



ANNUAL REPORT
2009

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BOARD OF DIRECTORS

DR. JOSEPH BACHAR

Chairman of the Board

ILAN (EILON) AISH

ILAN BIRAN

(Outside Director)

JOSEPH CIECHANOVER - ITZHAR

BETZALEL EIGER

ITSHAK FORER

BEN-ZION GRANIT

GITTIT GUBERMAN

EDITH LUSKY

(Outside Director)

DR. ARIE OVADIA

PROF. DAFNA SCHWARTZ

DR. YITZHAK SHARIR

ZVI STREIGOLD

JORGE ZAFRAN

PROF. BEN ZION ZILBERFARB

* Details regarding members of the Board of Directors and their occupation see p. 346.

MANAGEMENT

GIORA OFFER

President & Chief Executive Officer

ISRAEL DAVID

Deputy Chief Executive Officer

Retail Banking Division

EHUD ARNON

Senior Executive Vice President

Corporate Banking Division

DORIT BENSIMON

Senior Executive Vice President

Finance Division and the Bank's

Chief Risk Manager

JOSEPH BERESSI

Senior Executive Vice President

Chief Accountant

Comptroller Accounting Group

ESTHER DEUTSCH

Senior Executive Vice President

Legal Adviser Legal Advisory Group

AMNON GIDEON

Senior Executive Vice President

Human Resources Group

NOAM HANEGBI

Senior Executive Vice President

Operations & Information

System Division

SHLOMO PITCHON

Senior Executive Vice President.

Internal Auditor

RUTH MOSHKOVITZ

Corporate Secretary

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The Board of Directors, on March 25, 2010, approved and authorized for publication the consolidated financial statements of the Bank and its subsidiaries for the year ended December 31, 2009.

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 five 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

Discount Bank is a universal bank, offering its customers comprehensive banking services, in all areas of financial activity, through 146 branches in Israel, direct banking services, 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 73 branches, and Discount Mortgage Bank Ltd., serving as the main arm of the Group in the mortgage loan field.

The activities in Israel also include:

- Credit cards - The Bank controls Israel Credit Cards Ltd. (hereinafter: "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 and basket certificates - the subsidiary, Tachlit Investment House Ltd., (hereinafter: "Tachlit") which manages securities investment portfolios for private customers, corporations, not-for-profit organizations and institutional bodies. In addition, Tachlit holds 20% of the equity capital of Tachlit Basket Certificates, jointly with the Michael Davis Group, engaging in the issue of basket certificates, (for details as to the steps taken to sell the basket certificate operations, see "Capital market activity" below);
- Non-financial investments and underwriting - the subsidiary "Israel Discount Capital Markets and Investments Ltd." engages in investment banking, investments in private equity funds, in venture capital funds and in other non-financial investments. This subsidiary also engages in underwriting and managing the issue of securities.

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.

In the years 2009-2008 the Bank continued to strengthen its position in the retail banking market, by several central

processes: attracting State employees and teaching staff, marketing mortgages jointly with the subsidiary Discount Mortgage Bank, and 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, while taking the necessary steps required under the circumstances. Alongside the diligent management of the credit portfolio during this period, the Bank made considerable efforts in supporting its longstanding customers also at times of slowdown and crisis.

Against the background of the crisis and its implications, the Bank adopted in the years 2009-2008 efficiency and savings measures (for details regarding the efficiency and savings see "Developments in Income and expenses").

The year 2009 is marked as the year in which the Bank solidified its capital adequacy. During the year, the Bank raised a total amount of NIS 2.2 billion by way of several capital instruments, and ended the year with a ratio of capital to risk assets of 12.1%, in terms of Basel II, and 13/1%, in terms of Basel I (for additional details, see "Capital resources" below).

The Ofek Project – one of the largest and more complex computer projects ever undertaken in Israel – reached its successful completion in 2009, and the Bank now has an advanced computer infrastructure, which serves as a basis for the application of modern banking, customer oriented, which provides both business and operational flexibility.

The year 2009 has also been marked by key processes for solidifying corporate governance at the Bank. In October 2009, the Board of Directors approved the corporate governance code for the Discount Group and a declaration of corporate governance principles at the Discount Group (see under "miscellaneous" below). In addition, the second social report of the Bank was launched in October 2009.

OPERATIONS ABROAD

Most of the operations abroad are 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 and directly holds a bank in Switzerland, with branches in Geneva and Zurich, which focuses on private banking. The Bank operates a London branch, which provides commercial and private banking services.

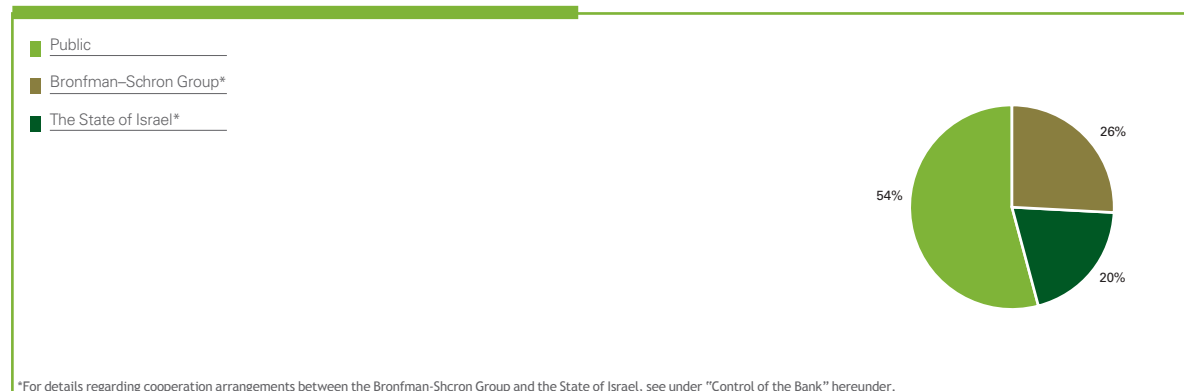
The Bank also has representative offices in Paris, Buenos Aires and Santiago and IDB New York has representative offices in various locations in South America.

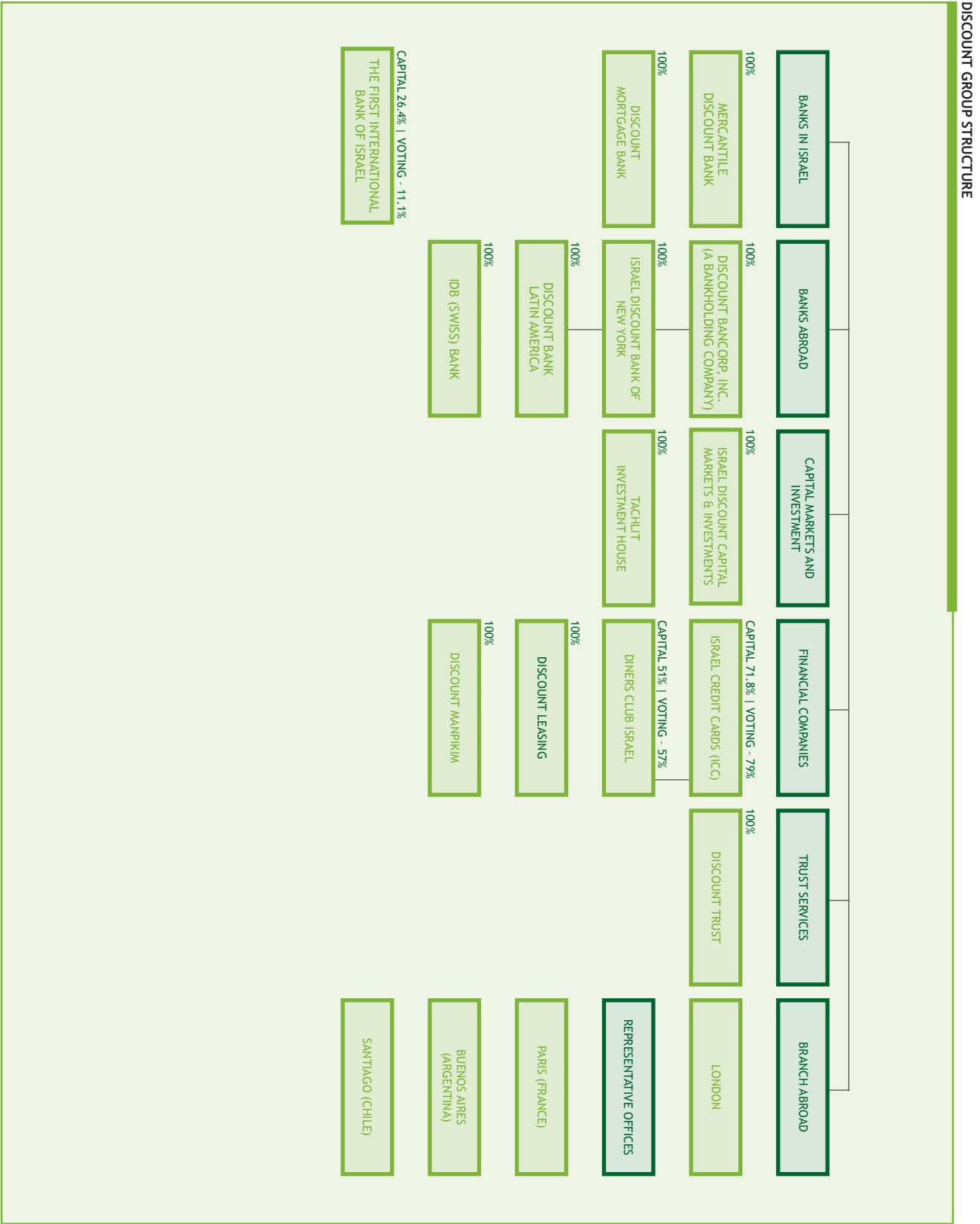
MARKET SHARE

Based on data relating to the banking industry as of September 30, 2009, 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, 2009	December 31, 2008	December 31, 2007
	In %		
Total assets	18.2	18.0	17.5
Credit to the public	16.8	16.7	16.0
Deposits of the public	17.8	17.8	17.4
Earnings from financing operations	21.0	23.0	18.5
Provision for doubtful debts	19.0	15.4	25.2
Operating income	19.7	19.9	17.5
Operating expenses	21.9	20.9	20.9

THE BANK'S SHAREHOLDERS





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 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 with financial wealth held with the Bank of US\$1 million and over, as well as foreign resident customers with financial wealth held at the Bank of US\$0.5 million and above. 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, which is part of the segment). 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 operations of the product segments, and Discount Group's international operations.

The Bank reports its activity in four product segments, as follows:

- **Credit Card operations:** The activity of the Bank in the credit card field is being conducted both through 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 activity includes the Bank's operations in the securities field, pension layouts as well as the operations of a specialized subsidiary - Tachlit Investment House and the operations in the capital market of Mercantile Discount Bank.
- **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 assets 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 “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.

MAIN FIGURES FROM THE CONSOLIDATED FINANCIAL STATEMENTS

PROFITABILITY

	For the year ended December 31			Rate of change in %	
	2009	2008	2007	2009	2008
				Compared with	
	In NIS millions			2008	2007
Income from financing activities before provision					
for doubtful debts	4,757	4,127	4,225	15.3	(2.3)
Provision for doubtful debts	998	780	447	27.9	74.5
Income from financing activities after provision					
for doubtful debts	3,759	3,347	3,778	12.3	(11.4)
Non-financing income	3,091	2,573	2,651	20.1	(2.9)
Of which: operating commissions	2,625	2,495	2,474	5.2	0.8
Non-financing expenses	5,486	5,348	5,145	2.6	3.9
Operating income before taxes	1,364	572	1,284	138.5	(55.5)
Operating income after taxes	857	403	718	112.7	(43.9)
Income (loss) from income after taxes	(20)	(10)	558	100.0	(101.8)
Net income	923	245	1,265	276.7	(80.6)
Net income disregarding certain components*	962	212	894	353.8	(76.3)
Net earnings per share of NIS 0.1 par value (in NIS)	0.94	0.25	1.29		
The return on shareholders' equity, in %	9.8	2.7	14.7		
The return on shareholders' equity disregarding certain components, in % *	10.3	2.3	10.4		

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

BALANCE SHEET

	As at December 31		Rate of
	2009	2008	change
	In NIS millions		In %
Total assets	187,817	183,831	3.3
Credit granted to the public	114,426	116,456	(1.7)
Securities	36,338	31,535	15.2
Deposits from the public	141,825	139,232	1.9
Shareholders' equity including minority interests	10,292	9,023	14.1
Shareholders' equity	9,994	8,797	13.6

FINANCIAL RATIOS

	As at December 31	
	2009	2008
	In %	
Capital resources in relation to total assets	5.5	5.0
Ratio of capital to risk assets (in Basel I terms)	13.12	10.24
Ratio of the provision for doubtful debts to credit to the public	0.83	0.64
Ratio of credit to the public to total assets	60.9	64.0
Ratio of credit to the public to deposits of the public	80.7	83.6
Ratio of deposits of the public to total assets	75.5	76.6
Ratio of operating income to operating expenses	56.3	48.1
Operating expenses relative to total income	69.9	79.8

* The ratio of capital to risk assets as of December 31, 2009, computed in accordance with the Basel II guidelines, was 12.06%.

THE STRATEGIC PLAN

CHANGES IN THE MULTI-ANNUAL STRATEGIC PLAN

The Bank's strategic plan for the years 2007-2011, the accelerated growth plan, had been written under assumptions of growth in the markets in which the Bank operates, and under assumptions of capital adequacy rates that had been in effect at the time. In August 2009, in view of the new economic reality, the Bank's Board of Directors decided to approve an update to the strategic plan, among other things, within the framework of this update, return on capital targets have been determined for the years 2010-2011, at a range of between 9% and 11%. It has also been determined, that the continued implementation of the strategic plan would be conducted bearing in mind the said targets and the decision of the Board of Directors with respect to the overall capital adequacy ratio target of 12% by the end of 2009. During the course of 2010, a new strategic plan for the years 2011-2015 will be presented for approval.

POINTS OF EMPHASIS FOR THE WORK PLAN FOR 2010

The work plan for 2010 that was approved by the Bank's Board of Directors, had been derived from strategic targets defined in the strategic plan and takes into consideration expected changes in the economic climate in Israel and around the world. As part of the work plan, Management determined principal focus points as follows:

People oriented banking

- The Bank is to take action to improve service, with a view, among other things, of reducing customer complaints and improving response to complaints;
- In addition, the Bank will continue to integrate the ethical code.

Continued intensification of the synergy and corporate governance at the Bank and Group levels while focusing on:

- The continued transition of risk management, asset and liability management and the dealing rooms to management on a Group basis;
- Improving procedures for Group level planning and management of capital;

- Approval of work procedures derived from the corporate governance principles document;
- The continued follow-up of and compliance with regulatory requirements;
- Implementation of Basel II.

Controlled growth of business activity

- Central focus on the capital market – increasing the Bank's share of the capital market activity of customers in all segments;
- The continued focusing on the retail segment – attracting new customers, preservation of existing customers and intensifying activity regarding State employees and teaching staff populations, which are to continue serving as the leverage for expanding the Bank's customer base;
- Development of private banking;
- Expanding the range of services offered to corporate banking customers;
- The continued development of Internet and cellular banking.

Efficiency and improvement of effectiveness

- The continued improvement in the Bank's operating efficiency through implementation of the "lean organization" project;
- The continued manpower efficiency process;
- Planning the future workforce required for the changing needs of the banking industry;
- Continued efficiency regarding operating expenses.

Development of the computer systems following the completion of the Unisys project

- With the completion of the Unisys project and the stabilization of the Bank's critical systems, the Bank will be free to attend to new developments;
- Beyond the developments required in response to regulation, the Bank will direct most of its efforts towards new developments in the capital market field;
- In addition, the Bank will invest in developments in the direct banking field and in improving the capabilities of management information;
- Furthermore, the Bank is to continue upgrading its capabilities in the area of continuing its business operations at times of emergency.

Investments

The Bank will focus on non-financial investments to which it had committed in the past, but will not expand them at this stage.

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 2009 amounted to NIS 923 million, compared with NIS 245 million in 2008, an increase of 276.7%.

Net Income disregarding certain components, as detailed hereunder, would have totaled NIS 962 million in 2009, compared with NIS 212 million in 2008, an increase of 353.8%.

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

		For the year ended on December 31,	
	Note	2009	2008
Reported net income		923	245
The effect of reduction in the rate of corporation tax	29	32	-
Dividend from VISA Europe	25	-	(70)
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
Loss on the sale of investee companies		17	-
Provision for taxes in respect of the investment in the First International Bank	6F	(10)	-
Net income disregarding certain components		962	212
The return on shareholders' equity disregarding certain components		10.3%	2.3%

Return on shareholders' equity for 2009 was 9.8%, compared with 2.7% in 2008.

Return on shareholders' equity, disregarding certain components, as detailed above, would have reached in 2009 a rate of 10.3% compared with 2.3% in 2008.

Net earnings per one share of NIS 0.1 par value amounted in 2009 to NIS 0.94, compared with NIS 0.25 in 2008.

Net earnings per one share of NIS 0.1 par value, disregarding certain components, as detailed above, would have reached in 2009 NIS 0.98 compared to NIS 0.22 in 2008.

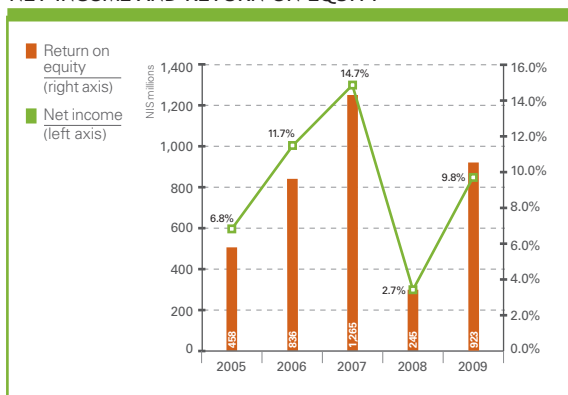
Following are the main factors that had an effect on the business results of the Group in 2009, compared with 2008:

- An increase of 15.3% in income from financing activities before provision for doubtful debts.
- An increase of 27.9% in provisions for doubtful debts.
- An increase in operating and other income at the rate of 20.1%, affected by an increase of 5.2% in operating commissions, An increase of NIS 146 million in profits on investment in shares and an increase of NIS 242 million in other income, mostly due to profits recorded by the severance pay funds.
- An increase in operating and other expenses at the rate of 2.6%, affected from an increase of 2.2% in payroll and related expenses and an increase of 7.8% in buildings and equipment depreciation and maintenance expenses.
- A tax expense of NIS 507 million on earnings from ordinary operations in 2009, compared with NIS 169 million in 2008. The increase in the provision for taxes on income stemmed mostly from the increase in earnings from ordinary operations, and was influenced, among other things, from the effect of the reduction in the tax rate on the balance of deferred taxes, in the amount of NIS 32 million and the utilization of brought forward losses in respect of which

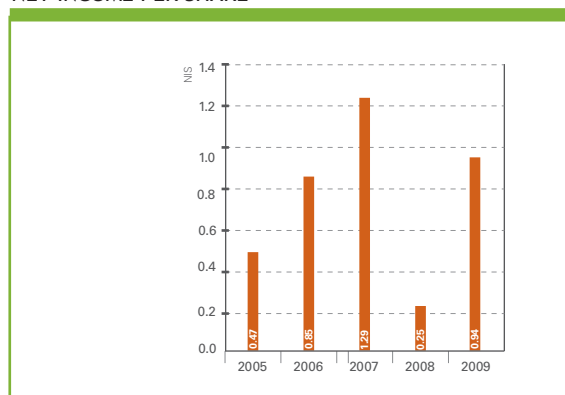
deferred tax assets had not been recognized.

- (f) The Bank's share in earnings from ordinary operations of affiliates in 2009 amounted to earnings of NIS 158 million, compared with a loss in the amount of NIS 70 million in 2008.

NET INCOME AND RETURN ON EQUITY



NET INCOME PER SHARE



DEVELOPMENTS IN INCOME AND EXPENSES

Income from financing activities before provision for doubtful debts amounted to NIS 4,757 million in 2009, compared with NIS 4,127 million in 2008, an increase of 15.3%.

