 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).
  (c) 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:
  (a) 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 150 days.
  (b) 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.
  (c) 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:
  (a) 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.
  (b) 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.
  (c) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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:

(a) 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.

(b) 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.

(c) Updating procedures regarding the method for determination of credit loses, taking into consideration, inter alia, methods for distribution of the credit portfolio, methods for identification of problematic debts the provision for which is measured on a specific basis, existing methods for measurement of provision for impairment in value 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.

(d) Documentation of entities and position holders in the banking corporation involved in determination of the provision for credit losses.

(e) 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.

(f) 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 include: 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 determins that it 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. This, excluding debts that have been rescheduled prior to January 1, 2007, and which at date of initial implementation adhere to with the rescheduling terms.

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 on 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.

(4) **Accounting Standard No. 15 (amended).** In January 2009, the Israel Accounting Standards Board issued Accounting Standard No. 15 (amended), "Impairment of assets" (hereinafter: "the Standard"), clarification No. 10, "The accounting treatment of impairment of investment in an investee company that is not a subsidiary" and a new version of clarifications Nos. 1 and 6 on the subject of "The accounting treatment of impairment of investment in an investee company that is not a subsidiary" and the "Treatment of impairment of assets of an investee company that is not a subsidiary", respectively.

Standard No. 15 (amended) for the most part changes the accounting treatment of the manner of allocation of goodwill upon consolidation to cash generating units. Clarification No. 10 specifies how a loss on impairment of an investee company that is not a subsidiary should be allocated, including the treatment of reversal of a loss on impairment recognized in prior periods.

According to the Standard, for the purpose of assessing the impairment, goodwill acquired upon a business combination, is to be allocated as from acquisition date to each of the cash generating units or groups of cash generating units of the acquired entity and to each of the cash generating units or groups of cash generating units of the acquiring entity, which are expected to benefit from the synergies created by the combination, this bearing no relation as to whether other assets or liabilities of the acquired entity have been related to such units or groups of units. The basis for the allocation is the fair value proportions of the units as of acquisition date. The impairment of goodwill is assessed at a level reflecting the way in which the entity conducts its operations and to which the goodwill is related. The Standard further provides that each unit or groups of units, to which goodwill has been allocated, shall represent the lowest level where the monitoring of goodwill exists for internal requirements of management, and which should not be larger than a segment, as determined in accordance with Accounting Standard No. 11, "Segment reporting". Thus, the Standard reversed the accounting treatment specified in the original Standard regarding the implementation of a two-stage test for assessing impairment recognition ("up-down" and "down-up" tests).

In accordance with clarification No. 10, the entity has to determine at each balance sheet date, whether indications of impairment of the investment in the affiliated company exist. Where such is the case, the entity shall assess the recoverable value of the investment in accordance with the provisions of the Standard. To the extent that a loss is recognized, then according to the Standard, such loss is to be allocated to the investment as a whole. The reversal of a loss on impairment of the investment will also be made while assessing the investment as a whole. Thus clarification No. 10 replaces the rules determined by the original Standard No. 15, according to which a loss on impairment of an investment in an affiliated company shall be allocated firstly to goodwill in the investment account and the remaining balance of the loss shall be recorded against the investment as a whole.

The new version of clarification No. 1 was modified to correspond with the accounting treatment of impairment of investee companies as specified in Standard No. 15 (amended) and clarification No. 10.

The provisions of the Standard and the clarifications will be applied from now onwards starting with the financial statements for periods beginning on January 1, 2009 or thereafter.

As of date of issue of the financial report, the Supervisor of Banks has not yet issued directives at to the mode of adoption of the Standard by banking corporations and credit card companies, if at all.

Z. COMPARATIVE FIGURES

Several items have been reclassified as stated in the financial statements**.** Including – Within the framework of the preparations for Basel

II the obligation components have been reviewed. This review showed that until 2007 "commitments for the granting of credit" also included amounts in respect of which no commitment existed. The comparative figures were reclassified accordingly.

The said reclassification had no effect on the computation of ratio of capital to risk assets.

2. CASH AND DEPOSITS WITH BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
Cash and deposits with central banks	12,281	3,428	7,847	2,649
Deposits with commercial banks	8,304	15,320	6,601	12,560
Deposits with specialized banking institutions	969	1,102	11,682	9,025
Total	21,554	19,850	26,130	24,234
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	19,068	17,313	12,251	14,436

3. SECURITIES[1]

A. CONSOLIDATED

	December 31, 2008				
	Book value	Net adjusted cost	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value[2]
	In NIS millions				
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	830	830	12	28	814
Government Sponsored Enterprises (GSE) Agencies	533	533	7	12	528
Others	554	554	3	44	513
Total held-to-maturity bonds	1,917	1,917	22	84	1,855

	Book value	Net adjusted cost (for shares - cost)	Cumulative other comprehensive income		Fair value[2]
			Profits	Losses	
(2) Available for sale securities:					
Bonds and bills:					
Government	10,313	9,993	344	24	10,313
Government Sponsored Enterprises (GSE) Agencies	11,487	11,401	118	32	11,487
Others	4,460	5,288	8	836	4,460
Total	26,260	[3]26,682	470	892	26,260
Shares:					
Funds of Funds	120	[7]120	-	-	120
Others	1,205	1,162	84	41	1,205
Total shares	1,325	1,282	84	41	1,325
Total available-for-sale securities	27,585	27,964	[4]554	[4]933	[5]27,585

General footnotes: 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 7,194 million (US$ 1,892 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 751 million.
(6) Recorded in the statement of income.
(7) The balance of the investment at December 31, 2008 is net of impairment considered to be other than temporary in nature in the amount of NIS 63 milion, and net of redemption of apart of the units of the fund. Subsequent to balance sheet date of fund redeemed further units in the total amount of NIS 17 million.

3. SECURITIES[1] (CONTINUED)

A. CONSOLIDATED (CONTINUED)

	December 31, 2008				
	Book value	Net adjusted cost	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value[2]
	In NIS millions				
(3) Trading Securities:					
Bonds and bills:					
Government	1,608	1,563	46	1	1,608
Government Sponsored Enterprises (GSE) Agencies	7	6	1	-	7
Others	376	458	2	84	376
Total	1,991	2,027	49	85	1,991
Shares:					
Others	42	52	-	10	42
Total trading securities	2,033	2,079	[6]49	[6]95	2,033
Total securities	31,535	31,960	625	1,112	31,473

General footnotes: 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 7,194 million (US$ 1,892 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 751 million.
(6) Recorded in the statement of income.
(7) The balance of the investment at December 31, 2008 is net of impairment considered to be other than temporary in nature in the amount of NIS 63 milion, and net of redemption of apart of the units of the fund. Subsequent to balance sheet date of fund redeemed further units in the total amount of NIS 17 million.

3. SECURITIES[1] (CONTINUED)

A. CONSOLIDATED (CONTINUED)

	December 31, 2007				
	Book value	Net adjusted cost	Unrealized gains from adjustment to fair value	Unrealized 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

	Book value	Net adjusted cost (for shares - cost)	Cumulative other comprehensive income		Fair value[2]
			Profits	Losses	
	In NIS millions				
(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	252	29,134
Shares:					
Funds of Hedge Funds	363	[7]363	-	-	363
Others	1,397	1,113	285	1	1,397
Total shares	1,760	1,476	285	1	1,760
Total available-for-sale securities	30,894	30,698	[4]449	[4]253	[5]30,894

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) 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 balance of the investment at December 31, 2007 is net of impairment considered to be other than temporary in nature in the amount of NIS 44 milion, recognized in the statement of income.

3. SECURITIES[1] (CONTINUED)

A. CONSOLIDATED (CONTINUED)

	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				
(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 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) 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 balance of the investment at December 31, 2007 is net of impairment considered to be other than temporary in nature in the amount of NIS 44 milion, recognized in the statement of income.

3. SECURITIES[1] (CONTINUED)

B. THE BANK

	Book value	Net adjusted cost (for shares - cost)	Cumulative other comprehensive income		Fair value[2]
			Profits	Losses	
(1) Available for sale securities:					
Bonds and bills:					
Government	8,472	8,151	335	14	8,472
Others	2,448	2,789	1	342	2,448
Total	10,920	10,940	336	356	10,920
Shares:					
Funds of Hedge Funds	120	[6]120	-	-	120
Others	448	429	60	41	448
Total shares	568	549	60	41	568
Total available-for-sale securities	11,488	11,489	[3]396	[3]397	[4]11,488

	December 31, 2008				
	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[3]
	In NIS millions				
(2) Trading Securities:					
Bonds and bills:					
Government	1,501	1,476	26	1	1,501
Others	258	334	-	76	258
Total	1,759	1,810	26	77	1,759
Shares:					
Others	1	4	-	3	1
Total trading securities	1,760	1,814	[5]26	[5]80	1,760
Total securities	13,248	13,303	422	477	13,248

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 128 million.
(5) Recorded in the statement of income.
(6) The balance of the investment at December 31, 2008 is net of impairment considered to be other than temporary in nature in the amount of NIS 63 milion, and net of redemption of apart of the units of the fund. Subsequent to balance sheet date of fund redeemed further units in the total amount of NIS 17 million.

3. SECURITIES[1] (CONTINUED)

B. THE BANK (CONTINUED)

	Book value	Net adjusted cost (for shares - cost)	Cumulative other comprehensive income		Fair value[2]
			Profits	Losses	
(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	57	14,002
Shares:					
Funds 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	[3]57	[4]15,081

	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				
(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 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 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 statment of income.

3. SECURITIES[1] (CONTINUED)

C. The item includes a balance of: consolidated - NIS 399 million; the Bank - NIS 285 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, 2008, the market value of the Bezeq shares did not exceeded the outstanding balance of the debt in respect of which they had been pledged.

In the course of 2008, the Bank and Mercantile Discount Bank received a dividend of approximately NIS 38 million in respect of the Bezeq shares (2007: NIS 70 million). 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, 2006, in the amount of NIS 31 million, has been deferred and was classified as deferred income under "Other liabilities". 20% of the shares were sold in 2008, resulting in a gain of NIS 13 million (of which NIS 6 million out of deferred income).

E. Further details regarding mortgage and asset backed securities, on a consolidated basis.

The Bank's securities portfolio as of December 31, 2008, includes investments in asset backed securities, primarily investment in mortgage backed securities (MBS) which are held for the most part by IDB New York.

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.

In accordance with the policy of IDB New York, this type of security must belong to one of the two upper rating groups as determined by authoritative credit rating companies.

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. Where the issue is executed by Ginnie Mae (GNMA), a US Government guarantee is in effect. When the issue is performed by Fannie Mae or Freddie Mac (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.

3. SECURITIES[1] (CONTINUED)

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

	December 31,2008			
		Other cumulative income[1]		
	Written down value	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value
	In NIS millions			
1. Mortgage-backed securities (MBS):				
Available for sale trading bonds				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	191	4	-	195
Securities issued by FHLMC and FNMA	6,328	55	24	6,359
Total mortgage-backed pass-through securities	6,519	59	24	6,554
B. Other mortgage-backed securities (including CMOs):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	4,541	53	8	4,586
Other MBS securities	104	-	26	78
Total mortgage-backed other MBS securities	4,645	53	34	4,664
Total available for sale MBS securities	11,164	112	58	11,218
Held-to-maturity bonds				
A. Mortgage pass-through securities:				
Securities Issued by FNMA and FHLMC	10	-	-	10
B. Other mortgage-backed securities	320	-	44	276
Total helds to maturity MBS securities	330	0	44	286
Bonds for sale				
A. Mortgage pass-through securities:				
Securities Issued by FNMA and FHLMC	6	-	-	6
Total bonds for sale MBS securities	6	-	-	6
Total mortgage-backed securities (MBS)	11,500	112	102	11,510
2. Asset-backed available for sale securities (ABS)				
Credit financing the purchase of motor vehicles	7	-	1	6
Credit to other than private individuals	1	-	-	1
Total asset-backed available for sale securities (ABS)	8	-	1	7
Total mortgage and asset-backed securities	11,508	112	103	11,517

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 31,2007			
		Other cumalative income[1]		
	Written down value	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value
	In NIS millions			
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 and FHLMC or GNMA	473	3	-	476
All other mortgage-backed securities	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
Total Held to Maturity Bonds	11	-	-	11
Bonds for sale				
Securities Issued by FNMA and FHLMC	7	-	-	7
Total mortgage-backed bonds for sale (MBS)	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	8,699	47	77	8,669

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)

Additional details regarding available for sale mortgage and asset-backed securities in unrealized loss position:

	December 31,2008			
	Less than 12 months		12 months and over	
	Fair value	Unrealized losses	Fair value	Unrealized losses
	In NIS millions			
Mortgage-Backed Securities (MBS):				
Available for sale trading bonds				
Mortgage pass-through securities:				
Securities guaranteed by GNMA	-	-	42	-
Securities issued by FHLMC and FNMA	1,309	6	927	18
Total Mortgage-backed pass-through securities	1,309	6	969	18
Other Mortgage-Backed Securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	1,000	7	36	1
Other MBS securities	63	19	15	7
Total Other Mortgage-Backed Securities	1,063	26	51	8
Total available for sale MBS Securities	2,372	32	1,020	26
Held to maturity bonds				
Other Mortgage-Backed Securities (including CMO, REMIC and STRIPPED MBS):				
Other MBS securities	276	44	-	-
Total Held to maturity MBS securities	276	44	-	-
Total mortgage-backed securities (MBS)	2,648	76	1,020	26
2. Asset-backed securities (ABS)				
Credit financing the purchase of motor vehicles	1	1	-	-
Total asset-backed securities (ABS)	1	1	-	-
Total mortgage and asset-backed securities	2,649	77	1,020	26

	December 31,2007			
Mortgage-Backed Securities (MBS):				
Available for sale trading bonds				
Mortgage pass-through securities:				
Securities guaranteed by GNMA	-	-	199	3
Securities issued by FHLMC and FNMA	203	1	4,081	72
Total Mortgage-backed pass through securities	203	1	4,280	75
Other Mortgage-Backed Securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	27	-	153	
Other MBS securities	22	1	-	-
Total Other Mortgage-Backed Securities	49	1	153	
Total available for sale MBS Securities	252	2	4,433	75

3. SECURITIES[1] (CONTINUED)

As of December 31, 2008 the mortgage backed securities (MBS) portfolio, included unrealized losses of US$27 million. As of March 17, 2009, the net unrealized losses, as mentioned, amounted to US$25 million.

G. Discount Group's available-for-sale securities portfolio includes corporate bonds, including bonds of banks, in a total amount of NIS 4,460 million (December 31, 2007: NIS 4,850 million). The balance of the said bonds included as of December 31, 2008, unrealized losses in the amount of NIS 836 million (December 31, 2007: NIS 136 million). As of March 19, 2009, the said balance of bonds included unrealized losses in the amount of NIS 1,061 million.

H. All of the unrealized losses as at December 31, 2008 relate to securities rated as "investment grade" and above and they are attributed to certain factors, including changes in market interest rate subsequent to date of acquisition, an increase in margins occurring in the credit market concerning similar types of securities, the impact of inactive markets and changes in the rating of securities. For debt securities, there are no securities past due or securities for which the Bank and/or it relevant consolidated companies estimates that it is not probable that they will be able to collect all the amounts owed to them pursuant to the investment contracts. Since the Bank and the relevant consolidated subsidiaries have the ability and intent to hold on to securities with unrealized losses until a market price recovery (which for bonds, may not be until maturity), the Bank and the relevant consolidated subsidiaries do not consider the impairment in value of these investments to be other than temporarily impaired at December 31, 2008 except for certain securities, in respect of which a provision for impairment in value has been included as detailed in Section J hereunder.

I. The securities portfolio of the Discount Group as at December 31, 2008, includes a direct investment in bonds of the Federal Home Loan Bank (FHLB), Fannie Mae and Freddie Mac (hereinafter: "the Federal Agencies"), that are being held by IDB New York, in an amount of US$203 million (compared to US$1,075 million on December 31, 2007). As of March 17, 2009, no material change has taken place in the said balance of investments.

J. Investment in bonds of foreign financial institutions. Investment in Lehman Brothers bonds - On September 15, 2008, the Lehman Brothers Group (hereinafter: "Lehman Group"), which until then was considered one of the four largest investment banks in the United States, collapsed.

At this time, the Bank and IDB New York held Lehman Group's holding company's bonds in a total amount of US$57 million. The Bank has also entered into transactions with the Lehman Group involving financial assets. As of September 15, 2008, the Bank's exposure in respect of these transactions was negligible. Furthermore, the Bank manages various accounts of Lehman Group companies, some of which are for their customers.

On September 18, 2008, at the request of Bank Leumi, a temporary comprehensive attachment order was issued with respect to assets and rights existing in the Lehman Group accounts with the Bank in an amount of up to NIS 370 million. On October 6, 2008, Bank Leumi filed a petition for approval of the attachment. The Bank has submitted a defense brief.

On November 17, 2008, the Bank served three companies of the Lehman Group with a notice of setoff in respect of all assets and monies held by the Group with the Bank as regards all the Group's debts to the Bank, except for accounts managed on behalf of Lehman Group customers. On March 12, 2009, an agreement was given the effect of a Court verdict, under which attachments executed by Bank Leumi were approved, subject to the priority rights of the Bank deriving from the right of set-off to which the Bank is entitled.

Investment in bonds of Washington Mutual Bank - Following its collapse WAMU ("Washington Mutual Bank") has been acquired by J.P. Morgan. The acquisition transaction was assisted by the FDIC, though J.P. Morgan did not accept the liability in respect of the WAMU bonds. At the time of the WAMU collapse, IDB New York held WAMU bonds in a total amount of US$10 million.

Investment in Landsbanki bonds - Landsbanki was the second largest bank in Iceland based on total assets, and the largest based on the number of branches and share in local activity in Iceland. During October 2008, and following the crisis in the markets, this bank was nationalized by the Government of Iceland and all of its domestic assets have been transferred to a new bank with a similar name, with the objective of ensuring the monies of local depositors. The old bank entered into receivership. At the time of the collapse of Landsbanki, IDB New York held bonds of that bank in a total amount of US$10 million.

The Bank and IDB New York recorded a provision for impairment in value in respect of the foreign financial institution bonds, which include the Lehman Group, WAMU and Landsbanki in the amount of NIS 283 million.

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	
	2008	2007	2008	2007
	in NIS millions			
Credit	117,147	102,203	69,443	59,715
Customers' liabilities for acceptances	260	284	158	164
Total credit	117,407	102,487	69,601	59,879
General provision and supplemental provision for doubtful debts	(607)	(588)	(318)	(305)
Total	116,800	101,899	69,283	59,574

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

Reported amounts:

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
a) Non-Income Bearing Loans to Problem Borrowers				
Balance at balance sheet date:				
In Israeli currency, non-linked	1,804	1,646	1,344	1,133
In Israeli currency, linked to CPI	154	231	98	115
In foreign currency (including linked to foreign currency)	284	*353	142	308
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	-	-	-	-
Average repayment period, in years	-	-	-	-
Effective rate of income:				
Included in the anticipated repayment flow	-	-	-	-
Included in the repayment flow according to original contracts		*15%	-	-
In Israeli currency, linked to CPI:				
Balance at balance sheet date	70	73	70	70
Average repayment period, in years	12.5	12.5	12.5	12.5
Effective rate of income:				
Included in the anticipated repayment flow	6.4%	6.4%	6.5%	6.5%
Included in the repayment flow according to original contracts	6.6%	6.6%	6.6%	6.6%
In foreign currency (including linked to foreign currency)				
Included in the repayment flow according to original contracts	7.0%	7.0%	-	-

* 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):

Reported amounts

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
2) Credit restructured in prior years, with waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	1	5	-	-
In Israeli currency linked to CPI	9	6	-	-
In foreign currency (including linked to foreign currency)	-	-	-	-
3) Credit restructured during the current year - without waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	174	*136	104	112
In Israeli currency, linked to CPI	31	49	21	23
In foreign currency (including linked to foreign currency)	69	8	69	7
c) Restructured Credit Not Yet Executed				
Balance at balance sheet date	231	33	216	33
d) Credit in Temporary Arrears				
Balance at balance sheet date	550	252	334	147
Interest in respect of such credit included in the statement of income	20	9	17	8
e) Credit Under Special Supervision				
Balance at balance sheet date	4,147	*3,322	3,011	2,411

* Reclassified.

2. Credit to the local autorities sector:				
Balance at the balance sheet date	212	216	178	180
The credit to local autorities included:				
(1) Credit under special supervision:				
Balance at balance sheet date	5	11	-	8
(2) Credit in Temporary Arrears				
Balance at balance sheet date	3	-	-	-
Interest in respect of such credit included in the statement of income	*-	-	-	-
(3) Credit that is not included in credit granted to problematic borrowers:				
Balance at balance sheet date	204	205	178	172
Interest in respect of such credit included in the statement of income	20	21	17	17
Total	212	216	178	180

* An amount lower than NIS 1 million.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

C. PROVISION FOR DOUBTFUL DEBTS

	2008			
	Specific provision[1]			
	According to period of arrears	Other	Supplemental provision[2]	Total
	In NIS millions			
Consolidated				
Balance of provision at beginning of year	163	5,149	663	5,975
Provision for current year	55	942	92	1,089
Reduction of provision	(50)	(156)	(86)	(292)
Collection of debts written-off in previous years	-	(17)	-	(17)
Provision charged to statement of Income	5	769	(6)	780
Net write-offs*	(5)	(447)	-	(452)
Exchange rate differentials	-	(1)	-	(1)
Balance of provision at end of year	163	5,470	669	6,302
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	186	62	248
The Bank				
Balance of provision at beginning of year	-	4,031	349	4,380
Provision for current year	-	629	53	682
Reduction of provision	-	(94)	(40)	(134)
written-off in previous years	-	(1)	-	(1)
Provision charged to statement of Income	-	534	13	547
Net write-offs*	-	(351)	-	(351)
Exchange rate differentials	-	(2)	-	(2)
Balance of provision at end of year	-	4,212	362	4,574
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	164	44	223

* Net of debts collected during the year.

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 404 million; 2007 - NIS 427 million; 2006 - NIS 423 million.
The bank: - NIS 197 million; 2006 - NIS197 million; 2005 - NIS 197 million (see Note 1 l).

(3) Including a special provision for doubtful debts of NIS 4 million.