After eliminating adjustments to fair value of derivative financial instruments, the effect of tax hedging, gains and provisions for impairment of bonds, earnings from financing operations before provision for doubtful debts amounted to NIS 4,713 million, compared to NIS 4,307 million in 2008, an increase of 9.4%

Following are details of the impact of certain components on financing income (in NIS millions):

	2009				
	Annual	Fourth quarter	Third quarter	Second quarter	First quarter
Reported financing income	4,757	1,222	1,329	1,266	940
Effect of adjustments to fair value of derivative financial instruments ALM	247	(49)	14	4	278
Effect of tax hedging in respect of IDB New York	(9)	6	(56)	(94)	135
Gains on sale of available for sale bonds, net	(388)	(49)	(93)	(59)	(187)
Provision for impairment of available for sale bonds	119	1	17	50	51
Net realized and unrealized losses (income) on bonds in the trading portfolio	(13)	9	17	(4)	(35)
Financing income after adjustments	4,713	1,140	1,228	1,163	1,182
	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 (income) 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

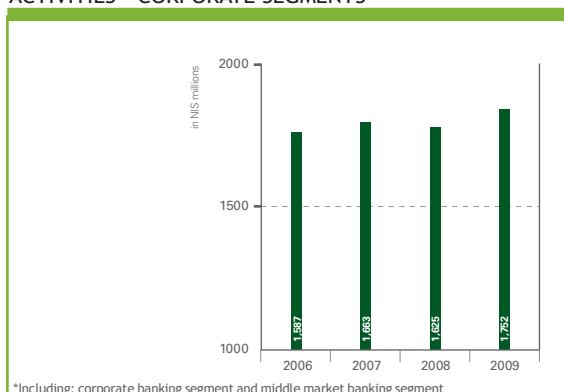
The principle factors affecting profits from financing operations before provision for doubtful debts in 2009, compared with 2008, were:

- An increase at the average rate of 9.7% in the income producing financial assets, from an amount of NIS 249,035 million to NIS 273,230 million;
- Adjustments to fair value of derivative financial instruments which created a negative gap of NIS 219 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;
- Decreased contribution of the active capital, mainly in the CPI linked segments;
- A net increase in other finance (as seen from the following Management Review) in the amount of NIS 722 million, mainly due to an increase of NIS 186 million in earnings from the sale of available-for-sale bonds due to a net increase of NIS 71 million in realized and unrealized gains on adjustment to fair value of trading bonds, due to a decrease in the provisions for impairment of available-for-sale bonds in the amount of NIS 192 million, and in respect of activity in options;

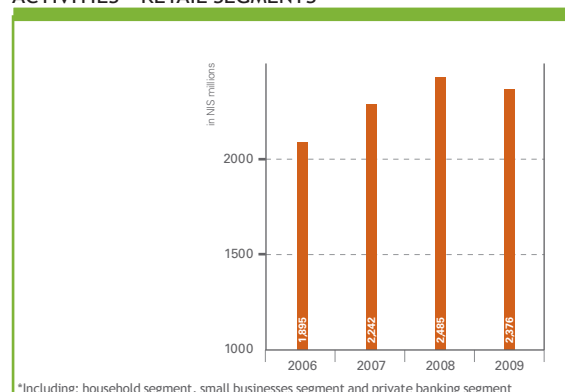
Income from financing activities before provision for doubtful debts in the fourth quarter of 2009 amounted to NIS 1,222 million, compared to NIS 873 million in 2008, an increase of 40.0%. Disregarding adjustments to fair value of derivative financial instruments, the effect of tax hedging, gains and provisions for impairment of bonds, profit from

financing operations before provision for doubtful debts amounted to NIS 1,140 million, compared with NIS 1,083 million in 2008, an increase of 5.3%.

**INCOME FROM FINANCING
ACTIVITIES - CORPORATE SEGMENTS***



**INCOME FROM FINANCING*
ACTIVITIES - RETAIL SEGMENTS**



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							
2009				2008			
Contribution to profit			Contribution to profit			Changes in contribution	
	Volume of activity*	in NIS		Volume of activity*	in NIS		
	in %	millions	In %	in %	millions	In %	millions
Unlinked shekels	49.2	2,375	49.9	47.3	2,388	57.9	(13)
CPI-linked shekels	10.4	(47)	(1.0)	10.4	298	7.1	(345)
Foreign Currency	40.4	1,644	34.6	42.3	1,377	33.4	267
	100.0	3,972	83.5	100.0	4,063	98.4	(91)
Options		83	1.7		(109)	(2.6)	192
Other derivative financial instruments (not including hedged derivatives and ALM)		32	0.7		27	0.7	5
Financing commissions		171	3.6		139	3.4	32
Other financing income (expenses), net		499	10.5		7	0.2	492
Total		4,757	100.0		4,127	100.0	630

* 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.

NET INTEREST INCOME ACCORDING TO LINKAGE SEGMENTS (INCLUDING ALM)

In the non-linked shekel segment, net interest income amounted to NIS 2,375 million in 2009, compared with NIS 2,388 million in 2008, a decrease of 0.5%. Income from this segment constituted 49.9% of total net interest income in 2009, compared with 57.9% in 2008.

The average balance of assets in this segment increased in 2009 by 14.2% compared with the preceding year.

The interest margin of the segment dropped from a rate of 1.88% in 2008 to a rate of 1.69% in 2009.

The decline in profit of this segment, stems from the decline in the interest spread, particularly in respect of an expense of NIS 57 million in respect of fair value adjustments of derivative financial instruments in 2009 compared to earnings of NIS 120 million in 2008 and from a decline in the contribution of the active capital, as a result of a decrease in the non-linked interest rate. The said decrease was offset by an increase in the volume of activity of this segment.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 1.73% in 2009, compared to 1.77% in 2008.

In the CPI-linked shekel segment, net interest expenses amounted to NIS 47 million in 2009, compared with income of NIS 298 million in 2008. Its proportion of total net interest income in 2009 was a negative rate of 1.0%, compared with 7.1% in 2008.

The average asset balance in this segment in 2009, rose by 8.7% 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 134 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 0.33% in 2009, compared to 0.79% in the corresponding period last year. This compared to an actual negative spread of 0.45% in 2009 and compared to an actual positive spread of 0.42% in the corresponding period last year.

The decrease in the interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, stems mostly from a relatively low rate of decline in the cost of resources, part of which were designed to improve the Bank's capital adequacy, compared with the decline at a higher rate in the returns on income producing applications.

The capital contribution of the active capital decreased by an amount of NIS 120 million, mostly as a result of a decline in the volume of the active capital employed.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net interest income amounted to NIS 1,644 million in 2009, compared with NIS 1,377 million in 2008, an increase of 19.4%. Its proportion of all net interest income was 34.6% in 2009, compared with 33.4% in 2008.

In 2009, the average balance of assets in this segment increased by 5.0% compared with the preceding year, which contributed to an increase in the segment's financing earnings.

The interest margin of the segment increased from a rate of 1.32% in 2008 to a rate of 1.51% in 2009.

The increase in segment earnings is due, among other things, to adjustments to fair value of derivative financial instruments creating a positive difference of NIS 92 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.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 1.49% in 2009, compared to 1.37% in 2008.

In addition, a hedging operation performed by the Bank resulted in an increase of NIS 9 million in earnings from financing operations in 2009, compared to an increase of NIS 15 million in the previous year.

Total interest margin (not including the effect of hedge transactions) was 2.39% in 2009, compared with 2.98% in 2008.

The interest margin, including the effect of other derivatives (in hedge transactions and ALM), reached a rate of 1.39% in 2009, compared with a rate of 1.57% in the preceding year.

Total interest margin, disregarding the effect of adjustments to fair value of ALM derivative financial instruments and the effect of tax hedging in respect of IDB New York reached a rate of 1.48% in 2009 compared with 1.57% in 2008.

The decline in the interest spread in 2009 stemmed largely from the decline of the spreads on deposits, against the background of the low interest rate prevailing this 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		
	2009	2008	Rate of change in %
	In NIS Millions		
Retail - household segment	1,210	1,338	(9.6)
Retail - small bussiness segment	813	830	(2.0)
Corporate marker segment	1,096	1,001	9.5
Middle market segment	656	624	5.1
Private banking segment	353	344	2.6
Financial management	629	(10)	-
Total	4,757	4,127	15.3

The decline in the household sector stemmed mostly from the decline in interest spreads, due to the decrease in market interest rate. The increase in the business sector stemmed mostly from the growth in volume of operations in this sector. The increase in the financial sector stemmed mostly from gains on sale of available-for-sale bonds, an increase in realized and unrealized gains from adjustment to fair value of trading bonds and from a decline in the provisions for impairment of available-for-sale bonds.

Provision for doubtful debts in 2009 amounted to NIS 998 million, compared with a provision of NIS 780 million in the preceding year, an increase of 27.9%. In 2009, the provision constituted 21.0% of the income from financing activities before provision for doubtful debts, compared with 18.9% of this income in the preceding year.

Following are details regarding the provision for doubtful debt expenses:

	For the year ended December 31		Rate of change
	2009	2008	
	In NIS Millions		in %
Specific provision for current year	1,264	994	27.2
Reduction of specific provision and collection of debts written-off in previous years	(233)	(223)	
Change of specific provision	1,031	771	33.7
Change of supplemental provision	(33)	9	
Provision charged to statement of Income	998	780	27.9

The annual provision for doubtful debts, as a ratio of credit to the public, not including off-balance sheet credit risk, was 0.83% in 2009 (0.55% - including off-balance sheet credit risk), compared with 0.64% (0.42% - including off-balance sheet credit risk) in 2008.

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, amounted to NIS 6,394 million in 2009 (NIS 6,641 million - including provision for off-balance sheet credit risk). The balance of this provision constitutes 5.29% of the credit to the public (3.64% - including off-balance sheet credit risk), compared with a balance of the provision in the amount of NIS 6,054 million, not including provision for off-balance sheet credit risk (NIS 6,302 million - including provision off-balance sheet credit risk), constituting 4.93% of the credit to the public (3.39% - including off-balance sheet credit risk) at the end of the preceding year.

The specific provision for doubtful debts amounted to NIS 1,031 million in 2009, compared with NIS 771 million in the preceding year, an increase of 33.7%. The change in provisions largely reflects the effect of the economic crisis on the financial condition of certain borrowers.

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.

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

	2009				2008			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
Specific provision	269	260	242	260	342	187	120	122
Supplemental provision	-	(14)	(11)	(8)	24	(5)	19	(29)
Total	269	246	231	252	366	182	139	93
Rate of specific provision from credit granted to the public *	0.89%	0.85%	0.79%	0.82%	1.12%	0.62%	0.43%	0.44%

* On an annual basis.

The increase in the provisions for doubtful debts, as from the third quarter of 2008, 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 3,759 million in 2009, compared with NIS 3,347 million in the preceding year, an increase of 12.3%.

Non-financing income in 2009 amounted to NIS 3,091 million, compared with NIS 2,573 million in the preceding year, an increase of 20.1%.

The distribution of operating and other income item components are as follows:

	2009	2008	2007
In NIS millions			
Account management	666	624	585
Credit cards	1,010	937	847
Revenue from the capital market	705	386	600
Gains on investment in shares, net	197	51	58
The handling of credit	212	213	208
Conversion differences	128	159	143
Foreign trade operations	59	70	74
Other	114	133	136
Total	3,091	2,573	2,651

Operating Commissions amounted to NIS 2,625 million in 2009, compared with NIS 2,495 million in the preceding year, an increase of 5.2%. The increase results mainly from an increase in commissions from credit cards and from account management commissions.

Income from credit card operating activities amounted to NIS 1,010 million in 2009, compared with NIS 937 million in 2008, an increase of 7.8%.

Income from capital market activity in 2009 amounted to NIS 705 million, compared with NIS 386 million in 2008, an increase of 82.6%. The increase stems mainly from earnings of the severance pay fund.

Presented below are details regarding earnings from capital market operations in the years 2007-2009:

	Consolidated		
	2009	2008	2007
In NIS millions			
Income from operations in securities and in certain derivative instruments	339	306	315
Distribution of financial products	55	37	54
Management, operating and trusteeship services to institutional entities	49	30	127
Profit from severance pay funds	260	-	89
Other income	2	13	15
Total	705	386	600

Gains on investment in shares, net, amounted to NIS 197 million in 2009, compared to NIS 51 million in the previous year. The profit in 2009 resulted primarily from a dividend of NIS 38 million received by the Bank and by Mercantile

Discount Bank from Bezeq, gross gains of NIS 22 million on the sale of the balance of the shares in "HOT", gross gains of NIS 121 million on the realization of the Bezeq shares and gross gains of NIS 25 million on the realization of the shares in Harel (see Notes 3 and 25 to the financial statements) and eliminating a provision for impairment of a fund of hedge funds in the amount of NIS 19 million. Gains in 2008, resulted primarily from a dividend in the amount of NIS 38 received by the Bank and Mercantile Discount Bank from Bezeq and from a dividend in the amount of NIS 110 million received by the Bank and Israel Credit Cards Ltd. from Visa Europe. In 2008 the income was partly offset by a provision for impairment in value in respect of a fund of hedge funds, of NIS 67 million.

Other income in 2009 amounted to NIS 269 million, compared with NIS 27 million in the preceding year. The increase stems mainly from the fact that in 2008, no profits of the severance pay funds were recorded as part of other income, while in 2009 income in the amount of NIS 260 million was so recorded.

Non-financing expenses amounted to NIS 5,486 million in 2009, compared with NIS 5,348 million in 2008, an increase of 2.6%.

Salaries and related expenses amounted to NIS 3,175 million in 2009, compared with NIS 3,106 million in the preceding year, an increase of 2.2%. (for details as to the components of this item, see Note 27 to the financial statements).

Following are details of the effects of certain components on salaries and related expenses:

	For the year ended December 31			Change in %	
	2009	2008	2007	2009	2008
	In NIS millions			compared to	
				2008	2007
Salaries and Related Expenses - as reported	3,175	3,106	3,030	2.2	2.5
Awards	(179)	(103)	(290)		
Expense resulting from share based payment transactions	(2)	(15)	(27)		
The effect of changes in retirement rates on the provision for long-term service awards	(65)	-	-		
Encouragement of early retirement expenses	(6)	-	(91)		
The influence of the severance pay fund	80	(81)	96		
Salaries and Related Expenses - Disregarding certain components	3,003	2,907	2,718	3.3	6.9

The increase in payroll expenses in 2009, disregarding certain components, compared to the preceding year, has been affected mostly by the wage agreements expected for 2009 at the Bank and at Mercantile Discount Bank.

In 2009, the severance pay fund recorded profits of NIS 340 million, which served to partially cover the increase in liabilities for severance pay in respect of prior years in the amount of NIS 80 million, resulting from the expected wage agreement for 2009 and the surplus profit in the amount of NIS 260 million being recorded in other income. In 2008, the severance pay funds recorded net losses of NIS 81 million, a loss that increased the recorded severance pay expense. The expenses for 2009 include a provision for bonuses in accordance with the annual return rate. For additional details, including details on employees retired in 2007-2009, see "Human Resources" below.

Salaries expenses, excluding related expenses, amounted in 2009 to NIS 2,135 million, compared with NIS 2,009 million in 2008, an increase of 6.3%.

Depreciation and maintenance of building and equipment amounted to NIS 981 million in 2009, compared with NIS 910 million in the previous year, an increase of 7.8%. 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 amounted to NIS 1,330 million in 2009, compared with NIS 1,332 million in the preceding year, a decrease of 0.1%. The Bank recorded a decrease of 15.4% in other expenses which was offset by an increase in other expenses at the Bank's consolidated subsidiaries (increase in deposit insurance expenses at IDBNY and increase in expenses at ICC concurrent, with expansion of its operations).

The cover rate of non-financing income to non-financing expenses reached 56.3% in 2009, compared with 48.1% in the preceding year.

Total operating expenses in relation to total income reached a rate of 69.9% in 2009 compared to 79.8% in the previous year.

Operating income before taxes amounted to NIS 1,364 million in 2009, compared with NIS 572 million in the preceding year, an increase of 138.5%.

Provision for taxes on operating income amounted to NIS 507 million in 2009, compared with NIS 169 million in the preceding year. The ratio of the provision for taxes in relation to earnings from ordinary operations, before taxes, reached 37.2% in 2009, compared with 29.5% in 2008. The increase in the effective tax rate stemmed, among other things, from the effect of the decrease in tax rate on outstanding deferred taxes as well as from utilization of carry forward losses in the amount of NIS 40 million, in respect of which no deferred tax assets had been recognized (for additional details see Note 29 B to the financial statements).

Operating income (losses) after taxes amounted to NIS 857 million in 2009, compared with NIS 403 million in 2008, an increase of 112.7%.

The Bank's share in operating income (losses) after taxes of affiliated companies in 2009 amounted to income of NIS 158 million, compared with a loss in the amount of NIS 70 million in the preceding year. The loss in 2008 stemmed primarily from a provision for impairment in respect of KFS (see Note 6).

Net operating income amounted to NIS 943 million in 2009, compared with NIS 255 million in the preceding year, an increase of 269.8%.

The ratio of operating income before taxes to shareholders' equity, including minority interest, was 17.0% in 2009, compared with a ratio of 7.7% in the preceding year.

The ratio of operating income after taxes to shareholders' equity, including minority interest, was 10.7% in 2009, compared with a ratio of 5.4% in the preceding year.

Net losses from extraordinary operations, after taxes, amounted, in 2009, to NIS 20 million, compared to losses of NIS 10 million in 2008.

Net income in 2009 amounted to NIS 923 million, compared with of NIS 245 million in the preceding year, an increase of 276.7%.

Return on shareholders' equity reached a rate of 9.8% in 2009, compared with a rate of 2.7% in 2008.

Net earnings per one share of NIS 0.1 par value amounted in 2009 to NIS 0.94 compared with NIS 0.25 in the preceding year.

The income in the fourth quarter of 2009 amounted to NIS 154 million, compared to NIS 292 million in the third quarter of 2009, and compared to a loss of NIS 121 million in the corresponding quarter last year.

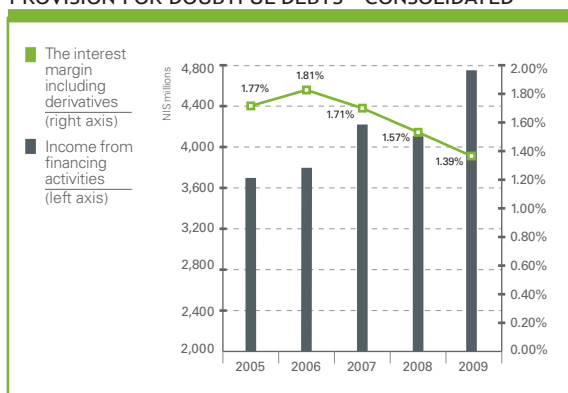
Return on shareholders' equity in the fourth quarter of 2009 reached an annualized rate of 6.3%, compared with a rate of 12.7% in the third quarter of 2009, and compared with a negative rate of 5.5% in the corresponding quarter last year.

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

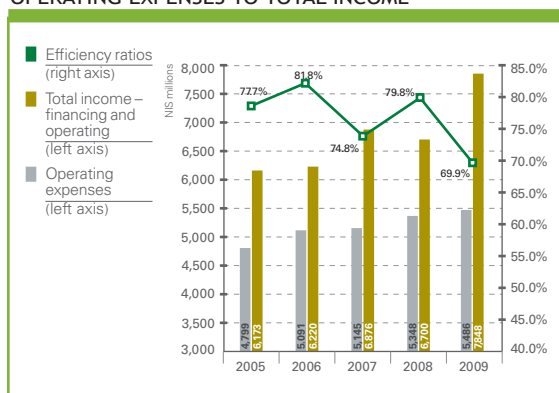
	2009		2008
	Quarter 4	Quarter 3	Quarter 4
Reported net income (loss)	154	292	(121)
Deferred taxes in respect of prior periods	(39)	-	-
The effect of reduction in the rate of corporation tax	(5)	37	-
Dividend from Visa Europe	-	-	(70)
The effect of the provision in respect of the wage agreement on the increase in liabilities provisions for wage related expenses	(16)	(15)	(19)
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
Provision for taxes in respect of the investment in the First International Bank	120	-	-
Net income (loss) disregarding certain components	214	314	(163)
The return on shareholders' equity disregarding certain components	8.8%	13.7%	(7.3%)

An estimate of the effect of the Bank's and Mercantile Discount Bank's wage agreements on the business results for the first quarter of 2010. The Bank will include in its financial statements for the first quarter of 2010, the full increase in the provisions for wage related liabilities in accordance with Management's evaluation of the cost of the wage agreement for 2010, in the estimated amount of NIS 115 million (first quarter 2008: NIS 99 million).

INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS - CONSOLIDATED



OPERATING EXPENSES TO TOTAL INCOME



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 also continued throughout 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. (for additional details, see "The retail segment – general" under "Activity of the Group according to principal segments of operation").

Change in the organizational structure. This change that was decided on towards the end of 2008 was implemented at the beginning of 2009, in the framework of which the Marketing and Strategic Planning Division as well as the Asset Management Division have been dissolved. This change included, 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. The conversion of all systems still operating on the Unisys computer has been completed, and in October 2009 production operations using the Unisys computer, were discontinued. 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. Most of the said savings will be reflected as from the year 2010 and thereafter.

Reduction in manpower. The above detailed actions resulted, among other things, in the reduction in the number of staff at the Bank to the tune of approximately 351 employees during 2009. This, following a decrease of 253 employees in 2008 (some 406 employees from March 2008 to December 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. In February 2009, the Board of Directors decided that the remuneration paid to Directors will be reduced by 10% for a period of twelve months starting March 2009. The total savings resulting from these actions at the Bank amounted to NIS 48 million.

Cost reductions. In response to the Bank's approach, most of the Bank's suppliers have agreed to a 6%-10% reduction, in 2008, in the price of goods and services supplied to the Bank. Concurrently, the Bank has examined and continues to examine 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 constitutes 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 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.

DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2009 amounted to NIS 187,817 million, compared with NIS 181,831 million at the end of the preceding year, an increase of 3.3%.

Following are the developments in the principal balance sheet items:

	December 31		Rate of change in %
	2009	2008	
	In NIS Millions		
Assets			
Cash and deposits with banks	24,583	21,554	14.1
Securities	36,338	31,535	15.2
Credit granted to the public	114,426	116,456	(1.7)
Liabilities			
Deposits from the public	141,825	139,232	1.9
Deposits from banks	3,724	4,555	(18.2)
Subordinated capital notes	11,529	9,373	23.0
Shareholders' equity	9,994	8,797	13.6

CREDIT GRANTED TO THE PUBLIC

General. Credit to the public as at December 31, 2009, amounted to NIS 114,426 million, compared with NIS 116,456 million on December 31, 2008, a decrease of 1.7%. The ratio of credit granted to the public to total assets reached 60.9% at the end of 2009, compared with 64.0% at the end of 2008.

For details regarding credit risk management, including strategy and policy relating to the credit risk management field, the structure and organization of credit risk management functions and more, see "Credit risk management" under "Exposure to risks and risk management" hereunder.