2007				2006			
Specific provision[1]				Specific provision[1]			
According to period of arrears	Other	Supplemental provision[2]	Total	According to period of arrears	Other	Supplemental provision[2][3]	Total
In NIS millions							
161	5,278	675	6,114	150	5,005	748	5,903
61	649	29	739	68	735	46	849
(56)	(185)	(41)	(282)	(52)	(99)	(119)	(270)
-	(10)	-	(10)	-	(9)	-	(9)
5	454	(12)	447	16	627	(73)	570
(3)	(575)	-	(578)	(5)	(342)	-	(347)
-	(8)	-	(8)	-	(12)	-	(12)
163	5,149	663	5,975	161	5,278	675	6,114
-	119	75	194	-	54	81	135
-	4,271	360	4,631	-	4,167	352	4,519
-	400	16	416	-	451	24	475
	(143)	(27)	(170)	-	(81)	(16)	(97)
	(1)	-	(1)	-	(1)	-	(1)
-	256	(11)	245	-	369	8	377
-	(496)	-	(496)	-	(265)	-	(265)
-	-	-	-	-	-	-	
-	4,031	349	4,380	-	4,271	360	4,631
-	118	44	162	-	51	44	95

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

D. COMPOSITION OF CREDIT TO THE PUBLIC[1] AND OFF-BALANCE-SHEET CREDIT RISK[2], BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS

Consolidated

	December 31							
	2008			2007				
	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	750,596	1,675	1,645	379,229	1,420	478
Over 10 Up to 20	276,212	1,913	2,424	124,462	1,165	626
Over 20 Up to 40	237,164	2,998	4,319	131,950	2,177	1,677
Over 40 Up to 80	149,657	4,000	4,837	114,400	3,207	3,617
Over 80 Up to 150	84,877	4,309	4,854	78,037	3,849	4,425
Over 150 Up to 300	35,036	5,393	2,039	33,769	5,142	1,848
Over 300 Up to 600	21,156	7,756	1,269	18,903	6,586	1,296
Over 600 Up to 1200	9,980	6,685	1,460	8,329	5,240	1,553
Over 1200 Up to 2,000	3,161	3,517	1,213	2,858	3,054	1,185
Over 2,000 Up to 4,000	2,292	4,816	1,695	2,242	4,561	1,586
Over 4,000 Up to 8,000	1,277	5,227	2,214	1,269	5,042	1,948
Over 8,000 Up to [4]20,000	1,185	10,212	4,954	1,138	9,443	4,553
Over 20,000 Up to [4]40,000	585	11,042	5,434	598	10,600	5,228
Over 40,000 Up to [4]200,000	613	31,479	15,297	590	27,875	16,132
Over 200,000 Up to [4]400,000	50	9,693	3,950	41	7,213	4,404
Over 400,000 Up to [4]800,000	17	7,094	2,156	16	6,051	2,988
Over 800,000 Up to [4]1,200,000	6	2,328	3,535	3	1,304	1,586
Over 1,200,000 Up to [4]1,600,000	1	1,251	-	1	-	1,273
Total	1,573,865	121,388	63,295	897,835	103,929	56,403
Income receivable and other debtors[5]		11			2,204	
Total	-	121,399	63,295	-	106,133	56,403

* Reclassified.

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)

D. COMPOSITION OF CREDIT TO THE PUBLIC[1] AND OFF-BALANCE-SHEET CREDIT RISK[2], BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS

The Bank

				December 31					
				2008			2007		
				Number of borrowers[2]	Credit	Credit risk	Number of borrowers*[2]	Credit*	Credit risk*
				in NIS millions					
Credit limit (in NIS thousand):									
		Up to	10	193,398	332	414	180,928	305	413
Over	10	Up to	20	76,739	531	579	75,440	501	584
Over	20	Up to	40	106,012	1,315	1,810	98,119	1,262	1,639
Over	40	Up to	80	98,399	2,314	3,629	92,263	2,075	3,487
Over	80	Up to	150	69,542	2,768	4,529	64,582	2,451	4,282
Over	150	Up to	300	19,679	2,163	1,748	18,609	2,000	1,716
Over	300	Up to	600	6,150	1,594	992	6,174	1,571	1,026
Over	600	Up to	1,200	3,424	1,824	1,059	3,469	1,821	1,068
Over	1,200	Up to	2,000	1,447	1,533	712	1,381	1,457	656
Over	2,000	Up to	4,000	1,274	2,534	1,091	1,242	2,516	1,021
Over	4,000	Up to	8,000	838	3,198	1,485	777	3,038	1,318
Over	8,000	Up to	20,000	707	5,999	3,145	616	5,162	2,575
Over	20,000	Up to	40,000	324	5,914	3,368	291	5,694	2,469
Over	40,000	Up to	200,000	359	20,609	8,035	333	18,240	9,284
Over	200,000	Up to	400,000	45	9,015	3,545	35	6,286	3,905
Over	400,000	Up to	800,000	15	6,266	2,001	15	5,436	2,648
Over	800,000	Up to	1,200,000	6	2,134	3,442	3	1,304	1,586
Over	1,200,000	Up to	1,600,000	1	1,251	-	1	-	1,273
Total				578,359	71,294	41,584	544,278	61,119	40,950

* Reclassified.

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 (CONTINUED):

E. DETAILS AS TO THE MANNER OF COMPUTING THE SPECIFIC PROVISION FOR HOUSING LOANS

Consolidated

	Balance of credit	Balance of debt[4]	Balance in arrears[5]	Specific provision: According to extent of delinquency	Specific provision: Other	Specific provision: Total
	in NIS millions					
	December 31, 2008					
Housing loans[1][6]	9,964	288	97	145	-	145
"Large loans"[2]	3,351	76	34	5	29	34
Other loans[3]	798	55	19	13	17	30
Total	14,113	419	150	163	46	209

	December 31, 2007					
Housing loans[1][6]	8,196	299	93	142	-	142
"Large loans"[2]	2,173	66	29	5	30	35
Other loans[3]	815	60	20	16	19	35
Total	11,184	425	142	163	49	212

* 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 841 thousand (2007: NIS 805 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 se
(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 19.0 million (2007: NIS 15.3 million)
(6) Including balance of credit at the Bank in the amount of 2008: NIS 91 million (2007: NIS 91 million).

4. CREDIT GRANTED TO THE PUBLIC (CONTINUED):

F. HOUSING LOANS AND THE PROVISION FOR DOUTFUL DEBTS IN RESPECT THEREOF BASED ON THE PERIOD OF ARREARS

Consolidated

	December 31, 2008					
	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
	In NIS millions					
Amount in arrears	6	12	17	79	-	114
Of which: Interest on the amount in arrears	1		1	23	-	25
Balance of provision for doubtful debts based on period of arrears[1]	-	17	38	108	-	163
Balance of loans net of provision for doubtful debts	137	107	43	28	-	315

	December 31, 2007					
Amount in arrears	7	13	18	71	-	109
Of which: Interest on the amount in arrears	1		1	19	-	21
Balance of provision for doubtful debts based on period of arrears[1]	-	20	39	104	-	163
Balance of loans net of provision for doubtful debts	135	117	44	27	1	324

Footnote:
(1) Not including a provision for interest in respect of the amount in arrears.

5. CREDIT GRANTED TO GOVERNMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
Deposit of the Accountant General - tender for teaching enployees	1,460	362	1,460	362
Other credit[1]	31	12	1	1
Total credit granted to Governments	1,491	374	1,461	363

Footnote:
(1) Including credit to foreign governments: Consolidated - NIS 20 million (2007: NIS 2 million), the Bank - no balance.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES

A. CONSOLIDATED

	December 31, 2008			December 31, 2007		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	In NIS millions					
Investments						
Shares stated on equity basis (including goodwill)[1]	1,784	-	1,784	1,931	-	1,931
Other investments:						
Capital notes	52	-	52	3	-	3
Shareholders' loans	64	-	64	74	-	74
Total other investments	116	-	116	77	-	77
Total investments	1,900	-	1,900	2,008	-	2,008
Includes:						
Earnings accumulated since January 1, 1992	817	-	817	891	-	891
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	(9)	-	(9)	32	-	32
Adjustment for translation of foreign currency financial statements	(16)	-	(16)	(3)	-	(3)
Details Regarding Goodwill:						
Period of amortization		10 years			10 years	
Original amount	204	374	578	214	292	506
Unamortized balance	98	272	370	206	240	446
Book and Market Values of Marketable Investments:						
Book value	1,453	-	1,453	1,451	-	1,451
Market value	705	-	705	1,387	-	1,387

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, 2008			December 31, 2007		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	in NIS millions					
Investments:						
Shares stated on equity basis (including goodwill)[1]	1,509	5,981	7,490	1,513	5,778	7,291
Other investments:						
Subordinated debt notes and Capital notes	3	1,419	1,422	3	107	110
Shareholders' loans	2	64	66	3	576	579
Total other investments	5	1,483	1,488	6	683	689
Total investments	1,514	7,464	8,978	1,519	6,461	7,980
Includes:						
Retained earnings since January 1, 1992	943	2,908	3,851	903	2,677	3,580
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	(11)	(214)	(225)	30	(41)	(11)
Adjustment for translation of foreign currency financial statements	(1)	13	12	(1)	34	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	374	382	8	292	300
Unamortized balance	5	272	277	6	240	246
Book and Market Values of Marketable Investments:						
Book value	1,453	-	1,453	1,451	-	1,451
Market value	705	-	705	1,387	-	1,387

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		
	2008	2007	2006	2008	2007	2006
	In NIS millions					
The Bank's share of operating income of investee companies (consolidated - affiliated companies)	18	175	190	272	457	248
Provision for impairment in value of investee companies	(88)	-	-	-	-	-
Total	(70)	175	190	272	457	248
Provision for taxes:						
Current taxes	-	-	-	26	22	25
Deferred taxes	-	(1)130	2	(2)(23)	(1)143	3
Total provision for taxes	-	130	2	3	165	28
The Bank's share of operating income (loss) after tax of investee companies (consolidated - affiliated companies)	(70)	45	188	269	292	220

Footnotes:
(1) Including a provision for taxes in the amount of NIS 130 million in respect of the Bank's share in earning s of the First International Bank (see Section F below).
(2) Including the reversal of the provision for taxes in respect of the Bank's share in the earnings of ICC (see Note 29 K hereunder).

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

C. INFORMATION ON PRINCIPAL INVESTEE COMPANIES

		Share in capital conferring rights to profits		Share in voting rights	
		2008	2007	2008	2007
Name of Company	Details of Company	As a percentage		As a percentage	
1. Consolidated Subsidiaries:					
Discount Bancorp, Inc.[2]	Holding company, U.S.A.	100.00	100.00	100.00	100.00
Israel Discount Bank of New York[3]	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.[4]	Mortgage bank	100.00	100.00	100.00	100.00
Israel Credit Cards Ltd.	Credit card service	71.83	71.83	79.00	79.00
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
IDB (Swiss) Bank Ltd.	Commercial bank, Switzerland	100.00	100.00	100.00	100.00
Companies held by Israel Discount Bank of New York:					
Discount Bank (Latin America)[6]	Commercial bank, Uruguay	100.00	100.00	100.00	100.00
IDBNY Realty (Delaware), Inc.[6]	Holding company, USA	100.00	100.00	100.00	100.00
IDB Realty LLC.[7]	REIT, USA	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.[8]	Commercial bank	26.45	26.45	11.09	11.09
Company held by Discount Israel Capital Markets and Investments Ltd.:					
Kardan Financial Services N.V.[9]	Financial Investments,the Netherlands	11.00	11.00	20.00	20.00

Footnotes:
(1) Including allocated excess of cost over book value and goodwill.
(2) 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.
(3) The company is owned by Discount Bancorp, Inc.
(4) For details regarding a full purchase offer for the shares of Discount Mortgage Bank, see section I. hereunder.
(5) For details regarding a guarantee unlimited in amount in favor of VISA Europe, securing all of ICC's liabilities, see Note 19 C 12 below. For details as to the acquisition of additional means of control in the years 2006-2007, see Section K hereunder.
(6) Including the reversal of the provision for taxes in respect of the Bank's share in the earnings of ICC (see Note 29 K hereunder).
(7) For details regarding the acquisition of Arzi Bank and its merger with the company, see Section L hereunder.
(8) Included in the financial statements of Israel Discount Bank of New York.
(9) Included in the financial statements of IDBNY Realty (Delaware), Inc.
(10) For additional details regarding the investment, see Section F below.
(11) For details regarding the agreement for the sale of the investment in KFS and the option agreement for the purchase of shares in KFS, see section J hereunder.
(12) 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.
(13) Goodwill.
(14) Including a provision for taxes in the amount of NIS 130 million in respect of the Bank's share in earning s of the First International Bank (see Section F below).

Value of investment in shares on equity				Of which excess of cost				Contribution to net operating income		Of which loss from impairment in value		Other items recorded in shareholders' equity[12]		Guarantees issued for consolidated subsidiaries in favor of entities outside the group	
Equity basis[1]		Market value		balance		Other investments									
2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
In NIS millions															
20	25	-	-	-	-	-	-	(3)	(1)	-	-	3	2	-	-
2,390	2,445	-	-	-	-	285	-	58	(59)	-	-	(428)	(290)	-	-
1,480	1,363	-	-	-	-	-	58	149	166	-	-	12	44	-	-
907	880	-	-	[13]8	[13]9	371	-	27	22	-	-	-	-	7	7
774	603	-	-	[13]198	[13]231	40	43	191	87	-	-	3	-	61	57
104	100	-	-	-	-	-	-	4	3	-	-	-	-	-	-
219	(153)	-	-	-	-	327	294	(63)	2	-	-	(2)	-	-	-
56	54	-	-	-	-	-	-	2	-	-	-	-	-	-	-
173	74	-	-	[13]66	-	-	-	(1)	2	(10)	-	-	-	-	-
190	172	-	-	-	-	-	-	27	18	-	-	(6)	3	-	-
1,694	1,661	-	-	-	-	-	-	25	(84)	-	-	5	2	-	-
6,401	6,382	-	-	-	-	-	-	56	(317)	-	-	(87)	(41)	-	-
(41)	(19)	-	-	-	-	454	282	(21)	6	-	-	(4)	(3)	-	-
1,453	1,451	705	1,387	-	-	-	-	43	[14]26	-	-	(21)	32	-	-
189	316	-	-	92	203	-	-	(107)	-	(85)	-	(20)	-	-	-

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").

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 and committed to act insofar as possible to ensure fulfillment of the above-mentioned liabilities.

Concurrently and additionally, on December 15, 2005 IDB New York reached a compromise arrangement with the District Attorney for the State of New York regarding cessation of his investigation. According to the arrangement, IDB 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. In February 2006 Mr. Reuven Spiegel was appointed as President and CEO of IDB New York, in place of Mr. Arie Sheer. During 2006 all senior management and members of the Board of Directors of IDB New York were replaced.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 in accordance with the fixed timetable. 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.

Most of the required actions have been completed and IDB New York continues the process of strengthening the controls and procedures.

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 2007, US$13.3 million in 2007 and US$3.5 in 2008. IDB New York has tightened the controls and procedures relating to compliance, and it believes that no additional material costs in this respect are expected in 2009.

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 in the years 2006 and 2007, 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.

Additional developments. 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 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 Bank, participation of controlling shareholders and their representatives creates difficulties in the functioning of the Board of Directors and management of IDB New York.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

(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 of directors of IDB New York, for her employment as president and CEO of IDB Capital Corp., a wholly owned subsidiary of IDB New York (hereinafter: "the investigated transactions").

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

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

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

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

(2) The committee held several meetings and among other things requested a legal opinion from an independent New York Counsel regarding the U.S. 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 IDB New York was submitted to the Committee. The report's findings indicate, among other things, deficiencies at Bancorp and IDB New York 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 noncompliance with proper corporate

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 reprisentatives 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 recommendations are subject to the possibility of their application under the U.S. 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 tenant 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 as well as by the authorized organs at the Bank, as an entitled transaction. For further details, see Note 22 I (1).

(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. The Bank is acting to implement the recommendation, including within the framework of a company governance code for the Discount Group.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

(11) In March 2009, Mr. Len Grunstein the former Chairman of the Board of IDB New York, approached IDB New York with a request for the payment of remuneration in respect of his period of office as Chairman of the Board. In his approach, Mr. Grunstein did not specify the amount requested by him nor the mechanism for its calculation.

E.THE SALE OF OPERATIONS OF THE PROVIDENT FUNDS

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 anagement 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.

The agreement includes provisions with respect to the transfer the owenrship of the data base of the sold provident funds and with respect to limited utilization rights of the said data base for the Bank and for Discount 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.

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 in 2007 under "Net income from extraordinary items, net of taxes".

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

F. THE INVESTMENT IN THE FIRST INTERNATIONAL BANK ("FIBI")

(1) ISSUE BY THE FIRST INTERNATIONAL BANK ("FIBI")

In an immediate report dated March 13, 2007, FIBI informed of the decision of its Board of Directors to take action towards the increase of the share capital of the bank by means of a rights issue for shares and/or issue of rights for other securities intended to improve its capital structure. These rights are to be offered to all the shareholders of the bank, and are to include a possible benefit component in relation to the price of the shares on the market. It should be noted that in view of the capital structure of the said bank, and in view of the provisions of the Securities Law, FIBI is entitled to issue and list for trading on the Stock Exchange only shares and/or rights for shares of NIS 0.01 par value each, which are the class of shares having preferred voting rights.

This was preceded by an approach by the controlling shareholder of FIBI to 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, 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 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.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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.

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, prior to the Bank submitting its response to the subject at hand. The meeting has not yet taken place, the Bank has not as yet responded addressing the substance of the approach. 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.

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 in FIBI, 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.

It had been assumed in financial statements published up to and including the financial statements as of September 30, 2007, that the investment in shares of FIBI would be a long-term one and therefore no provision for taxes had been recorded in them 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 recorded in the financial statements as of December 31, 2007 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.

The Supervisor of Banks held negotiating with the Bank and with FIBI and its controlling shareholder with a view to arrive at a solution between

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

the parties. Direct meetings between the parties have taken place in the third quarter of 2008 with a view to arrive at a solution, as stated. Various issues and possibilities have been discussed in this respect. The structure of the capital of FIBI, the arrangements between the bank and its controlling shareholders as well as the Bank's holdings in FIBI are among the issues being discussed. At this stage no arrangement has been formalized and the ideas introduces were preliminary and premature.

At the request of FIBI and its controlling shareholder, and against the background of the crisis in the financial markets in general and the uncertainty existing in the Israeli capital market in particular, negotiations between the parties have been brought to a halt.

(2) DATA REGARDING THE INVESTMENT IN FIBI

On December 31, 2008 the Bank's holdings in FIBI were 26.4% in the equity and 11.4% in the voting rites.

The net asset value of the Bank's investment in FIBI as of December 31, 2008, is NIS 1,453 million. The market value of the Bank's holdings in FIBI totaled on December 31, 2008 NIS 705. The market value of this investment at March 29, 2009 was NIS 790 million.

(3) An opinion in the matter of the provision for impairment in value. The Bank received an opinion rendered by Prof, Yoram Eden, CPA (Isr.), who gave his consent to the inclusion thereof in the financial statements, in which he examined the question whether the Bank should be required, in accordance with accepted accounting principles, to include a provision for the impairment in value of its investment in FIBI.

Restrictions in performing the valuation. FIBI refused to provide an appraiser appointed by the Bank with any assistance or information, except for information which is already published by it, and excluding several general clarifications, provided to Prof. Eden through the Bank. In view of this, Prof. Eden has been requested to assess the value of FIBI based on public information.

In his opinion, Prof. Eden noted that financial statements issued to the public as well as the accompanying Directors' reports, include information, which in the main is "backward looking". For the preparation of a professional and reliable assessment, additional information is required that may be obtained only from the entity being assessed and from its management.

The preparation of a valuation based on published information only is therefore problematic and by nature more exposed to error. This is even more so in the case of a valuation of a bank, where it is important to have more detailed information regarding the credit portfolio of the bank and the evaluations by its management as regards future developments, the anticipated margins, business plans, etc.

Performing a valuation based on the reports of FIBI's. For the purpose of performing the valuation, Prof. Eden relied on public information only, and in particular, on audited annual financial statements and reviewed interim financial statements published by FIBI. These resources are considered reliable, and nothing has come to his attention that might indicate unreasonableness of the data made use by him or that the financial items included in FIBI's financial statements had not been presented in accordance with generally accepted accounting principles, and that the value of the said financial items requires any reduction/adjustment. Prof. Eden did not perform examinations of the data, accordingly his work does not constitute a verification of correctness, completion and accuracy of such data.

Method of assessment. The assessment was made by the discounted cash flow method (DCF method) and included the following stages:

- Determination of the basic earnings of FIBI, reflecting the income and expense items, which are of a permanent nature and which are derived from the present volume of activity;
- Preparation of a cash flow forecast for the coming four years beginning in 2009, relying on basic assumptions as to developments in the income and expense items of FIBI;
- Computation of the residual value of FIBI at the end of the forecast period, based on the Gordon Model;
- Discounting the resultant cash flow by the appropriate cost of capital.

The valuation was based on the consolidated financial statements of FIBI as of December 31, 2008, while the model used by Prof. Eden is the model used by him in preparing the valuation as of September 30, 2008. and on the basis of the updated data included in FIBI's consolidated statemen ts as of December 31, 2008. The assessment was made as of March 29, 2009.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

A previous valuation of FIBI. Prof. Eden noted that in March 2003, he performed a valuation of Discount Bank's holdings in FIBI, for the purpose of determining whether a provision for impairment of this investment was required. Subsequently, he updated his valuation in each of the twelve following quarters. The methodology used and assumptions made in the preparation of these previous valuations, were also considered in performing the current valuation of FIBI. Moreover, Prof. Eden noted that the said valuation as of September 30, 2008, was prepared by him in November 2008. The methodology used and assumptions made in the said valuation were kept in mind when preparing the present valuation of FIBI.

Forward looking information. In his valuation, Prof. Eden stated that he also addressed the forward looking statement included in FIBI's Directors' Report. A forward looking statement includes uncertain information regarding the future, which is based upon information existing in FIBI's hands at date of the Report and includes evaluations and objectives of that bank as of that date. If such evaluations of management do not materialize, actual results may differ materially from the results expected or inferred from such data. Prof. Eden further noted that his valuation in itself contains forward looking statements, which reflect his evaluation concerning various parameters and based upon information available to him (public information). Prof. Eden noted that if such evaluations do not materialize, actual results may differ materially from the results estimated by him.

Principal assumptions applied in the preparation of the assessment:

- The annual rate of growth of income bearing assets: 3% in 2009, 3.5% in 2010, 4% in 2011 and 4% in 2012. These growth rates stemmed from the following considerations:
- Prof. Eden assumed that in view of the capital market crisis, the possibilities of raising capital from off-banking sources (including bond issues and obtaining credit from insurance companies and other financial institutions) have been materially reduced. The business sector will be obliged to turn to the banking industry in order to refinance loans taken in the past from off-banking sources;
- It is true that the economy is facing a recession and a slowdown in activity, which will naturally reduce the demand for credit. However, Prof. Eden believes that on the whole the demand for banking credit will increase in the future. Prof. Eden noted that in 2008, credit to the public increased by 10.17% compared to the credit at December 31, 2007 Income producing assets also grew in the fourth quarter of 2008 (even disregarding the effect of derivatives) and the expected rate of growth in 2009 is similar to the growth rate in the fourth quarter of 2008;
- The Bank of Israel and the Government of Israel announced economic lines of action designed to relieve the credit crunch in the market, and also include the granting of State guarantees to various borrowers. These measures may facilitate the approach to banks by borrowers and increase the credit granted by the banking industry;
- Financial margins: Examination of the quarterly data of FIBI would seem to show that the financial margin itself declined in the fourth quarter to 1.06%. However, it should be noted that deflections exist in the measurement and reporting of financial margins. Deflections stemming from the fact that the assets side also includes assets the income there from is recorded against the active capital and not against liabilities. A more adequate measurement in Prof. Eden's opinion, made by comparing the asset base to the liability base (while eliminating the said assets), indicates that the financial margin in the fourth quarter amounts to 1.34%.

  Prof. Eden assumed that the spread in the coming period will be affected by several factors having an offsetting effect:

  - The decline in interest rates in itself will decrease the spread;
  - FIBI will be given the opportunity to improve its credit portfolio and increase the risk premium.

  Prof. Eden assumed that the rate of the spread is expected to grow in the coming years, as follows: 1.30% in 2009, 1.31% in 2010, 1.33% in 2011 and 1.35% as from 2012 and thereafter;
- The rate of additional return on the active capital - For reasons of caution, due to the reduction in the market interest rates, Prof. Eden assumed that the gross pre tax return on FIBI's active capital will be 3.5%;

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

- Provision for doubtful debts - Prof. Eden noted that it should be remembered that until the year 2000 inclusive, the rates of the provisions for doubtful debts were of the lowest in the entire banking industry. However, due to certain credit failures in the years 2001 and 2002 that were intensified by the economic recession in the years 2001-2003, the rate of the provision has risen steeply.

  With the renewal of economic growth and primarily due to a change of policy at FIBI, the rate of the provision for doubtful debts has declined.

  The acquisitions of Otsar Ha'Hayal Bank and of Massad Bank, whose customers are mostly households and individuals with steady incomes, significantly improved the credit mix of FIBI.

  The annualized rate of the provision for doubtful debts in 2008 at FIBI was 0.39% compared to 0.32% in 2007 and 0.40% in 2006. Under these circumstances, Prof. Eden found it proper to assign the rate of 0.4% for the whole of the forecasted period, and to add a provision of 0.7% for 2009 and 0.5% for 2010, 0.1% in 2011 and 0.05% as from 2012 and thereafter;
- Operating and other income - The operating income included in FIBI's financial statements already reflect the effect of the sale of the operations of the provident and mutual funds. Furthermore, they reflect the effect of the legislation concerning restrictions on banking commissions. The year 2008 recorded an increase of 9.5% in earnings from operating commissions (NIS 1,223 million in 2008 compared to NIS 1,117 million in 2007). Notwithstanding, the decline in gains from investments in shares and in other income (mainly management fees and operating fees from provident and mutual funds) resulted in a decrease in the overall amount of other operating earnings at the rate of 4.8% (from NIS 1,425 million in 2007 to NIS 1,357 million in 2008). Prof. Eden believes that it is reasonable to assume that the rate of growth in operating income will be similar to the rate of growth in income producing assets. For reasons of caution, Prof. Eden assumed that this moderate growth rate embodies the expected growth in operating income derived from the capital market, if and when operations in this market recover;
- Operating expenses - Operating expenses of FIBI in 2008 amounted to NIS 2,635 million compared to NIS 2,338 million in 2007 (an increase of 12.7%, and after eliminating Massad Bank which was consolidated for the first time in the financial statements for 2008, an increase of 6.8%).

  Payroll expenses amounted in 2008 to NIS 1,461 million compared to NIS 1,330 million in 2007 (an increase of 9.8% and after eliminating Massad Bank, an increase of 3.9%). The board of directors of FIBI explains most of the increase as resulting from the losses of the funds deposited in respect of severance pay (NIS 54 million) and from selective raises in wages. In contrast, following the decline in the provision for employee awards a decrease was recorded in the payroll expenses base.

  The board of directors of FIBI notes that since 2008 that bank is conducting the integration of Massad Bank and Otsar Ha'Hayal Bank (which were based on the infrastructure systems of Hapoalim Bank) into the infrastructure systems of FIBI, while upgrading their systems. FIBI estimates the cost of integrating Massad Bank and Otsar Ha'Hayal Bank and upgrading their systems at US$30 million.

  The rate of coverage of operating and other expenses by operating and other income reached 51.5% in 2008 (51.9% after eliminating Massad Bank) in comparison with a rate of 60.9% in 2007. The board of directors of FIBI explains the decrease in the rate of coverage as resulting from the decline in income from provident fund management fees and in dividend income from "Bezeq" which was received in 2007, the decline in gains from the sale of shares and from the provision for impairment of investment in hedge funds. A cover rate of 51.5% is among the worst in the Israel banking industry.

  Prof. Eden assumed that due to the recession expected in 2009 FIBI's payroll expenses will increase by only 1%. Prof. Eden assumed an annual increase in payroll of 3.0% as from 2010.

  The operating and other expenses in 2008 also included the amortization of goodwill on the basis of its useful life in the amount of NIS 42 million – comprising an expense not involving the flow of cash. Prof. Eden eliminated this expense from the basic operating and other expenses and assumed that due to the existence of a fixed component in the other operating expenses, they will increase

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

at the rate of 50% of the annual growth rate of operating and other income as assumed above.

The forecast prepared by Prof. Eden assumes that in 2012 the cover rate will reach 55.3%;

- Taxes on income: The effective tax rate would be higher by 2% in each year than the statutory tax rate applying to banks, due to permanently disallowed expenses. In addition, in view of the cancellation of the Inflationary Adjustments Law, Prof. Eden assumed that the effective tax rate would be higher than the statutory tax rate, due to the inflationary erosion of the shareholders' equity. Prof. Eden assessed this difference by adding the product of multiplying the available capital (which is no longer entitled to protection against inflation) by the expected rate of inflation for the coming periods, to the taxable income of each year.

  The forecasted inflation rate for the coming periods, used for this purpose, is 0% for 2009, 1.5% for 2010, and 2% as from 2011 onwards;
- A fixed in perpetuity rate of growth - Prof. Eden assumed that due to the growth in the GDP, the rate of growth to infinity will be 1.5%. He noted that. to the best of his knowledge, this is the accepted long-term growth rate in Israel used in performing valuations. It should be noted that this growth rate does not in fact assume a per capita growth in the GDP;
- Cost of capital: In his previous valuations, Prof. Eden used discount rates in the range of between 9% and 11%.

  The computation of the discount rate according to the market model results in a discount rate in the range of between 9.8% and 10.85%. Prof. Eden noted that greater caution is to be exercised, when the market model is technically adhered to, in determining the discount rate. This is so, both due to the low level of trading in FIBI shares, and due to the fact that the empiric validity of this model, particularly in periods of crisis, is relatively low. On this basis, Prof. Eden found it proper to assume a price of capital in the range of between 10.5% and 11.5% for the purpose of examining the impairment of the investment in FIBI. Prof. Eden performed sensitivity tests for this valuation in the range of 9.5% and 12.5%. Prof. Eden noted that in his valuation for September 30, 2008, he performed a sensitivity test in the range of 10% and 12.5%. In view of the recent decline in the risk-free interest rate, Prof. Eden found it proper to reduce by 0.5% the lower limit for the sensitivity analysis.

  Prof. Eden further noted that in the valuations he made in the years 2003 to 2006, stated a discount rate in the range of between 9% and 11%.

  An analysis made by UBS Bank, published on February 19, 2009, referring to the four large commercial banks in Israel (Hapoalim Bank, Bank Leumi, Discount Bank and Mizrahi-Tefahot Bank) stated a discount rate of 11.5% for the first three banks and a discount rate of 11% for Mizrahi-Tefahot Bank. A sensitivity analysis was made at a range of one percent above and below the said discount rate.

  In Prof. Eden's opinion such discount rates are inclined upwards and to his best knowledge the valuation of UBS is not acceptable by the banking industry. On such grounds, Prof. Eden found it proper, as stated above, to assume a cost of capital in the range of between 9.5% and 12.5%;

Investment in ICC. The investment in ICC is a strategic investment by FIBI, which is not intended for sale in the coming years. Accordingly, he has included this investment in his valuation on the basis of the value derived from the transaction signed with Mizrahi-Tefahot Bank on November 18, 2008, net of tax at the rate of 21% (assuming that it will not be sold in the next five years).

A special provision. For reasons of caution, Prof. Eden found it proper to include an additional special provision (over and above the provisions included in FIBI's financial statements as at December 31, 2008) in the overall amount of NIS 100 million (net after the tax effect). This provision is intended to cover a possible realization of a loss, which might arise as a result of any of the following factors: possible loss on available for sale securities and in respect of contingent liabilities.

Rights of the minority shareholders. The rights of the minority shareholders represent their share in the equity of subsidiaries of FIBI. The balance as of December 31, 2008, reflects the equity value of the rights of the minority shareholders. Prof. Eden believes that had the fair value of the rights of the minority shareholders been computed using a similar methodology, the effect on the result of the valuation would not have been material, if at all.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

Summary of the assessment results (in terms of December 2002 millions of NIS):

Discount rate	9.5%	10%	10.5%	11%	11.5%	12%	12.5%
Value of Activity	6,743	6,314	5,933	5,593	5,287	5,010	4,759
Investment in ICC	619	619	619	619	619	619	619
Excess liability	(100)	(100)	(100)	(100)	(100)	(100)	(100)
Minority interest	(518)	(518)	(518)	(518)	(518)	(518)	(518)
Value of Shareholders Equity	6,744	6,315	5,934	5,594	5,288	5,011	4,760

As arises from this valuation, the value of FIBI is in the range of NIS 4,760 million and NIS 6,744 million. This overall economic value reflects a capital multiplier ranging from 86.7% to 122.8%.

The value of the investment, computed according to the proportionate share of the Bank in FIBI, is therefore in the range of NIS 1,257 million and NIS 1,780 million.

Prof. Eden noted that the value of the investment is not restricted to the value mentioned above, but has an additional value as a shares parcel, particularly, from the standpoint of a strategic investor in FIBI. Indeed, this value is not readily realizable, but it should not be disregarded, stated Prof. Eden.

An additional sensitivity analysis. Prof. Eden prepared a sensitivity analysis in order to examine the possible impact of changes in the following parameters on the basic result:

A. A change of 0.5% in the assumed rate of growth of income generating assets all along the forecasted period;

B. A change of 0.1% in the assumed rate of the provision for doubtful debts during the whole period of the forecast;

C. A change of 0.02% in the assumed rate of the financial spread during the whole period of the forecast.

	9.50%	10.00%	10.50%	11.00%	11.50%	12.00%	12.50%
The basic result	6,744	6,315	5,934	5,594	5,288	5,011	4,760
A change stemming from a 0.5% decease in the rate of growth of income generating assets	(407)	(380)	(356)	(336)	(317)	(299)	(284)
In %	(6.03%)	(6.01%)	(6.00%)	(6.00%)	(5.99%)	(5.97%)	(5.97%)
An increase of 0.1% in the provision for doubtful debts	(250)	(236)	(222)	(211)	(200)	(190)	(181)
In %	(3.70%)	(3.73%)	(3.74%)	(3.77%)	(3.78%)	(3.80%)	(3.81%)
A decrease of 0.02% in the rate of the financial spread	(272)	(256)	(241)	(229)	(217)	(206)	(197)
In %	4.09%	4.05%	4.06%	4.09%	4.10%	4.12%	4.15%

Conclusion. In view of the above, Prof. Eden reached the conclusion That the recoverable value of the investment of Israel Discount Bank in FIBI is in the range of 96.3% to 108.1% of the stated value of the investment. Accordingly, the value of FIBI is not materially lower, if at all, from its equity value, and therefore, he is of the opinion that in all material respects the Bank is not required to record a provision in its books in respect of its investment in FIBI.

The Bank deliberated the opinion and decided to adopt it.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

Personal interest. Prof. Eden stated in his opinion that he has no personal interest in the shares of Israel Discount Bank or in the shares of FIBI.

(The Bank granted Prof. Eden a letter of indemnification in respect 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).

G. 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.

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.

The total consideration in respect of the shares was NIS 306 million.

H. 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 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).

On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of it holdings in the shares of KFS in consideration for €38.5 million. This amount is to be paid as follows: An amount of €30 million will be paid upon signing the agreement and an amount of €8.5 million is payable at the end of seven years from date of the agreement, without interest. In view of the above, Discount Capital Markets adjusted the value of this investment on its books to the value of the sale consideration. In total, an amount of NIS 85 million was recorded in 2008 in respect of impairment of this investment.

At the same time, DCMI signed an option agreement for the purchase of 5% of the share capital of KFS by way of an issue of shares. The Option is exercisable within six years from date of signing the agreement, at an exercise price of €386 million together with interest of 5% per annum to accumulate as from the third year since the signing of the agreement (subject to adjustments specified in the agreement). The option is exercisable at any time within the said period of six years, unless this period is shortened following the listing for trade of the

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

KFS shares or another event of their sale (as these are specified in the option agreement). If and when DCMI exercises the option, then it will be entitled to rights including a "tag along" right in the case of sale of a controlling interest by Karden and the right to participate in future allotments of shares. The shares of DCMI are also subject to the right of first refusal by Karden, and all subject and in accordance with the terms prescribed in the option agreement.

At this stage, being cautious, the Bank did not take into account, in computing the provision for impairment, the economic value attributed to the option and the matter is to be examined as part of the preparation of the financial statements for the first quarter of 2009, in which the sale will be recognized.

In addition to the above, the Bank has approved a new credit facility to the Karden Group in amounts exceeding the said consideration amount.

I. ACQUISITION OF MEANS OF CONTROL IN ICC.

1. **Acquisition of the ICC shares held by Fishman Store Chains.** 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, by exercising of its right of first refusal, in consideration for NIS 232 million, following fulfillment of all related conditions. 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. FIBI has also exercised its priority right for the purchase of the Fishman Chains shares.

   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 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 May 1, 2007, a transaction was consummated for the acquisition by the Bank and FIBI of ICC`s shares held by Harel (5%) according to their proportionate share in ICC. 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. 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.

J. DETAILS OF INVESTMENT IN AN INITIALLY CONSOLIDATED COMPANY

As part of the steps taken by the Bank for expanding its operations in Switzerland, the Bank completed on June 20, 2008 the transaction for the purchase of the shares of Arzi Bank in Zurich, Switzerland. This bank was purchased in return for CHF41 million (approximately NIS 133 million) and soon thereafter the merger between Arzi Bank and the subsidiary IDB (Suisse) Bank (formerly: Israel Discount Bank (Switzerland) SA) was completed.

Hereunder are details regarding Arzi Bank as of June 30, 2008:

	Unaudited
	in NIS millions
Total assets	135
Cash and bank deposits	83
Securities	20
Credit to the public	30
Deposits of the public	76
Excess of cost over equity value	78

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	2,112	3,574	5,686	1,533	2,390	3,923
Additions	170	545	715	114	448	562
Disposals	(28)	(165)	(193)	(14)	(157)	(171)
Balance as at December 31, 2008	2,254	3,954	6,208	1,633	2,681	4,314
Depreciation						
Balance at beginning of the year	882	2,024	2,906	609	1,173	1,782
Depreciation for the year	47	370	417	28	280	308
Recognized impairment losses	11	-	11	11	-	11
Reversed impairment losses	(3)	-	(3)	(3)	-	(3)
Accumulated depreciation on disposals	(10)	(152)	(162)	(4)	(144)	(148)
Balance as at December 31, 2008	927	2,242	3,169	641	1,309	1,950
Depreciated balance as at December 31,2008	1,327	1,712	3,039	992	1,372	2,364
Depreciated balance as at December 31,2007	1,230	1,550	2,780	924	1,217	2,141
The average depreciation rate in 2008	2.9%	13.9%	9.7%	2.5%	16.3%	10.8%
The average depreciation rate in 2007	3.0%	13.5%	9.2%	2.6%	15.7%	10.1%

* Includes:
- Installations and leasehold improvements, the depreciated balance of which amounted to NIS 134 million - consolidated and to NIS 66 million in the Bank. (2007: NIS 116 million - consolidated; and NIS 54 million - in the Bank).
- Interest capitalized in prior years net of amortization, in the amount of NIS 2 millions (2007: NIS 2 millions).
- Including a provision for decline in value in the amount of NIS 42 million - consolidated and NIS 40 million - in the Bank (2007: NIS 34 million - consolidated and NIS 32 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 33 million (2007: NIS 32 million). The Bank, stand alone: NIS 31 million (2007: NIS 30 million).The Bank and a consolidated subsidiary are the owners of capitalized leasehold rights: Consolidated – NIS 80 million (2007: NIS 86 million). The Bank, stand alone – NIS 53 million (2007: NIS 58 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 479 million (2007: NIS 506 million) on a consolidated basis, and NIS 431 million (2007: NIS 457 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 47 million (2007: NIS 29 million) on a consolidated basis, and NIS 43 million (2007: NIS 24 million) for the Bank.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

E. THE COST OF IN-HOUSE DEVELOPMENT OF COMPUTER SOFTWARE:

	Consolidated		The Bank	
	2008	2007	2008	2007
	in NIS millions			
The cost of software put into operation	1,211	1,112	1,133	1,047
Accumulated depreciation	(568)	*(416)	(516)	*(371)
Undepreciated balance	643	696	617	676
Cost of software not yet in operation	173	129	162	115
Total	816	825	779	791

* Reclassified.

8. OTHER ASSETS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	In NIS millions			
Net deferred tax assets (see Note 29 C)	599	*244	149	*-
Excess advance tax payments over current provisions	134	38	54	-
Excess deposits for severance pay and pensions, over provision (see Note 16 E)	237	491	235	475
Goodwill	272	240	-	-
Issue costs and discount expenses of debentures and subordinated capital notes	25	13	24	12
Income receivable	151	174	64	51
Debit balances of derivative financial instruments	3,407	1,517	3,302	1,414
Surrender value of life assurance policies owned by the Bank and corporate owned life insurance	591	614	-	-
Other debtors and debit balances	488	853	251	490
Total other assets	5,904	4,184	4,079	2,442

* Reclassified.

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	In NIS millions			
Demand deposits	22,009	13,335	13,068	9,706
Time and other deposits	111,542	111,218	84,273	77,671
Savings plan deposits	5,681	5,965	5,000	5,253
Total deposits from the public	139,232	130,518	102,341	92,630

10. DEPOSITS FROM BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	In NIS millions			
Commercial banks:				
Demand deposits	1,157	1,028	312	594
Time deposits	1,078	1,604	1,987	2,049
Acceptances	253	295	150	174
Central banks:				
Schedule deposits	1,969	2,038	-	-
Specialized banking institutions:				
Deposits on demand	16	24	62	67
Schedule deposits	82	83	412	157
Total deposits from banks	4,555	5,072	2,923	3,041

11. DEBENTURES AND SUBORDINATED CAPITAL NOTES

	Average maturity	Internal rate of return(1)	Consolidated December 31		The Bank December 31	
	years(1)	%	2008	2007	2008	2007
			in NIS millions			
Subordinated capital notes convertible into shares:						
In non-inked Israeli currency	5.37	6.57	1,979	867	73	181
In Israeli currency, linked to CPI	4.57	5.01	6,155	5,513	2,276	*2,599
Subordinated capital notes convertible into shares:						
In Israeli currency, linked to CPI(2)			1,239	*1,057	1,239	*1,057
Total subordinated capital notes			9,373	7,437	3,588	3,837

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, 2008.
(2) Subordinated capital notes regarded as "hybrid tier I capital" (see Note 14 5 bellow).

12. OTHER LIABILITIES

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
Net provision for deferred taxes (see Note 29 H)	16	*76	16	*76
Excess current tax provisions over advance payments	51	231	1	123
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16 D,H)	18	5	-	-
Provisions for vacation pay, seniority bonus and retirement benefits	947	969	786	829
Deferred income	210	215	55	61
Credit balances of derivative financial instruments	4,222	1,559	4,005	1,453
Payables for credit card activity	5,570	5,314	2,015	2,106
Provision for doubtful debts in respect of guarantees	185	187	160	155
Accrued expenses	546	825	328	542
Amounts received from realization of Other creditors and credit balances	900	940	425	531
Total other liabilities	12,665	10,321	7,791	5,876

* Reclassified.

13. SHAREHOLDERS' EQUITY

A. THE AUTHORIZED, ISSUED AND PAID-UP NOMINAL SHARE CAPITAL (IN NEW ISRAEL SHEKELS):

	December 31,2008		December 31,2007	
	Authorized	Issued and Fully Paid-Up	Authorized	Issued and Fully Paid-Up
Ordinary "A" Shares of NIS 0.1 par value each	185,000,000	98,063,921	143,000,000	98,063,921
6% Cumulative Preferred Shares, of NIS 0.00504 par value each (equivalent to 10 pounds sterling each)	202	202	202	202
Total	185,000,202	98,064,123	143,000,202	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 3.33, and at the time of liquidation to a distribution in an amount of NIS 55.5. According to generally accepted accounting principles 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 special meeting of shareholders convened on September 22 ,2008 resolved to increase the registered share capital of the Bank by 420 million ordinary A shares of NIS 0.1 par value each, and to amend the Memorandum and Articles accordingly.

The shares derived from the said increases are intended to be issued to investors in subordinate capital notes (series "A") in a total amount of NIS 2 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, 2008, subordinate capital notes in the amount of NIS 1,147 million 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 increases 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 State of Israel permitted the Bank to use 267 million shares out of the balance of shares created by the said increase in capital (approximately 350 million ordinary "A" shares of NIS 0.1 par value each), if required, upon the occurrence of a compulsory conversion event. Accordingly, the balance of the shares (approximately 83 million shares) may be used for additional future issues of subordinated capital notes Series "A", in the amount of NIS 202 million only.

D. EQUITY BASED COMPENSATION TRANSACTIONS - AN OPTION PLAN FOR OFFICERS OF THE BANK

(1) An option plan for officers of the Bank (excluding the Chairman of the Board and President and CEO)

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 part of the plan applying to the Chairman of the Board and to the President and CEO has been suspended, and ultimately, a different plan was approved in respect of these Officers in July 2007.

According to this plan, 10,787,031 stock option warrants would be allotted to ten officers of the Bank, including the Internal Auditor and excluding the Bank's Chairman of the Board and President and CEO (hereinafter in this Note - "Officers").

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 officers, who took office at the Bank on March 1, 2006, as well as to one 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.

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 44 million.

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 48 million. 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.

13. SHAREHOLDERS' EQUITY (CONTINUED)

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 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, ("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.

Ratification of the remuneration plan to officers. In view of 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 G.

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.

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.

13. SHAREHOLDERS' EQUITY (CONTINUED)

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.

(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.

Allotment of option warrants. On August 4, 2006, the Bank allotted to a Trustee on behalf of the 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 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.

13. SHAREHOLDERS' EQUITY (CONTINUED)

The value of the benefit on behalf of the said nine 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 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. Following the retirement of a member of management at the end of January 2009, a proportionate number of option warrants allotted to him have expired (392,256).

In the year ended on December 31, 2008, an amount of NIS 8.5 million were charged in respect of seven officers, as salary expenses as against a capital reserve. (2007: an amount of NIS 8.5 million in respect of seven Officers).

(2) Option plan for the Chairman of the Board and 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 and 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 and 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.

An amount of NIS 6.5 million was recorded as an expense in respect of the said benefit in 2008.

(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).

13. SHAREHOLDERS' EQUITY (CONTINUED)

(3) 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 Audit 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, and that the option price shall be determined in accordance with the said date. The Committee determined 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.

(4) Share based payment of the share option type - quantitative detail summary

a. Share based payment for Officers of the Bank (Consolidated and Bank)

	2008		2007		2006	
Changes in option	Number of Options	Weighted average exercise price[1]	Number of Options	Weighted average exercise price[1]	Number of Options	Weighted average exercise price[1]
Outstanding at beginning of the year	7,452,857	7.34	8,629,624	7.06	-	-
Granted during the year[2]	-	-	-	-	9,806,391	7.02
Lapsed during the year	[3]-	-	1,176,767	6.59	1,176,767	6.52
Outstanding at end of the year[4]	7,452,857	7.42	7,452,857	7.34	8,629,624	7.06

Footnotes:
(1) The exercise price is linked to the last published CPI. The actual exercise price in addition to the linkage increments is subject to adjustments, as detailed above. As of December 31, 2008, the exercise price was adjusted by NIS 0.255 in respect of the dividend distributed during the year.
(2) The weighted average fair value of each option granted during 2006 was NIS 3.97.
(3) Subsequent to balance sheet date, 392,256 options have expired due to the retirement of an officer.
(4) Options outstanding at the end of the year divided by ranges:

	31 December 2008		31 December 2007		31 December 2006	
	Range 1	Range 2	Range 1	Range 2	Range 1	Range 2
Exercise price range (in NIS)	6.76	9.20-9.33	6.71	9.05-9.17	6.52	8.80-8.92
Number of options	5,491,579	1,961,278	5,491,579	1,961,278	6,668,346	1,961,278
Weighted average exercise price (in NIS)	6.76	9.26	6.71	9.11	6.52	8.86
Weighted average contractual life (years)	2.667	2.667	3.667	3.667	4.667	4.667

13. SHAREHOLDERS' EQUITY (CONTINUED)

b. Share based payment for the Chairman of the Board and the President and CEO of the Bank (Consolidated and Bank)

	2008		2007	
	Number	Weighted average exercise price[1]	Number	Weighted average exercise price[1]
Outstanding at beginning of the year	16,180,550	8.51	-	-
Granted during the year[2]	-	-	16,180,550	8.45
Outstanding at end of the year	16,180,550	8.64	16,180,550	8.51

Footnotes:
(1) The exercise price is linked to the last published CPI. The actual exercise price in addition to the linkage increments is subject to adjustments, as detailed above. As of December 31, 2008, the exercise price was adjusted by NIS 0.255 in respect of the dividend distributed during the year.
(2) The weighted average fair value of each option granted during 2007 was NIS 1.93.