HANDLING RISKS IN THE WAKE OF THE FINANCIAL AND NON-FINANCIAL CRISIS IN THE MARKETS

In view of the financial and non-financial crisis in the markets, which adversely affected the financial situation of part of the borrowers, the Bank is performing an ongoing monitoring of macro-economic developments, capital market trends, Shekel exchange rates, trends in the off-banking credit market and foreign market trends, particularly in the U.S. and Europe.

The second quarter of 2009 reflected a slight recovery trend in the economy alongside an accelerated rise of capital market indices. The Bank is following, on a current basis the developments in the recovery rate of the various economic sectors and is updating its credit policy accordingly.

The Bank continues to control the credit portfolio and is evaluating the position of borrowers in the various economic sectors while examining new borrowers on a selective basis.

The Bank regularly reviews and updates the debt ratings and its adjustment to the customer's condition.

Several extensive examinations were carried out last year with the purpose of identifying and locating warning signs or deterioration in the financial condition of customers. An examination has been made of transactions for the acquisition of means of control, examination of the exposure of Bank customers to bonds that had been issued by them and are now traded at excessive returns, examination of customers the majority of whose business activity is located in developing countries and examination as to whether borrowers are honoring their off-banking obligations. In the wake of these examinations it has been decided on the individual handling of certain borrowers, including their classification as problematic debtors, as well

as, to the extent to which the inclusion of a provision for doubtful debt in their respect is required. On October 12, 2009, the Supervisor of Banks issued a letter to the banking corporations in which they were requested to examine the need for reducing rating, increasing collateral, reclassification and/or creating provisions in respect of borrowers identified as sensitive to the crisis, this based on criteria described in the letter as well as criteria determined by the banking corporation itself. The Bank has performed an additional examination in accordance with guidelines of the Supervisor of Banks, as stated. In the examination, no additional adversely affected large borrowers not previously detected have turned up. This, based on the extensive examination already made this year.

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, 2009		December 31, 2008		
	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of changes in %
Non-linked shekels	59,498	52.0	56,020	48.1	6.2
CPI-linked shekels	19,021	16.6	21,016	18.0	(9.5)
Foreign currency and foreign currency-linked shekels	35,907	31.4	39,420	33.9	(8.9)
Total	114,426	100.0	116,456	100.0	(1.7)

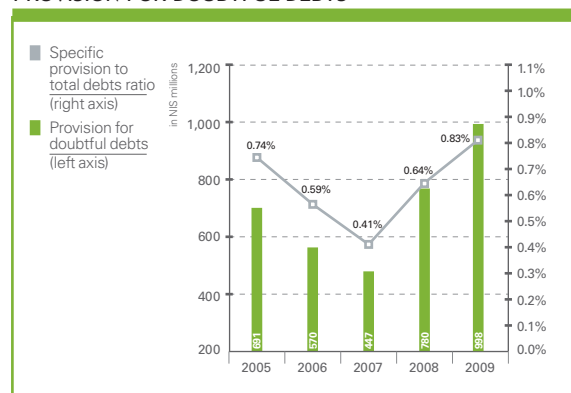
Credit to the public denominated in foreign currency and in Israeli currency linked thereto decreased by 8.9% compared with December 31, 2008. In U.S. Dollar terms, credit to the public in foreign currency and foreign currency linked Shekels decreased by US\$856 million as compared to December 31, 2008, a decrease of 8.3%.

The total credit to the public, which includes credit in foreign currency and Israeli currency linked to foreign currency, computed in dollar terms, decreased by 1.5% as compared to December 31, 2008.

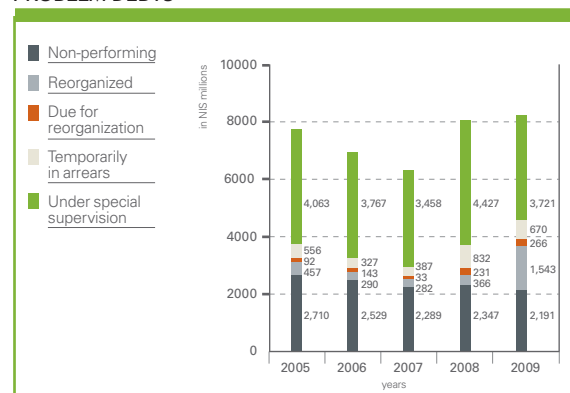
DEVELOPMENTS IN THE PROVISIONS FOR DOUBTFUL DEBTS AND IN CREDIT TO PROBLEMATIC BORROWERS IN THE GROUP

The balance of the provision for doubtful debts to credit to the public (excluding off-balance sheet credit risk) reached 5.29% in 2009 compared to 4.93% in 2008.

PROVISION FOR DOUBTFUL DEBTS



PROBLEM DEBTS



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

	December 31	
	2009	2008
Non-performing debts	2,191	2,347
Reorganized debts ⁽²⁾	1,543	366
Debts due for reorganization ⁽³⁾	266	231
Debts temporarily in arrears	670	832
Debts under special supervision ⁽⁴⁾	3,721	4,427
Total balance sheet credit to problematic borrowers	8,391	8,203
Off-balance sheet credit risk regarding problematic borrowers ⁽⁵⁾	873	1,359
Debentures of problematic borrowers	12	64
Other assets in respect of derivative	24	209
Total overall credit risk concerning problematic borrowers	9,300	9,835
The overall credit risk in respect of problematic borrowers and banks	11	6
The total credit risk in respect of problematic borrowers and banks	9,311	9,841

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 and 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 980 million, presented net of specific provision made thereof, and housing loans of NIS 156 million, in respect of which a provision according to the period of default exists (December 31, 2008: NIS 622 million and NIS 178 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 overall credit risk is in the construction and real-estate, financial services and industry sectors. 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.

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 original 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 Directive and the principal changes included therein as compared with prevailing instructions, see Note 1 AA (3) to the financial statements.

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 if not actually collected by this date, in respect of defective debts as defined in the Directive and to create provisions in accordance with requirements of 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, 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 results of operations of the Bank, including the effect of the initial implementation of the Directive of the Bank's equity. 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's management is preparing for the implementation of the Directive within the framework of a project 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 several teams are active in a number of areas (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 preliminary 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.

On February 18, 2010, the Supervisor of Banks published an update of the original instruction, which, among other things, defers the implementation of the instruction to January 1, 2011 (instead of January 1, 2010, as stated in the original instruction). For details regarding the said update, including the disclosure requirements specified therein with respect to the financial statements for December 31, 2010, see Note 1 (AA) (3) to the financial statements.

THE RISK CHARACTERIZATION OF THE CREDIT TO THE PUBLIC PORTFOLIO

The deterioration in the quality of the portfolio was reflected in the increase in the rate of outstanding problematic debts to the total Group's outstanding credit to the public, from 7.0% at the end of 2008 to 7.3% at the end of 2009.

Since 2008, most borrowers in most economic sectors experienced a continued deterioration in activity and in the loan repayment ability, while since the third quarter of 2009, corporations reported a more rapid than expected recovery in business activity and in repayment ability, which continued during the fourth quarter of the year.

The provision for doubtful debts of the Group amounted in 2009 to NIS 998 million, compared to a provision of NIS 780 million in 2008, an increase of 28%.

The Group's specific provision for doubtful debts amounted in 2009 to NIS 1,031 million, compared to a provision of NIS 771 million in 2008, an increase of 33%.

As a result of the deterioration, the ratio of the specific provision to the outstanding balance sheet credit increased from 0.7% in 2008 to 0.9% in 2009.

The deterioration in the quality of the credit portfolio stemmed from an increase in the volume of the reorganized problematic debt, which grew from NIS 366 million in 2008 to NIS 1,541 million in 2009, as a result of the deterioration in cash flows of a part of the borrowers and the need to adjust the repayment terms to the current repayment ability.

The non-performing debt decreased to an amount of NIS 2.22 billion, compared with NIS 2.35 billion in 2008, a decrease at the rate of 5.5%, stemming from the stricter collection arrangements and/or debt repayment arrangements with customers and from the increase in the value of collateral securing the debt to the Bank.

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

- Commercial sector - a moderate decline was recorded in income and operating profit margin as a result in the slow down in current consumption and a decline in demand on the domestic market;
- Construction and real estate sector - stability was recorded in the occupancy and rental fee rates of income producing commercial property, an increase in the rate of occupancy of office space in demand areas in the center of the country, excluding Tel Aviv, including an increase in income from residential construction as a result of an increase in the number of new residential units sold as part of private entrepreneurship. The activity of income bearing entrepreneurial real estate companies abroad deteriorated, exhibiting a decline in the value of real estate property in certain areas affected by the global economic crisis, a fact that caused, among other things, difficulties in refinancing part of the assets;
- Industry sectors - a decline in the extent of industrial production as a result of a decline in domestic and foreign demand against the background of the slowdown in global trade;
- Communications sector - registered a moderate increase in the scope of activity alongside an improvement in the operating profit margin following mergers, acquisitions and efficiency measures.
- Other business services sector - the circumstances of certain private customers and of small and medium sized businesses in the sector SME 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	2009	2008
Construction and real-estate	1.3%	0.9%
Hotels, hotel services and food	1.3%	1.3%
Commerce	0.9%	0.7%
Industry	0.9%	0.8%
Communications and computer services	1.7%	0.3%
Business services and other	1.1%	1.2%

The above data indicate that, with the exception of the hotel industry and the other business services industry, an increase in the rate of the specific provision for doubtful debts was recorded in respect of the remaining principal economic sectors, in relation to the credit to the public at the Bank. The significant increase in the provision for doubtful debts in respect of the real estate sector stemmed mainly from foreign operations of borrowers, requiring an increase in the provision from NIS 28 million in 2008 to NIS 123 million in 2009.

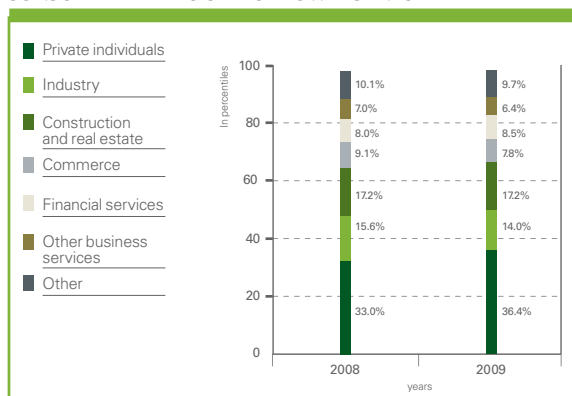
The increase in the provision for doubtful debts in respect of the communications industry stemmed mostly from the Bank's exposure to a certain borrower.

Following are the proportionate share of certain economic sectors in the total specific provision compared to 2008:

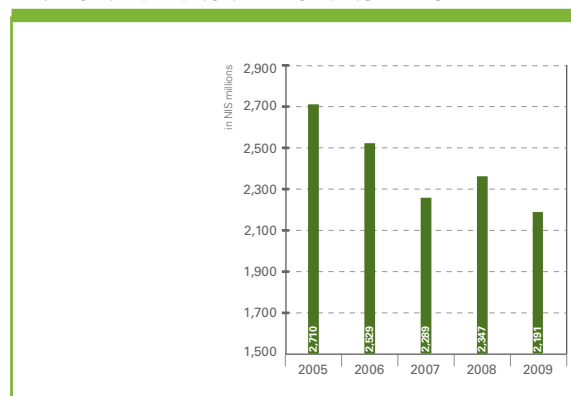
Sector	Proportion of provision	
	2009	2008
Construction and real-estate	27.6%	25.0%
Hotels, hotel services and food	3.7%	5.6%
Commerce	9.6%	12.5%
Industry	13.4%	17.6%
Communications and computer services	4.8%	0.9%
Business services and other	10.0%	15.0%

The above data indicate that, the weight of the construction and real estate industry and the communications industry in the total provision has increased compared to 2008.

CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS - BORROWERS IN ISRAEL



DEVELOPMENT IN NON-PERFORMING DEBTS



Development of credit to the public by economic sectors. Balance sheet credit risk for the construction and real estate sector amounted to NIS 22.5 billion as at December 31, 2009, compared with NIS 22.6 billion on December 31, 2008, a decrease of 0.5%, which constituted about 19.1% of the total balance sheet credit risk to the public, compared with 18.7% on December 31, 2008. Off-balance sheet credit risk for the construction and real estate sector (mostly sales guarantees and non-utilized credit lines) amounted to NIS 11.0 billion as at December 31, 2009, compared with NIS 12.0 billion on December 31, 2008, and it constituted 17.9% of the off-balance sheet credit risk, compared with 19.1% as at December 31, 2008.

Total credit risk for the construction and real estate sector constituted 18.7% of the total credit risk to the public as at December 31, 2009, compared with 18.8% on December 31, 2008.

Total credit risk for the industrial sectors amounted to NIS 27.3 billion as at December 31, 2009, compared with NIS 29.6 billion at December 31, 2008, a decrease of 8%, and it constituted 15.2% of the total credit risk to the public under the Group's responsibility, compared with 16.1% as at December 31, 2008. 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, 2009 amounted to NIS 2.9 billion, compared to NIS 3.6 million on December 31, 2008, a decrease of 19.4%.

Total credit risk for the commercial sector amounted to NIS 17.4 billion as at December 31, 2009, compared with NIS 20.3 billion as at December 31, 2008, a decrease of 14.4%, and it constituted 9.7% of the total credit risk to the public, compared with 11.0% the preceding year.

Total credit risk to individuals was NIS 52.0 billion as at December 31, 2009, compared with NIS 50.4 billion as at December 31, 2008, an increase of 3.3%, and it constituted 29.0% of the total credit risk to the public, as compared with 27.4% as at December 31, 2008.

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

	December 31				
	2009		2008		Rate of change in %
	In NIS Millions	% of total credit to public	In NIS Millions	% of total credit to public	
Retail - household segment	32,534	28.4	*29,502	25.3	10.3
Retail - small business segment	13,653	11.9	14,152	12.2	(3.5)
Corporate market segment	44,725	39.1	47,025	40.4	(4.9)
Middle market segment	19,815	17.3	22,690	19.5	(12.7)
Private banking segment	3,699	3.3	3,087	2.6	19.8
Total	114,426	100.0	116,456	100.0	(1.7)

* Reclassified.

Developments in credit to the public, including off-balance sheet credit risk by borrower size. Approximately 99.5% of borrowers were granted credit of less than NIS 1.2 million. Credit to this group constituted 32.4% of total credit to the public as at December 31, 2009, compared with 31.2% as at December 31, 2008.

The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 50.8% of all credit as at December 31, 2009, compared with 52.5% as at December 31, 2008.

The 65 largest borrowers, in the credit brackets between NIS 200 million and NIS 1,600 million, were granted credit constituting 16.5% of total credit as at December 31, 2009, compared with 74 borrowers that were granted credit constituting 16.3% of the total credit as at December 31, 2008.

Credit levels in excess of NIS 800 million – additional details. The financial statements as of December 31, 2009, present details regarding composition of credit to the public and off-balance-sheet credit risk, by size of credit to individual borrower (Note 4 D), in accordance with public reporting instructions published by the Supervisor of Banks.

Following are general details regarding the largest borrowers included in the two upper levels of the said Note⁽¹⁾ As at December 31 2009 and December 31 2008 (Consolidated):

	As at December 31	
	2009	2008
	in NIS thousands	
Field of activity:		
Finance ⁽²⁾	1,217,540	617,988
Security ⁽²⁾⁽³⁾	1,135,741	940,805
Energy ⁽²⁾⁽³⁾	1,082,979	1,020,598
Finance ⁽²⁾⁽³⁾	984,081	1,250,663
Finance ⁽²⁾	968,970	480,248
Sea freight ⁽²⁾⁽³⁾	965,185	984,063
Real estate ⁽²⁾	945,620	685,756
Real estate ⁽²⁾⁽³⁾	929,384	1,167,348
Infrastructure ⁽²⁾⁽³⁾	914,000	914,000
Food ⁽²⁾	910,496	690,492

Footnotes:

(1) The above data represent "indebtedness" data (also including unutilized credit facilities).

(2) One of the 10 borrowers in the two upper levels in 2009.

(3) One of the 7 borrowers in the two upper levels in 2008.

CREDIT GRANTED TO GOVERNMENTS

Credit granted to the Governments amounted to NIS 1,820 million as at December 31, 2009, compared with 1,491 million as at end of 2008, an increase at a rate of 22.1%.

The balance as at December 31, 2009 includes NIS 1,517 million deposited with the Accountant General's deposit as part of the Bank's success in the teachers tender and the state employees tender (compared to NIS 1,460 million as at December 31, 2008; see "Retail banking segment - Household segment" under "Activities of the Group according to principal segments of operations" hereunder).

SECURITIES

General. Securities amounted to NIS 36,338 million as at December 31, 2009, compared with NIS 31,535 million at the end of 2008, an increase of 15.2%.

Nostro portfolio management policy. The "nostro" investment portfolios of the Bank and of its subsidiaries are used primarily as a central tool in the management of linkage base and interest rate risks, as well as in the management of excess liquid funds. The portfolios are managed with a general overview, aiming at maximizing interest income, under risk limitations determined by the Board of Directors and the Boards of Directors of the subsidiaries. The asset and liability management committee is the factor which actually determines the composition of the portfolio in each of the companies.

As seen from the data detailed hereunder, some 62% of the portfolio is invested in Government bonds, and 25% of the portfolio is invested in bonds of U.S. Government Supported Enterprises (GSE).

Within the framework of the steps taken by the Bank for the improvement in its capital adequacy and for the preparations

towards the implementation of the Basel II guidelines, the Bank realized a large part of the corporate bonds portfolio held by it in Israel. Likewise, IDB New York has exchanged part of its asset backed securities (ABS) of the Fannie Mae and Freddie Mac agencies for collateralized mortgage obligations (CMO) of the Ginnie Mae agency, which are fully guaranteed by the government.

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 %
	2009	2008	
	In NIS Millions		
Non-linked shekels	8,594	8,206	4.7
CPI-linked shekels	6,897	3,527	95.5
Foreign currency and foreign currency-linked shekels	20,134	18,435	9.2
Shares - non-monetary items	713	1,367	(47.8)
Total	36,338	31,535	15.2

Securities in foreign currency and in Israeli currency linked foreign currency increased by 9.2% compared with December 31, 2008. In U.S. Dollar terms, the securities in Israeli currency and in foreign currency linked Israeli currency increased by US\$485 million, an increase of 10.0% as compared with December 31, 2008.

Total securities, including securities in foreign currency and in Israeli currency linked to foreign currency expressed in U.S. Dollar terms, increased by 15.7% as compared with December 31, 2008.

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, 2009			December 31, 2008		
	Net adjusted cost	Fair value	Book value	Net adjusted cost	Fair value	Book value
In NIS millions						
Bonds						
Held-to-maturity	1,989	2,014	1,989	1,917	1,855	1,917
Available-for-sale	31,451	31,491	31,491	26,682	26,260	26,260
Trading	2,110	2,145	2,145	2,027	1,991	1,991
Shares						
Available-for-sale	700	703	703	1,282	1,325	1,325
Trading	16	10	10	52	42	42
Total Securities	36,266	36,363	36,338	31,960	31,473	31,535

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 40 million as of December 31, 2009, is included in equity under "adjustments to fair value of available-for-sale securities" as a positive capital reserve (December 31, 2008: NIS 186 million as a negative capital reserve). 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 17 million as a positive capital reserve (December 31, 2008: NIS 10 million as a negative capital reserve).

Transfer of bonds from the available-for-sale portfolio to the held-to-maturity portfolio. Due to the significant change in the treatment of available-for-sale bonds when computing the ratio of capital to risk assets (in Basel II terms), the Supervisor of Banks informed that he would allow banking corporations the one off transfer on March 31, 2010, of bonds from the available-for-sale portfolio to the held-to-maturity portfolio, subject to the terms determined by him. The Bank is considering with the Supervisor of Banks the possibility of such a transfer.

Corporate bonds. Discount Group's available for sale securities portfolio as of December 31, 2009, includes investments in corporate bonds in the amount of NIS 3,350 million (an amount of NIS 1,381 million is held by IDB New York and an amount of NIS 1,573 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 G to the financial statements.

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:

Available for sale bonds - data according to economic sectors

December 31, 2009				
	Net adjusted cost	Fair value	Cumulative other comprehensive income	
			profits	losses
In NIS millions				
Non governmental bonds and bills				
Industry	38	38	2	2
Construction and real estate	141	130	3	14
Electricity and water	138	142	5	1
Commerce	16	15	-	1
Transportation and storage	33	34	2	1
Financial services ⁽¹⁾	3,332	2,991	21	362
Total non governmental bonds and bills	3,698	3,350	33	381
Government bonds and bills				
US government*	5,204	5,207	29	26
Israel Government	13,328	13,494	183	17
Other Governments	236	236	1	1
Total government bonds and bills	18,768	18,937	213	44
Government Sponsored Enterprises (GSE) Agencies				
Freddie Mac	4,074	4,177	115	12
Fannie Mae	4,696	4,804	115	7
Other	215	223	8	-
Total Government Sponsored Enterprises (GSE) Agencies	8,985	9,204	238	19
Total available-for-sale bonds	31,451	31,491	484	444
December 31, 2008				
Total non governmental bonds and bills	5,288	4,460	8	836
Total government bonds and bills	9,993	10,313	344	24
Total Government Sponsored Enterprises (GSE) Agencies	11,401	11,487	118	32
Total available-for-sale bonds	26,682	26,260	470	892

* Including Ginnie Mae bonds in a fair value of NIS 5,093 million.
For additional details see next page.