E. DIVIDEND

(1) General

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.

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.

(2) Restrictions on the distribution of dividends specified in the Governor's permit for the acquisition and holding of means of control in the Bank

The permit issued by the Governor of the Bank of Israel to the Bronfman-Schran Group to acquire and hold control means in the Bank, specified, among other things, the following restrictions:

(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;
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.

(3) An agreement signed on February 1, 2005, concurrently with the signing of the agreement for the sale of a controlling interest in the

13. SHAREHOLDERS' EQUITY (CONTINUED)

Bank, between the New Federation of Labor, the Representative Committee of Israel Discount Bank Employees and the Accountant General at the Ministry of Finance, which the Bank has joined at a later date, specified, among other things, a restriction according to which 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.

(4) 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.

It should be noted that the Bank's Management decided in February 2009 to defer the date of presenting the proposal for a dividend policy to the Board of Directors to the first quarter of 2010.

(5) Distribution of dividend in 2008

The Special Meeting of Shareholders convened on September 22, 2008, approved of the Bank's Board of Directors' recommendation dated August 31, 2008, for the distribution in cash of a dividend in the amount of NIS 250 million, out of earnings of the years 2007-2008. The dividend was paid on October 23, 2008, to the shareholders that held shares of the Bank as of October 6, 2008 (the determining date). The amount distributed comprises approximately NIS 0.255 per share of NIS 0.1 par value (225%).

On November 3, 2008, the Board of Directors of the Bank resolved to pay on December 30, 2008, an interim dividend of 6% to the holders of the said preferred shares, and to recommend to the annual General Meeting of Shareholders that will convene in 2009 to declare such dividend as final.

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 capital 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 I capital.

The tier III capital includes subordinated capital notes, which comply with characteristics determined in Directives of the Supervisor and

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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 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.

It should be noted that in view of the changes that have occurred in the economic environment in which the Bank operates, against the background of the international financial crisis, and their impact on the Bank's profitability on the one hand and on the fund raising possibilities in the capital market on the other hand, that the Bank was not able to achieve the interim goal set for 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	
	2008	2007
	in NIS millions	
Tier I capital:		
Original tier I capital	8,907	8,908
Hybrid tier I capital	1,223	1,044
Tier II capital:		
Upper Tier II capital[(1)]	256	257
Other Tier II capital	5,065	4,562
Deductions[(2)]	(1,472)	(1,466)
Total capital	13,979	13,305

For footnotes see next page.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

2. WEIGHTED CREDIT RISK BALANCE

	December 31			
	2008		2007	
	Balances	Weighted credit risk	Balances[4]	Weighted credit risk
	in NIS millions			
Credit risk assets				
Cash and deposits with banks	21,554	2,133	19,850	3,493
Securities	31,535	7,066	37,278	7,692
On securities borrowed or purchased under buy-back agreements	25	-	346	-
Credit granted to the public[1][5]	117,129	101,749	102,188	86,132
Credit granted to the government	1,491	20	374	2
Investment in affiliated companies[3][5]	1,783	310	1,930	457
Buildings and equipment	3,039	3,039	2,780	2,780
Other assets	5,904	3,399	*4,184	*2,866
Total assets	182,460	117,716	168,930	103,422
Off-Balance Sheet Instruments	13,179	12,086	*13,804	12,599
Transactions whose balance represents credit risk	11,038	4,337	10,959	3,844
Derivative financial instruments[6]	61	26	56	*26
Other	24,278	16,449	24,819	16,469
Total off-balance sheet instruments	206,738	134,165	193,749	119,891
Total credit risk assets	-	1,916	-	2,126
Market risk	206,738	136,081	193,749	122,017
Total risk assets	206,737	136,081	193,749	122,017

* Reclassified.

Footnotes:

(1) The balance of the general provision for doubtful debts in the amount of NIS 211 million (2007: NIS 211 million) constitutes a part of the upper Tier II and is not deducted from credit to the public.

(2) 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.

(3) 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.

(4) Loans and capital notes presented in the balance sheet under investments in affiliated companies in the amount of NIS 118 million (2007: NIS 77 million) are included in credit to the public.

(5) Including a NIS 16 million (2007: NIS 86 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	
	2008	2007
	Percent	
A. The bank		
Ratio of original tier I capital to credit risk assets	6.5	7.3
Ratio of tier I capital to credit risk assets	7.4	8.1
Ratio of total capital to credit risk assets	10.3	10.9
Ratio of total minimum 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	10.1	9.9
Ratio of total capital to credit risk assets	12.7	13.2
Ratio of total minimum 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	7.2	8.5
Ratio of total capital to credit risk assets	10.8	10.6
Ratio of total minimum capital required by the Supervisor of Banks	9.0	9.0
3. Discount Bancorp Inc.[1]		
Ratio of tier I capital to credit risk assets	9.9	10.0
Ratio of total capital to credit risk assets	12.1	11.0
Ratio of total minimum 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	18.7	13.9
Ratio of total capital to credit risk assets	19.3	14.6
Ratio of total minimum 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 Bancorp 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 (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).

   In 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. In September 2008 Discount Manpikim issued NIS 411 million par value, of subordinate capital notes (series G) and NIS 495 million par value (series H), in accordance with a shelf offer report dated September 9, 2008.

   Amendment of the shelf Prospectus of 2008. On December 24, 2008, Discount Manpikim published an amendment to the shelf Prospectus of February 2008. The amendment added the option for issuance according to the Prospectus of up to NIS 3 billion subordinated capital notes (for each of the series 1-3).

5. **The issue of hybrid tier I capital**

A. Issue of hybrid tier I capital – Series "A"

The issue of hybrid tier I capital in the years 2006-2007. 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 issue of hybrid tier I capital in 2008. Pursuant to the decision of the Board dated September 7, 2008, the Bank issued on September 25, 2008, subordinated capital notes (Series "A"), by way of enlarging of an existing Series, listed for trade per Prospectus dated May 30, 2007, in a par value of approximately NIS 147 million, through a private issue to classified investors (as defined in the Securities Regulations (Offer of Securities to the Public), 2007). The said notes were issued in consideration for NIS 135 million, namely, i.e. at a discount of 14.6% of their adjusted value.

On September 22, 2008, the Supervisor of Banks approved the said capital notes as hybrid capital instruments recognized as part of the Bank's Tier I capital, as defined in Proper Banking Management Directive No. 311 - "The minimum capital ratio", subject to the following conditions:

a. The capital notes are to be issued under terms identical to those of the capital notes issued as part of the existing Series;

b. The rate of the Hybrid Tier I Capital is not to exceed 15% of the Bank's total Tier I capital;

c. The capital notes are not and will not be pledged in favor of the Bank or in favor of its subsidiary companies. The Bank complies with the said conditions.

Additional issues of tier I hybrid capital Series "A". The remainder of the not yet issued subordinated capital notes Series "A" amounted, at December 31, 2008, to NIS 853 million. It should be noted that the balance of the shares remaining in the registered share capital of the Bank, which may be used in the event of a compulsory conversion of capital notes Series "A" (NIS 83 million; see Note 13 C above) may enable additional issues in the amount of approximately NIS 202 million, and each additional issue in excess of the said amount will require the increase of the Bank's registered share capital.

Terms of the subordinated capital notes - Series "A". 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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.

The subordinated capital notes will bear linked interest at the rate of 5.10%. In the event that the capital notes are not prematurely redeemed after fifteen years, they will bear interest at a variable rate, to be determined in advance for each period of five years, with the addition of step-up interest at a rate of 1% over the original spread determined for the first fifteen years (namely 2.495%).

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, 398.5 million ordinary "A" shares of the Bank.

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, 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.

Recognition of the capital notes as upper tier I capital. The Governor of the Bank of Israel approved the Bank's inclusion of the capital notes as upper tier I capital.

Following are the basic conditions for recognition of the capital notes as upper tier I 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

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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;

(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.

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(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 upper 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.

B. Issue of hybrid tier I capital – Series "B"

Issue of hybrid tier I capital in March 2009. In accordance with resolutions of the Board of Directors dated February 9, February 23 and March 25, 2009, The Bank entered into an agreement with Migdal Insurance Company Ltd. (participation in profits), Migdal Insurance Company Ltd. (nostro) and Migdal Makefet Pension Funds and Provident Funds Management Ltd., each of them separately according to its share, for the private placement of NIS 350 million par value of subordinated capital notes (Series "B") of the Bank in a total consideration for NIS 350 million.

On March 26, 2009 the Supervisor of Banks approved the said capital notes as hybrid capital instruments recognized as part of the Bank's Tier I capital, as defined in Proper Banking Management Directive No. 311 - "The minimum capital ratio", subject to the following conditions:

(a) The rate of the Hybrid Tier I Capital is not to exceed 15% of the Bank's total Tier I capital;

(b) The ratio of the original tier I capital is not to fall below 6.5% at any time;

(c) The capital notes are not and will not be pledged in favor of the Bank or in favor of its subsidiary companies.

The Bank complies with the said conditions.

Terms of the subordinated capital notes - Series "B". The principal on the subordinate capital notes 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 shall be entitled to announce, at its own discretion, the early redemption of the principal sum of the subordinated capital notes and of the linkage increments and interest accrued as of date of the actual early redemption, subject to the terms specified in the note, and subject to the prior approval of the Supervisor of Banks.

The subordinated capital notes will, in the period from date of issue and until December 31, 2021 (hereunder: "the first interest period"), carry linked interest at the rate of 8.7%. In the event that an early redemption will not occur on December 31, 2021, then the subordinated capital notes will carry interest at a variable rate to be fixed in advance for each period of five years, with the addition of a "step up" interest of 1% over the original margin fixed for the first interest period (namely, 7.13%)

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, 267 million 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, 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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 terms for recognition of the subordinated capital notes (series "B") as hybrid tier I capital. The basic terms determined by the Supervisor of Banks for the recognition of the subordinated capital notes as upper tier I capital are identical to the terms determined for Series "A" (as detailed in Section A above) with the following changes:

- The definition of "special circumstances" no longer includes the case of six consecutive quarters showing a loss (subsection (6) C).
- The following case was added to the definition of "special circumstances": where the Supervisor has instructed the cancellation of interest payments after realizing that a real danger exists that the interest payment might lead to a situation where the Bank would be unable to meet its obligations.
- Within the framework of the definition of cases where, if realized, an immediate conversion of the outstanding balance of principal and interest of the subordinated capital notes into ordinary "A" shares of the Bank would be effected, the definition of the term relating to the reduction in the proportion of the original tier I capital to below 5% (Section (8) (d)), was changed as follows: in the event that the proportion of the original tier I capital, as stated in the financial statements or in the interim financial statements of the Bank, once in every quarter, fell in a particular quarter below 5%, the said conversion shall be effected immediately.

6. The issue of upper tier II capital

Resolution regarding the issue of upper tier II capital. The Board of Directors, in its meeting of December 17, 2008, resolved to approve the issue of upper tier II capital by way of the issue of subordinated capital notes through Discount Manpikim. As part of the said resolution, the shelf Prospectus of Discount Manpikim has been amended (see above). The raising of the capital, its volume and terms as well as the actual issuance will be determined in accordance with the Bank's needs and with market conditions.

Terms of the subordinated capital notes to serve as upper tier II capital. The subordinated capital notes will be issued for a period of 49 years; the principal sum of the subordinated capital notes will be repayable in one amount on a date to be determined in the first shelf offer report for the relevant series. The principal and interest of the subordinated capital notes are linked to the CPI. Interest on the said subordinated capital notes will be paid four times a year.

The Bank shall be entitled, at its discretion, to prematurely redeem the subordinated capital notes, starting with the end of the period to be announced in the shelf offer report and which in no case shall be shorter than ten years (hereinafter: "the initial period"), subject to the terms specified in the notes and subject to the approval of the Supervisor of Banks.

Until the end of the initial period, the capital notes will bear linked interest to be determined in the tender. In the event that the capital notes are not prematurely redeemed at the end of the initial period, then in the period beginning with the end of the initial period, they will bear interest at a variable rate, to be determined in advance for each period of five years, with the addition of step-up interest at a rate to be determined in the first shelf offer report, as stated.

The rights of the holders of the subordinated capital notes shall be deferred as regards claims by all other creditors of Discount Manpikim and of the Bank of any class, with the exception of holders of capital notes which constitute and/or will constitute from time to time the hybrid tier I capital issued by the Bank.

Terms for the recognition of the subordinated capital notes as upper tier II capital. Below are details of the terms specified by the Supervisor of Banks for the recognition of the subordinated capital notes as upper tier II capital:

1. Capital adequacy at date of issuance – at date of issue of the hybrid capital instrument, the ratio of capital to risk assets of the Bank shall not fall below 10%.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

2. Original tier I capital ratio – the original tier I capital ratio shall not fall at any time below 6.5%.
3. Directive 311 – hybrid tier II capital must comply with the terms determined for hybrid capital instruments as defined in Section "C" (Definitions) of annex "A" to Proper Banking Management Directive 311 – "Minimum capital ratio", included in tier II capital.
4. During the five years prior to the final redemption date, the hybrid capital instruments are to be included in the tier II capital as though they were subordinated capital notes, in accordance with Section 2(b)(2) of annex "A" "to Proper Banking Management Directive 311 – "Minimum capital ratio".
5. Structure of the issue - the issue shall be effected by the Bank or by a subsidiary thereof.
6. A quantitative restriction – the tier II capital may comprise up to 100% of the tier I capital and subordinated capital notes up to 50% of the tier I capital that was not issued in respect of market risk. This means that the upper tier II capital may reach up to 100% of tier I capital, though in actual fact, the potential for the issue of upper tier II capital ranges between the total amount of the tier I capital and the volume of the capital notes.
7. Redeamability – Only capital notes that have been fully paid up in cash may be considered upper tier II capital.
8. Collateral – the liability in accordance with the capital notes may not be secured by collateral.
9. Pledge on capital notes – the capital notes may not be financed and may not be pledged as security for a loan granted by the Bank or a subsidiary thereof.
10. Suspension of interest payments – Interest payments shall not be made if on their due date "suspending circumstances" prevail, as the term is defined below, and the payment thereof shall be deferred for unlimited periods. The suspending circumstances are:
    (a) The Board of Directors of the Bank has determined that the Bank is not able to honor on their due dates its liabilities that have preference over or that are equal to the subordinated capital notes, or where the Bank's independent auditor in his opinion or review report appended to the Bank's financial statements or the interim financial statements, as the case may be, has drawn attention to notes to the financial statements concerning the inability of the Bank to honor its liabilities, as above.
    (b) The Board of Directors of the Bank has determined that reasonable concern exists that the payment of interest will cause a situation where the Bank will not be able to meet its existing and/or expected liabilities, or where the Bank's independent auditor in his opinion or review report appended to the financial statements or the interim financial statements of the Bank, as the case may be, has drawn attention to notes to the financial statements mentioning the existence of such reasonable concern.
    (c) Where according to the financial statements of the Bank last issued prior to the interest payment date, the Bank has no distributable earnings.
    (d) The Supervisor of Banks has ordered the suspension of interest payments after realizing that real concern exists that the payment of interest will cause a situation where the Bank would not be able to meet its liabilities.
11. Settlement of suspended interest payments – if at the date determined for the settlement of whatever interest payment it becomes clear that a change has taken place in the Bank's financial stability in a manner that suspending circumstances, as described in Section 10 above, exist, then payment of such interest would be suspended until such time as one or more of the conditions detailed hereunder exist, and provided that none of the suspending circumstances is still in existence and/or has ceased to exist.
    These are the circumstances where upon the first coming into existence any of which, and subject to a determination by the Board of Directors of the Bank that suspending circumstances no longer exist at that time, the suspended interest payments may be paid together with interest and linkage increments thereon:
    (a) The Bank has declared the payment of dividend to the holders of any class of its shares.
    (b) The Bank has announced a premature redemption, in full or in part, of the principal sum of the subordinated capital notes, or has

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redeemed the principal sum of the subordinated capital notes, in full or in part.

(c) A liquidation order has been issued against the Bank, however in such a case, settlement of the suspended interest payments is subject to the settlement of all the Bank's liabilities that take precedence over the principal and interest of the subordinated capital notes, or subject to another arrangement reached with creditors of the Bank that are preferable to the holders of the subordinated capital notes.

12. Non-payment of dividends – the Bank shall not pay a dividend to its shareholders so long as all the suspended interest payments have not been settled in full, this whether the declaration of the dividend had been made prior to the announcement by the Bank that suspending circumstances emerged or made after such an announcement.
13. Premature redemption by the holder – the holder may not redeem the subordinated capital notes prematurely.
14. Premature redemption by the Bank – subject to restrictions detailed hereunder, the Bank may decide, based upon its judgment with no option to the holders of the subordinated capital notes, to prematurely redeem the principal of the subordinated capital notes, in full or in part, as the case may be, as well as the linkage increments and interest accrued in respect of the subordinated capital notes to date of the actual premature redemption, in respect of the principle of the subordinated capital notes this upon all the following conditions being materialized cumulatively:

    (a) At least ten years have elapsed since the date of issue of the subordinated capital notes and the actual date of premature redemption.

    (b) Premature redemption may only be made after receiving the prior approval of the Supervisor of Banks and on condition that the instrument shall be replaced by other capital of an identical or higher caliber, unless the Supervisor has determined that the capital adequacy of the corporation is adequate in relation to its risks.

    (c) Effecting the premature redemption will not bring about any of the suspending circumstances, as defined in section 10 above, immediately after execution of the resolution for the premature redemption, and the Board of Directors of the Bank has determined that even considering the premature redemption it does not expect suspending circumstances to emerge in the course of the twelve months following the date of the premature redemption.

15. Change in terms, premature redemption and/or determination of an interest mechanism – the capital notes are issued for a period of 49 years.

    The terms of the capital notes may not be altered without the prior approval in writing of the Supervisor of Banks. Without derogating from this provision, and following at least ten years from date of issue (hereinafter: "the initial period"), a step-up of interest is permitted only once in the instrument's life time. The rate of increase in the interest shall not exceed 100 base points less the swap spread between the initial index base of the increased interest and the stepped-up index basis, or – 50% of the initial credit margin less the swap spread between the initial index base and the stepped-up index base.

    Following the end of the initial period and if the subordinated capital notes are not prematurely redeemed at the end of the initial period, the capital notes shall bear interest at a variable rate in accordance with a predetermined and fixed basis to be established by the Trustee for the notes.

16. Subordination – The Bank's obligation for the payment of principal and interest of the capital notes shall be subordinate to all its other liabilities of whatever class, including liabilities towards the holders of subordinated debt notes issued or to be issued in the future by the Bank, and shall only take precedence over the rights of the Bank's shareholders to the reimbursement of the Bank's surplus assets upon liquidation, and over the rights of holders of other securities, the Bank's obligation in respect of which is recognized as tier I capital of the Bank, if and when the Bank will issue such securities. The status of the Bank's obligations, as stated above, shall

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

not be altered as a result of the fact that the capital notes shall no longer be considered tier II capital of the Bank, for whatever reason. The Bank's obligation to pay the principal of the capital notes and the interest thereon stands parri passu with additional securities and/or additional securities that may be issued by the Bank or its subsidiaries and approved by the Supervisor of Banks as "hybrid capital instruments".

17. Allotment to related parties – The Bank shall not allot (to the extent that the matter depends on the Bank upon the initial issue) the hybrid capital notes to provident funds and/or mutual funds controlled and/or managed by the Bank.
18. Transparency – The terms of issue will be clear and disclosed. In this respect, full disclosure shall also be given in the annual financial statements of the Bank issued to the public, to the terms of the hybrid tier II capital. Such disclosure will include, among other thing, the following details regarding the hybrid capital: its amount, composition, its share as a percentage of the total inclusive tier I capital as well as it principal characteristics.

The terms described above are the basic terms for the recognition of the hybrid capital notes as upper tier II capital. Final approval shall be given only after a detailed examination of the Prospectus and terms of issue as detailed by the Bank in a letter to be based on the terms detailed in the letter of the Supervisor of Banks.

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, 2008, of the pledged securities amounts to US$237 million (NIS 900 million) [December 31, 2007 - US$23 million (NIS 89 million)].

In addition, IDB New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US$582 million (NIS 2,214 million) as of December 31, 2008 as a collateral for deposits received from it [as at December 31, 2007 US$327 million (NIS 1,259 million)].

B. IDB New York has sold securities, under buyback terms, in the amount of US$549 million (NIS 2,086 million) as of December 31, 2008 [as at December 31, 2007: US$1,901 million (NIS 7,309 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$ 15 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 discribes 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, 2008, amounted to NIS 44 million (December 31, 2007: NIS 38 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, 2008, was NIS 47 million (2007: NIS 112 million).

15. PLEDGES (CONTINUED)

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 and cash in favor of the Ma'of Clearing House, the amount of which at December 31, 2008, totaled NIS 527 million (December 31, 2007: NIS 616 million).

Mercantile Discount Bank has created a similar pledge in favor of the Ma'of Clearing House. The value of the collateral in favor of the Ma'of Clearing House, as stated, amounted on December 31, 2008, to NIS 129 million (December 31, 2007: NIS 181 million).

Balance of collateral* provided to the Ma'of Clearing House:

	Balance as of December 31, 2008	Highest balance During the year	Average balance in 2008	Balance as of December 31, 2007
	In NIS millions			
Securities	656	656	613	797

* The reporting is made on the basis of the quarter-end balances.

G. 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.

H. Israel Discount Bank (Switzerland) has pledged assets in the amount of CHF 20 million (December 31, 2007: CHF 10 million), as collateral for credit facilities in the amount of US$0.5 million.

I. As detailed in Note 19 C 7 hereunder, in accordance with the requirements of the Articles of the Tel-Aviv Stock Exchange Clearinghouse Ltd. (hereinafter: "the Clearinghouse" or "Stock Exchange") Articles and the bylaws of the Clearinghouse, the Bank 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, 2008, to NIS 106 million (as at December 31, 2007: NIS 61 million). Mercantile Discount Bank has created a similar pledge in favor of the Stock Exchange Clearing House. The value of the collateral as of December 31, 2008, amounted to NIS 8 million (December 31, 2007: NIS 6 million).

15. PLEDGES (CONTINUED)

Balance of collateral* provided to the Stock Exchange Clearing House:

	Balance as of December 31, 2008	Highest balance During the year	Average balance in 2008	Balance as of December 31, 2007
	In NIS millions			
Securities	114	114	87	67

* The reporting is made on the basis of the quarter-end balances.

J. 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, 2008, at NIS 6 billion (December 31, 2007: 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 570 million (December 31, 2007: NIS 549 million).

K. 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).

	Balance as of December 31, 2008	Highest balance During the year	Average balance in 2008	Balance as of December 31, 2007
	In NIS millions			
Pledged securities (market value)	6,475	8,006	6,441	5,495
Deposits with the Bank of Israel	7,714	7,724	1,972	1,901
Deposits by the Bank of Israel	-	4,222	585	-

* The report is based on outstanding quarterly balances.

L. 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, 2008, the Bank allocated in favor of foreign banks deposits in a total amount of NIS 798 million (December 31, 2007: NIS 17.5 million).

15. PLEDGES (CONTINUED)

M. The Bank deposits bonds with foreign brokers (in the United States) as security for option transactions performed by its customers by means of these brokers. The value of such security at December 31, 2008 amounted to NIS 85 million (December 31, 2007: NIS 91 million).