(1) Following are details regarding available for sale securities in financial services sector:

December 31, 2009				
	Net adjusted cost	Fair value	Cumulative other comprehensive income	
			profits	losses
Rating	In millions NIS			
banks and banking holding companies ⁽²⁾	3,040	2,711	18	347
insurance	34	31	-	3
other	258	249	3	12
Total financial services	3,332	2,991	21	362

(2) Following are details according to geographical areas of investments in available for sale securities of banking and banking holding companies:

North America ⁽³⁾	2,135	1,824	11	322
West europe ⁽⁴⁾	609	587	1	23
Israel	193	197	5	1
Asia	56	56	1	1
Australia	25	25	-	-
Other	22	22	-	-
Total bank and other banking holding companies	3,040	2,711	18	347

(3) Following are details by rating of investments in available-for-sale bonds of banks and bank holding companies in the available-for-sale portfolio in North America:

		December 31, 2009		
			Cumulative other comprehensive income	
	Net adjusted cost	Fair value	profits	losses
Rating	In millions NIS			
AAA	148	148	-	-
AA	150	146	1	5
AA-	69	68	-	1
A+ to A-	1060	966	2	96
BBB+ to BBB-	591	427	2	166
BB- to B+	59	37	-	22
Not rated	58	32	6	32
Total	2,135	1,824	11	322

Footnote (4) is presented next page.

(4) Following are details by country of investments in available-for-sale bonds of banks and bank holding companies in the available-for-sale portfolio in Western Europe:

England	238	221	-	17
Other*	371	366	1	6
Total	609	587	1	23

* Fair value amounts lower than NIS 100 million per country.

Held-to-maturity bonds - 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, 2009				
	Amortized cost	Fair value	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value
In NIS millions				
Non governmental bonds and bills				
Industry	17	17	-	-
Electricity and water	18	18	-	-
Commerce	9	9	-	-
Transportation and storage	4	4	-	-
Financial services	360	336	2	26
Total non governmental bonds and bills	408	384	2	26
Government bonds and bills	1,561	1,609	49	1
Government Sponsored Enterprises (GSE) Agencies				
Fannie Mae	10	11	1	-
Other government agencies	10	10	-	-
Total Government Sponsored Enterprises (GSE) Agencies	20	21	1	-
Total held-to-maturity bonds	1,989	2,014	52	27
December 31, 2008				
Total non governmental bonds and bills	554	513	3	44
Total Government bonds and bills	830	814	12	28
Total Government Sponsored Enterprises (GSE) Agencies	533	528	7	12
Total held-to-maturity bonds	1,917	1,855	22	84

Trading bonds - 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, 2009				
	Amortized cost	Fair value	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value
In NIS millions				
Non governmental bonds and bills				
Industry	18	20	2	-
Construction and real estate	5	4	-	1
Electricity and water	1	1	-	-
Commerce	6	6	-	-
Transportation and storage	4	4	-	-
Communication	4	4	-	-
Financial services	57	53	-	4
Other business services	16	15	-	1
Total non governmental bonds and bills	111	107	2	6
Total Government bonds and bills	1,994	2,033	41	2
Total Government Sponsored Enterprises (GSE) Agencies	5	5	-	-
Total trading bonds	2,110	2,145	43	8
December 31, 2008				
Total non governmental bonds and bills	458	376	2	84
Total governmental bonds and bills	1,555	1,600	46	1
Total non governmental Enterprises (GSE) Agencies	14	15	1	-
Total trading bonds	2,027	1,991	49	85

INVESTMENTS IN ASSET BACKED SECURITIES

General. Discount Group's securities portfolio as of December 31, 2009 includes investment in asset backed securities in the amount of US\$3,641 million, which are held by IDB New York, compared to an amount of US\$3,039 million as at December 31, 2008, an increase of 20%. In 2009, IDBNY acquired Ginnie Mae CMOs, which are a direct obligation of the U.S. Government, amounting in total to US\$1,452 million. About 98% 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, except for exposure in a negligible amount, as detailed below.

As of December 31, 2009, the portfolio of mortgage backed securities (MBS) included unrealized net gains of US\$49 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 U.S. Treasury has recently removed this restriction, and is now willing to provide assistance up to any amount necessary.

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.

This measure adds to market stability by providing additional security to GSE debt holders - senior and subordinated and adds to mortgages affordability by providing additional confidence to investors in GSE mortgage-backed securities. This commitment also eliminates any mandatory triggering of receivership.

All of IDB New York's GSE-MBS are performing up to their conditions. As at December 31, 2009 their market value increased by US\$59 million over their value in the books.

In addition to Fannie Mae and Freddie Mac, a third GSE is the Federal Home Loan banks whose mission is to provide liquidity and stability to its U.S. member banks.

Direct investments in Federal Agencies' bonds. The securities portfolio of the Discount Group as at December 31, 2009, includes a direct investment in Federal Home Loan Bank (FHLB), Fannie Mae and Freddie Mac bonds (hereinafter: "the Federal Agencies"), that are held by IDB New York, in an amount of US\$161 million, compared to US\$203 million on December 31, 2008.

The decrease in the portfolio during 2009 was due to multiple debentures maturing or being repaid, and to the emphasis on purchasing GNMA's, as set forth above.

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 NIS 251 million. This investment was made in the first half of 2008, and was backed by mortgage backed loans of private home owners.

The legal maturity periods of these bonds vary between 26 years and 38 years. The average maturity of bonds of this type is generally much lower, due to current repayments of the mortgages backing the loans.

Additional exposure exists to sub-prime RMBS in the available-for-sale portfolio in respect of a single investment amounting at December 31, 2009, to NIS 2.6 million, which is rated at a level below investment grade rating, 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 expected level 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.

The rating of all mortgage backed securities of the ALT-A type has been decreased during the past year to below the investment rating. In the opinion of the Bank's Management, there is no impairment in these investments of an other than temporary nature, due to several reasons, including:

- All mortgage backed securities honor the due payments of principal and interest;
- All mortgage backed securities are of a senior layer;
- All mortgage backed securities, except for one, have a very high rate of current repayment, while the latter has just started repayments on account of principal;
- Based on analysis made of stress tests, management expects to collect the principal sum of these securities in its entirety.

Following are details regarding RMBS Alt-A and RMBS Subprime Exposure:

	As at December 31, 2009				As at December 31, 2008		
	Maturity Date	Adjusted cost	Fair Value	Book Value	Adjusted cost	Fair Value	Book Value
In NIS millions							
RMBS Alt-A	2035	92	82	92	114	98	114
	2036	62	55	62	72	60	72
	2037	72	64	72	98	84	98
	2047	25	24	25	34	32	34
Total RMBS Alt-A		251	225	251	318	274	318
Total RMBS Subprime	2037	4	3	3	4	3	3

As reflected in the table, the amount of exposure was reduced during 2009 as a result of current repayments.

Exposure to commercial mortgage backed securities (CMBS).

IDB New York holds a portfolio of nine commercial mortgage backed bonds (CMBS) with a total balance sheet exposure of NIS 72 million. These securities are classified under the financial services segment. The collateral pertaining to these securities is all located in the United States.

During 2009, IDB New York sold 2 securities with an amortized cost value of NIS 18.5 million, and in respect of which an impairment loss of NIS 11 million was recognized in the financial statements as of December 31, 2009.

As regards the remaining balance of such securities, managements of IDB New York and of the Bank are of the opinion that the impairment in value of these securities is not of an other than temporary nature.

Following are details regarding CMBS Exposure:

Maturity Date	As at December 31, 2009			As at December 31, 2008		
	Adjusted cost	Fair Value	Book Value	Adjusted cost	Fair Value	Book Value
In NIS millions						
2039-2040	19	18	18	19	15	15
2045-2047	14	13	13	15	11	11
2049-2051	48	41	41	66	49	49
Total CMBS	81	72	72	100	75	75

INVESTMENT IN BONDS OF FOREIGN FINANCIAL INSTITUTIONS

The global financial crisis and the collapse of international financial institutions compelled the Bank to record provisions for impairment of securities held in its “nostro” portfolio. The provisions for impairment in respect of international financial institutions amounted to NIS 108 million in 2009, in addition to provisions amounting to NIS 283 million in 2008.

For further details regarding exposure to foreign financial institutions, see hereunder in the Chapter “Exposure to risks and risk management”.

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:

December 31, 2008					
Period of decline in fair value below cost					
in NIS millions					
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

At December 31, 2009, there were no unrealized accumulated losses in respect of available-for-sale shares.

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:

December 31, 2009					
Period of decline in fair value below cost					
in NIS millions					
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%	31	6	-	6	43
From 20% to 40%	-	-	-	5	5
Over 40%	-	-	-	-	-
Total	31	6	-	11	48

December 31, 2008					
Up to 20%	6	5	4	21	36
From 20% to 40%	-	5	11	7	23
Over 40%	-	-	-	-	-
Total	6	10	15	28	59

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:

December 31, 2009					
Period of decline in fair value below cost					
in NIS millions					
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%	31	2	6	53	92
From 20% to 40%	-	-	-	253	253
Over 40%	-	-	-	51	51
Total	31	2	6	357	396
Of which: Government bonds	18	-	-	-	18

December 31, 2008					
Up to 20%	70	36	55	81	242
From 20% to 40%	29	60	33	275	397
Over 40%	50	7	67	70	194
Total	149	103	155	426	833
Of which: Government bonds	13	-	11	-	24

Presented below are details as of December 31, 2009 and December 31, 2008, of certain debentures with unrealized losses, which are considered temporary, held by IDB New York in their available for sale portfolio, with a ratio of unrealized loss to amortized cost in excess of 20%, and where the period in which the fair value has been lower than the amortized cost exceeds 12 months:

December 31, 2009							
(in NIS thousands)							
Issuer's / Group's Name	Net adjusted Cost	Market Value	Unrealized Loss	Final Maturity	Securities Ratings		
					Moody's	S&P	Fitch
securities with ratio of unrealized loss over 40%							
Huntington bank	18,875	7,799	(11,076)	2027	Baa3	B	BB+
Community trust bancorp	17,610	6,606	(11,004)	2037	NR	NR	NR
International bancshares corp.	17,437	6,607	(10,830)	2037	NR	NR	NR
United bancshares inc	17,059	6,606	(10,453)	2037	NR	NR	NR
Barclays Bank	18,875	11,314	(7,561)	2026	Aa3	AA-	AA-
Boden - Argentina	42	15	(27)	2012	B3	B-	B-
Total securities with ratio of unrealized loss over 40%	89,898	38,947	(50,951)				
securities with ratio of unrealized loss from 20% to 40%							
Wells Fargo	209,437	137,795	(71,642)	2027	Baa2	A-	A
J.P. Morgan Chase	243,271	173,981	(69,290)	2037	A2	BBB+	A+
Bank of America	195,210	139,785	(55,425)	2028	Baa3	BB	BB+
Suntrust Capital	77,754	48,677	(29,077)	2027	NR	BB+	BBB
PNC Bank	23,730	16,437	(7,293)	2028	Baa1	BBB	A
Firsf Maryland	18,252	11,406	(6,846)	2027	Baa1	BBB-	NR
Other	5,710	4,158	(1,552)	2049			
Total securities with ratio of unrealized loss from 20% to 40%	773,364	532,239	(241,125)				

Notes:

NR - Non Rated.

The data in the table was aggregated by issuer's group.

December 31, 2008							
(in NIS thousands)							
Issuer's / Group's Name	Net adjusted Cost	Market Value	Unrealized Loss	Final Maturity	Securities Ratings		
					Moody's	S&P	Fitch
securities with ratio of unrealized loss over 40%							
Huntington bank	19,010	6,984	(12,026)	2027	Baa1	BBB-	BBB+
International bancshares corp.	17,508	6,653	(10,855)	2037	NR	NR	NR
Emigrant	36,389	15,816	(20,573)	2037	NR	BB-	NR
FPL Group	5,821	2,662	(3,159)	2066	A3	BBB+	A-
Total securities with ratio of unrealized loss over 40%	78,728	32,115	(46,613)				
securities with ratio of unrealized loss from 20% to 40%							
Bank of America	194,563	142,894	(51,669)	2028	Aa3	A-	A-
First Maryland	18,345	11,402	(6,943)	2027	A3	BBB	NR
J.P. Morgan Chase	187,610	129,260	(58,350)	2037	Aa3	A-	A+
PNC Bank	23,751	18,272	(5,479)	2028	A2	BBB+	A
Suntrust Capital	78,276	59,178	(19,098)	2028	NR	A-	A
Wells Fargo	135,849	90,271	(45,578)	2027	A+	A1	AA-
Other	28,834	19,964	(8,870)	2065			
Total securities with ratio of unrealized loss from 20% to 40%	667,228	471,241	(195,987)				

Notes:
NR - Non Rated.
The data in the table was aggregated by issuer's group.

96% of the unrealized loss related to Trust Preferred Securities (hereinafter: "TRUPS"), issued by financial institutions. Unrealized loss in the amount of NIS 96 million is in respect of securities rated below investment grade by one or more rating agencies.

TRUPS Characteristics:

- Background - Formal guidelines for the issuance of TRUPS were published by the Federal Reserve Board in 1996, which allowed Bank Holding Companies ("BHCs") to raise capital cost-efficiently through the issuance of TRUPS. While TRUPS are treated as debt securities for U.S. financial statements prepared in accordance with GAAP in the U.S. and for U.S. income tax purposes, the FRB ruled that a BHC's TRUPS can be treated as part of the company's regulatory tier I capital (up to a limit of 25%) if it meets certain criteria as described under structure below.
- Issue structure - TRUPS are limited-life, cumulative preferred stocks, for the most part issued with contractual maturities up to 35 years. Although TRUPS may be issued by corporations and bank holding companies, when issued by a bank holding company and adhering to certain criteria, TRUPS may be treated as regulatory capital rather than debt. It is for this reason that the vast majority of TRUP issuances have been by banks. The issuer, usually a BHC, Forms a special purpose trust vehicle ("SPTV") and holds 100% of the vehicle's common equity (generally 3%

of total assets). The SPTV issues preferred shares of the Trust, hence, the name trust preferred stock and receives proceeds from the investors. The SPTV then lends the proceeds to the BHC against a junior subordinated note. The maturity and interest rate on the note will match the terms on the trust preferred shares issued by the SPTV. Dividend payments on the TRUPS are more like interest payments, since the issuer usually pays them quarterly or semi-annually and as previously noted are tax-deductible as interest for the issuers. For a BHC, the revenue source for the servicing of its TRUPS obligations are dividends upstreamed from its bank subsidiary (ies), as the primary asset of the typical BHC is the equity ownership in its bank subsidiary (ies).

In order to qualify as regulatory capital the debt must meet the following criteria:

- A five-year cumulative deferral of interest at the option of the issuer. If interest is deferred, all prior interest deferred is contractually due to the holder of the instrument after the deferral period ends.
- The debenture issued must also have a minimum stated maturity of 30 years (not to exceed 50 years for tax-deductibility) and be subordinate to all other forms of debt issued by the BHC.
- The issuer may not announce of an early redemption until the end of the first five years.
- TRUPS may not have voting rights.
- Restrictions - the FRB has restricted the maximum amount of cumulative preferred stock (TRUPS or regular perpetual preferred stocks) that will be eligible for inclusion as tier I (core) capital up to 25% of total capital. Any excess over 25% is treated as tier II (supplementary) capital.
- Deferral Provision - Dividend payments on a security may be deferred by the issuer for up to five years accumulated. If an issuer elects to defer interest payments on TRUPS it must also cease dividend/interest payments on preferred and common stock, which are subordinate to TRUPS (This includes the funds received by certain banks under a law passed by the U.S. Congress in Fall of 2008 known as Temporary Asset Relief Program - TARP).
- Parent Guarantee - TRUPS have a parent holding company guarantee that only provides for payment of dividends or distributions, if the SPTV has sufficient funds to pay investors. If the BHC has defaulted on its junior subordinated note payment to the SPTV and as a consequence the latter does not have funds on hand to pay investors, then the BHC is obligated to pay any amount owed on the TRUPS.
- Hierarchy of TRUPS vs. TARP - The U.S. Government responded to the financial crisis in Fall 2008 with the passage of the Temporary Asset Relief Program ("TARP"), which an eligible institution participates in, through the issuance of preferred stock to the Government. By virtue of its placement in the bank's credit hierarchy, TRUPS type debt is superior to TARP-related preferred stock in the creditors queue.

Management reviews its investment securities regularly and determines whether other-than-temporary-impairment (OTTI) has occurred. The evaluation of OTTI requires management to make estimates, assumptions and judgments. This process for reviewing the existence of impairments of an other than temporary nature, does not contain quantitative thresholds for a decision as to whether the impairment shall be deemed other than temporary. Managements assessment, based on conducting the impairment review process, after having reviewed all available data, is that said loss is not other than temporary.

In addition to quantitative data presented in the above table, other significant parameters are reviewed including: the intent and ability of management to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value; regular payments in respect of said securities. Quantitative parameters for each issuer are reviewed, including: Total assets, total capital, capital adequacy ratio, profitability and profitability trends etc. Wherever in management's judgment it's more likely than not that issuer will not be able to make principal or interest payments, an impairment has been recognized.

The impairment review process also considers market conditions: downward pressure on market prices due to uncertainty concerning the general economic and market conditions (not necessarily referring to a specific issuer) the lack of an active trading volume of certain securities in the market which pose a challenge to determination of fair value; issuer rating compared to rating of specific securities from said issuer; analysis of the sector in which the issuers operate and the market on which they are traded; and analysis of the issuer's financial standing.

management believes that the continued uncertainty in the credit market, apprehension regarding the profitability of the banks and the volume of their equity and the expectation for the economic recovery effected the decline in market prices.

All the securities presented in the table are current in principal and interest and management has stated that it has the intent and ability to hold the security to maturity or recovery

Review of fluctuations in prices of the aforementioned securities subsequent to the balance sheet date (through March 5, 2010) did not reveal any significant change compared to market prices as of December 31, 2009, with the exception of the security issued by Huntington, whose price rose by 38% over its price as of December 31, 2009.

Below are further details in reference to certain groups for which an unrealized loss of NIS 10 million or more exists:

Huntington Bancshares, Inc. (HBAN) is a regional bank holding company located in Columbus, Ohio. HBAN reported in the fourth quarter of 2009 net loss of US\$369.7 million, compared with a net loss of US\$166.2 million in the third quarter of 2009 and a net loss of US\$417.3 million, in the corresponding period last year. For the full year 2009, HBAN reported a net loss of US\$3,094.2 million compared with full year 2008 loss of US\$113.8 million. The 2009 loss includes a US\$2,607 million goodwill impairment charge that was recorded in the first quarter 2009. Fourth quarter financial data indicate continued growth trend in pre-tax, pre-provision income, as well as in net interest revenues. The bulk of the quarterly loss was due to provision for loan losses of US\$894 million, compared to a US\$475.1 million provision in the third quarter, and a US\$154 million increase compared to the corresponding period last year. OTTI losses were US\$2.6 million compared with US\$2.4 million in the linked quarter and US\$127.1 million in the corresponding period last year. HBAN's efficiency ratio, which has been on the decline during the year, improved substantially, declining to 49.0% at the fourth quarter 2009 from 61.4% in the prior quarter. Credit quality performance in the fourth quarter 2009 continued to be negatively impacted by the sustained economic weakness in the U.S. Midwest markets; however, improvement was reported in the level of non-performing loans and assets. NPLs declined 12% in the linked quarter to US\$1,917 million, to represent 5.21% of total loans and leases, down from 5.85%. NPAs also declined 12% to US\$2,058 million to represent 3.99% of total assets, down from 4.53%.

HBAN's liquidity position strengthened at the fourth quarter 2009 with 16% annualized linked quarter growth in average total core deposits and a 91% period end loan to deposit ratio, down from 94% in the third quarter 2009. Capital strengthening was a key priority during the year. At the fourth quarter 2009 HBAN's regulatory Tier 1 and Total capital to risk assets ratios were 12.05% and 14.43%, respectively, down from 13.04% and 16.23%, respectively, at September 30, 2009, but significantly improved from 10.72% and 13.91%, at the fourth quarter 2008. These ratios remain well-above the minimum required for the "well capitalized" designation.

Review of the security's price fluctuation subsequent to quarter end (through 5 March 2010) revealed that the market price has increased by 38% from the market price as of 31 December 2009.

Community Trust Bancorp, Inc. (CTBI). CTBI is a regional banking institution headquartered in Pikeville, Kentucky with US\$3.1 billion in total assets and US\$322 million in capital as of December 31, 2009 (at the third quarter 2009: US\$3 billion and US\$319 million, respectively). For the year ended December 31, 2009, CTBI reported increased net earnings of US\$7.0 million (at the third quarter 2009: US\$5.6 million) and interest revenues of US\$28.6 million (at

the third quarter 2009: US\$27.0 million). Provision for credit losses was US\$5.1 million (at the third quarter 2009: US\$5.8 million and at the fourth quarter 2008: US\$3.5 million). The growth in provision for credit losses supported credit growth of US\$33 million during the fourth quarter (at the third quarter 2009: US\$22.4 million). As of December 31, 2009, CTBI's Tier 1 capital to risk assets ratio was 12.91 % and the Total Capital to risk assets ratio was 14.15% (similar to ratios in September 2009). These ratios remain well-above the minimum required for the "well capitalized" designation by federal directives.

International Bancshares Corporation (IBOC). IBOC is a financial holding company based in Laredo, Texas with US\$11.8 billion in total assets and US\$1.405 billion in capital as of 31 December 2009 (compared to US\$11.7 billion and US\$1.378 billion, respectively, as of September 2009).

IBOC reported net income for the quarter ended December 31, 2009 of US\$37.1 million, an increase of 17% compared to the corresponding period last year. For full-year 2009, IBOC reported net income of US\$142.7 million compared to US\$132.1 million in 2008, an 8% increase.