N. The sources of the securities that had been received and which the Bank is entitled to sell or pledge, at their fair value, before setoffs effect:

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
Securities against cash	22	341	22	341
Total	22	341	22	341
The use of securities that had been received as collateral and securities of the Bank, at their fair value, before setoffs effects:				
Securities against cash	22	341	22	341
Total	22	341	22	341

O. Details of securities pledged to the lenders:

Trading Securities	673	416	673	416
Available for sale securities	10,157	13,203	5,923	5,758
Held-to-maturity securities	245	1,841	-	-
Total (as stated in the balance sheet)	11,075	15,460	6,596	6,173

These securities have been deposited as collateral with the lenders, who are not permitted to sell or pledge them

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 2007. The financial statements include provisions for long-service bonuses totaling: Consolidated - NIS 380 million (2007: NIS 454 million); the Bank - NIS 313 million (2007: NIS 392 million).

16. EMPLOYEE BENEFITS (CONTINUED)

An agreement with the representatives of the employees was signed in November 2007, regarding the redemption in cash of "Jubilee vacation" days. The agreement provided 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 146 million (2007: NIS 141 million); and for the Bank - NIS 116 million (2007: NIS 113 million).

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 421 million (2007: NIS 374 million); the Bank - NIS 357 million (2007: NIS 324 million).

D. THE PROVISION AND DEPOISTS FOR EMPLOYEES' SEVERANCE PAY ARE AS FOLLOWS:

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
Deposits	2,142	2,286	1,896	2,024
Provisions	1,915	1,812	1,661	1,549
Excess of deposit over provision	227	474	235	475
The excess (shortage) of amounts deposited over the provision is included in the item:				
Other assets (Note 8)	237	479	235	475
Other liabilities (Note 12)	(10)	(5)	-	-
Total, Net	227	474	235	475

The Bank and its subsidiaries are not permitted to withdraw these deposits except for the purpose of making severance payments.

E. In the years 2006-2008, 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 senior employees of a certain subsidiary and of a subsidiary company of that subsidiary are entitled to remuneration within the framework of a plan which is subject to certain conditions precedent that, at date of this report have not yet materialized.

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

16. EMPLOYEE BENEFITS (CONTINUED)

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 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 2008. In March 2008, the Board of Directors approved an award plan to employees and managers of the Bank for 2008. The budget for the plan would be determined according to grades determined in the plan on the basis of the annual return to capital of earnings from ordinary operations. 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.

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 (in US$ millions):

	As at December 31	
	2008	2007
The actual liability for pension payments	25	27
Fair value of the pension fund assets	15	22
The actuarial liability for pension payments, net of marketvalue of the Fund's assets	(10)	(5)
Balance of the deferred actual loss	8	8
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)	2	-
Pension payment expenses recognized in the income statement	7	(3)
The assumptions used for the measurement of the components of the pension plan:		

	%	%
The annual discount rate	6.26	6.37
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. An agreement signed on February 1, 2005, concurrently with the signing of the agreement for the sale of a controlling interest in the Bank, between the New Federation of Labor, the Representative Committee of Israel Discount Bank Employees and the Accountant General at the Ministry of Finance, which the Bank has joined at a later date, specified, among other things, that 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.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS

CONSOLIDATED

	December 31 2008						
	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	9,289	970	6,904	1,887	2,504	-	21,554
Securities	8,206	3,527	16,866	1,384	185	1,367	31,535
Securities borrowed or purchased under resale agreements	25	-	-	-	-	-	25
Credit granted to the public	56,364	21,016	29,526	6,203	3,691	-	116,800
Credit granted to the Government	10	1,461	20	-	-	-	1,491
Investments in affiliated companies	57	48	-	11	-	1,784	1,900
Buildings and equipment	-	-	-	-	-	3,039	3,039
Other assets	2,400	39	2,093	231	676	465	5,904
Total assets	76,351	27,061	55,409	9,716	7,056	6,655	182,248
Liabilities							
Deposits from the public	64,770	12,516	47,480	10,540	3,926	-	139,232
Deposits from banks	1,308	516	2,587	101	43	-	4,555
Deposits from the Government	138	27	41	-	-	-	206
Securities loaned or sold under buy-back arrangements	-	-	7,194	-	-	-	7,194
Subordinated capital notes	1,979	7,394	-	-	-	-	9,373
Other liabilities	8,902	418	1,826	402	936	181	12,665
Total liabilities	77,097	20,871	59,128	11,043	4,905	181	173,225
Difference	(746)	6,190	(3,719)	(1,327)	2,151	6,474	9,023
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	3,859	(5,423)	2,726	1,177	(2,339)	-	-
Options in the money, net (in terms of underlying asset)	72	262	(427)	94	(1)	-	-
Options out of the money, net (in terms of underlying asset)	122	2	(113)	(9)	(2)	-	-
Total	3,307	1,031	(1,533)	(65)	(191)	6,474	9,023
Options in the money, net (discounted par value)	344	481	(933)	109	(1)	-	-
Options out of the money, net (discounted par value)	524	4	(525)	(6)	3	-	-

Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)

CONSOLIDATED (CONTINUED)

	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	5,465	1,102	6,628	4,670	1,985	-	19,850
Securities	13,580	2,685	17,736	1,319	185	1,773	37,278
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	*1,369	30	1,789	314	241	441	4,184
Total assets	68,888	22,853	53,363	10,037	6,653	6,925	168,719
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	*8,559	214	853	206	265	*224	10,321
Total liabilities	65,644	18,882	60,862	10,399	3,357	224	159,368
Difference	3,244	3,971	(7,499)	(362)	3,296	6,701	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 underlying asset)	150	-	33	(183)	-	-	-
Options out of the money, net (in terms of underlying asset)	179	2	(118)	(62)	(1)	-	-
Total	3,857	907	(2,095)	(11)	(8)	6,701	9,351
Options in the money, net (discounted par value)	529	-	(312)	(217)	-	-	-
Options out of the money, net (discounted par value)	961	179	(1,004)	(141)	4	1	-

* Reclassified.
Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

BANK

	December 31, 2008						
	Israeli currency		Foreign currency[1]			Non-monetary Items	Total
	Non-linked	Linked to the CPI	In US$	In EURO	In other currencies		
	NIS millions						
Assets							
Cash and deposits with banks	9,844	9,267	3,926	1,231	1,862	-	26,130
Securities	7,675	2,084	1,592	1,312	16	569	13,248
Securities borrowed or purchased under resale agreements	25	-	-	-	-	-	25
Credit granted to the public	39,285	7,614	13,288	5,770	3,326	-	69,283
Credit granted to Governments	-	1,461	-	-	-	-	1,461
Investments in affiliated companies	723	481	286	-	-	7,488	8,978
Buildings and equipment	-	-	-	-	-	2,364	2,364
Other assets	2,177	33	881	217	663	108	4,079
Total assets	59,729	20,940	19,973	8,530	5,867	10,529	125,568
Liabilities							
Deposits from the public	55,330	11,658	23,181	9,036	3,136	-	102,341
Deposits from banks	1,229	179	1,185	236	94	-	2,923
Deposits from the Government	101	27	-	-	-	-	128
Subordinated capital notes	73	3,515	-	-	-	-	3,588
Other liabilities	4,957	340	1,303	326	805	60	7,791
Total liabilities	61,690	15,719	25,669	9,598	4,035	60	116,771
Difference	(1,961)	5,221	(5,696)	(1,068)	1,832	10,469	8,797
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	3,666	(4,927)	2,561	901	(2,201)	-	-
Options in the money, net (in terms of underlying asset)	169	262	(518)	88	(1)	-	-
Options out of the money, net (in terms of underlying asset)	118	2	(108)	(10)	(2)	-	-
Total	1,992	558	(3,761)	(89)	(372)	10,469	8,797
Options in the money, net (discounted par value)	239	481	(844)	125	(1)	-	-
Options out of the money, net (discounted par value)	505	4	(501)	(11)	3	-	-

Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

BANK (CONTINUED)

	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		
	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 Governments	-	363	0	-	-	-	363
Investments in affiliated companies	5	626	58	-	-	7,291	7,980
Buildings and equipment	-	-	-	-	-	2,141	2,141
Other assets	*1,112	22	685	289	225	109	2,442
Total assets	53,570	16,801	18,535	9,334	5,763	10,622	114,625
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	*4,908	182	328	148	223	87	5,876
Total liabilities	51,451	13,822	27,871	9,417	2,773	87	105,421
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 underlying asset)	200	-	(25)	(175)	-	-	-
Options out of the money, net (in terms of underlying asset)	179	2	(118)	(62)	(1)	-	-
Total	2,728	268	(4,258)	16	(85)	10,535	9,204
Options in the money, net (discounted par value)	313	-	(118)	(195)	-	-	-
Options out of the money, net (discounted par value)	935	179	(988)	(126)	-	-	-

*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, 2008

	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	25,361	11,411	10,617	8,500
Liabilities	37,459	8,827	22,712	3,784
Difference	(12,098)	2,584	(12,095)	4,716
Derivative instruments (excluding options)	1,095	1,183	598	781
Options (in terms of underlying assets)	(133)	25	86	7
Israeli currency, CPI-linked:				
Assets	455	537	3,267	4,654
Liabilities	641	615	2,037	3,999
Difference	(186)	(78)	1,230	655
Derivative instruments (excluding options)	(131)	(57)	(955)	(741)
Options (in terms of underlying assets)	-	-	-	-
Foreign currency-local activity[3]:				
Assets	8,093	6,232	4,525	2,456
Liabilities	21,471	11,038	5,037	248
Difference	(13,378)	(4,806)	(512)	2,208
Derivative instruments (excluding options)	(1,108)	(1,296)	312	(147)
Options (in terms of underlying assets)	133	(25)	(86)	(7)
Foreign currency-foreign activity of extensions:				
Assets	13,332	2,956	5,623	3,685
Liabilities	13,992	6,979	4,201	1,409
Difference	(660)	(4,023)	1,422	2,276
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Options (in terms of underlying assets)	-	-	-	-
Total:				
Assets	47,241	21,136	24,032	19,295
Liabilities	73,563	27,459	33,987	9,440
Difference	(26,322)	(6,323)	(9,955)	9,855
Derivative instruments (excluding options)	(144)	(170)	(45)	(107)
Options (in terms of underlying assets)	-	-	-	-

Footnotes:
(1) This Note presents the anticipated future contractual cash flows in respect of assetes 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 2,145 million (2007: NIS 2,046 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	Over 20 years	Total cash flows	No fixed maturity date[2]	Total
7,192	2,315	2,416	6,412	3,145	287	77,656	3,388	76,351
508	302	243	2,183	592	15	76,625	118	77,097
6,684	2,013	2,173	4,229	2,553	272	1,031	3,270	(746)
69	(13)	44	146	27	-	3,930	-	3,859
8	(96)	17	92	188	-	194	-	194
3,380	3,214	2,243	9,900	5,733	888	34,271	144	27,061
3,243	2,490	2,423	6,862	1,920	2	24,232	83	20,871
137	724	(180)	3,038	3,813	886	10,039	61	6,190
(504)	(630)	(788)	(2,398)	(798)	-	(7,002)	-	(5,423)
262	-	-	2	-	-	264	-	264
1,659	1,725	2,797	3,790	413	-	31,690	978	30,860
162	107	32	74	51	-	38,220	26	40,476
1,497	1,618	2,765	3,716	362	-	(6,530)	952	(9,616)
401	611	690	2,120	672	-	2,255	-	1,564
(270)	96	(17)	(94)	(188)	-	(458)	-	(458)
1,721	1,182	1,053	5,040	8,703	15,019	58,314	1,064	41,320
1,687	1,735	2,317	4,651	-	-	36,971	67	34,600
34	(553)	(1,264)	389	8,703	15,019	21,343	997	6,720
-	-	-	-	-	-	-	6,656	6,656
-	-	-	-	-	-	-	181	181
-	-	-	-	-	-	-	6,475	6,475
-	-	-	-	-	-	-	-	-
13,952	8,436	8,509	25,142	17,994	16,194	201,931	12,230	182,248
5,600	4,634	5,015	13,770	2,563	17	176,048	475	173,225
8,352	3,802	3,494	11,372	15,431	16,177	25,883	11,755	9,023
(34)	(32)	(54)	(132)	(99)	-	(817)	-	-
-	-	-	-	-	-	-	-	-

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS(1) (CONTINUED)

CONSOLIDATED (IN NIS MILLIONS)

B. Balance Sheet Amount at 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
Total:				
Assets	*50,974	20,090	18,830	16,154
Liabilities	*72,005	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 assetes 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 2,145 million (2007: NIS 2,046 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	Over 20 years	Total cash flows	No fixed maturity date[2]	Total
	13,113	10,049	6,900	20,840	18,006	11,872	186,828	11,345	168,719
	3,950	3,663	4,138	11,020	3,345	111	165,265	454	159,368
	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)

THE BANK (IN NIS MILLIONS)

A. Anticipated Future Contractual Cash Flows as of December 31, 2008

	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	19,780	7,305	7,330	7,056
Liabilities	29,893	6,039	18,590	3,367
Difference	(10,113)	1,266	(11,260)	3,689
Derivative instruments (excluding options)	972	1,169	566	782
Options (in terms of base assets)	(111)	85	134	100
Israeli currency, CPI-linked:				
Assets	346	485	2,498	3,489
Liabilities	305	451	1,165	2,801
Difference	41	34	1,333	688
Derivative instruments (excluding options)	(31)	(37)	(955)	(721)
Options (in terms of base assets)	-	-	-	-
Foreign currency-local activity[3]:				
Assets	7,052	5,741	4,782	2,497
Liabilities	19,433	10,278	4,626	167
Difference	(12,381)	(4,537)	156	2,330
Derivative instruments (excluding options)	(1,080)	(1,281)	348	(158)
Options (in terms of base assets)	111	(85)	(134)	(100)
Foreign currency-foreign activity of extensions:				
Assets	1,740	297	1,067	968
Liabilities	1,838	238	208	-
Difference	(98)	59	859	968
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Total:				
Assets	28,918	13,828	15,677	14,010
Liabilities	51,469	17,006	24,589	6,335
Difference	(22,551)	(3,178)	(8,912)	7,675
Derivative instruments (excluding options)	(139)	(149)	(41)	(97)
Options (in terms of base assets)	-	-	-	-

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 1,235 million (2007: NIS 1,347 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	Over 20 years	Total cash flows	No fixed maturity date[2]	Total
6,015	1,910	2,908	5,879	2,666	234	61,083	2,704	59,729
382	243	237	2,198	436	16	61,401	118	61,690
5,633	1,667	2,671	3,681	2,230	218	(318)	2,586	(1,961)
69	(16)	43	136	1	-	3,722	-	3,666
43	24	4	7	1	-	287	-	287
2,652	2,573	1,668	8,506	2,836	799	25,852	99	20,940
2,525	1,997	1,591	5,791	2,080	-	18,706	83	15,719
127	576	77	2,715	756	799	7,146	16	5,221
(484)	(610)	(768)	(2,297)	(328)	-	(6,231)	-	(4,927)
262	-	-	2	-	-	264	-	264
1,566	1,671	2,721	3,802	228	-	30,060	941	29,866
93	88	22	42	1	-	34,750	26	36,990
1,473	1,583	2,699	3,760	227	-	(4,690)	915	(7,124)
390	599	678	2,045	320	-	1,861	-	1,261
(305)	(24)	(4)	(9)	(1)	-	(551)	-	(551)
214	75	65	-	-	-	4,426	103	4,503
-	-	-	-	-	-	2,284	19	2,312
214	75	65	-	-	-	2,142	84	2,191
-	-	-	-	-	-	-	10,530	10,530
-	-	-	-	-	-	-	60	60
-	-	-	-	-	-	-	10,470	10,470
10,447	6,229	7,362	18,187	5,730	1,033	121,421	14,377	125,568
3,000	2,328	1,850	8,031	2,517	16	117,141	306	116,771
7,447	3,901	5,512	10,156	3,213	1,017	4,280	14,071	8,797
(25)	(27)	(47)	(116)	(7)	-	(648)	-	-
-	-	-	-	-	-	-	-	-

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, 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
Total:				
Assets	*34,188	12,933	11,641	11,319
Liabilities	*47,476	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 1,235 million (2007: NIS 1,347 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	Over 20 years	Total cash flows	No fixed maturity date[2]	Total
	9,435	7,925	4,795	13,667	4,360	565	110,828	14,165	114,625
	1,796	2,033	2,153	6,145	3,139	115	108,045	388	105,421
	7,639	5,892	2,642	7,522	1,221	450	2,783	13,777	9,204
	(60)	(20)	(32)	(54)	(5)	-	(130)	-	-

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	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	1,417	1,421	714	562
Credit guarantees	2,928	*2,889	1,833	1,473
Guarantees for home purchasers	3,644	*3,143	2,219	1,947
Other guarantees and obligations[3]	4,946	4,339	4,249	3,764
Unutilized credit line for credit cards	16,508	*14,827	9,410	8,832
Unutilized revolving and other credit lines	9,943	*8,535	8,943	*7,579
Irrevocable commitments to extend credit approved but not yet granted	18,101	*21,884	13,638	*13,793
Commitment to issue guarantees	4,524	*4,437	2,854	*3,369
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	855	262	818	216
Israeli currency - linked to the CPI	1,924	2,075	21	27
Foreign currency	476	736	476	736
Total	3,526	3,073	1,316	979

* Reclassified (See Note 1Z).

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 131 million (2007:NIS 169 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 31,2008							2007
	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	16	27	24	50	32	1	150	170
Expected future flows based on Management's estimates of early repayments	16	26	21	37	20	-	120	142
Discounted expected future flows based on Management's estimates of early repayments[2]	15	24	19	30	13	-	101	114

3. Information as to the granting of loans during the year by the mortgage banks:

	31.12.2008	31.12.2007
Loans out of deposits repayable according to the repayment of loans	41	65
Standing loans	-	1

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 totl amounts repayable according to collection of loans granted therefrom.
(2) Discounted at the rate of 3.16% (2007: 3.58%).

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2008	2007	2008	2007
	in NIS millions			
1. Long-term lease contracts - rent payable in future years[1]:				
First year	81	87	46	47
Second year	72	79	39	42
Third year	62	65	30	32
Fourth year	53	54	24	22
Fifth year	35	80	15	17
Sixth year and thereafter	148	133	27	26
Total	451	498	180	186
2. Commitment to acquire buildings and equipment	32	44	25	29

Footnote:
(1) For details as to long-term lease agreement, see section 18 hereunder.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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, 2008, amounts to NIS 44 million, comprising 6.3% 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 F). Each of the banks is also committed to pay the Ma'of Clearing House any monetary charge that may result from its operations and from the 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. Furthermore, each member is also responsible for his share of the Risk Fund, established for this purpose, based on the clearing ratio of turnovers of the members. 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 I).

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 not to be fall below US$5 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, 2011.

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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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.

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 indemniy 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) Discount Manpikim Ltd. granted in February 2009 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 the issue of subordinated capital notes in accordance with the amended a shelf prospectus dated December 24, 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 3 billion.

h) Concurrently with approval of the engagement in an agreement for the sale of the provident fund management activity, as stated in Note 6 E 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.

i) For details as to the indemnification granted to the purchasers of the operations of the provident funds, see Note 6 E above.

(j) The agreement for the sale of the Ilanot-Discount shares, specified indemnification arrangements to be provided by the Bank in respect of a claim or demand that may be submitted during the seven years following the date of consummation of the transaction (June 18, 2008) against Ilanot-Discount the purchaser or officers thereof, on grounds of acts of omission or commission by the Bank, Ilanot-Discount

or its officers, performed in the period prior to the said consummation date, in respect of which no provisions had been included in the financial statements of Ilanot-Discount for the year 2005. The indemnification in respect of matters relating to claims by employees or by officers regarding taxes, levies or other obligatory payments will be in full. The indemnification with respect to other matters will be at the rate of 50% and will be limited to a cumulative charge in excess of US$1 million. In any event, the cumulative amount of the indemnification shall not exceed the overall consideration for the transaction with the addition of interest and linkage increments.

k) **Responsibility Insurance of Officers.** On May 22, 2008 a 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, 2008 through March 31, 2009, 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. The Bank's part (not including the subsidiaries) in the said 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.

l) **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 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 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

Management Regulations;

(2) Realization of the indemnification will not impair the required original 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. In November 2008, the Bank signed a guarantee, unlimited in amount, in favor of the VISA Europe organization, securing all liabilities of ICC, applying due to the status of ICC as a member of the VISA Europe organization, this in relation to the transactions of VISA connected to the operations of ICC both in Israel and abroad.

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 275 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 evide nce 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 (Service to customer), 1981, were submitted 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.

On January 15, 2009, the Court approved the Plaintiffs' withdrawal of their motion to approve the suit as a class action suit, thereby the action was terminated.

See section 14.4 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 May 10, 2009.

14.4 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 (Service to customer) 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

prospectus and fraudulently manipulating the price of the shares), violating the Banking Laws (Banking Rules (Service to customer) [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 petition for a class action against the Bank and Mercantile Discount Bank together is NIS 500 million.

On January 15, 2009, the Court approved the Plaintiffs' withdrawal of their motion to approve the suit as a class action suit, thereby the action was terminated.

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.

14.5 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 plaintff'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 by the plaintiff and others already in 2000 was dismissed in limine with the consent of the company's Liquidator, and that the proceedings instituted in the USA by the plaintiff several years ago with respect to the issue which is the subject of the claim, had been dismissed by the Court in New York, following the admittance of the Bank's argument regarding improper forum.

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. On February 10, 2009, the Federal Court in the United States held an oral hearing of the appeal submitted by the plaintiff. A ruling in the matter has not yet been given by the Court.

14.6 Request to approve an action against Discount Mortgage Bank ("DMB") as a class action suit:

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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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.

14.7 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 B.M. ("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, there being a prohibited binding arrangement, and under the Banking Law (Service to customer), 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 nonlinked 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 Restrictive Trade Practices 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 Authority dated May 20, 2007, which had been attached by the Plaintiff to the material presented to the Court.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

On March 19, 2008, the Bank received a summons for a hearing before the Authority, in connection with the said investigation. The summons states that in view of the findings of the investigation by the Authority, the Commissioner of Restrictive Trade Practices (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, interalia, to relate in arriving at her determination, and the Bank was given the opportunity to present its position to her in writing before the Commissioner decides whether to act on her authority as above stated. In September 2008, the Bank submitted its position as part of the hearing, in which it discussed extensively the factual and legal reasons indicating that under the circumstances of the case, the Commissioner has no grounds to act on her authority and determine that a cartel had in fact existed.

On April 9, 2008, the Plaintiff appealed the decision of the District Court to dismiss the motion of the Plaintiff for approval of the lawsuit as a class action suit, also on grounds of prevention of harm to the customer under the Banking Law, as well as the District Court's ruling that the Plaintiff does not have a personal cause of action against Bank Hapoalim. On April 15, 2008, the banks applied to the Supreme Court for permission to appeal the decision of the District Court. On May 29, 2008, the Supreme Court ruled that the Attorney General to the Government of Israel should consider joining the proceedings. On July 26, 2008, the Attorney General informed of his decision to join the proceedings, and a date has been fixed for submitting his position in writing as regards the proceedings. On November 16, 2008, the plaintiff submitted, its response to the Bank's motion requesting permission to appeal. At the request of the Attorney General of the Government, the Court has granted an extension for the submission of his response until March 31, 2009.

The hearing of the request for approval of the appeal was suspended by the District Court until a ruling is given by the Supreme Court in the request for permission to appeal.

14.8 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 clame 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 since the claim is not a claim relating to a matter between a banking corporation and a customer, as required by the Class Action Law, 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

On March 23, 2008 the Bank applied for permission to appeal to the Supreme Court against the decision of the District Court.

The hearing of the motion for permission to appeal filed by the Bank has been fixed by the Supreme Court for January 4, 2010. A preliminary hearing at the District Court was fixed for November 12, 2009.

14.9 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 BM and Bank Leumi Le Israel BM ("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 (Service to customer) 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 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 14.7 above. On May 15, 2008, the Court decided to stay the proceedings until a ruling is given in the appeal filed by the banks with respect to the said action.

On June 17, 2008 the Plaintiffs requested permission to appeal against the Courts decision to stay the proceedings.

On July 7, 2008 the Supreme Court rejected the request for permission to appeal filed by the Claimants.

14.10 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 (Service to customer), 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 not responded yet to the motion for approval of a Class Action Suit. A date for a hearing has not yet been fixed.

14.11 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 preliminary discussion was fixed for April 22, 2009.

In the opinion of the Bank's Management, the claim is most excessive.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

14.12 On May 29, 2008, a motion for approval of an action as a class action suit was filed against Bank Leumi, Israel Discount Bank, Mercantile Discount Bank and the First International Bank. The Plaintiffs claim that foreign currency transferred to the defendant banks by way of bank transfers of checks from abroad are being credited to the accounts of the customers only several business days after the money has left the account of the transferor.

The Plaintiffs argue that the damage caused is a loss of interest or a charge of interest in case the customer's account is in debit. The cause of action is misrepresentation based on the non-disclosure of the delay in crediting customers' accounts, the unlawful creation of wealth, violation of an enacted duty (Section 26 of the Banking Rules) (Customer Service)), violation of the duties of the banks as delegates, causing harm to the property of the Plaintiffs in violation of the basic law regarding human dignity and liberty of a person and the violation of an agreement between the bank and its customers.

The plaintiff group includes all bank customers that transferred money from abroad and the date on which their accounts were credited was one day later then the date on which the transfer was debited to the transferor's account. The personal damage is estimated by the Plaintiffs at NIS 2 for each plaintiff. Due to lack of information the amount of the action against all the banks involved was set at NIS 115 million.

The relief requested is indemnification of the damage caused to the customers during the past seven years, as well as an order prohibiting the banks to act as hitherto. The Bank submitted its response on October 22, 2008.

On January 19, 2009, the Court approved the withdrawal by the Plaintiffs of their motion to approve the suit as a class action suit, thereby the action was terminated.

14.13 Two motions for approval of an action as a class action suit were submitted on August 4, 2008 to the Jerusalem District Court, one against the Bank, Discount Gemel Ltd. (hereinafter: "the Manager") and the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance (hereinafter: "the Commissioner"), and the other against the Bank, Bank Leumi Le'Israel BM, KAHAL - Employee Training Funds Management (1996) Ltd. (hereinafter: "the Manager") and the Commissioner.

The Plaintiffs claim that they were members of the provident funds managed by the Managers as well having current accounts at the Bank. According to the Plaintiffs, the banks unlawfully took possession of the consideration monies received in respect of the "transfer of control over the assets of the provident funds, the management thereof and trusteeship thereon", this instead of passing on the consideration to the members of the provident funds proportionally to their share in the assets of the provident funds, the consideration monies being the profit generated by the assets of the funds.

As argued by the Plaintiffs, the Control over Financial Services (Provident Funds) Law, 2005 (hereinafter: "the Provident Funds Law") and the Investment in Mutual Trusts Law, 1994 (hereinafter: "the Mutual Trust Law") entitle the management company only to the reimbursement of expenses and to management fees and it is not entitled to any other benefit. Therefore, the Bank has no right to the consideration received and no share therein, and it should have transferred it to the provident funds for the benefit of their members.

The Plaintiffs claim that the Managers violated their fiduciary duty towards the members in that they did not protect the assets of the provident funds nor the rights derived there from, and that the Bank violated its fiduciary duty towards the members, as everything it had received derived from it being the owner of the Manager and no right may be created to the Bank which did not belong to the Manager.

It was further argued that the Bank and the Manager unlawfully created wealth for themselves, violated the increased fiduciary duty they have towards the provident funds and their members, violated enacted duties under the Contract Law, the Delegation Law, the Fiduciary Law, the Banking (Licensing) Law, the Mutual Trust Law and the Provident Funds Law.

The amount of damages claimed is the amount of the consideration received in each of the transactions. The damages are attributed both to the Bank that received the consideration, unlawfully as alleged by the Plaintiffs, and to the Manager. Accordingly, the amount of damages claimed in one of the actions is NIS 607 million and in the other action (relating to the Bank and Bank Leumi) NIS 260 million.

The principal relief requested is to order the Defendants to transfer the consideration to the provident funds in favor of their members and

to order the Defendants to pay damages to the members of the provident funds as the Court sees fit. The Court is also motioned to issue various declaratory relief relating to the conduct of the Bank and the Manager. The Bank filed its response on February 12, 2009.

14.14 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, and the Bank estimates that the maximum exposure as of date of submission of the claim does not exceed NIS 60 million. The Bank submitted on April 3, 2008, its response to the motion.

On October 12, 2008, a motion was filed for the dismissal of the request for approval of a class action suit on grounds that it is not possible to approve within the framework of a request for approval of a class action suit five different class actions that do not raise common issues. The Court decided that the parties complete their arguments in writing, following which a ruling shall be given. On December 9, 2008, the Court admitted the Bank's request and ordered the removal of four of the five causes in respect of which the Court had been motioned to approve the action as a class action suit. The Plaintiff had split the claim in a manner that five separate claims have been filed in respect of the causes described above.

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 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. The Court has not yet heard the Bank's motions mentioned above. On September

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

12, 2008, the District Court dismissed the Bank's motion requesting the Court to rule that the claim against it had expired. On November 16, 2008, the Bank applied for permission to appeal the said decision at the Supreme Court. The District Court has not yet ruled on the request for amendment of the claim as described above.

15.2 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.

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 14.6 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 case was transferred for hearing at the District Court of the Central Region.

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.

15.3 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.

DCMI denied the accusations. On May 18, 2006, the court decided, amoung other things, to acquit DCMI and its two former employees from the charges brought against them.

On June 26, 2006, the State Attourney placed an appeal against this verdict.

On January 21, 2009, the oral argumentation in front of the Appeal Court was completed. A decision in the appeal has not yet been given.

15.4 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 or Americans 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 U.S. 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 U.S. 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.

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 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 filed a motion for an in limine dismissal with respect to the said third party notices.

In a hearing of December 5, 2008, the parties completed their oral argumentation. The Court has not yet given a decision on the motions.

At this preliminary stage, in view of the fact that the motion for an in limine dismissal of the action has not yet been heard, there is no decision as yet regarding the procedure for the hearing of the case, if at all, and that documents and evidential matter has not yet been exchanged between the parties as part of preliminary disclosure procedures, and due to the fact that at this stage the amount of the action is not clear, it is not possible to assess the Bank's exposure.

15.5 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. On April 9, 2008, the Bank submitted its response to the motion for exemption from Court fees. The continued hearing of the motion for exemption from Court fees was fixed for October 13, 2009.

At this early stage, prior to the ruling in the motion for exemption from Court fees, it is not possible to assess the prospects of the action.

15.6 On June 30, 2008, a motion for the approval of an action as a class action suit against the Bank, Bank Hapoalim and Bank Leumi, was submitted to the Tel Aviv District Court. The core issue of the suit rests on the Plaintiffs' claim that, since the end of the 1990's and possibly even earlier, the three defendant banks created a cartel coordinating the prices of commissions charged to their customers.

The Plaintiffs further claim that the banks have created an unlawful restrictive business practice regarding the rates of the various

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

commissions charged to customers. As alleged by the Plaintiffs, as a result of the cartel, the price paid by the public is higher than the price that would have been paid had competition not been prevented by the cartel.

The causes for the action are as follows: Violation of Section 4 of the Antitrust Law the Plaintiffs request that the rules applying to a concerted group/ monopoly, as these terms are defined in the said Law, should apply to the defendant banks; a material misrepresentation in accordance with the Consumer Protection Law; violation of Section 2 of the Fiduciary Law; violation of the provisions of the Unlawful Creation of Wealth Law. The Plaintiff estimates the gap between commissions actually charged and the commissions that would have been charged had the banks not acted as they did, at 25%. Based on this assessment, the Plaintiffs claim a personal damage of NIS 3,750 and an overall damage for all member of the group of NIS 3.5 billion. The Bank's share in the claimed amount is 22% (namely an amount of NIS 770 million).

The Bank filed its response on March 19, 2009.

15.7 An action was filed on September 28, 2008 with the Tel Aviv District Court against the Bank, Bank Leumi, Bank Hapoalim and Otsar Ha'Hayal Bank, together with a motion for approval of the action as a class action suit.

The motion was filed on behalf of all those who had traded through investment portfolio managers in options on the TA 25 Index, using bank accounts held with the defendant banks, the respondent banks having charged such accounts with a commission named "realization commission."

The Claimants argue that the banks have furtively charged a "realization commission" at the rate of 0.5% of the amounts due to the option holders upon expiry of the options, this without providing proper and sufficient disclosure. The Claimants state that the banks have indeed sent notices to the customers detailing the commission charged, though they argue that customers making up the claimant group do not follow such notices and do not know how to analyze them.

The Claimants further argue that the "realization commission" was charged by the Defendants despite the fact that they do not have to take any action justifying such a commission, and that no reasonable ratio exists between the rate of the commission and the so called action required from the Defendants. The respondent banks did not receive approval of Bank of Israel for charging such a commission.

The causes of action in this case are: violation of an enacted duty under Section 63 of the Tort Ordinance; violation of an enacted duty under Section 23 of the Banking Rules (Service to customer) (Fair disclosure and delivery of documents), 1992; violation of Section 26 of the above Banking Rules; violation of instructions 3, 5 and 5(a) of the Banking Law; violation of the engagement contract between the customers and the respondents; unlawful creation of wealth and violation of the duty of care while committing the injustice of negligence with respect to their customers members of the group.

The combined damage to all members of the group is estimated by the Claimants at NIS 672 million. The Claimants do not disclose the amount of the damage attributed to each of the Defendants.

The case is fixed for a preliminary hearing on April 6, 2009.

15.8 A lawsuit was filed with the Tel Aviv District Court on February 15, 2009, against Discount Mortgage Bank in an amount of NIS 2,155, together with a motion for approval of the lawsuit as a class action suit.

The claims of the Plaintiff relate to a dollar linked loan that he and his wife had received from this bank in 2004, alleging that the linkage mechanism, as specified in an annex to the loan agreement, which states that repayment of the loan will be according to the exchange rate of the dollar that will not fall below the basic exchange rate determined on the date of the loan, is a discriminating term in a uniform agreement, which grants the Discount Mortgage Bank an improper advantage.

The Plaintiff motions the Court to recognize the group of customers who in the past seven years were granted dollar linked loans, under a single direction linkage mechanism, as entitled to relief of the reimbursement of amounts collected by the bank based on the said mechanism, with the addition of linkage and interest. The Plaintiff estimated that the amount of the claim is within the authority of a District Court (namely, exceeding NIS 2.5 million), however he did not specify the estimated amount of the class action. Discount Mortgage Bank has not yet responded to the allegations.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 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 (Service to customer), 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. Recently, according to the recommendation of the Supreme Court, all parties agreed to refer the case to mediation procedures.

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 2008 to NIS 14 million, compared with NIS 16 2007. If the said motions were granted, the earnings of FIBI Group would be reduced in this field.

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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

As of December 31, 2008, DCMI has a commitment to additional investments in 16 such entities amounts totaling US$205.5 million (as of December 31,2007, US$247.3 million).

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, 2008, guaranties have been provided in the amount of NIS 46.2 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 as at that date). 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.

An amendment to the share purchase agreement was signed in August 2008, subject to the fulfillment of several conditions by September 7, 2008 and subject to obtaining the approval of the Bank of Israel and the Antitrust Commissioner until December 15, 2008. Subsequent to this date, each of the parties is entitled to terminate the agreement. As of a date proximate to date of issue of these financial statements, all conditional provisos in the agreement had been fulfilled, with the exception of the approval of the Bank of Israel which is still pending.

In addition, as of December 31, 2008, the Bank is committed to invest US$4.1 million in a venture capital fund.

Furthermore, Mercantile Discount Bank has a commitment to invest in five venture capital funds amounts totaling NIS 0.6 million, as of December 31, 2008.

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, 2008, the nominal amount deposited by members of the Fund, in respect of which the commitment had been given, totaled NIS 166 million. Mercantile Discount Bank's exposure as at December 31, 2008 (with respect to the negative difference between the value of members' rights and the nominal amount deposited by them, as stated) amounted to NIS 12 million. 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 took effect on January 1, 2009, according to which enrollment of new members by central provident founds is no longer permitted. 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.

20. The sale of KAHAL. On May 26, 2006, the Bank, Bank Leumi Le'Israel B.M., KAHAL – Employee Training Fund Ltd. (hereinafter – "KAHAL") and KAHAL Training Fund Management (1996) Ltd. (hereinafter – "KAHAL Management"), entered into an agreement with

Migdal Capital Markets (1965) Ltd. on behalf of a company controlled by it and Migdal Insurance Holding and Finance Ltd. on behalf of a company controlled by it (hereinafter – "the Purchaser") for the sale of goodwill, management rights, additional rights and the means of control of the banks in KAHAL, and for the sale of goodwill, operations, assets and liabilities connected to the 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 so entitled are 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 is 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.

    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 a motion to the Supreme Court.

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 (Kesher) 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 the commitment of the Mayer Group to make a parallel investment of 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

new and used private vehicles of Mayer Group in European countries. Mayer Europe holds the Hertz leasing franchise in Hungary.

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, 2008, DCMI invested an amount of €11.1 million in the two companies of the Mayer Group (December 31, 2007: €7.3 million).

23. a. 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. 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.

b. 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.

c. 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.

d. 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.

e. Without derogating from the resolutions detailed in items b to d above, the Bank intended 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.

f. The financial statements include full provisions in respect of items b to d stated above. A specific provision has not been included in respect of Section E above, however a general provision has been included in respect of contingent liabilities.

g. 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 b to e 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.

h. 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 above said letter of the controlling shareholders (see g above).

i. On January 8, 2009, the former chairman of the Board of Directors submitted, through his representative, a demand for the payment of various amounts in respect of his term of office at the bank (hereunder: "the demand letter").

j. In the demand letter, the representative of the former Chairman of the Board suggested that the issue be submitted to the decision of a third party, in order to avoid referring the case to the Court.

k. The Bank's Board of Directors of the Bank discussed the demand letter, and with a view of finding the most appropriate way of settling the dispute with the former Chairman, the Bank, in a letter dated March 8, 2009, informed the representative of the former Chairman, as follows:

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

1. The Board of Directors of the Bank decided to appoint an independent expert, to be agreed upon by the parties, in order to examine and decide what the fair and appropriate remuneration to be paid to Mr. Mientkevitch should be (over and above the amounts that were paid to him pursuant to the terms of the employment arrangements with him), this in view of his activity in the Bank, among other things, in the crisis years that the Bank had experienced, his contribution to the Bank's recovery, and his activity in the last year prior to the termination of his office.
2. In order for the Bank to be able to act as above, without being bound by any former obligations of the Bank, Mr. Mientkevitch will be asked to inform in writing that he forgoes any claim or demand based on a cause of action derived from former obligations of the Bank towards him, if any, and to the extent that any shall arise, except for his demand for an appropriate and fair remuneration for his activity, contribution to the Bank and his retirement.

l. On March 16, 2009, the representative of the former chairman informed that he agrees to the Bank's demand.

m. On March 18, 2009, the Bank and the former Chairman applied to Prof. Yaakov Ne'eman to act as above. It was further agreed that the proceedings before him shall be conducted in accordance with the First Addendum to the Arbitration Law, 1968; each party will bear its own costs while the arbitrator fee and its allocation to the parties will be decided by the arbitrator. It should be noted that the former Chairman limited his claim to an amount of NIS 17 million (this amount was provided in the books of the Bank as part of a specific and non-specific provisions).

n. On that day, March 18, 2009, the first meeting in front of Prof. Ne'eman was held, in which, among other things, two witnesses on behalf of the former Chairman were heard. The Bank has not yet presented its arguments with respect to the demand of the former Chairman.

o. On March 25, 2009, the representatives of the State of Israel and of M.I. Holdings Ltd. sent the Bank and the controlling shareholders a letter in which they argue, among other things, that the Bank's consent to the said proceedings without prior notice to the State and without enabling it to participate in the proceedings, is in contradiction to the law and prevents the State from stating its position in the matter. In continuation, the State requested to cancel the arbitration process and to revert the issue to the approval of the authorized organs in the Bank. Without derogating from the above, The Bank was requested to freeze the proceedings before the arbitrator and to verify that no decisions be taken before the discussion is resolved. The Bronfman-Schron Group also announced that will join the demand by the State to suspend all proceedings and refrain from taking any decisions until the matter is entirely clarified and discussed in full with the State.

p. In the Bank's opinion, the consent of the shareholders, including the State, is not required for these proceedings. The process implemented is a proper one, appropriate to the circumstances and the Bank's benefit and is lawful. Notwithstanding, the parties applied to Prof. Ne'eman for a stay of three weeks in the proceedings in order to clarify the matter with the controlling shareholders and the State. It was agreed that in the event that Prof. Ne'eman will not be able to continue acting as an expert arbitrator in the matter due to his expected appointment as a Government Minister, then the matter will be forwarded to another expert arbitrator, the identity of whom has been agreed upon by the parties.

24. On March 19, 2008, following an investigation conducted since 2004 by the Antitrust Authority, within the framework of which many documents and computer material had been seized and Bank employees interrogated, including a member of management, the Authority informed the Bank that in view of the investigation findings, the Antitrust Commissioner is studying the possibility of applying the authority conferred on her by law and determine that binding arrangements had existed between Bank Hapoalim Ltd., Bank Leumi Ltd., Mizrahi-Tefahot Bank, the First International Bank Ltd. and the Bank (hereinafter: "the banks"), in the matter of communicating information regarding to commissions ("the considered determination"). The Bank was given a chance to submit its position in writing to the Commissioner before she takes a decision whether to make use of the said authority.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

In September 2008, the Bank submitted to the Commissioner its position in writing within the framework of hearing, in which the Bank presented in great detail the factual and legal reasons supporting its argument that there is no place for the Commissioner to make use of her authority to determine that a binding arrangement had in fact existed.

On January 11, 2009, the Authority called a meeting in which it raised the possibility of forming an "agreed upon order", that will include the payment to the Treasury of an amount of NIS 290 million, to be divided among the banks, so that Bank Hapoalim Ltd., Bank Leumi Ltd. and the Bank will pay an amount of NIS 80 million each, the First International Bank Ltd. will pay NIS 30 million and United Mizrahi-Tefahot Bank will pay NIS 20 million. In addition to the monetary payment, the Commissioner suggested that the agreed upon order shall include agreed upon restrictions on the communication of information between the banks and the mapping of all cooperation arrangements between them and their regularization.

On February 4, 2009, the Bank informed the Authority that it rejects the said suggestion for an "agreed upon order".

The Antitrust Authority's decision with respect to the considered determination has not yet been given.

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 exposure to 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 and 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 and 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

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE (CONTINUED)

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 hosting agreement, treated as a derivative in its own right and stated in the balance sheet together with the hosting 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 hosting 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.

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 item;

   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.

6. Fair value hedging

   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.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS

1. Par value of derivative instruments

	December 31, 2008				
	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	-	-	77	-	-
Swaps	-	1,460	-	-	-
Total	-	1,460	77	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	1,414	-	-	-
B. ALM derivatives[1][2]					
Futures contracts	-	2,815	-	-	-
Forward contracts	2,033	5,105	30,300	-	-
Marketable option contracts					
Options written	-	-	8	-	-
Options purchased	-	-	12	-	-
Other option contracts					
Options written	-	-	4	-	-
Options purchased	-	-	167	-	-
Swaps	-	45,585	5,969	-	-
Total	2,033	53,505	36,460	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	23,400	-	-	-
C. Other derivatives[1]					
Forward contracts	36	237	335	713	2,198
Marketable option contracts					
Options written	-	-	641	2,465	-
Options purchased	-	-	620	2,465	-
Other option contracts					
Options written	-	74	15,611	263	775
Options purchased	-	105	14,975	278	209
Swaps	-	932	-	-	-
Total	36	1,348	32,182	6,184	3,182
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	330	-	-	-
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	6,134	-	-

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 (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)

	December 31, 2007				
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
	in NIS millions				
1. Par value of derivative instruments (continued)					
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	-	-
Marketable option contracts					
Options purchased	-	-	-	-	-
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 (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)

	December 31, 2008				
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
	in NIS millions				
2. Gross fair value of derivative instruments					
A. Hedging derivatives					
Positive gross fair value	-	1	15	-	-
Negative gross fair value	-	109	14	-	-
B. ALM derivatives					
Positive gross fair value	23	1,531	844	-	-
Negative gross fair value	10	1,662	1,460	-	-
C. Other derivatives					
Positive gross fair value	1	47	1,040	184	94
Negative gross fair value	1	44	998	173	93

	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					
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

* Reclassified.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE (CONTINUED)

B. DERIVATIVE INSTRUMENT CREDIT RISK BASED ON THE COUNTERPART TO THE CONTRACT, ON A CONSOLIDATED BASIS

	December 31, 2008				
	Stock markets	Banks	Dealers/ brokers	Others	Total
	In NIS millions				
Gross positive fair value of derivative instruments[1]	67	2,345	55	1,313	3,780
Net of set-off agreements	32	1	-	225	258
Balance of assets deriving from derivative instruments[2]	35	2,344	55	1,088	3,522
Off-balance sheet credit risk in respect of derivative instruments[3]	35	7,982	34	2,987	11,038
Total credit risk in respect of derivative instruments	70	10,326	89	4,075	14,560

Footnotes:
(1) Of which, NIS 115 million of positive gross fair value of derivative instruments.
(2) Of which, a balance of non-related derivative instruments of NIS 3,407 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, 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

* Reclassified.
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 1517 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 per-borrower indebtedness.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE (CONTINUED)

C. DUE DATES – PAR VALUE: CONSOLIDATED YEAR END BALANCES

	December 31, 2008				
	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	300	853	766	150	2,069
Other	8,569	17,016	15,128	15,600	56,313
Foreign currency contracts	50,413	18,225	2,105	4,110	74,853
Contracts on shares	5,467	503	214	-	6,184
Commodities and other contracts	2,556	540	86	-	3,182
Total	66,705	37,137	18,299	19,860	142,601

	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

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 - market value for securities traded on an active market, or quotations of international providers of prices for securities traded on an inactive market.