The quarter's provision for credit losses, at US\$13.4 million was 30% higher along with a 65% compared with the previous quarter increase in 2009, compared to 2008, in net charge-offs to average loans ratio (0.58% from 0.35%) and an increase in reserves to gross loans (1.68% from 1.57%). IBOC's ratio of non-performing loans ("NPL") to gross loans at the fourth quarter 2009 and full year 2009 was 0.81%, down from 2.23% in the previous quarter and 2.93% in the corresponding period last year. Capital adequacy improved; the Tier I capital to risk assets ratio expanded to 17.74% at the fourth quarter 2009 and full year 2009 from 17.19% at the third quarter 2009 and 15.31% at 2008. The Total Capital to risk assets ratio also increased to 18.99% at the fourth quarter 2009 and the whole of 2009 from 18.44% at the third quarter 2009 and 16.35% at 2008.

United Bancshares Inc. (UBSI). UBSI is a financial holding company based in Charleston, West Virginia with US\$7.8 billion in total assets (similar to September 2009) and US\$761 million in capital as of 31 December 2009 (compared to US\$772 million as of September 2009).

For the quarter ended 31 December 2009, UBSI reported net income of US\$17.4 million. In 2009 UBSI earned US\$67.2 million compared with US\$86.9 million in 2008. The fourth quarter's results include a US\$2.8 million OTTI charge on certain securities (similar to the third quarter 2009 and compared to US\$15 million for full year 2009). For the quarter ended 31 December 2009, UBSI reported a provision for credit losses of US\$6.7 million, compared to US\$12.2 million in the corresponding period last year. The provision for 2009 was US\$46.1 million as compared to US\$25.2 million for 2008. The overall jump in 2009's provision as compared to the prior year is the result of the inclusion of a previously reported credit loss provision of US\$17.6 million during the first quarter 2009 for three loans with fraudulent collateral. The ratio of NPLs to loans, excluding unrealized interest, at 1.26% as of December 31, 2009, were unchanged over the previous quarter though it rose from 0.90% at December 31, 2008, which is indicative of the impact of the current economic conditions on both consumer and commercial portfolios.

UBSI continues to be well-capitalized, with Tier I capital to risk assets Total capital to risk assets ratios of 11.0% and 12.2% respectively as of December 31, 2009 (compared to 10.8% and 12.1% as of September 30, 2009).

Wells Fargo & Co. (WFC). WFC posted at the fourth quarter 2009 net profit of US\$2.8 billion (its fourth straight quarterly profit), compared with US\$3.2 billion in the third quarter 2009, on record revenue of US\$22.7 billion as revenue continued to build across the majority of business lines. For full-year 2009, WFC reported record net income of US\$12.3 billion on revenues of US\$88.7 billion. The quarter's results were affected by a US\$5.9 billion provision for credit losses, US\$21.9 billion for full year 2009, which built the allowance for credit losses to US\$25.0 billion, or 3.25% of total loans, up from 3.07% at the third quarter 2009. In December 2009, WFC completed its US\$25 billion

repayment of TARP to the government. Credit losses remained elevated. Fourth quarter net charge-offs were US\$5.4 billion, or 2.71% of average loans, compared with the third quarter 2009 net charge-offs of US\$5.1 billion, or 2.50% of average loans. Full year charge-offs were 2.10% of average loans. Total nonperforming loans grew to 7.58% from 6.55% the prior quarter and 3.38% a year earlier. Commercial real estate loans grew as a percent of NPLs to 87% from 86% at the third quarter 2009 and at the fourth quarter 2008, while consumer NPLs declined to 3.9% from 6.9% in the corresponding period. C&I non-performing loans grew to 7.9% at the fourth quarter 2009 compared with 5.1% in the corresponding period last year, but were down from 9.1% at the third quarter 2009.

Capital adequacy ratios continued to improve in the fourth quarter 2009 following the issue of stocks in December that raised US\$12.2 billion. the Tier I adequacy ratio was 9.25% at 31 Dec 09 compared with 7.84% a year earlier, while the Total capital to risk assets adequacy ratio rose to 13.26% from 11.83%.

JP Morgan Chase (JPM). JPM reported the fourth quarter 2009 net income of US\$3.3 billion compared with net income of US\$702 million in the the fourth quarter 2008, and on revenue of US\$25.2 billion. For the full year 2009, JPM's net income was US\$11.7 billion up from US\$5.6 billion in 2008 and revenue of US\$108.6 billion. The fourth quarter's revenues were offset by an US\$8.0 billion provision for credit losses. Among the business units, the investment bank was the best performer, contributing US\$1.9 billion towards net income, compared with a loss of US\$2.3 billion in the fourth quarter 2008. Corporate and private equity Division was the second best performer, contributing US\$1.2 billion to net income. In June 2009, JPM was among the first major banks to repay its TARP funding of US\$25 billion to the U.S. Treasury. The difficult economic environment is behind the deterioration in asset quality seen throughout the year which culminated in the nonperforming loans / gross loan ratio growing to 7.54% at the fourth quarter 2009 from 6.75% sequentially and 3.43% at the fourth quarter 2008. Real estate loans (residential and commercial) formed approximately 45% of JPM's loan portfolio and represented 80% of total non performing loans. At December 31, 2009, JPM's Tier I Capital adequacy ratio was 11.10% (10.2% at the third quarter 2009, and 10.9% at the fourth quarter 2008). The Total Capital ratio was 14.78%, compared with 13.81% a year ago and 13.88% at the third quarter 2009.

Bank of America Corporation (BOA). BOA reported at the fourth quarter 2009 net loss of US\$194 million on revenue of US\$25.4 billion (an increase of 59% compared to the previous quarter), following at the third quarter 2009 net loss of US\$1.0 billion and a loss of US\$1.8 billion in the corresponding period last year. For full-year 2009, net income was US\$6.3 billion compared with net income of US\$4.0 billion in 2008. The quarterly loss is attributed to the impact from the US\$45 billion repayment of TARP funds to the government and to a lesser degree payment of dividends on preferred stock and continued elevated credit costs. Net charge-offs of US\$8.4 billion were US\$1.2 billion lower than in the third quarter 2009, reflecting improvements across most retail credit portfolios. Provision for credit losses was US\$10.1 billion, US\$1.6 billion decrease compared to the third quarter 2009 but US\$1.6 billion increase compared to the corresponding period last year. For full-year 2009, the provision amounted to US\$48.3 billion, compared against US\$26.9 billion in 2008. The non-performing loans ratio grew to 6.97% at the fourth quarter 2009 from 5.79% the prior quarter-end and 3.73% a year earlier. Real estate loans (residential and commercial) comprised the bulk of non-performing loans, accounting for 83% of NPLs. At December 31, 2009, BOA's capital adequacy ratios compared against the prior quarter were: Tier I Capital to risk assets, 10.41% vs. 12.46%; Total Risk Based Capital, 14.67% vs. 16.69%.

SunTrust Banks, Inc. (STI). STI reported at the fourth quarter 2009 net loss of US\$248 million, the fifth consecutive quarterly loss, compared with a loss of US\$317 million at the third quarter 2009. The full year's loss of US\$1.5 billion compared with a net profit of US\$795 million the year before. STI maintained an elevated level of provision for credit losses during the 2009, representing 2.25% of average assets (2008: 1.38%) which aggregated to US\$4.0 billion compared with US\$2.4 billion in 2008 and raised the level of reserves / gross loans to 2.64% from 1.79% in the corresponding period last year. Asset quality

has been weak, given the Bank's large exposure to the troubled Florida and Southeast real estate market. Non-performing loans grew to 5.83% at the fourth quarter 2009 from 5.74% in the linked quarter and 3.79% at the fourth quarter 2008. Residential loans comprised 86.4% of NPLs at the fourth quarter 2009, up from 84.5% sequentially. STI's 2009 net charge-offs reached 2.56% of average loans from 1.19% a year earlier. STI is among the banks that underwent the U.S. Treasury's stress test and have still not repaid TARP. therefore, STI's Tier I adequacy ratio of 12.96% at the fourth quarter 2009 (at the fourth quarter 2008: 10.87%) includes US\$4.8 billion of TARP funds. STI expects to repay the government in the course of 2010. The Total capital to risk assets ratio was a healthy 16.43% at the fourth quarter 2009, up from 15.92% in the linked quarter and 14.04% from the fourth quarter 2008, helped by the more than US\$2.3 billion in new capital raised during 2009.

Impairment provisions. In 2009, IDBNY recorded provisions in respect of impairment of an other-than-temporary nature amounting to US\$27 million - all in respect of available for sale securities.

Review of impairment of securities. 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 in certain cases, including when realized.

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 of 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.

It should be noted, that the Supervisor of Banks issue on March 1, 2009, a guideline regarding the conditions under which an impairment of an other than temporary nature is to be recognized, which in fact, applies stricter parameters than those applied under previous guidelines (for additional details, see below under "Critical accounting policy").

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 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, 2009, amounted to NIS 141,825 million, compared with NIS 139,232 million at the end of the preceding year, an increase of 1.9%.

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

	December 31 2009		December 31 2008		
	In NIS millions	% of deposits from the public	In NIS millions	% of deposits from the public	change in %
Non-linked shekels	68,048	48.0	64,770	46.5	5.1
CPI-linked shekels	12,982	9.1	12,516	9.0	3.7
Foreign currency and foreign currency-linked shekels	60,795	42.9	61,946	44.5	(1.9)
Total	141,825	100.0	139,232	100.0	1.9

Deposits from the public in foreign currency and in Israeli currency linked to foreign currency decreased at the rate of 1.9%, compared with December 31, 2008. In dollar terms the deposits from the public in foreign currency and in Israeli currency linked to foreign currency decreased by US\$188 million, a decrease of 1.2% compared with December 31, 2008.

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 2.2% as compared with December 31, 2008.

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

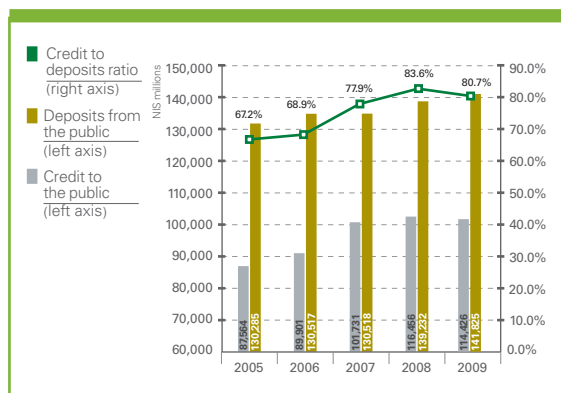
	December 31				
	2009		2008		
	In NIS Millions	% of deposits from the public	In NIS Millions	% of deposits from the public	Rate of change in %
Retail - household segment	56,934	40.1	57,115	41.0	(0.3)
Retail - small business segment	13,144	9.3	10,851	7.8	21.1
Corporate market segment	22,375	15.8	21,720	15.6	3.0
Middle market segment	9,261	6.5	8,844	6.4	4.7
Private banking segment	40,111	28.3	40,702	29.2	(1.5)
Total	141,825	100.0	139,232	100.0	1.9

The ratio of total credit to the public to deposits from the public was 80.7% at the end of 2009, compared with 83.6% at the end of the previous year.

TOTAL ASSETS - CONSOLIDATED



CREDIT TO THE PUBLIC AND DEPOSITS FROM THE PUBLIC - CONSOLIDATED



FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2009, the investment in buildings and equipment amounted to NIS 3,178 million, compared with NIS 3,039 million at the end of 2008, an increase of 4.6%.

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, 2009, was 172 thousand square meters, compared with 168 thousand square meters at the end of 2008. Of this area, 110 thousand square meters were freehold property and 61 thousand square meters leasehold property (2008: 99 thousand square meters were freehold property and 69 thousand square meters leasehold property). At the end of 2009, some 77 thousand square meters served the Bank's branches and the balance served the head office, similar to 2008.

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

Concentration of the offices of Mercantile Discount Bank's management. The management of Mercantile Discount Bank and its central head office units operate at present at five separate locations. In order to improve the efficiency of management's and head office work, Mercantile Discount Bank signed an agreement on September 22, 2009, for the purchase of a part of an office building in central Tel Aviv, in consideration for NIS 110 million. The transaction was consummated at the end of November 2009. The relocation of the Management offices and Head Office units to the new building shall be made after the fitting of the premises to Mercantile Discount Bank's needs has been completed.

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 centers and work stations at the branches and at the head

office units. The central system is currently based on IBM 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. In 2009 the Bank completed the implementation of all systems purchased from Accenture.

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.

Development costs for the core systems ("Ofek Project") are amortized over a period of seven years.

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 2007-2009 is the completion of the conversion of the principal systems to the IBM computers, including the credit system and the securities system.

The conversion of all systems still operating on the Unisys computer has been completed and in October 2009 production operations using the Unisys computer, were discontinued. The Bank believes that the shutting down the Unisys computer will save costs in the amount of NIS 60-70 million per annum in computer operating licenses and computer maintenance and will allow for manpower reduction in the relevant units. Most of the said savings will be reflected as from the year 2010 and thereafter.

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.

The Bank is acting to upgrade the capabilities of the direct banking operations at times of disaster. The upgrade will enable direct banking to operate even when the Bank's telephone service center is out of service.

DATA PROTECTION

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 data 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. 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.
2. 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 2010 in respect of projects for the development of information systems, including for information system development projects, amounts to NIS 320 million.

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.

Development of the principal part of the system supporting the process of the granting of loans has been completed, and at present finalization of the process is being made. At the end of September 2009, Discount Mortgage Bank began a pilot at three branches, which has gradually been extended so that in January 2010 the integration of the system at 38 branches and at the relevant Discount Mortgage Bank Head Office units was completed.

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. IBM is engaged with the Bank through IBM (Israel) Ltd.

INTANGIBLE ASSETS

Trade marks and brand names. The Bank has exclusive intellectual property rights in the following trademarks that are duly registered with the Registrar of Trademarks, and in the label accompanying each of them: "Israel Discount Bank Ltd.", "Discount Bank", and "Discount". In addition, the Bank registers from time to time, for the purpose of its business and marketing operations, names of services and products such as: "Drive, you have the drive to live" and slogans such as "In Discount we take you personally", "Discount Banking from the heart", etc.

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 "WWW.Card". ICC is also in the process of registering several additional trade marks. Furthermore, the Bank's subsidiary companies own trade marks, related brand names and slogans registered for the purpose of their business and marketing operations.

Licenses and franchises. The Bank and ICC have the status of a "principal member" in the International VISA Organization, which grants them the license to use the trade marks of VISA as well as the right to issue and clear credit cards under this brand name in Israel.

The International Diners Organization has granted Diners in Israel the exclusive franchise for the use of the "Diners" trade mark and for operating issuance and clearing services for Diners credit cards in Israel. Diners and Diners International signed agreements in March 2007 granting Diners the license to make use of trade marks and to issue credit cards, to open accounts and the exclusivity to provide services to customers in Israel until the year 2017. The said agreements are renewable for periods of five years each at the discretion of Diners International.

ICC is also a "Principal Member" of MasterCard Worldwide organization, which has granted it licenses to use the "MasterCard", "EuroCard", "Cirrus" and "Maestro" trade marks in Israel.

Software. The Bank also has intellectual property rights in designated software systems and various modules used in its business, which the Bank develops and/or acquires in the course of its ongoing operations for its own use and/or the use of subsidiaries and affiliates.

Data bases. The Bank and its subsidiaries have data bases regarding their various fields of operations relating mostly to their customers and employees. Thus, among other things, 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.

TAXATION

GENERAL

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 16.0% of the payroll expense and of the profit, respectively (on December 31, 2009 - a rate of 16.5%).

Final tax assessments have been issued to the Bank for the years up to and including the tax year 2005 (for details regarding the settling of the income tax assessments for 2004-2005 and its implications, see Note 29 C to the financial statements).

REDUCTION IN COMPANY TAX RATES

An Income Tax Amendment (No. 147), 2005, (hereinafter - "the Amendment") was published in August 2005, which stipulated a gradual reduction in the rate of corporation tax down to a rate of 25% as from the 2010 tax year and thereafter.

On July 14, 2009, the Knesset passed the Economic Efficiency Act (Legislation amendments for the implementation of the economic program for the years 2009 and 2010), 2009, which stipulated, among other things, an additional gradual reduction in the corporation tax rates down to 18% as from the 2016 tax year and thereafter.

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

- (1) A Value Added Tax Order (Tax rate applying to non-profit organizations and financial institutions) (Provisional directive), 2009, was published on July 1, 2009. Accordingly, in the period from July 1, 2009 and December 31, 2010, the rate of wage tax and profit tax applying to financial institutions will be 16.5% instead of 15.5% (hereinafter: "the Amendment"). According to the Amendment, the new rate of profit tax will apply to one half of the earnings for 2009. Therefore, the average rate of profit tax for 2009 was 16%.
- (2) On December 31, 2009, a Value Added Tax Order (Rate of tax applying to non-profit organizations and financial institutions) (Provisional order) (Amendment), 2009, was officially published, according to which, in the period from January 1, 2010 to December 31, 2010, the rate of value added tax and the rate of wage tax and profit tax applying to financial institutions will be 16% instead of 16.5%.

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 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.

THE COMMITTEE FOR THE EXAMINATION OF THE TAX IMPLICATIONS RELATING TO THE IMPLEMENTATION OF THE BACHAR COMMITTEE RECOMMENDATIONS

In June 2009, the Committee submitted its report to the Head of the Taxation Authority. The Committee was appointed in June 2006 in order to study the tax implications and to provide recommendations with respect to the manner in which sale transactions effected as a result of the recommendations of the Bachar Committee report, would be taxed.

Among other things, the Committee recommended to determine that a sale of goodwill would be recognized only in cases where the operations of the management company had been sold as a going concern (in full) and not in cases where the shares of the management company had been sold. The Committee further recommended that 15%-20% of the excess of cost over equity value shall be attributed to intangible assets, the sale of which is subject to capital gains tax, and that the remaining balance of the excess of cost (up to 80%) shall be attributed to goodwill, at the following rates: for mutual trust funds 50%-63%; for provident funds 34%-42%.

The Bank believes that the recommendations of the committee will not have a material effect on the Bank.

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 U.S. 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.

CAPITAL RESOURCES

TRANSITION TO MEASUREMENT OF CAPITAL RATIO ACCORDING TO BASEL II GUIDELINES

Capital adequacy as of December 31, 2009, has been computed in accordance with the provisional instruction issued by the Supervisor of Banks regarding "framework for the measurement of capital adequacy" dated December 31, 2008 (hereinafter: "Basel II guidelines"). Until December 31, 2009, capital adequacy has been computed in accordance with Proper Banking Management Directives Nos. 311 and 341 regarding "minimum capital ratio" and "allocation of capital in respect of exposure to market risk", respectively (hereinafter: "Basel I guidelines").

For details regarding clarifications by the Supervisor of Banks in the matter of the continued recognition of hybrid capital instruments issued prior to the coming into effect of the Basel II guidelines, see Note 14 to the financial statements, item 6.

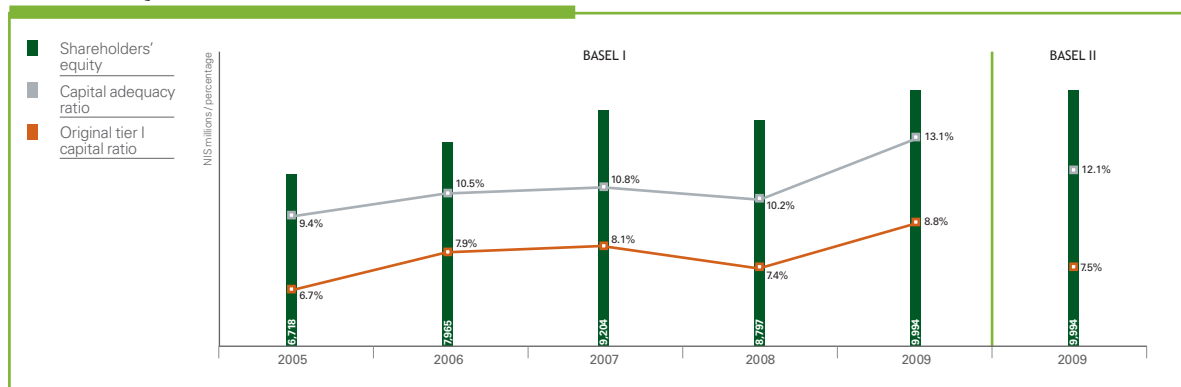
It should be noted that in view of the coming into effect of the Basel II guidelines, the possibility arises that the Supervisor of Banks would make changes to the basic terms that had been determined by him in the past with respect to the recognition of subordinate capital notes to be issued in the future as hybrid capital instruments.

In view of the above, it is possible that the Bank would not be able to make use of the balance of existing series designated to serve as hybrid capital instruments, and the Bank will have to create new series in line with the terms to be determined by the Supervisor of Banks.

According to the second pillar of the said provisional instructions, banking corporations are required to perform an internal evaluation process of capital adequacy (ICAAP process), while the Supervisor of Banks is required to perform an internal process of review and evaluation (SREP). In his letter of August 20, 2009, the Supervisor of Bank clarified that in the interim period, until the completion of a comprehensive SREP process, banking corporations are also required to comply with capital targets that had been defined by them in accordance with Basel I guidelines.

In the Annual Report for 2009, the capital adequacy data as of December 31, 2009 is presented both in accordance to Basel I guidelines as well as Basel II guidelines (the comparative data as of December 31, 2008, is presented according to Basel I guidelines).

CAPITAL ADEQUACY



COMONENTS OF CAPITAL

The Bank's capital resources as at December 31, 2009, including minority interest, amounted to NIS 10,292 million, compared with NIS 9,023 million at the end of the preceding year, an increase of 14.1%.