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, 2008, the Bank has classified some 94% of the indebtedness which has to be classified according to the directives of the Supervisor of Banks (31.12.2007: 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 date. With respect to short-term credit balances (initial period of up to three months), or balances bearing variable market interest (prime,

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

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 31,2008			
	(1)	(2)	Total	Fair value
	in NIS millions			
Financial assets:				
Cash and deposits with banks	19,797	1,757	21,554	21,697
Securities	29,618	1,917	31,535	31,473
Securities borrowed or purchased under resale agreements	25	-	25	25
Credit to the public	56,423	60,378	116,800	116,829
Credit to the Government	29	1,461	1,491	1,235
Other financial assets	3,745	-	3,745	3,745
Total financial assets	109,637	65,513	175,150	175,004
Financial liabilities:				
Deposits from the public	89,288	49,944	139,232	140,045
Deposits from banks	3,963	592	4,555	4,545
Deposits from the Government	33	173	206	212
Securities loaned or sold under buy-back arrangements	2,761	4,433	7,194	7,450
Subordinated capital notes	305	9,068	9,373	8,651
Other financial liabilities	10,414	-	10,414	10,414
Total financial liabilities	106,764	64,210	170,973	171,317

	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	*1,906	-	1,906	*1,906
Total financial assets	107,212	53,532	160,744	160,691
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	3,963	592	4,555	4,545
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

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 31,2008			
	(1)	(2)	Total	Fair value
	in NIS millions			
Financial assets:				
Cash and deposits with banks	15,600	10,530	26,130	26,226
Securities	13,248	-	13,248	13,248
On securities borrowed or purchased under buy-back agreements	25	-	25	25
Credit to the public	33,724	35,559	69,283	69,430
Credit to the Government	-	1,461	1,461	1,206
Other financial assets	3,469	-	3,469	3,469
Total financial assets	66,067	47,550	113,616	113,604
Financial liabilities:				
Deposits from the public	70,554	31,787	102,341	102,405
Deposits from banks	2,569	354	2,923	2,927
Deposits from the Government Subordinated capital notes	38	3,550	3,588	3,244
Other financial liabilities	6,353	-	6,353	6,353
Total financial liabilities	79,537	35,796	115,333	115,047

	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	*17,545	-	17,545	*17,545
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	*1,509	-	1,509	*1,509
Total financial assets	66,238	37,333	103,571	103,491
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

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, 2008									
	Interested parties[1]						Related parties held by the Bank[1]			
	Controlling Shareholders[2]		Others Shareholders[3]		Directors and President[4]		Affiliated		Others[5]	
	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)
	in NIS millions									
Assets:										
Deposits with banks	-	-	-	-	-	-	118	201	-	-
Securities[8]	-	-	-	-	-	-	-	-	15	15
Credit granted to the public	[a]-	[a]-	27	28	30	30	1,528	1,545	242	250
Investments in affiliated companies[8]	-	-	-	-	-	-	1,900	2,025	-	-
Other assets	-	-	-	-	-	-	9	13	-	-
Liabilities:										
Deposits from the public	7	7	49	60	1	17	2,637	2,730	286	367
Deposits from banks	-	-	-	-	-	-	196	501	-	1
Subordinated capital notes	-	-	-	-	-	-	21	22	-	-
Other liabilities	-	-	-	-	5	9	5	16	-	-
Shares (included in shareholders' equity)	2,287	2,406	-	-	-	-	-	-	-	-
Credit risk in off-balance-sheet financial instruments[9]	3	3	14	16	19	19	1,037	1,037	106	106

(a) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 23 million for credit received by a third party.
For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

A. BALANCES: (CONTINUED)

	December 31, 2007									
	Interested parties[1]						Related parties held by the Bank[1]*			
	Controlling Shareholders[2]		Others Shareholders[3]		Directors and President[4]		Affiliated		Others[5]	
	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)
	in NIS millions									
Assets:										
Deposits with banks	-	-	-	-	-	-	1	423	-	-
Securities[8]	-	-	-	-	-	-	-	-	15	15
Credit granted to the public	[a]-	[a]-	19	22	8	8	417	433	48	62
Investments in affiliated companies[8]	-	-	-	-	-	-	2,008	2,008	-	-
Other assets	-	-	-	-	-	-	6	11	-	-
Liabilities:										
Deposits from the public	6	12	29	48	1	2	351	761	167	1,045
Deposits from banks	-	-	-	-	-	-	373	619	-	1
Subordinated capital notes	-	-	-	-	-	-	16	31	24	172
Other liabilities	-	-	-	-	9	9	12	15	-	-
Shares (included in shareholders' equity)	2,393	2,393	-	-	-	-	-	-	-	-
Credit risk in off-balance-sheet financial instruments[9]	3	3	1	2	1	1	1,622	1,727	57	193

* Reclassified.
(a) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 37 million for credit received by a third party.
For notes to the tables see after Note 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, 2008				
	Interested parties[1]		Related parties held by the Bank[1]		
	Controlling Shareholders[2]	Others Shareholders[3]	Directors and president[4]	Affiliated companies	Others[5]
	in NIS millions				
Income from financing activities before provision for doubtful debts**	-	-	1	13	6
Non-financing income	-	-	-	15	1
Non-financing expenses***	-	-	(24)	(31)	-
Net income from extraordinary items	-	-	-	-	-
Total	-	-	(23)	(3)	7

	For the year ended December 31, 2007				
	Interested parties[1]		Related parties held by the Bank[1]		
	Controlling Shareholders[2]	Others Shareholders[3]	Directors and president[4]	Affiliated companies	Others[5]
	in NIS millions				
Income from financing activities before provision for doubtful debts*	-	-	-	(21)	(22)
Non-financing income	-	-	-	5	[10]107
Non-financing expenses**	-	-	(38)	(29)	-
Net income from extraordinary items	-	-	-	50	-
Total	-	-	(38)	5	85

* Reclassified.
** See Note D.
*** See Note C.

C. BENEFITS FROM THE BANK AND CONSOLIDATED SUBSIDIARIES TO INTERESTED PARTIES:

	For the year ended December 31			
	2008		2007	
	Directors and President and CEO[4]		Directors and President and CEO[4]	
	Total benefit	Number of benefit Recipients	Total benefit	Number of benefit Recipients
	in NIS millions			
Interested parties employed by the Bank or on its behalf	18	2	35	2
Directors who are not employed by the Bank or on its behalf	4	*16	2	*16
Total	22	18	37	18

* Including three Directors who retired during 2008 and 2007.
For notes to the tables see after Note 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*		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
A. On assets						
Credit granted to the public	80	11	44	69	7	5
Total	80	11	44	69	7	5
B. On liabilities						
Deposits from the public	(42)	(28)	(58)	(38)	(8)	(1)
Deposits from the banks	(20)	(22)	(3)	(20)	(22)	(3)
Subordinated capital notes	(2)	(9)	(11)	(2)	(3)	-
Other liabilities	-	-	(1)	-	-	(1)
Total	(64)	(59)	(73)	(60)	(33)	(5)
C. On Derivative Financial Instrument						
Financing income (expenses) from other transactions	6	6	(14)	4	6	(14)
Total	6	6	(14)	4	6	(14)
D. Other						
Other financing income	(1)	-	-	-	-	-
Other financing expenses	(1)	(1)	-	-	(1)	-
Total	(2)	(1)	-	-	(1)	-
Total expenses from financing activities before provision for doubtful debts	20	(43)	(43)	13	(21)	(14)

* Reclassified.
** 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) Controlling shareholder – as defined in the Securities Law.
(3) Whoever holds 5% or more of the issued share capital of the banking corporation or of the voting rights therein, whoever is entitled to appoint one or more of the directors of the corporation or its general manager.
(4) Including spouses and their infant children.
(5) 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.
(6) The balance at balance sheet date.
(7) The highest balance during the year on the basis of month-end balances.
(8) Details of these items are included also in the following notes:
Securities - Note D.
Investments in Investee Companies - Note 6
Guarantees - Note 19A.
(9) Credit risks relating to off-balance sheet financial instruments, as computed for the purpose of the limitations on indebtedness of a borrower.
(10) 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	
	2008	2007
	In NIS millions	
(1) Managed by Discount Provident Fund Management Ltd. and the Bank[(1)]:		
Management fees	-	*57
(2) Managed by Mercantile Discount Bank:		
Management fees	-	26

* Reclassified.
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 B.M. 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). On December 31, 2006, 2007 and 2008, the state owned 25% 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 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. The option expired at the end of 2008 without being exercised;
- 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.

The permit issued to the Buyers by the Governor of the Bank of Israel to jointly hold the control and means of control in the Bank, determined, among other things, as follows:

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 odinarily 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.

H. Remuneration plan for the Chairman of the Board and 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)

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 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 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 agreement for the engagement of the Chairman of the Board was approved by an extraordinary shareholders meeting held on August 26, 2007. The special General Meeting decided that the employment agreement will be for the period as from February 6, 2006 until February 5, 2011, and shall not be renewed automatically at each time for an additional period of one year.

The agreement stipulates indemnification to which the Chairman of the Board of Directors will be entitled in the event that the Bank would terminate his service prior to the end of the defined period of the agreement or in the event of material impairment of his authority, in an amount equivalent to payment of his full salary, including benefits and provisions, as detailed in the employment agreement, for the balance of the period until the determining date. In addition, the Chairman of the Board of Directors will be entitled to a proportionate share of the annual bonus for the year in which the employment agreement was terminated.

The agreement also states that the Chairman of the Board of Directors will be entitled to a bonus in the event of termination of his service, at his initiative or at the Bank's initiative, as long as such termination did not involve circumstances of breach of trust toward the Bank. The bonus will be equivalent to 12 months' salary, including benefits and provisions as detailed in the employment agreement.

The Chairman of the Board of Directors will be employed in a full time position, and will not be entitled to engage in additional salaried work, except with the approval of the Board of Directors of the Bank.

The monthly salary of the Chairman of the Board of Directors will be NIS 178,700, gross, and will be updated every three months according to the rate of increase in the consumer price index, relative to the index published on January 15, 2006.

The employment agreement determines that the Bank will grant the Chairman of the Board of Directors, annually from 2006 until 2010, a special bonus as detailed hereunder.

The agreement further stipulates that the Chairman of the Board of Directors will be entitled to vacation days, sick leave, recreation pay, appropriate vehicle, entertainment expenses, social benefits (severance pay, retirement benefits, loss of ability to work and payments

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 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.

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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

(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 2008 with the determined indices, and they are entitled to a bonus of NIS 2.3 million each in respect of this year. According to the terms of the plan, the Chairman of the Board and the President and CEO received an award of NIS 4.4 million each in 2007.

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, one of the controlling shareholders in the Bank (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, (hereinafter: "the controlling shareholder" and "the 2005 agreement").

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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 2005 agreement has been discussed and approved by the authorized organs of IDB New York, and was brought for approval of the authorized organs of the Bank as a qualifying transaction. The resolutions passed on April 13, 2008 and on April 15, 2008, by the Audit Committee and by the Bank's Board of Directors, respectively, approved the amendments to the 2005 agreement, mainly relating to an increase of US$3.25 per sq. foot in rental fees. The annual rental fees payable amount to US$324,000 reflecting US$52.7 per sq. foot. In addition, as security for the tenant's obligations under the 2005 agreement, the controlling shareholder provided a personal unlimited guarantee in amount as well as a monetary deposit of US$81,000.

The company paid in 2008 rental fees of US$317 thousand (2007 - US$303 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, 2008, Ernest Partners Corporation managed on behalf of IDB New York an investment portfolio of US$80 thousand (2007 - US$146 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 2008, an amount of US$273 thousand was paid to Ernest Partners Corporation in management fees (2007 - US$278 thousand). IDB New York informed Ernest Partners on March 20, 2009, of the termination of the engagement between them.

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 at the time 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.

K. 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, 2008, amounted to NIS 4,834 million (as at December 31, 2007 - NIS 2,731 million).

L. 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.

M. 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)

N. 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.

O. Upon granting of the control permit of Discount Bank (hereinafter - "the Bank"), Mr. Milstein, one of the Bank's controlling shareholders, 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.

P. Approval of remuneration to a former Director in respect of his service as Director of IDB New York.

On May 22, 2008, the general meeting of shareholders of the Bank resolved to approve the payment of remuneration to a former Director who had served in the Bank until December 27, 2007, in respect of his service as a Director in IDB New York. This Director served on the Board of the Bank from December 27, 2001 until December 27, 2007. This Director acted as an outside director under Proper Banking Management Directive No. 301 (hereinafter - "Directive 301") and as chairman of the Audit Committee.

In December 2005, he was appointed Director of IDB New York, as part of the actions taken by the Bank to reinforce the control and supervision over IDB New York, following the investigation in the matter of money laundering prohibition.

In March 2007, the Supervisor of Banks approved the continuation of his tenure as Director of IDB New York, including his membership of the compliance committee there, concurrently with his duties as outside director of the Bank according to Directive 301. The approval of the Supervisor was subject to the Companies Regulations (Matters that do not constitute affinity), 2006, in everything connected to the remuneration a director is entitled to receive. The Supervisor of Banks indicated that his position applied to periods subsequent to the date of his letter. Accordingly, the Director did not receive remuneration in respect of his tenure as Director of IDB New York in respect of the period from April 1, 2007 until December 27, 2007. It should be noted that the Director was reimbursed for expenses incurred by him during this period, as detailed below:

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

Payments approved by the General Meeting:

- Payments made to the Director in respect of the period from January 1, 2006 until March 31, 2007: Upon appointment of the Director as director of IDB New York, he was paid director's remuneration in amounts paid to other directors of IDB New York for their service as directors and as members of the board's committees. Accordingly, the Director was paid by IDB New York the sum of US$180,000 for participation in meetings of the board and its committees in New York.
- Payments in respect of the period from April 1, 2007 until December 27, 2007. Remuneration for this period will be paid according to the provisions of the Companies Regulations (Matters that do not constitute affinity), 2006, and the Companies Regulations (Provisions for payment of remuneration and expenses of an outside director), 2000 (Version prior to the amendment of March 2008). The said payments will be made by IDB New York.
- Reimbursement of expenses: During the period from January 1, 2006 until December 27, 2007, the Bank defrayed the Director's air travel expenses, while IDB New York defrayed his hotel and per diem expenses.

Q. On July 6, 2008, the Board of Directors, following approval of the Audit Committee, approved the payment of annual remuneration and remuneration for participation in meetings to outside Directors and to other present and future Directors (excluding the Chairman of the Board), in an amount equal to the "maximum amount" stipulated in the Second Addendum and in the Third Addendum to the Companies Regulations (Rules for remuneration and expenses to an outside Director), 2000, as amended in the Companies Regulations (Amendment) (Rules for remuneration and expenses to an outside Director), 2008, in accordance with the grade of the Bank. The said updated remuneration will be paid retroactively as from April 1, 2008, or starting with the date of appointment of a director, the later of the two.

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
A. On Assets*						
Credit granted to the Public	6,558	4,162	3,709	3,488	2,645	2,403
Credit granted to the Governments	66	3	(2)	63	4	(2)
Deposits with the Bank of Israel and cash	(1)	(55)	(49)	20	(23)	(26)
Deposits with Banks	(160)	144	244	545	586	553
Securities borrowed or purchased under buy-back agreements	5	10	-	5	10	-
Bonds[(1)]	1,342	84	(26)	737	811	798
Total	7,810	4,348	3,876	4,858	4,033	3,726
B. On Liabilities*						
Deposits from the public	(1,779)	(41)	(64)	(1,376)	(961)	(1,183)
Deposits from the Government	(5)	(2)	(1)	(1)	(1)	-
Deposits from the Bank of Israel and cash	(21)	(44)	(30)	(21)	(44)	(30)
Deposits from banks	(216)	73	45	(44)	7	(56)
Securities loaned or sold under buy-back arrangements	(328)	310	-	(4)	-	-
Subordinated capital notes	(763)	(539)	(287)	(359)	(320)	(193)
Total	(3,112)	(243)	(337)	(1,805)	(1,319)	(1,462)
C. In Respect of Derivative Financial Instruments and Hedging Activities						
Net expenses in respect of ALM derivative instruments**	(636)	(231)	(45)	(558)	(218)	(134)
Income (expenses) net in respect of other derivative instruments	(81)	16	105	(84)	(4)	84
Total	(717)	(215)	60	(642)	(222)	(50)
D. Other						
Commissions on financing activities	139	125	123	84	71	65
Other financing income	(18)	126	79	83	90	93
Interest income on problem debts	87	110	103	48	77	78
Gain from sale of loans	-	2	-	-	2	-
Other financing expenses	(62)	(28)	(114)	(62)	(40)	(27)
Total	146	335	191	153	200	209
Total income from financing activities before provision for doubtful debts	4,127	4,225	3,790	2,564	2,692	2,423
Of which: Net exchange differences	(121)	115	(80)	6	337	166

* 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 128 million for the year ended December 31, 2008 (for the year ended December 31, 2007: 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 change in the exchange rate of the US Dollar as against the Shekel, an income of NIS 599 Million for the year ended December 31, 2008 was recorded in respect of the said securities (for the year ended December 31, 2007: expense of NIS 467 million).

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS (CONTINUED)

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
E. Results of Activity in Investments in Bonds[1]						
Accrual basis, financing income (expenses) from bonds:						
Held-to-maturity	(22)	(209)	(262)	-	-	-
Available for-sale	1,261	83	151	656	638	693
Trading	103	210	85	81	173	105
Total included in income on assets from financing activities	1,342	84	(26)	737	811	798
Gains on sale of available-for-sale bonds	209	68	50	133	33	29
Losses on sale of available-for-sale bonds	(7)	(1)	(58)	(2)	-	(1)
Provision for decline in value of available-for-sale bonds	(311)	-	-	(57)	-	-
Net realized and unrealized gains (losses) from adjustment of trading bonds to fair value*	(58)	(43)	30	(40)	(37)	23
Total included in other financing income	(167)	24	22	34	(4)	51
Total from investments in bonds	1,175	108	(4)	771	807	849
F. Details of the Net Effect of Derivative instruments Hedging Earnings From Financing Operations						
Financing income (expenses) in respect of assets (item A)	(103)	6	10	(103)	6	10
Financing expenses in respect of liabilities (item B)	(1)	-	-	(1)	-	-

* Of which: a part of the gains and losses relating to trading bonds that are still on hand at balance sheet date. Consolidated - NIS (12) million, the Bank – NIS (32) million (2007: consolidated – NIS 8 million, the Bank – NIS (22) million, 2006: consolidated - NIS 119 million, the Bank – NIS 8 million).

Footnote:

(1) Financing income generated by mortgage backed securities (MBS) amounted to US 128 million for the year ended December 31, 2008 (for the year ended December 31, 2007: 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 change in the exchange rate of the US Dollar as against the Shekel, an income of NIS 599 Million for the year ended December 31, 2008 was recorded in respect of the said securities (for the year ended December 31, 2007: expense of NIS 467 million).

24. OPERATING COMMISSIONS

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Ledger fees (in Israeli and in foreign currency)	282	252	225	188	167	146
Payment order system service (in Israeli and in foreign currency)	488	475	424	335	324	304
Income from credit cards	849	760	640	101	85	58
Credit and contracts service	237	218	177	151	140	114
Computerized services, information and confirmations	28	38	45	23	31	38
Foreign trade transactions and special foreign exchange services	73	79	93	56	62	60
Income from customers' securities transactions	318	*326	243	216	220	164
Margins and collection fees on credit and deposits, from deposits according to collection:						
Collection commissions on credit granted out of Treasury funds	14	15	16	-	-	-
Commissions and other margins	5	3	3	5	4	3
Management fees and commissions from life insurance	14	14	15	-	-	-
Management fees and commissions from property insurance	8	10	11	-	-	-
Commission on transfer of rent	-	-	1	-	-	-
Other income	23	24	18	26	21	16
Total operating fees	2,339	2,214	1,911	1,101	1,054	903

* Reclassified.

25. NET GAIN (LOSSES) FROM INVESTMENTS IN SHARES

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Gains on sale of shares available-for-sale	7	-	8	7	-	8
Provision for decline in value of available-for-sale shares	(117)	(46)	(7)	(67)	(44)	-
Net realized and unrealized gains (losses) from adjustment of trading securities to fair value[1]	(7)	(4)	3	(1)	(3)	2
Dividends from available-for-sale or trading shares[2]	168	108	61	59	60	34
Total from investments in shares	51	58	65	(2)	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 (5) million, Bank: NIS (1) million, (2007-consolidated: NIS (4) million, Bank: NIS (0.4) million, 2006-consolidated: NIS 1 million, Bank: NIS 2 million).
(2) Including a dividend received in 2008 from VISA Europe, in the amount of NIS 110 million (consolidated), and NIS 24 million (for the Bank).

26. OTHER INCOME

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	In NIS millions					
Management fees and expense refunds from provident funds	-	107	189	-	*57	114
Provident funds operating fees	22	12	-	-	-	-
Management fees from mutual funds	4	6	100	-	-	15
Distribution fees of mutual funds	43	*54	24	35	51	47
Management fees from consolidated subsidiaries	-	-	-	3	3	3
Profit from severance pay funds	-	89	49	-	87	46
Other income	31	32	21	67	*62	54
Total other income	100	300	383	105	260	279

* Reclassified.

27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Salaries	2,009	*2,146	2,209	1,262	1,322	1,388
Expense resulting from share based payment transactions*(1)(2)	15	27	8	15	27	8
Severance pay, pension, continuing education fund, bonuses, vacation and medical insurance	464	*267	*258	302	193	187
National Insurance and payroll taxes	392	*377	399	301	286	309
Other related expenses	112	99	99	63	58	57
Adjustment of reserves for salary-related expenses due to changes in salaries during the year	114	*23	*55	100	21	42
Encouragement of early retirement expenses(3)	-	91	174	-	68	91
Total salaries and related expenses	3,106	3,030	3,202	2,043	1,975	2,082
Includes: Overseas salaries and related expenses	405	426	499	19	22	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		
	2008	2007	2006	2008	2007	2006
	In NIS millions					
Advertising	216	235	202	92	96	73
Communications	122	115	115	65	60	60
Computer services	231	228	256	190	195	206
Office expenses	36	34	34	18	13	12
Insurance	39	38	34	8	9	11
Professional services	162	196	196	67	61	50
Directors' fees	11	10	9	4	2	2
Instruction and training	16	18	18	13	15	13
Fees	43	37	56	27	27	20
Amortization of goodwill*	*50	32	11	-	-	-
Other	323	274	208	130	108	93
Total other expenses	1,249	1,217	1,139	614	586	540

* Of which, loss from impairment in value amounted to10 million NIS.

29. PROVISION FOR TAXES ON OPERATING INCOME

A. COMPOSITION:

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Taxes for current year	263	365	391	56	137	104
Taxes for previous years	(7)	1	1	(20)	-	(1)
Total current taxes	256	366	392	36	137	103
Addition (deduction):						
Deferred taxes for current year	(18)	199	(42)	(41)	104	-
Deferred taxes for previous years	(69)	1	-	(45)	-	-
Total deferred taxes	(87)	200	(42)	(86)	104	-
Total provision for taxes on operating profit	169	566	350	(50)	241	103
Includs taxes of foreign subsidiaries	32	140	62	11	17	6

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		
	2008	2007	2006	2008	2007	2006
Statutory tax rate on banks in Israel	36.80%	38.53%	40.65%	36.80%	38.53%	40.65%
	in NIS millions					
Income tax at the statutory tax rate	211	494	227	24	253	80
Income tax (tax savings) on:						
Increment (deduction) for inflation	-	(41)	3	-	(21)	1
Income of foreign subsidiaries[1]	2	110	90	14	11	-
General and supplemental provision for doubtful debts	2	(9)	1	5	(5)	5
Income exempt from tax or taxed at preferred rates	(3)	9	8	-	9	10
Adjustment differences on depreciation and capital gains	(2)	(20)	(6)	(1)	(19)	(10)
Other non-deductible expenses	43	56	96	18	39	80
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	23	(31)	(88)	-	(28)	(89)
Profit tax on payroll tax	15	27	29	12	22	24
Change in the balance of deferred taxes resulting the from change in tax rates	(15)	(19)	5	(9)	(20)	3
Taxes for prior years	(76)	1	1	(65)	-	(1)
Income of Israeli subsidiaries	(31)	(11)	(16)	-	-	-
Provision for taxes on income (tax savings)	169	566	350	(50)	241	103

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 2005. Final withholding tax assessments have been issued to the Bank for the years up to and including 2003. Following the settlement of the income tax assessment for the year 2003, and the settlement

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

of withholding tax assessments for the years 2003-2005, excess provisions for tax amounting to NIS 40 million were reversed in 2008.

(2) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2003 to 2005. Following the settlement of tax assessments of a consolidated subsidiary for the years 2002-2006, an additional provision for taxes was required in 2008, in the amount of NIS 12 million.

D. Following the submission of a Income tax adjustment statement for the year 2007 at the end of 2008, an excess provision of NIS 22 million, included in the financial statements as of December 31, 2007 on the basis of an estimate, was reversed.

E. In December 2008, the Bank received a tax assessment for the 2004-2005 tax year. In January 2009, the Bank filed an objection to the said assessment. The amount of tax in dispute for the said tax year is NIS 76 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.

F. The consolidated balance as of December 31, 2008, of the carry forward tax losses, deductibles and timing differences amounted to NIS 188 million (December 31, 2007: NIS 140 million).

G. 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 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.

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

I. 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; and will amount to 36.80% in 2008; 35.93% in 2009 and 35.06% as from 2010 onwards.

J. On March 6, 2008, the Israeli Income Tax Law (Inflationary Adjustments) (Amendment No. 20) (Restriction of Period of Application) – 2008 ("the Amendment") was published. According to the Amendment, the Inflationary Adjustments Law will no longer be applicable subsequent to the 2007 tax year, and commencing with the 2008 tax year the provisions of the law will no longer be applicable, except for certain transitional provisions the objective of which is to avoid distortions in tax computations. According to the amendment, starting with the year 2008, the adjustment of income for tax purposes to a real-term measurement basis, will no longer apply.

In addition, 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.

The Group's tax expense in 2008 increased by an amount of NIS 63 million, as a result of the abovesaid.

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 said Amendment decreased the Group's expenses in 2008 by an amount of NIS 18 million.

K. Following the decision of ICC's Board of Directors not to distribute a dividend that would cause ICC's capital ratio of ICC to fall below 15.5%, and the decision of the Board of Directors of ICC not to distribute a dividend out of profits accumulated as of December 31, 2008, the Bank reversed the provision for taxes in the amount of NIS 23 million, in respect of its share in the retained earnings of ICC.

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

L. 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			
	2008	2007	2008	2007
	in NIS millions			
Balance at beginning of year	74	*86	64	74
Non-deductible amount for the current year	(9)	*(12)	(8)	(10)
Balance at end of year	65	74	56	64

* Reclassified.

M. 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	
	2008	2007	2008	2007	2008	2007	2008	2007
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	115	77	34.8	35.2	-	-	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	341	349	34.9	33.9	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	84	172	35.1	35.1
On income tax carry - forward deductions	62	55	25.0	25.7	-	-	-	-
On foreign operations	366	170	36.7	38.5	-	-	-	-
On securities	9	-	28.9	-	-	107	-	36.8
On adjustment of depreciable non-monetary assets	-	-	-	-	141	104	29.1	27.9
On adjustment of other monetary assets	45	53	29.1	28.4	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	130	153	35.1	25.3
Total, net	938	704	34.3	33.7	355	536	32.4	30.5

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

M. 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	
	2008	2007	2008	2007	2007	2006	2007	2006
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	75	51	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	289	309	35.1	33.8	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	78	166	35.1	35.1
On income tax carry- forward deductions	61	51	25.0	25.0	-	-	-	-
On foreign operations	4	-	30.3	-	-	-	-	-
On securities	14	-	35.1	-	-	94	-	36.8
On adjustment of depreciable non-monetary assets	-	-	-	-	123	90	28.9	27.5
Other monetary assets	21	16	27.8	25.1	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	130	153	35.1	25.3
Total, net	464	427	32.9	32.1	331	503	32.5	30.3

	Consolidated		The Bank	
	December 31			
	2008	2007	2008	2007
	in NIS millions			
Deferred taxes are included:				
In "Other assets" (Note 8)	599	*244	149	*-
In "Other liabilities" (Note 12)	(16)	*(76)	(16)	*(76)
Total, net	583	168	133	(76)

* Reclassified.

30. NET INCOME ON EXTRAORDINARY ITEMS, AFTER TAXES

	Consolidated			The Bank		
	2008	2007	2006	2008	2007	2006
	in NIS millions					
Capital income on sale of buildings and equipment	-	3	5	-	3	4
Capital loss on sale of buildings and equipment	(3)	(3)	(13)	(3)	(1)	(13)
Provision for impairment in value of buildings[1]	(7)	(1)	(4)	(7)	(1)	(5)
Gain on sale of shares of investee companies	-	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 (loss) before taxes	(10)	789	405	(10)	666	403
Provision for taxes on profit from extraordinary items:						
Current taxes	-	(159)	(73)	-	(90)	(72)
Deferred taxes	-	(118)	14	-	(144)	14
Total provision for taxes	-	(277)	(59)	-	(234)	(58)
Income (loss) after taxes	(10)	512	346	(10)	432	345
Bank's share in income on extraordinary items after taxes of investee (in consolidated-affiliated) companies	-	46	2	-	126	3
Income (loss) on extraordinary items, after taxes	(10)	558	348	(10)	558	348

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 U.S. 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 U.S. 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 also clarified that the data for the international operations segment is to be presented similarly to the segment data presentation of the operations of the Group in Israel.

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 included up to December 31, 2006 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

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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. The segment also includes customers of IDB New York's corporate banking segment.
- **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. The segment also includes customers of IDB New York's commercial banking segment.
- **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 IDB (Swiss) Bank and the private banking customer activity at IDB New York, including all the operations of the subsidiary Discount Bank Latin America.
- **Financial Management Segment -** This segment includes activities that are characterized as banking operations, but do not involve customers of the Group (except for activity with the dealing room and banking corporations). 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, which includes investmets made by 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.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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 and from deposits from the public are 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.

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 36.8% (2007: 38.53%).

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.

According to directives of the Supervisor of Banks, the segments of operations are credited with imputed interest on the capital allocated to them, on the basis the risk assets attributed to the segment.

Computation of the return in each segment was made in accordance with the equity attributed, as stated, to the segment. Regarding recognition of the capital notes as upper 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 6.5%, at all times.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

Accordingly, as from the financial statements for 2008, the capital allocated to each segment was also increased. Only the calculation of the return on capital was amended in the comparative figures.

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 inconsequence 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, 2008							
						Financial Management		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Other	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From external sources	155	1,160	1,736	798	395	(39)	(78)	4,127
- Intersegmental	1,183	(323)	(735)	(174)	(58)	(16)	123	-
Total Income from financing activities	1,338	837	1,001	624	337	(55)	45	4,127
Operating and other income								
- From external sources	1,397	485	387	354	273	(32)	(374)	2,490
Total income	2,735	1,322	1,388	978	610	(87)	(329)	6,617
Provision for doubtful debts	176	156	233	198	7	-	10	780
Operating and other expenses	2,187	829	706	633	407	4	499	5,265
Operating Income (loss) before taxes	372	337	449	147	196	(91)	(838)	572
Provision for taxes on operating income	92	114	116	(15)	23	(10)	(151)	169
Operating Income (loss) before taxes	280	223	333	162	173	(81)	(687)	403
Bank's share in operating income of affiliated companies	-	-	(1)	-	-	(115)	46	(70)
Minority interest in the income of subsiduaries	(56)	(8)	(11)	(3)	-	-	-	(78)
Net gain from extraordinary items, net of taxes	-	-	-	-	-	-	(10)	(10)
Net income (loss)	224	215	321	159	173	(196)	(651)	245
Net income (loss) disregarding certain components*	173	219	327	165	177	(75)	(446)	540
Return on equity (percentage)	15.1	27.5	9.7	10.8	61.2	(249.3)	(38.8)	2.7
Return on equity disregarding certain components* (percentage)	11.6	28.1	9.9	11.3	62.4	(96.2)	(26.6)	5.9
Average Assets	28,017	14,648	42,733	19,934	4,546	1,206	57,952	169,036
Of which - Investment in Investee companies	9	2	2	-	-	139	1,555	1,707
Average Liabilities	58,035	13,019	19,677	9,279	34,857	684	24,223	159,774
Average Risk-assets	22,909	12,027	50,955	22,498	4,373	1,206	14,575	128,543
Average assets of provident and mutual funds	50	45	372	193	294	-	1,897	2,851
Average customers' securities	27,488	5,008	59,817	9,510	16,033	-	-	117,856
Average other assets under management	3,617	309	256	1,457	1,196	-	-	6,835
Margin from credits activity	648	644	748	489	89			
Margin from deposits activity	604	135	95	83	261			
Other	86	58	158	52	(13)			
Income (loss) from financing activities before provision for doubtful debts	1,338	837	1,001	624	337	(55)	45	4,127

* The following components have been eliminated: provision for impairment of available-for-sale bonds, loss and provision for impairment of available-for-sale shares, dividend from VISA Europe, gains from severance pay funds, the cost of improvements and examinations performed by IDB New York, settling income tax assessments and reversal of the tax provision in respect of the Bank's share in the earnings of ICC and losses on impairment of investee companies.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)

Reported Amounts

	For the year ended December 31, 2007							
						Financial Management		
	Households*	Small Businesses*	Corporate Banking*	Middle Market Banking*	Private Banking	Non-Financial Companies	Other	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From external sources	120	906	1,256	1,237	134	(13)	585	4,225
- Intersegmental	1,064	(162)	(316)	(514)	180	(23)	(229)	-
Total Income from financing activities	1,184	744	940	723	314	(36)	356	4,225
Operating and other income								
- From external sources	1,416	420	310	229	140	32	25	2,572
Total Income	2,600	1,164	1,250	952	454	(4)	381	6,797
Provision for doubtful debts	123	128	60	124	5	-	7	447
Operating and other expenses	2,096	753	616	706	381	4	510	5,066
Operating Income (loss) before taxes	381	283	574	122	68	(8)	(136)	1,284
Provision for taxes on operating income	113	101	218	43	38	(6)	59	566
Operating Income (loss) after tax	268	182	356	79	30	(2)	(195)	718
Bank's share in operating income of affiliated companies	(2)	-	1	-	-	21	25	45
Minority interest in the income of subsidiaries	(45)	(5)	(4)	(2)	-	-	-	(56)
Net gain from extraordinary items, net of taxes	416	55	3	29	13	-	42	558
Net income (loss)	637	232	356	106	43	19	(128)	1,265
Net income (loss) disregarding certain components**	197	170	348	84	35	20	(14)	840
Return on equity (percentage)*	50.3	34.0	13.9	7.1	16.9	29.9	(5.6)	14.7
Return on equity disregarding certain components** (percentage)*	15.5	24.9	13.5	5.6	14.0	31.5	(0.6)	9.7
Average Assets	23,977	12,160	37,822	21,192	3,950	958	*65,105	165,164
Of which - Investment in Investee companies	-	3	2	-	-	69	1,381	1,455
Average Liabilities	54,089	11,145	18,004	14,109	37,346	248	*21,361	156,302
Average Risk-assets	19,480	10,505	39,540	22,846	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 credit activity	548	580	711	530	46			
Margin from deposits activity	571	123	60	139	266			
Other	65	41	169	54	2			
Income (loss) from financing activities before provision for doubtful debts	1,184	744	940	723	314	(36)	356	4,225

* Reclassified.

** The following components have been eliminated: provision for impairment of available-for-sale bonds, loss and provision for impairment of available-for-sale shares, expenses in respect of encouragement of early retirement, gains from severance pay funds, the cost of improvements and examinations performed by IDB New York, gain on the sale of the provident fund activity and Kahal and a provision for taxes in respect of the investment in 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							
						Financial Management		
	Households*	Small Businesses*	Corporate Banking*	Middle Market Banking*	Private Banking	Non-Financial Companies	Other	Total Consolidated
	in NIS millions							
Income (loss) from financing activities before provision for doubtful debts								
- From external sources	443	747	1,278	1,224	814	(3)	(713)	3,790
- Intersegmental	603	(200)	(365)	(550)	(512)	(15)	1,039	-
Total Income from financing activities	1,046	547	913	674	302	(18)	326	3,790
Operating and other income								
- From external sources	1,317	375	240	195	130	13	89	2,359
Total Income	2,363	922	1,153	869	432	(5)	415	6,149
Provision for doubtful debts	109	182	159	118	2	-	-	570
Operating and other expenses	2,107	675	609	726	375	4	524	5,020
Operating Income (loss) before taxes	147	65	385	25	55	(9)	(109)	559
Provision for taxes on operating income	66	30	160	18	32	(4)	48	350
Operating Income (loss) after tax	81	35	225	7	23	(5)	(157)	209
Bank's share in operating income of affiliated companies	(2)	-	-	-	-	56	134	188
Minority interest in the income of subsidiaries	(68)	(8)	(5)	(1)	-	-	-	(82)
Net gain from extraordinary items, net of taxes	220	25	2	2	8	104	160	521
Net income (loss)	231	52	222	8	31	155	137	836
Net income (loss) disregarding certain components**	103	66	251	59	53	51	14	597
Return on equity (percentage)*	22.6	8.6	10.1	0.7	21.1	431.2	7.1	11.7
Return on equity disregarding certain components** (percentage)*	10.0	11.0	11.4	4.9	36.7	143.3	0.7	8.4
Average Assets	18,905	12,263	37,057	22,866	3,533	307	*59,403	154,334
Of which - Investment in Investee companies	1	-	-	-	-	81	1,523	1,605
Average Liabilities	54,033	7,984	14,954	11,612	37,478	24	*20,897	146,982
Average Risk-assets	17,031	10,054	36,726	20,005	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 credit activity	406	400	645	457	67			
Margin from deposits activity	548	96	79	180	231			
Other	92	51	189	37	4			
Income (loss) from financing activities before provision for doubtful debts	1,046	547	913	674	302	(18)	326	3,790

* Reclassified.

** The following components have been eliminated: the award paid to employees in respect of the sale of the controlling interest in the Bank, gains from the severance pay fund, the cost of improvements and examinations performed by IDB New York, gain from the sale of Ilanot Discount, gain from the sale of the shares in Harel Insurance investments and from the reversal of the provision for impairment of the investment in the First International Bank created in 2003.

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	
	2008	2007	2006	2008	2007	2006	2008	2007
	in NIS millions							
Israel	5,726	5,629	5,201	145	1,110	845	140,732	127,177
Europe	103	108	84	(118)	27	9	5,600	4,531
North America	670	932	741	63	103	(45)	33,586	35,128
Sout America	118	128	123	34	25	27	2,330	1,883
Total Overseas	891	1,168	948	(22)	155	(9)	41,516	41,542
Total Consolidated	6,617	6,797	6,149	245	1,265	836	182,248	168,719

* Reclassified.
Footnote:
(1) Income-earnings from financing operations before provision for doubtful debts and other operating income.

32. EARMARKED DEPOSITS, CREDIT AND DEPOSITS FROM EAMARKED DEPOSITS

	Consolidated		The Bank	
	December 31			
	2008	2007	2008	2007
	in NIS millions			
Credit and deposits from earmarked deposits				
Deposits with banks	-	-	-	-
Credit granted to the public	506	421	104	13
Credit granted to Governments	-	-	-	-
Total	506	421	104	13
Earmarked deposits				
Deposits from the public	1	1	-	-
Deposits from banks	554	537	-	-
Deposits from the Government	134	45	104	13
Total	689	583	104	13

33. CREDIT CARD ACTIVITY

A. HOLDING MEANS OF CONTROL 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 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. At this stage, the "YOU Club" activity has not reached the level specified 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.

B. 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 Restrictive Trade Practices Court requests for approval of a binding arrangement between themselves and for temporary permits to act in accordance with such an arrangement. In these requests, the Court was asked to approve the rates of issuer commission 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 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 Commissioner of the Antitrust Authority granted the request, extending the exemption granted to the existing arrangement between the parties until October 31, 2006.

33. CREDIT CARD ACTIVITY (CONTINUED)

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 evaluate the implications that this commission has on competition.

The Court has decided that the expert shall perform the examination in accordance with the methodology determined in previous proceedings to which the Bank and ICC were parties, the expert being appointed and supervised by the Antitrust Authority.

On September 25, 2008, the Commissioner with the consent of all the parties, applied for an extension of 60 days, until the end of December 2008, for submitting the expert's interim report.

On July 6, 2008, the Commissioner approved the request for extension until the end of February 2009 of the temporary permit to the agreement, submitted by the credit card companies and the banks as shareholders of the credit card companies.

On July 9, 2008, the Antitrust Court extended the validity temporary permit until February 28, 2009. The Court dismissed the motion of the Opponents for retroactive compensation and determined that the difference between the rates of commission specified in the temporary permit and the rates of commission to be determined by the Court at the end of the proceedings may be taken into consideration by the Court in giving its ruling as regards the terms for approval of the continued existence of the arrangement.

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 further specifies 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, 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.

33. CREDIT CARD ACTIVITY (CONTINUED)

The expert rendered an opinion on January 4, 2009. In his opinion, the expert presented a summary review of the Israeli credit card market, a description of Court rulings and the general methodology determined for the purpose of computing the issuer commission, based mainly on the cost of services provided by the issuer directly to the trader; a qualitative description of those services determined by the Court as entitling services, on the basis of the cost of which the issuer commission should be computed; an expense based system, according to which, in his opinion, the issuer commission should be computed in accordance with the methodology determined by the Court; implementation aspects of the elected costing system, considering the unique characteristics of credit card companies and the field in which they operate; the cost structure of the three credit card companies, their nature and classification between entitling and non-entitling costs; and a discussion in the matter of the categories and the proper layout with respect to a change in commission from its present level to its normative level.

In accordance with the Court's ruling of January 12, 2009, ICC, the Bank and the First International Bank informed the Court on February 11, 2009 of their intention to interrogate the Expert with respect to his opinion concerning the computation of the issuer commission rate.

On January 28, 2009, the three credit card companies and the banks owning shares therein, submitted a motion for the extension of the validity of the provisional permit until April 30, 2009, and the provisional permit has been extended accordingly.

The clearing revenues form a function of the clearing commission charged to traders, the cross commission between the credit card companies and the clearing turnover of ICC. In the opinion of the Bank and ICC, the decrease in the cross commission rate is expected to have an effect on the rates of clearing commissions charged to traders.

3) **A joint issuance agreement between ICC and FIBI.** 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. The said agreement replaced a previous agreement of August 1, 2000.

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) **A joint issuance agreement with Mizrahi-Tefahot Bank.** On November 18, 2008, ICC and Diners signed an agreement with Mizrahi-Tefahot Bank for the joint issuance of VISA, MasterCard and Diners Club credit cards, including Mizrahi-Tefahot branded cards, and for determining operating arrangements and providing services by ICC and/or Diners for credit cards issued by them and distributed by Mizrahi-Tefahot Bank to its customers. This agreement replaces the agreement between the parties dated July 26, 1995, as amended.

   The agreement is for a period of five years from date of signature. In the event that the option for the purchase of ICC shares described hereunder is exercised or redeemed, the period of the agreement will be extended to ten years from date of signature. The agreement period will be extended by additional periods of two years, unless a notice in writing is given by one party to the other, six months prior to the end of each period or additional period, of its reluctance to further extend the period of the agreement.

6) **The grant of an option to Mizrahi-Tefahot Bank to purchase up to 10% of ICC's share capital.** Within the framework of the joint issuance agreement described above, Mizrahi-Tefahot Bank was granted an option to purchase from ICC, by way of a share issue, up to 121,978 ordinary shares in ICC, comprising at date of the agreement, 10% of the fully diluted ordinary share capital of ICC. The amount of shares allotted may be higher in the event that prior to the exercise of the option, ICC will issue shares at a price reflecting a value lower than market, in accordance with the formula determined in the agreement. Furthermore, the number of shares may vary respectively, in the event that ICC decides to carry out a reverse split of its ordinary shares into shares having a higher par value or to split its ordinary shares into shares having a lower par value, or decides to distribute bonus shares, all this from date of signing the agreement and until a date prior to the exercise date of the option.

   The option is exercisable in one lot no later than five years from date of the agreement (or, under certain circumstances, during a slightly longer period) at any time after the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers reaches the minimum amount stated in the agreement. The number of ordinary shares to be allotted within the framework of the exercise of the option shall be

33. CREDIT CARD ACTIVITY (CONTINUED)

computed according to a formula determined in the agreement, which is effected by the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers and to the increase in volume of transactions on the bank credit card market in Israel.

In consideration for the exercise of the option, Mizrahi-Tefahot Bank will pay an exercise price in accordance with a formula determined in the agreement, which reflects ICC's present company value and is effected by the net accumulated earnings of ICC in the last four calendar quarters ending prior to the date of the agreement, less the contribution to the profitability to ICC of the cards issued to customers of Mizrahi-Tefahot Bank, as well as subject to a profit multiplier of 12 and certain additional adjustments.

The option may be converted into a cash payment to Mizrahi-Tefahot Bank, if difficulties arise in the exercise of the option by way of allotment of ICC shares, as stated, or if ICC elects to redeem the option in consideration for a payment. Redemption of the option shall be effected by a payment computed according to a formula determined in the agreement, which reflects the future company value of ICC and is subject to the net earnings of ICC (excluding nonrecurring items and capital gains/losses) in the last four calendar quarter ending prior to the date of notice of exercise and a profit multiplier of 12 (or a multiplier derived from the value of ICC on the market, if it is listed for trade prior to the date of exercise of the option, but not higher than a multiplier of 14) and net of the exercise price as stated. The amount to be paid for the redemption of the option shall not exceed an amount of between NIS 85 and NIS 100 million (such maximum amount shall be determined on the basis of the volume of the average monthly amount of credit transactions made by Mizrahi-Tefahot Bank customers in the three calendar months preceding the notice of redemption).

The agreement is subject to all regulatory requirements under any law, if such exist.

34. 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.

35. EARNINGS PER SHARE

	Consolidated		
	2008	2007	2006
Basic earnings[1] Per share[1] of NIS 0.1 (in NIS)			
Net operating income	0.26	0.72	0.32
Net income (loss) from extraordinary items, net of taxes	(0.01)	0.57	0.53
Net income	0.25	1.29	0.85
Weighted average of the number of shares	980,639	980,639	980,639

Footnote:
(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.

36. INFORMATION BASED ON NOMINAL DATA - THE BANK

	December 31	
	2008	2007
	in NIS millions	
Balance Sheet		
Total assets	125,110	*114,138
Total liabilities	116,761	*105,410
Shareholders' equity	8,349	8,728

* Reclassified.

	For the Year Ended on December 31	
	2008	2007
	in NIS millions	
Statement of Income		
Net income	273	1,285

MAIN OFFICE

Tel Aviv, 23 Yehuda Halevi Street. Tel: 972-3-5145555

OVERSEAS BRANCH

London, United Kingdom: 65 Curzon Street

REPRESENTATIVE OFFICES

Paris, France: 33 Rue Galilee
Buenos Aires, Argentina: Corrientes 447 6^0
Santiago, Chile: Av. Vitacura 2771 Of. 804

SUBSIDIARY BANKS ABROAD

Israel Discount Bank of New York
website: http://www.idbbank.com
Main New York Office: 511 Fifth Avenue.
New York Branch: 1350 Broadway
Beverly Hills, CA Branch: 9401 Wilshire Boulevard, Suite 600
Downtown Los Angeles, CA Branch: 888 South Figueroa Street, Suite 550
Aventura, FL Branch: Harbour Centre, 18851 NE 29th Avenue, Suite 600
Grand Cayman (B.W.I.) Branch: P.O.Box 694GT, 11 Dr. Roy's Drive
International Banking Facility: 511 Fifth Avenue
Representative Offices of Israel Discount Bank of New York: Tel Aviv, Israel / Paris, France / Santiago, Chile / São Paulo, Brazil / Lima, Peru / Mexico City, Mexico

Discount Bank Latin America, Uruguay
Montevideo Head Office: Rincon 390
Branches in Uruguay: Montevideo / Punto del Este

IDB (Swiss) Bank Ltd.
Geneva, Switzerland Head Office: 100 Rue du Rhone
Zurich Branch: Talacker 41
Representative Office of IDB (Swiss) Bank: Tel Aviv, Israel

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