Shareholders' equity as at December 31, 2009, amounted to NIS 9,994 million, compared with NIS 8,797 million at the end of the preceding year, an increase of 13.6%.

The change in shareholders' equity in 2009 was affected, among other things, by earnings in that period and by an increase of NIS 253 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, 2009, stood at 5.5%, compared with 5.0% at the end of the preceding year.

Ratio of tier I capital to risk assets as of December 31, 2009, computed according to the Basel II guidelines, reached a rate of 7.51%. The ratio of tier I capital to risk assets as of December 31, 2009, computed according to the Basel I guidelines, reached a rate of 8.79%, compared with 7.42% at the end of the preceding year.

Ratio of original tier I capital to risk assets, computed according to the Basel II guidelines, reached 7.03% as of December 31, 2009. The ratio of tier I capital to risk assets as of December 31, 2009, computed according to the Basel I guidelines, reached 7.56%, compared to 6.53% 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 as of December 31, 2009, ("Ratio of total capital to risk assets" in terms of Basel II) computed according to the Basel II guidelines, stood at 12.06%. The ratio of capital to risk assets as of December 31, 2009, computed according to the Basel I guidelines, reached 13.12%, compared with 10.24% at the end of 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, 2009 amounted to NIS 1,636 million, compared with NIS 1,223 million at the end of 2008. 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, 2009, the hybrid primary capital amounted to 14.04% of the overall primary capital (December 31, 2008: 12.07%). The balance of the hybrid tier I capital that may be issued until the limit is reached was NIS 131 million as of December 31, 2009, compared to NIS 349 million at the end of the preceding year. It should be noted that raising of additional hybrid tier I capital, over the amount of NIS 202 million, would required an increase

in the Bank's registered capital and may be done subject to terms and conditions set by the Supervisor.

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 amounted to NIS 7,396 million as at December 31, 2009, including NIS 5,827 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, 2009, the said ratio was 50% (December 31, 2008: 50.00%). In view of the said restriction, capital notes in the amount of NIS 497 million were not included in the Bank's tier II capital as of December 31, 2009.

Upper tier II capital. ("Tier II capital" in terms of Basel II). The volume of the Tier II capital is limited to 100% of the tier I capital. The Bank's upper tier II capital as of December 31, 2009 amounted to NIS 1,315 million. The balance of the upper tier II capital that the Bank is permitted to raise as of December 31, 2009, amounted to NIS 4,257 million.

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. 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 which had been prescribed by regulation at the date of the resolution, had 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.

ISSUE OF CAPITAL INSTRUMENTS

During 2009, the Bank raised, through various instruments, a total amount of NIS 2.2 billion, as detailed hereunder.

Issue of complex capital instruments. In 2009, the Bank issued complex capital instruments - hybrid tier I capital and upper tier II capital – in a total amount of NIS 1,608 million, as follows:

- Issue of hybrid tier I capital in March 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. The Supervisor of Bank confirmed on March 26, 2009, that the said capital notes will be considered as complex capital instruments and shall be recognized as part of the Bank's tier I capital, subject to the terms specified by the Supervisor. For details regarding the terms of the subordinated capital notes (Series "B") and the terms for recognizing them as hybrid tier I capital, see Note 14 to the financial statements.
- Issue of upper tier II capital in April 2009 - In April 2009, Discount Manpikim issued subordinate capital notes (Series 1) in a par value of NIS 265 million, in accordance with a shelf offer report dated April 7, 2009, for total proceeds of NIS 258 million. For details regarding the terms of the subordinated capital notes (Series 1) and the terms for recognizing them as upper tier II capital, see Note 14 item 6 to the financial statements.
- Issue of upper tier II capital in May 2009 - In May 2009 Discount Manpikim Ltd. issued by a private placement to classified investors, subordinated capital notes (Series 1) in a par value of NIS 191 million, for the total proceeds of NIS 191 million
- The issue of upper tier II capital in July 2009 - in July 2009, Discount Manpikim issued subordinated capital notes (Series 1) in the par value of NIS 696 million, in accordance with a shelf offer report dated July 12, 2009, for the total consideration of NIS 702 million.

- The issuance of upper tier II capital in August 2009 - Discount Manpikim Ltd. issued in August 2009, subordinated capital notes (Series 1) of a par value of NIS 100 million, through a private placement to a qualified investor, for total consideration of NIS 107 million.

Issue of capital notes. Discount Manpikim issued in October 2009 deferred capital notes (Series "D") of a par value of NIS 326 million and deferred capital notes (Series "I") of a par value of NIS 240 million, in accordance with a shelf offer dated October 18, 2009, for a total consideration of NIS 605 million.

Issuance of tier II capital in February 2010. Discount Manpikim issued in February 2010 deferred capital notes (Series "I") of a par value of NIS 327 million in accordance with a shelf offer dated 22 February, 2010, for a total consideration of NIS 340 million.

Issuance of Capital Notes in 2010. An amount of NIS 759 million of capital notes issued in the past will be deducted in the course of 2010 from the tier II capital of the Group, 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 256 million;
- Carrying-out non-financial investments in a total amount of NIS 793 million (it should be noted that the total of the said investments included the investment in KFS, which was realized at the end of the first quarter of 2009 - see below under "Non-financial companies sub-segment");
- Significant increase in credit, from a level of NIS 87.8 billion at the end of 2005, to a level of NIS 116.5 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 14.5% 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 10.2% on December 31, 2008.

As at December 31, 2009, the ratio of capital to risk assets amounted to 13.1% in Basel I terms and to 12.1% in terms of Basel II. The improvement in the capital ratio stems, among other things, from a real-term decline in the Bank's risk assets as well as from a further decline caused by the weakening of the U.S. dollar against the Shekel. The improvement also stems from funds raised by the Bank through various capital instruments during 2009.

On August 31, 2009, the Bank published, a shelf prospectus, with respect to a variety of classes of securities and forms of offerings. According to the resolution of the Board of Directors dated July 12, 2009, the actual execution of a rights issue

according to a shelf prospectus shall be made in coordination and agreement with the Bank's controlling shareholders. It should be noted that the agreement for the sale of the controlling interest in the Bank determined, among other things, that during the restriction period (for a definition of this term see "Control of the Bank" hereunder) the buyers may not take any action to allotment shares, change rights attaching to shares, increase the capital (whether registered or issued) and distribute bonus shares or effect a rights issue by the Bank, and to the best of their ability cause the Bank to refrain from taking any action, unless the prior consent in writing of the Government is received in respect of such actions. The agreement further states that the Government shall not withhold its consent to actions as above unless it has good reasons pertaining to a material change in the rights of the Government under the agreement, or to impairment of Bank shares held by the Government or reducing the Government's ability to sell its shares.

In recent months, the Bank, together with the controlling shareholders, has been considering the possibility of raising tier I capital. Bronfman-Schron Group has consented in principle to the aforementioned plan to raise capital and to the increase in registered capital required for execution thereof, subject to obtaining the required permits. Subsequently, the State of Israel has consented in principle to the increase in the Bank's registered capital, in order to allow the capital raising plan to go forward, subject to the Bronfman-Schron Group accepting the rights issue proposal. This consent is contingent on the procedure being carried out in coordination with the Government and with M.I. Holdings, the cooperation by the Bank with the Government should the latter decide to join the procedure and by the Bank allowing the procedure to include sale of the balance of State's holdings in the Bank, in whole or in part, as agreed, and subject to provisions of the agreement concerning acquisition of the controlling interest in the Bank.

The special meeting of shareholders convened on December 15, 2009 resolved to increase the registered share capital of the Bank by 111 million ordinary "A" shares of NIS 0.1 par value each. The shares created by the said increase were intended to promote a move for the raising of tier I capital, in the volume, format and dates to be determined. The Bank is committed towards the State of Israel, which holds 20% of the share capital of the Bank, that the shares constituting part of the registered share capital of the Bank, which were created as a result of the said increase in capital, will be utilized for the above purpose and will not be used for any other purposes.

The move for the public offering of shares and the issue of rights is at present at the stage of obtaining permits from the various regulatory authorities in Israel and abroad.

A temporary decline in the original tier I capital ratio. The original tier I capital ratio as of March 31, 2009 was 6.43%, slightly lower than the tier I capital ratio required for complex capital instruments issued by the Bank.

At the Bank's request, the Supervisor of Banks has granted it an extension until October 1, 2009, the terms of which had been determined in a letter of the Supervisor dated June 11, 2009, as an interim period during which the Supervisor will continue to recognize complex capital instruments, already issued by the Bank and recognized by the Supervisor, and which include the term according to which the original primary capital ratio shall not fall below 6.5%, this in order that the Bank will take measures to increase the original primary capital ratio to at least 6.5%.

The said letter required the Bank's Board of Directors to approve until July 31, 2009, a detailed and applicable defined capital adequacy outline in order to attain the capital adequacy target determined by the Board for the end of 2009, such outline is to include inter-alia: an examination of the capital mix and the possibilities existing as of the present time for raising new capital, including the issue of shares/rights; a defined action plan for reducing risk assets at specific rates at the Bank and at its Group subsidiaries, including additional alternatives in respect of the sale of assets and the assignment of credits; adjustment of the Bank's work plan for 2009 and the business targets determined therein to the capital adequacy target and to the resolutions to be adopted with respect to the reduction in risk assets; determination of an interim target for the overall capital adequacy ratio for the end of the third quarter of 2009 and determination

of interim targets for the original primary capital ratio.

The Board of Directors of the Bank approved on July 27, 2009, a capital adequacy outline, as follows:

- (1) A target of 6.5% for the original capital ratio and a target of 12% for the overall capital ratio at the end of 2009. In addition, the Bank is to preserve an additional security margin of 0.5% over and above the original capital ratio;
- (2) An interim target of 11.4% for the overall capital ratio at the end of the third quarter of 2009.

The outline included the raising of capital as well as the reduction of risk assets as compared to the balance of risk assets as of March 31, 2009, both at the Bank and at its subsidiaries. In order to reach the said targets, the outline also included alternative plans in the event that the raising of new capital will not be materialized.

In the immediate range, concurrently with continued review of various options for improving the Bank's capital adequacy, the Bank has adopted a restraining policy with regard to risk assets, in order to raise the original tier I capital ratio above the required minimum with due urgency.

It should be noted, that in view of the improvement indicated in the capital adequacy data as of June 30, 2009, and particularly, in view of the fact that the ratio of the original tier I capital has risen above the required minimum, the Bank applied again to the Supervisor of Banks requesting that the issues of the upper tier II capital effected in the period from April to August 2009, would be recognized as part of the Bank's tier II capital. On August 24, 2009 the Supervisor granted the approval requested by the Bank.

As abovementioned, the original tier I capital ratio as of December 31, 2009 was 7.6%. in terms of Basel I, and to 7.0% in terms of Basel II.

CAPITAL STRUCTURE

	December 31		
	2009	2008	
	Basel II ⁽¹⁾	Basel I ⁽²⁾	Basel I ⁽²⁾
	in NIS millions		
Tier 1 capital less deductions	10,699	11,653	10,130
Tier 2 capital less deductions	6,485	5,742	3,849
Total capital	17,184	17,395	13,979

(1) Computed in accordance with the provisional instructions regarding "Framework for measurement and capital adequacy", dated December 31, 2008.

(2) Calculated in accordance with the Supervisor of Banks' Directives Nos. 311 and 341, with regard to "Minimum Capital Ratio" and "Capital Allocation With Respect to Market Risk Exposure".

For further details regarding the structure of capital, see Note 14 to the financial statements.

Risk assets and capital requirements basel II

	December 31 2009	
	Risk assets	Capital requirements
		9%
	in NIS millions	
Risk assets and capital requirements in respect of credit risk caused by exposures of:		
Sovereigns	872	78
Public sector entities	2,735	246
Banking corporations	4,201	378
Corporates	87,172	7,845
Single retailer exposures	12,562	1,132
Small business loans	5,822	524
Residential mortgage	7,531	678
Securitization	37	3
Other assets	5,843	526
Total risk assets and capital requirements in respect of credit risk	126,775	11,410
Risk assets and capital requirements in respect of market risk according to the standard approach	2,752	248
Risk assets and capital requirements in respect of operational risk according to the basic indicator approach	12,969	1,167
Total risk assets and capital requirements	142,496	12,824

* The minimum capital requirement is 8% in respect of the first pillar instructions with the addition of 1% in respect of the second pillar instructions.

Risk assets and capital requirements basel I

	December 31 2009			December 31 2008		
	Balances	Weighted credit risk	Requested capital	Balances	Weighted credit risk	Requested capital
in NIS millions						
Credit risk assets						
Cash and deposits with banks	24,583	1,271	114	21,554	2,133	192
Securities	36,338	5,512	496	31,535	7,066	636
Securities borrowed under resale agreements	336	-	-	25	-	-
Credit granted to the public	114,758	99,762	8,979	116,785	101,199	9,108
Credit granted to the government	1,820	2	-	1,491	20	2
Investment in affiliated companies	1,674	20	2	1,709	237	21
Buildings and equipment	3,178	3,178	286	3,039	3,039	274
Other assets	5,341	3,187	287	5,904	3,399	306
Total assets	188,028	112,932	10,164	182,042	117,093	10,538
Off-Balance Sheet Instruments						
Transactions whose balance represents credit risk	13,549	12,075	1,087	14,141	13,048	1,174
Derivative financial instruments	11,294	4,144	373	11,038	4,372	394
Other	50	22	2	61	26	2
Total off-balance sheet instruments	24,893	16,242	1,462	25,240	17,446	1,570
Total credit risk assets	212,921	129,174	11,626	207,282	134,539	12,109
Total assets as above	188,028			182,042		
General provision	(211)			(211)		
Total assets according to the financial statements	187,817			181,831		

ratio of capital to risk assets

	December 31		
	2009	2008	
	Basel II	Basel I	Basel I
in %			
Ratio of original tier 1 capital to risk assets	7.0	7.6	6.5
Ratio of tier 1 capital to risk assets	7.5	8.8	7.4
Ratio of total capital to risk assets	12.1	13.1	10.2
Ratio of total minimum capital required by the Supervisor of Banks	9.0	9.0	9.0

Footnote: For details regarding the capital ratio of significant banking subsidiaries and additional details, see Note 14 to the financial statements.

RATING THE BANK'S LIABILITIES

Details regarding the rating determined for the Bank and some of its subsidiaries by different rating agencies are presented hereunder.

Rating given by	Subject of rating	Rating	Rating horizon	Date of rating/ ratification of rating	Additional details
Discount Bank					
Standard & Poor's, Ma'alot	Issuer rating (including deposits)	il AA-	Negative	January 24, 2010	On April 30, 2009, Ma'alot announced the downgrade in the issuer rating of the Bank (including deposits) to "AA-" (instead of "AA"), and changed the rating forecast for the Bank to "negative" (instead of "stable"). Ma'alot noted that the downgrade reflect its opinion regarding the negative impact of global and domestic recession on the profitability of the Discount Group and of the quality of its credit portfolio, with the following effect on the relatively weak capital position of the Group considering the environment of its business activity.
	Subordinate capital notes	il A+	Negative	January 24, 2010	As above The rating also relates to subordinate capital notes issued by Manpikim
	Upper tier II capital (Series 1)	il A-	Negative	January 24, 2010	The rating was reduced on March 18, 2009, from "A+"
	Hybrid tier I capital (Series "A")	il BBB-	Negative	January 24, 2010	In March 2009, Ma'alot downgraded the rating of the capital notes (series "A") to "BBB" and then after, at the end of April 2009, to "BBB-".
Midroog	Long-term deposits	Aa2	Stable	December 14, 2008	
	Short-term deposits	P-1	Stable	December 14, 2008	
	Subordinate capital notes	Aa3	Stable	December 14, 2008	The rating also relates to subordinate capital notes issued by Manpikim
The international rating agency S&P	Issuer rating Short-term	A-3	Negative	January 20, 2010	The rating was reduced on April 30, 2009 from "A-2"
	Issuer rating Long-term	BBB-	Negative	January 20, 2010	The rating was reduced on April 30, 2009 from "BBB"
The international rating agency Moody's	Issuer rating	C-	Negative	March 1, 2010	On March 2, 2010, Moody's published a review of the Israeli banking industry, which noted, among other things, that in the event that economic growth will continue for several more months, and that as a result the quality of the credit portfolio will continue to improve, they would be willing to consider a change in the rating horizon to "stable".
	Long-term foreign currency deposits	A-2		March 1, 2010	

Details regarding the rating determined for the Bank and some of its subsidiaries by different rating agencies are presented hereunder (continued).

Rating given by	Subject of rating	Rating	Rating horizon	Date of rating/ ratification of rating	Additional details
Mercantile Discount Bank					
Standard & Poor's, Ma'alot	Issuer rating (including deposits)	ilAA-	Negative	January 24, 2010	
	Subordinate capital notes	ilA+	Negative	January 24, 2010	
Discount Mortgage Bank					
Midroog	Long-term deposits	Aa2	Stable	November 4, 2009	
	Short-term deposits	P-1	Stable	November 4, 2009	
	Subordinate capital notes	Aa3	Stable	November 4, 2009	

As part of the rating of the subordinate capital notes (Series A), which comprise hybrid tier I capital, Ma'alot and Midroog emphasized that this rating was 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 ration.

DIVIDENDS

The Bank has not distributed dividends to its shareholders since 1996, excluding the distribution of dividend in October 2008 (see hereunder), and 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 June 3, 2009, the General Meeting of Shareholders resolved to approve as final dividend for the year 2008, the interim dividend at the rate of 6%, paid on December 30, 2008, to the holders of 40,000 cumulative preferred shares NIS 0.00504 par value each. On November 16, 2009, the Board of Directors of the Bank resolved to pay on December 30, 2009, 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 2010, 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 13 E 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, among other things, 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 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. The Bank's Management believes that it would not be possible to distribute a dividend in 2010, and accordingly the Board of Directors has been informed that an update regarding the date on which such a proposal will be formed, would be communicated to the Board no later than March 2011.

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 2009, the monetary base decreased by an amount of NIS 913 million, compared to an increase of NIS 6.1 billion during the period from January to September 2009. The decrease in the monetary base in the fourth quarter stemmed from the inflow of cash generated by the Government, alongside absorption by the Bank of Israel, for the first time after a long period.

For the whole of 2009, the monetary base increased by NIS 5.1 billion, against the background of a net inflow NIS 18.6 billion generated by the Bank of Israel and an absorption by the Government of NIS 14.2 billion. The increase in the monetary basis in 2009 was 40% lower, compared to the increase in 2008.

Following are the components of the effect of the Bank of Israel on the monetary base in the fourth quarter of 2009:

- Supply of money by way of the purchase of foreign currency in the amount of NIS 5.2 billion (in the months of January to September total purchases of foreign currency amounted to NIS 72.2 billion);
- Supply of money by way of the granting of monetary loans in the amount of NIS 420 million (in the months of January to September no monetary loans were granted whatsoever);
- On the other hand, the Bank of Israel acted towards absorbing liquidity from the system by way of increasing the volume Shekel deposits in the amount of NIS 9.4 billion (a relatively low amount for the first three quarters of the year, approximately NIS 18 billion on an average per quarter);
- Absorption of liquidity by way of open market operations in an amount of NIS 5.7 billion (in contrast to supply of liquidity during the months of January to September in the amount of NIS 10.7 billion).

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 9.2 billion, compared to a cash inflow of NIS 27.7 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 8.3 billion, compared to cash absorption of NIS 22.5 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.

Government fund raising in the local bond market, during the fourth quarter of the year, was relatively lower than in earlier quarters and amounted to NIS 11.7 billion, alongside redemptions of principal sums and interest in the amount of NIS 9 billion. In total for the year, the Government raised an amount of NIS 18.9 billion by way of marketable bonds, alongside redemptions of principal sums and interest in an amount of NIS 52.4 billion. Respectively, a net positive raising of funds was recorded in 2009 for the second year running in an amount of NIS 16.5 billion. In comparison, in 2008 the raising of funds by way of marketable bonds amounted to NIS 53.1 billion and the net amount raised was NIS 5.2 billion. Furthermore, in 2009 the Government issued tenders for exchange of bonds in the amount of NIS 13 billion (issued par value).

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 2009:

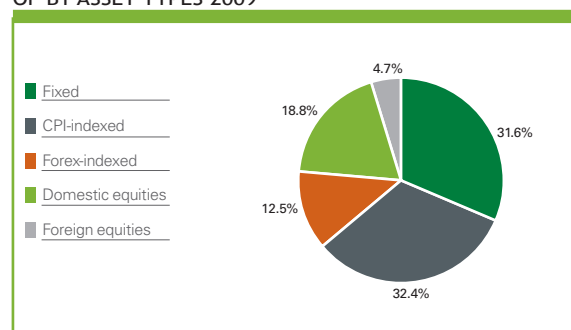
The non-linked segment. The volume of non-linked deposits of the public with the Bank reached at the end of 2009 an amount of NIS 58.2 billion, compared with NIS 55.3 billion at the end of 2008, an increase of 5.2%.

The CPI linked segment. The total of CPI linked financial resources amounted to NIS 13.6 billion at the end of 2009, compared with NIS 11.7 billion at the end of 2008, an increase of 16.2%.

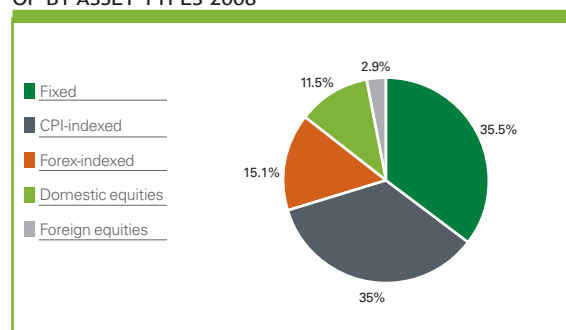
The foreign currency and foreign currency linked segment. The volume of non-linked deposits of the public with the Bank reached US\$9.0 billion at the end of 2009, compared to US\$9.3 billion at the end of 2008, a decrease of 3.0%. After eliminating exchange differences, the change between the currencies amounted to a decline of US\$348 million, a drop of 3.7%. The said change was affected by the increase in current account balances of US\$627 million, and from a drop in deposit balances of US\$974 million.

Raising of capital. For details regarding raising capital in 2009, by means of various capital instruments, see "Capital resources" above.

DISTRIBUTION OF THE PUBLIC'S PORTFOLIO
OF BY ASSET TYPES 2009



DISTRIBUTION OF THE PUBLIC'S PORTFOLIO
OF BY ASSET TYPES 2008



EXPOSURE TO RISKS AND RISK MANAGEMENT

RISK MANAGEMENT POLICY AND OBJECTIVES

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.

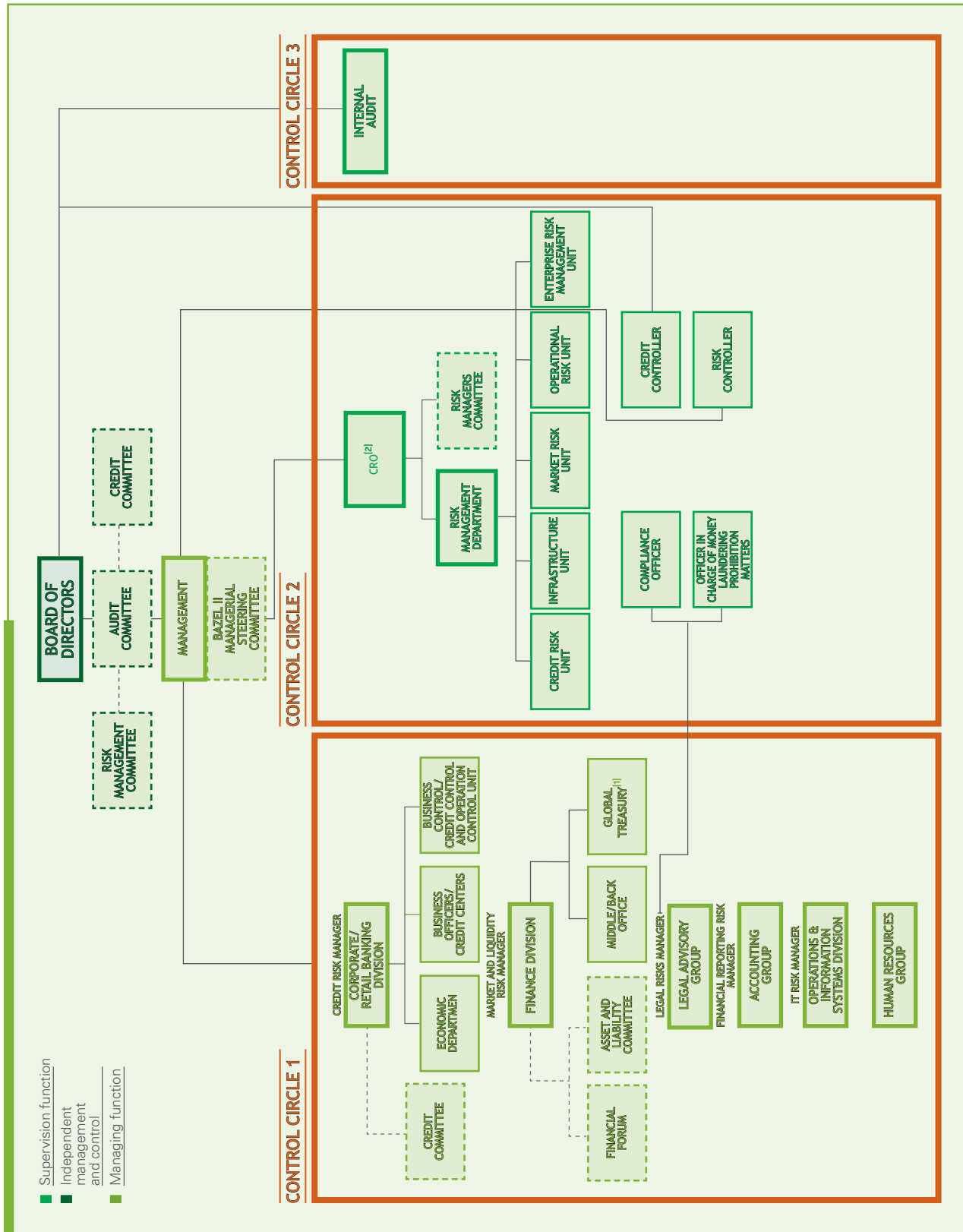
The risk management policy is intended to increase the profit expectancy as part of the means to attain the Bank's business targets, while maintaining an approved and controlled risk level. In order to address all risks, the Bank adopted a risk management policy that defines the kind of risk exposure 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, control and reporting of risk exposure. During the year 2009, the Bank made preparations for the modification of its policy, within the framework of preparing for the implementation of the Basel II guidelines and with a view of upgrading the quality of risk management according to the best accepted practice. A model for risk management has been defined, as detailed below.

THE STRUCTURE AND ORGANIZATION OF THE RISK MANAGEMENT FUNCTION FACTORS INVOLVED IN RISK MANAGEMENT

Risk management model. The Enterprise Risk Management Model, which has been adopted by the Bank and the Group, is intended to create a balance between the separate circles related to risk management and to define the relations and affinities between them. The factors involved in risk management include: the Board of Directors, the Board's Risk Management Committee, Management of the Bank as well as the three circles related to risk management: the creators of risk, the factors responsible for the independent management of risk and the controlling and audit factors that are subject to Management or to the Board of Directors.

The chart on the next page describes the Corporate Governance framework tasked with risk management at the Bank.

CONTROL CIRCLES DIAGRAM



(1) INCLUDING DEALING ROOM AND ASSET AND LIABILITY BRANCH. (2) TODAY THE MARKET AND LIQUIDITY RISK MANAGER ALSO PERFORMS THE FUNCTION OF THE CRO.

The Bank's Board of Directors. The Board bears the ultimate responsibility for determining the risk management model and policy of the Bank and of the Group and for supervising their implementation, subject to the provisions of the law. This includes: capital adequacy of the Bank and of the Group; determination of the Bank's capital targets; determination of the risk propensity as part of planning the use of capital and approval of the limitations on risk derived from the propensity; determination of a policy for risk management that secures compliance with the limitations on risk propensity, as part of the strategy and business policy; establishment of the organizational structure and core processes for risk management (as defined by the policy); supervision and control of exposure to risks and the manner of its management.

The Board of Directors is assisted by its Risk Management Committee, by the controlling factors that answer to the Board and by various factors within the Management of the Bank.

The Risk Management Committee of the Board. The Committee discusses and submits recommendations to the Board of Directors with respect to any issue related to the risk management field at the Bank, including procedures of the Board in this field. The Committee has been authorized by the Board to receive and discuss the quarterly report that is required under the guidelines of the Supervisor of Banks in the matter of preparations for the implementation of Basel II.

The Committee supervises the implementation of the Bank's risk management policy, 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.

The 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.

The Bank's Management. The Management is responsible for the realization of the risk management model and policy, the existence of control and supervision over the quality of risk management and for an adequate layout of risk measurement. Management acts through a chief risk manager and the risk management department and by a committee of risk managers of the Bank and of the Bank Group.

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

Ms. Dorit Ben-Simon, Senior Executive Vice President - Chief Risk Manager of the Bank, Market and Liquidity Risk Manager and Chairperson of the Committee;

Mr. Ehud Arnon, Senior Executive Vice President - Credit risk manager of the Bank;

Ms. Esther Deutsch, Senior 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 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 department, which answers to the Bank's Risk Manager, is responsible for the overall risk management at the Bank and the Group.

The Risk Management Department. The department is responsible for managing the overall risks at the Bank and the Group within the framework of the second control circle (see below), including the implementation of the Basel II guidelines, excluding legal risks and compliance and regulation risks, which are managed by the Legal Services Layout, financial reporting risks, which are handled by the Accounting Layout and excluding information technology risks, which are managed by the operations and information systems division.

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 under its responsibility, and the 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 pillared Basel II Project in the entire Discount Group.

Creators of risk (the first control circle). The Bank's units that take on risks for the Bank and are responsible for the current management of such risks. These units are responsible both for forming the "strategy and business policy" and its execution, and for the implementation of the "risk management policy" with respect to the risks taken as part of their operation. The first control circle includes the middle office and back office units, which act under the creators of risk (in divisions where such units exist) and assist them in the realization of the risk management policy.

Independent management and control (second control circle)

- Chief Risk Manager - has the overall responsibility for risk management at the Bank and Group levels;
- Risk management department – the department through which the Chief Risk Manager operates is responsible for the formation of recommendations for risk management policy; the development of methodologies and of quantitative and qualitative tools for identifying and measuring exposure to risk; support of creators of risk in everything relating to managing the risks for which they are responsible; analysis and reporting exposure of the Bank and the Bank Group to the various risks. The department is also responsible for the formation of recommendations relating to risk management, including definition and updating of the propensity for risk, capital adequacy targets, etc.
- Independent risk controllers – credit controller subject to the Board of Directors, market risk controller subject to the President and CEO all assist the Board of Directors and Management in the supervision of risk, including efficiency of its management.
- The compliance officer-monitors the preparations of the Bank towards the fulfillment of the duties imposed on it under the legislation and regulation in the field of consumer instructions, including verification of the Bank's compliance with consumer instructions relevant to new operations of the Bank. The compliance officer also verifies the correction of deficiencies identified in this field.

Audit factors (third control circle). The internal audit layout, which is subject to the Board of Directors, serves the Board and Management as the third control circle in the audit of risk management, including efficiency and effectiveness of the risk management procedures. It should be noted that whereas the audit of the risk controllers is the authority and responsibility of the internal audit, it belongs to a control circle that is separate from them.

The Supervisor of Banks' guideline regarding a chief risk manager and the risk management function. In December 2009, the Supervisor of Banks issued a guideline on this subject, which is based on the principles of the second layer of Basel II and specifies guidelines regarding the position, duties and responsibilities of the risk management function

and the officer heading it. The guideline determines that the risk management function shall have a significant position in the organization and that it shall be headed by a chief risk manager, who is to be independent and shall not be involved in business decisions creating risks. The chief risk manager shall be a member of senior management and shall be directly responsible to the President and CEO.

The Bank is preparing for the implementation of the guideline and for submission of the planned structure of the risk management function for approval of the Supervisor of Banks, until March 31, 2010, as required.

CREDIT RISK MANAGEMENT

GENERAL

Credit risk is the risk of damage to the value of the Bank and its profitability following deterioration in the ability of borrowers to honor their obligations or due to a decline in the quality of borrowers and in the value of the collateral provided by them to the Bank.

The credit risk management concept at the Bank and at the Discount Group is designed to secure a proper balance between the business factors that directly create and manage exposure to credit risk, and the factors engaged in supervision, control and risk evaluation, including the formation of the policy and methodology for credit risk management, analysis, evaluation and reporting procedures regarding exposure to credit risk, and the factors engaged in the independent audit and risk control.

Aimed at securing the existence of effective processes of credit risk management and compliance with determined exposure limits. Each subsidiary in the Group will be required to approve a credit risk management policy, which in all material respects, is compatible with the guidelines of Discount Bank.

The application of the credit risk management policy at the Bank is reflected in the credit strategy and policy documents.

The credit strategy document outlines the mode of operation of the Bank as regards the granting of credit, within the framework for the implementation of the strategic plan of the Bank, by detailing target markets and business targets, improving the management of the credit portfolio and its quality and the pricing of credit with a view of reflecting and expressing credit risks.

The policy document includes principles and guidelines supporting the management of credit risk, including the policy regarding collateral, credit authority, the credit underwriting process and exposure limits. Risk indicators have been determined within the framework of the credit policy, the existence of which requires validation and updating of the documents. Furthermore, a policy and specific limitations have been determined with respect to exposure defined as significant.

In addition, credit risk management is conducted by means of procedures and work processes that define the underwriting principles at the Bank, the management and control of the existing credit portfolio, credit granting authority and the ranking of the credit committees, work methodology approval and control procedures, required collateral, the monitoring of credit portfolios and reporting by means of information systems. 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.

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

Hereunder is included reference, as the case may be, to the principal subsidiaries – IDB New York, Israel Credit Cards and Discount Mortgage Bank. In view of the fact that Mercantile Discount Bank is similar to the Bank in its general characteristics, from the general lines of operation and related regulatory aspects, no separate reference is generally included with respect to this bank.

STRATEGY AND POLICY OF THE BANK WITH RESPECT TO CREDIT RISK MANAGEMENT

The strategy and policy of the Bank and of its subsidiaries with respect to the granting of credit to the public are, among other things, intended to improve the quality of the credit portfolio, to diversify the portfolio, to limit its concentration and to spread out the risks inherent therein.

The documents are discussed once a year, while determining the credit policy for the following year. The policy is approved by Management of the Bank and the Board of Directors. Due to the economic crisis, it has been decided to examine the credit policy on a current basis, and where necessary, to submit to the Board of Directors a proposal for amendment of the policy.

In addition, a detailed credit policy is determined with respect to various areas and activities that include: economic sectors, large borrowers and borrower groups. Special emphasis is put on economic activities having a material and unique credit risk, such as: the acquisition of means of control, the diamond industry, real estate and construction projects, the London branch, large capital market operators.

A strategy has been determined this year also for environmental issues in view of the increased awareness of ecological and social damage caused as a by-product of the activities of corporations and due to increased legislation in the matter and in accordance with the guidelines of the Supervisor of Banks in this respect. A strategy has also been determined with respect to complex foreign trade transactions and to banks and financial institutions as well as borrowers in less developed countries (LDC).

The regulatory limitations imposed on the Discount Group within the framework of directives of the Supervisor of Banks as to industry concentration, single borrower, group of borrowers and the six largest borrower groups, impose an effective limitation on the group regarding the granting of credit to certain borrowers. The credit policy of the Bank and of its subsidiaries include internal restrictions and lines of operation in addition to those promulgated by the Supervisor of Banks.

The distribution of risk among economic sectors is based on the evaluation of forecasted developments through current reviews of the situation in the economic sectors and surveys of various industries performed from time to time.

The Bank conducts ongoing monitoring of large borrowers/the six largest borrower groups and of compliance with the limitations set by the Supervisor of Banks and with the internal limitations determined by the Bank in their respect. Each large borrower group is discussed by the Bank at periodic intervals.

According to the Supervisor of Banks' instructions, the Bank prepares in each quarter an exposure document that describes, among other things, the overall credit risks in the different areas to which the Bank and the Group are exposed, compliance with regulatory limitations as well as the Bank's and the Group's internal restriction for monitoring and control purposes. The exposure document is presented to Management and to the Bank's Board of Directors of the Bank.

The credit exposure document relates to the following exposures: linkage segments base exposure, exposure to segments of operation, exposure to economic sectors, and exposure to large borrowers/large borrower groups.

In addition, the quality of the credit portfolio is examined in accordance with the distribution of the indebtedness rating of borrowers, the volume of problematic debt and the expense for doubtful debt provision.

A letter from the Bank of Israel was received on December 10, 2009, on the subject of "Lessons learnt from the financial

crisis regarding credit risk management". The letter deals with principles and methodology regarding the management of credit risk, including the field of leveraged finance. In General, the Bank acts in conformity with the spirit of the letter. Notwithstanding, an extensive study is being made by the Bank regarding the implications of the letter on the credit policy and the methodology of managing credit risk by the Bank.

For details regarding the manner in which the Bank faced credit risks following the financial and non-financial crisis in the markets, see above "Credit granted to the public" under "Developments of assets and liabilities".

Foreign extensions – IDB New York. The credit portfolio of the subsidiary IDB New York, is monitored according to the following concentration categories: type of industry, geographical distribution, exposure to large borrower groups, risk rating and the real estate portfolio, with the aim of distributing the risks inherent in the credit portfolio. Management of IDB New York is responsible for determining limitations and/or targets within the framework of such concentration risks. Credit exposure and compliance with limitations are reported to the Board of Directors on a quarterly basis.

ICC. The credit policy of ICC, which is approved by the board of directors of ICC at least once a year, determines limitations to the different lines of operation. Within the framework of the credit risk exposure report, senior management and the board of directors examine in each quarter, among other things, compliance with the limitations set by the board, deviations from such limitations and plans of action for correction of these deviations.

The mortgage loans field. The activity of the Group in granting mortgage loans is mainly conducted through the subsidiary Discount Mortgage Bank Ltd. (hereinafter: "DMB"). This activity is typified by a highly spread out credit portfolio, due to the focus of loans to households. DMB's policy in recent years dictated the focus on mortgage loan activity, both in financing the acquisition of residential apartments, including the construction of private houses, and in loans for other purposes secured by a residential unit owned by the borrower. This policy contributes to the distribution of the existing credit portfolio over a large number of borrowers, at a significant geographic distribution. In addition DMB also finances the acquisition of property for commercial, office or light industry purposes in demand areas, both for owner use and for investment in income producing property. DMB does not provide new financing for hotels, event halls, heavy industry real estate or large commercial centers. DMB also finances groups of borrowers organized as "acquisition groups", mostly for residential purposes.

DMB has determined limitations on exposure to the following segments of activity: (a) the ratio of credit to the commercial segment to the total credit portfolio; (b) the ratio of credit to foreign residents to the total mix of DMB's operations; (c) the combined volume of credit facilities allocated to acquisition groups. Furthermore, DMB has defined internal limitations on exposure to a single borrower and to groups of borrowers.

STRUCTURE AND ORGANIZATION OF THE CREDIT RISK MANAGEMENT FUNCTIONS

The organizational structure designed for the management of credit risk is composed, as above said, of three control circles.

The first control circle

- Various processes for the reduction of credit risk are performed within the framework of the **business units** through the economic and business analysis of applications for credit in order to evaluate the credit risk involved in the operations of the borrower, credit rating and the ongoing monitoring and control over the credit granted as well as the quality of the borrower. Within the framework of such processes, the collateral provided is being assessed and revalued in accordance with the collateral policy and procedures derived there from. The current survey of credit files includes a review of implementation of decisions taken by the credit committees, including documents related

to credit transactions (loan agreements, pledge documents, compliance with terms and conditions, availability of current reporting by the customer, etc.)

The control procedures are performed using irregularity reports and outstanding debt reports at various profiles. The aim of the control is to identify as early as possible defaults in customer accounts and to draw the attention of the business factors to the urgent need to correct any irregularities in their indebtedness;

- **The credit committees** discuss and take decisions on matters of credit, both as regards new applications for credit and as regards existing indebtedness. Discussions of the committees include a review of borrowers including compliance with the credit terms, changes in credit profitability, developments in the financial condition of the borrower, evaluation of the level of exposure to changes in exchange rates, rating of the borrower, etc;
- **Business control units** monitor deviations from credit terms and the development of indicators for problematic debts. This is achieved through periodic irregularity reports and ongoing follow-up of customers in respect of whom "red flags" have been identified;
- **Credit management and operation unit** is engaged in the preparation and updating of follow-up files for the credit committees. The unit is also responsible for relating groups of borrowers, in accordance with directives of the Bank of Israel in the matter, and for the current monitoring for the prevention of deviations from the limitations on a single borrower/group of borrowers;
- An additional layer of handling credit is the **Economic department** at the corporate banking division, among its duties are:
 - Preparing strategy and credit policy documents, and analysis of credit exposure at the Bank's level;
 - Participation in the development of models for credit rating and designing the methodology for the analysis of credit risk;
 - Preparation of surveys for credit risk evaluation of the different economic sectors and of certain borrower groups;
 - The analysis of credit risk applying to complex applications for credit;
- The Bank has two units engaged in the management of problematic debts with a view of arriving at collection arrangements and repayment of the debt: the **special credit department** that operates teams of business managers and deals with large credit files. The **collection department**, responsible for customers of the retail banking division, managing small credit files.

The second control circle

- Duties of the credit risk management unit, which operates within the framework of the risk management department, include:
 - Formation and implementation of policy and methodology documents for the management of credit risks, all this in order to monitor and verify that the credit portfolio is managed in accordance with exposure limitations approved by the Board of Directors;
 - Development and application of internal models for internal credit rating of Bank customers, in order to quantify credit risk and support decisions;
 - Development of a statistical model for the computation of a group provision, according to the directive of the Supervisor of Banks concerning defective debts;
 - Follow-up of trend and developments in the field of risk management and their communication to all of the Bank's units.

- **The credit control unit** evaluates, independently of factors approving the credit, the quality of the specific borrower and of the credit portfolio of the Bank. The unit also renders an opinion on the quality of borrowers rating. The sample test includes the principal borrowers of the Bank, and covers 45% of the total credit granted over a three-year work plan. The unit answers to the Chairman of the Board.

The third control circle

The internal audit performs sample test checks of credit files. It examines the procedures for approval of the credit granted, the management of credit, examines borrowers' files and tests whether work procedures are in line with procedures of the Bank. In addition, the internal audit performs across the board audits in respect of credit issues.

CREDIT UNDERWRITING AND MANAGEMENT PROCESSES

The credit underwriting process at the Bank is defined by procedures, credit authority and work processes. The underwriting process is structured and begins with the customer's application for credit, analysis of the application, stages of approval of the application in accordance with the credit authority, the actual granting of credit, following which the current control of the borrower's file.

The Bank has determined a scale of credit authority for managers and the various credit committees, reaching up to the Board of Directors. The credit authority at the Bank is determined by the Board of Directors and is defined by the procedures of the Board. According to procedures, credit applications by customers are directed to the different credit committees in accordance with the scope of credit facility of the borrower or of the group of borrowers to which he belongs, in accordance with the following scale:

- The Bank's Board of Directors;
- The credit committee of the Board;
- The central credit committee headed by the Bank's CEO;
- Division level credit committees (corporate and retail banking divisions) and at the level of the commercial department;
- Local credit committees (in accordance with the business unit to which the customer belongs).

Specific credit committees exist for customers belonging to the diamond industry. These are rated according to the scope of the customer's credit facility, starting with the credit committee of the Diamond Exchange branch and reaching the Board of Directors.

The considerations for the granting of credit to a business customer are mostly based on purpose of credit and repayment ability, financial soundness, business position and quality of collateral provided by the customer. An additional important parameter is the quality of the customer and past experience with him.

An economic and business analysis of the customer is performed as part of the approval of the credit designed to locate and evaluate credit risks inherent in his business. Furthermore, as part of the discussions held by the credit committee, it is being considered whether the approval of the credit reflects acceptance of a reasonable risk on the part of the Bank concurrently with profitability and an appropriate return.

The consumer credit at the Bank is characterized by small amounts and a high distribution. The methodology and procedures regarding the examination of credit applications submitted by private customers, is intended to focus more on acquaintance with the customer, on socio-economic parameters and on his financial soundness in addition to the examination of the collateral. Furthermore, a private customer credit scoring system is also used, in order to determine

the rating and credit recommendations for existing customers. Decisions on the granting of consumer credit are taken under personal authority or by the relevant credit committee, in accordance with the scope of credit.

The Bank emphasizes the qualitative examination process of the credit application and the response to the customer. The Bank also offers a comprehensive financing package and endeavors to modify it to the customer's needs.

Within the framework of the **credit management process at the Bank**, current discussions are conducted at the credit committees at frequencies of about twice a year in respect of every customer having a credit facility in excess of NIS 400 thousand. Preparation and updating of follow-up files are made prior to each discussion. Developments and principal changes in the business condition of the borrower are reviewed within the framework of the discussion, including compliance of the borrower with the credit terms, changes in the credit profitability, the financial condition of the customer and his indebtedness rating.

The Bank acts according to procedures that define criteria for identifying credits having a problematic potential, in order to ensure the ongoing monitoring of the quality of the credit portfolio, and where required, the classification of problematic debts and/or creation of provisions at the appropriate time. The process of classifying debts as problematic and determination of provisions is made once a quarter by the Bank's Management, and in a manner that would reflect the risk level of the credit portfolio.

The monitoring process of the credit portfolio includes two stages:

- Identification of customers whose financial condition and/or their ability to honor their obligations towards the Bank have deteriorated, and classifying them, in consequence, as "problematic debts".
- The creation of provisions that reflect the expected loss to the Bank in respect of the "problematic debts". In determining the provisions, the Bank's Management relies on information at hand regarding the borrower, such as: his credit rating, financial soundness and/or owner guarantees, scope and quality of the collateral held, the risk level of the industry in which he operates, etc.

Credit underwriting process at IDB New York. The credit underwriting process at IDB New York begins with the submission of a credit application by the business unit. The credit risk management unit prepares an "opinion" with respect to each credit application, which, among other things, relates to cases where the credit exposure exceeds the various limitations determined by the credit policy. The opinion may voice consent, consent under certain terms or a recommendation for rejection.

Credit underwriting and management processes at ICC. ICC operates according to procedures and work processes which define the underwriting principles, management and monitoring of the credit portfolio. Procedures for the handling of credit and collateral and the relevant information systems are updated on a regular basis with a view of improving credit management.

Evaluation of credit risk at ICC is based on the following statistical models:

- Credit scoring model – a statistical model used for determining customer scores, according to which the level of credit/type of card is determined.
- Behavior scoring model – a statistical model used for determining customer scores based on their behavior during the period of their relationship with the company.

Every new of evaluation and re-approval of credit facilities is made in accordance with criteria and authority scale defined in the policy document.

Credit underwriting and management processes at DMB. The documentation and criteria required for the examination of applications for credit are defined in the procedures of this bank and include, among other things, a "getting to know the customer" policy, evaluation of the repayment ability of the customer in accordance with his characteristics

(private and corporate), purpose of the transaction and the type of collateral offered in respect thereof.

DMB does not operate the grading model prior to the approval of credit, and is acting towards the formation of principles for the development of such a system.

However, DMB operates credit quality control from the moment of granting the credit through a back office that includes an underwriting unit and an examination unit, which serve as control units over the operation of the branches prior to the granting of the credit.

The underwriting unit performs control over both the appropriateness of documents submitted by the customer and his economic condition, both as to the rights offered as collateral and the statements made by him in connection with the granting of the credit, as well as the possibility of registering the property as an adequate collateral for the loan. Following the validation of the file, the underwriting unit issues an approval, which includes reference to the collateral documents required for the granting of the credit.

DMB reviews periodically the large credit files in accordance with the authority scale approved by the Board of Directors of this bank. In addition, DMB grades its customers, excluding housing loans, in accordance with requirements and definitions of the Supervisor of Banks. The grading system includes behavioral scoring received once a month. DMB makes efforts for the continued improvement of the grading model.

The review of the credit portfolio is performed by the collection unit in order to examine the need for the classification of debts and the creation of provisions. Furthermore, the unit deals with loan arrears both by forming repayment arrangements and by taking legal action, as the case may be.

CREDIT RISK MEASUREMENT AND REPORTING SYSTEMS

The Bank uses several measurement and reporting systems supporting credit risk management, as follows:

- Computerized system for the management of credit facilities and for the management of borrower debt, which also enables following up on the volume of the credit file. The system covers all Bank customers whose indebtedness exceeds NIS 400 thousand. The system is in the integration stage also with respect to customers of the retail banking division having a smaller indebtedness. The system provides information regarding the status of credit and collateral of the borrower, credit facility, guarantees and financial covenants. The system supports the work of the various credit committees and summarizes customer data in a comprehensive report presented to the various credit committees.

Furthermore, the system supports the customer credit risk management on the basis of a model for customer indebtedness rating. This rating model is composed of a questionnaire and includes a scoring of a financial statistical model for credit rating, based on an analysis of the borrower's financial statements;

- A computerized system for credit scoring and providing credit recommendations for private customers;
- A computerized system for the management of material collateral. The system documents pledges on real estate assets, fixed assets, securities and floating pledges. The system manages the value of the material collateral securing the debt;
- A computerized system for guarantee management;
- The Bank has integrated a computerized system for the computation of risk assets on a Group level, in accordance with Basel II guidelines.

REDUCING THE RISK IN RESPECT OF CONCENTRATION OF CREDIT

Concentration risk is the risk emanating from the lack of diversification of the credit portfolio. This risk is made up of two main categories: (1) Risk emanating from a large volume of credit granted to a specific borrower and/or several borrowers who belong to the same group of borrowers; (2) Risk emanating from a large volume of credit granted to borrowers belonging to a certain economic sector or to a certain geographical area.

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.

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 and within internal limitations determined by the Bank. In addition, the Bank conducts surveys and holds periodic discussions with respect to each borrower group, with a view of evaluating the credit risk at Group level.

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.

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. The Bank adopts a cautious credit policy regarding the different economic sectors and credit segments. The credit policy takes into consideration the slowdown in economic activity and the increase in risk pertaining to the entire system. 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 exposure to possible changes in the exchange rate of the Shekel as against foreign currencies, among other things, by way of testing the sensitivity of borrowers that took out loans 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.

METHODOLOGY AND TRAINING IN CREDIT MANAGEMENT

- Methodology and procedures exist with respect to the manner of preparation of credit applications and for financial analysis of the condition of the borrower. A current analysis is performed on most recent financial statements of the Bank's business customers and a current follow-up of their business and financial condition is conducted. Furthermore, an economic and business analysis of credit applications is made, which focuses on the identification and evaluation of credit risk inherent in the customer's operations;
- Several methods developed by the Bank for the evaluation of the repayment ability of the borrower, of his needs for working capital and for evaluating the reasonableness of the credit exist. These methods are modified to the type of customer and structure of the transaction;
- Credit officers at all levels undergo training and study sessions with a view of preserving and updating the existing

knowledge and their professional standards;

- A process of drawing conclusions is conducted at the Bank by committees from the various divisions, discussing various issues including credit issues. The committees meet periodically in order to discuss failure events, to analyze failure data and to form means for the prevention of similar failure events in the future.

DEFINITION OF PROBLEMATIC DEBTS

The identification and classification of debts as "problematic debts" is performed according to classifications determined by Proper Banking Management Directive No. 314 and according to criteria specified in this Directive: "doubtful debts", "non-performing debts", "rescheduled debts", "debts in temporary arrears" and "debts under special supervision". See Note 1 to the financial statements for details regarding expected changes in the above definitions, following the instruction regarding "Measurement and disclosure of delinquent debts, credit risk and provisions for credit losses" taking effect.

For details regarding credit risk and its components relating to problematic debts, see above "Credit granted to the public" under "Developments of assets and liabilities".

DESCRIPTION OF THE APPROACH AND STATISTICAL METHODS FOR THE CREATION OF SPECIFIC AND GENERAL PROVISIONS

As part of the Bank's preparation for the implementation of the instruction in the matter of "Measurement and disclosure of delinquent debts, credit risk and provisions for credit losses", the Bank is acting towards the development of statistical tools for the determination of provisions for loan losses. See Note 1 AA to the financial statements for details regarding this instruction.

QUANTITATIVE DISCLOSURE REGARDING CREDIT RISK

Segmentation of credit risk according to main credit exposure types

1. Gross credit risk exposure

	December 31	Average in
	2009	2009 ⁽¹⁾
	In NIS millions	
Credit	140,094	140,849
Bonds	33,503	32,215
Others ⁽²⁾	8,521	8,717
Guarantees and other liabilities on account of clients ⁽³⁾	62,860	65,300
Transactions in derivative financial instruments ⁽⁴⁾	2,290	2,743
Total	247,268	249,824

Footnotes:

(1) Computed on a quarterly basis as from December 31, 2008. The data in respect of prior quarters are based on data reported to the Supervisor of Banks during the period of integration of the Basel II guidelines and are not audited.

(2) Primarily: cash, shares, fixed assets.

(3) Off balance sheet credit risk is stated prior to conversion to credit equivalent (before multiplication by the CCF coefficient).

(4) Credit risk in respect of transactions in derivative financial instruments is presented in terms of credit equivalent (after netting effect and after multiplication by the "add-on" coefficient).

Segmentation of exposures according to counterparty class

December 31 2009						
	Credit	Bonds	Other ⁽¹⁾	Guarantees and other liabilities on account of clients ⁽²⁾	Transactions in derivative financial instruments ⁽³⁾	Total
in NIS millions						
Sovereigns	19,213	19,152	-	-	-	38,365
Public sector entities	1,047	10,579	-	327	3	11,956
Banking corporations	7,820	1,537	-	3,217	856	13,430
Corporates	72,136	1,894	-	40,435	1,268	115,733
Single retailer exposures	15,355	-	-	13,755	93	29,203
Small business loans	8,571	-	-	3,495	3	12,069
Residential mortgage	15,952	-	-	1,631	67	17,650
Securitization	-	341	-	-	-	341
Other assets	-	-	8,521	-	-	8,521
Total	140,094	33,503	8,521	62,860	2,290	247,268

Footnote:

- (1) Primarily: cash, shares, fixed assets.
(2) Off balance sheet credit risk is stated prior to conversion to credit equivalent (before multiplication by the CCF coefficient).
(3) Credit risk in respect of transactions in derivative financial instruments is presented in terms of credit equivalent (after netting effect and after multiplication by the "add-on" coefficient).

Division of the file according to remaining contractual maturity periods⁽¹⁾

December 31 2009					
	Up to 1 year	Over 1 year and up to 5 years	Over 5 years	No fixed maturity date ⁽²⁾	Total Cash Flow
in NIS millions					
Credit	90,661	35,211	24,097	3,532	153,501
Bonds	6,578	13,217	30,565	20	50,380
Others ⁽³⁾	3,183	295	178	4,865	8,521
Guarantees and other liabilities on account of clients ⁽⁴⁾	44,313	12,956	3,762	1,829	62,860
Transactions in derivative financial instruments ⁽⁵⁾	12,955	2,154	2,445	-	17,554
Total	157,690	63,833	61,047	10,246	292,816

Footnotes:

- (1) This note presents the anticipated future contractual cash flows in respect of the exposures, 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 1,686 million.
(3) Primarily: cash, shares, fixed assets.
(4) Off balance sheet credit risk is pre conversion to credit risk (pre multiplying by CCF coefficient).
(5) Presented as calculated for the purpose of limitation on borrower indebtedness.

DISCLOSURE AS TO CREDIT FILES MANAGED ACCORDING TO THE STANDARD APPROACH

For the purpose of averaging out exposure risk, the Bank and its banking subsidiaries in Israel use international rating data issued by Moody's – the international rating agency. IDB New York uses rating data issued by the international rating agencies – Moody's, Fitch and S&P.

The Group uses independent rating for all types of relevant exposures, including: sovereign entities, public sector entities, multi-purpose development banks, banking corporations, securities companies, corporations and securitization.

The Group acts according to the standard mapping published by the Supervisor of Banks.

The process, which is used for the application of public issue rating to similar assets existing in the banking book, is in accordance with the framework published by the Supervisor of Banks. When the Bank invests in a particular issues that has a specific issues rating the weight attributed to the risk is based on such rating. Where the debt to the Bank does not comprise a particular rated issues, the Bank applies the principles determined in the framework.

Exposure amounts according to risk weights

December 31 2009									
	0%	20%	35%	50%	75%	100%	150%	Deduction from capital	Total
in NIS millions									
Exposure before credit risk mitigation ⁽¹⁾⁽²⁾	39,097	19,281	13,907	8,381	43,373	119,661	3,314	254	247,268
Exposure after credit risk mitigation ⁽¹⁾⁽²⁾	39,308	19,313	13,870	9,175	39,369	115,008	3,270	-	239,313

Footnotes:

(1) Off balance sheet credit risk is pre conversion to credit risk (pre multiplying by CCF coefficient).

(2) Credit risk in respect of transactions in derivative financial instruments is presented in terms of credit equivalent (after netting effect and after multiplication by the "add-on" coefficient).

Below is the distribution of credit risk assets of the Bank, in accordance with various levels of risk determined in Directive No. 311:

December 31 2009					
	0%	20%	50%	100% or more	Total
in NIS millions					
Cash and deposits with banks	18,614	5,873	-	96	24,583
Securities	21,282	11,471	997	2,588	36,338
Securities borrowed or purchased under buy-back agreements	336	-	-	-	336
Credit granted to the public	9,461	3,086	6,134	96,077	114,758
Credit granted to the government	1,818	-	-	2	1,820
Investment in affiliated companies	* 1,654	-	-	21	1,675
Buildings and equipment	-	-	-	3,178	3,178
Other assets	766	1,735	-	2,840	5,341
Transactions whose balance represents credit risk	926	438	397	11,787	13,548
Derivative financial instruments	578	8,189	41	2,486	11,294
Other	-	35	-	15	50
Total credit risk assets	55,435	30,827	7,569	119,090	212,921
Deduction factors included in the above credit risk rates:					
Securities:					
Bonds and deposits	18	-	-	-	-
Guarantees received	4,644	172	-	-	-
Credit granted to the public:					
Bonds and deposits	9,241	-	-	-	-
Guarantees received	220	2,977	-	-	-
Transactions whose balance represents credit risk:					
Bonds and deposits	926	-	-	-	-
Guarantees received	-	438	-	-	-
Derivative financial instruments:					
Bonds and deposits	578	-	-	-	-

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

The distribution of credit risk assets of the Bank, in accordance with various levels of risk determined in Directive No. 311 (continued):

December 31 2008					
	0%	20%	50%	100% or more	Total
in NIS millions					
Cash and deposits with banks	11,913	9,385	-	256	21,554
Securities	12,371	15,123	-	4,041	31,535
Securities borrowed or purchased under buy-back agreements	25	-	-	-	25
Credit granted to the public	10,474	2,929	5,538	97,844	116,785
Credit granted to the government	1,471	-	-	20	1,491
Investment in affiliated companies	*1,472	-	-	237	1,709
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	12,797	14,141
Derivative financial instruments	251	7,982	58	2,747	11,038
Other	-	44	-	17	61
Total credit risk assets	39,208	38,182	5,982	123,910	207,282
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	10,208	-	-	-	-
Guarantees received	266	2,728	-	-	-
Transactions whose balance represents credit risk:					
Bonds and deposits	671	-	-	-	-
Guarantees received	-	287	-	-	-
Derivative financial instruments:					
Bonds and deposits	251	-	-	-	-

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

REDUCTION OF CREDIT RISK

General qualitative disclosure regarding the reduction of credit risk. The Bank operates according to a policy, procedures and work processes regarding the acceptance of collateral and its management that includes guidelines as to revaluation of the asset, the rate of reliance on the collateral, pledges registered on the collateral and their registration with the relevant Registrars, etc.

According to the Basel II guidelines, banking corporations may obtain relief from capital requirements with respect to usage of methods of reducing credit risks (CRM), subject to legal certainty. Legal certainty requires, among other things, that all documents securing a transaction, setoff documents, guarantees, etc. shall be binding on all parties involved and may be legally enforceable in all relevant judiciary fields.

In computing the capital requirements as of December 31, 2009, the Bank has only recognized a part of the collateral potential eligible for setoff in accordance with the Basel II guidelines. The Bank continues to act towards the improvement of processes and procedures in order to achieve the legal certainty required for the recognition of additional collateral.

Collateral management and control processes. Collateral received with respect to credit of various types is managed and controlled by the different units, as follows:

- The business units evaluate and value the collateral in accordance with the collateral policy and procedures derived there from. In addition, current control is performed over customer files, which includes a review of the collateral documents and updating of their value;
- The business control unit is engaged in examining the value of the collateral, compliance with procedures and is responsible for the development of control and warning reports with respect to the value of the collateral, validity of valuation, etc.;
- The valuation unit performs a periodic review of the value of real estate and closed finance projects accepted as collateral, in accordance with the type of asset and at frequency determined in the Bank's procedures;
- The credit control unit performs a sample check of customer files, which includes an examination of documents evidencing the collateral and their valuation and whether they are in compliance with the Bank's policy and procedures;
- The internal audit department performs each year current audits of the business divisions. Such audits include an examination of collateral from the registration and reporting aspects, evaluation of the value of collateral, existence of insurance policies etc. The audit monitors the correction of deficiencies and the implementation of recommendations by the business factors until completion of the process;
- The legal department is involved in the management of collateral, in accordance with its type, as regards one or more of the following three aspects: preliminary legal advice, preparation of the collateral documents, examination and approval of the collateral.

Policy and procedures regarding balance sheet and off-balance sheet netting. The Bank does not make use of balance sheet netting (in terms of Section 188 of the Instruction, and not in accounting terms of balance sheet setoff).

The reduction of credit risk relating to banking corporations. The Bank's policy, as approved by the Board of Directors in February 2010, is to enter into transactions in financial derivatives only with banking corporations with which an ISDA agreement had been signed. This agreement leads to a reduction in credit risk by permitting the netting of liabilities and mutual demands stemming from over the counter derivative transactions in cases of insolvency of the counterparty. The agreements are signed separately with each legal entity; with certain of the said banking corporations a credit support annex (CSA) to the agreement is signed, which regularizes with the counterparty the issue of collateral in respect of derivative transactions. The CSA includes a threshold amount that reflects the maximum exposure that each of the counterparties is ready to accept without receiving collateral.

IDB New York transacts business only with banking corporations with which ISDA agreements had been signed.

Mercantile Discount Bank applies off-balance sheet netting with respect to transactions in derivative instruments with banks with which netting agreements had been signed that comply with ISDA rules.

The reduction of clearing risks. The clearing of derivative transactions with foreign banks and financial institutions constitutes the main source for exposure of the Bank to clearing risks. In order to hedge the clearing risk inherent in these transactions, the Bank uses the services of the CLS – Continuous Linked Settlement system where the clearing process is executed net in the various currencies, simultaneously.

In order to reduce clearing risks, the Bank, where possible, performs the clearing of dual transactions in the principal currencies with banks, using CLS.

Policy and processes regarding the valuation and management of collateral. The Bank has a detailed policy as regards collateral referring to the acceptance of the collateral, management of the various collateral accepted and the rate of reliance thereon. In general, the Bank's practice is to grant credit to customers against collateral of various types, including liquid assets, fixed assets, pledges and guarantees of various kinds.

The scope and quality of the collateral are derived from the level of credit risk that the Bank is ready to accept at the time of the granting of credit, putting a special emphasis on borrowers' repayment ability. Thus, in certain cases, such as: a borrower having a high indebtedness rating, a reliable borrower, credit might be granted without collateral and/or special terms imposed on the borrower.

To the extent possible, the collateral is adjusted to the credit it secures from the stand point of the period of credit, currency in which the loan is granted, paid-up or renewable credit.

The collateral management policy and determination of their value for security purposes are based on principles and rules determined within the framework of the Bank's procedures for the granting of credit, in accordance with the type of assets. The rate of coverage of the debt by collateral is adjusted to the characteristics of the customer, his financial condition and the industry and economic sector in which he operates.

As a condition for reliance on material collateral, the Bank requires an insurance policy for the asset pledged.

Determination of the value for security purposes of the different collateral is derived from their type, their quality and how quickly they may be realized, including changes in their value due to situations of slowdown or growth in the economic environment of the borrower.

Furthermore, Bank procedures include determined maximum rates of reliance on collateral in accordance with the type of asset, for the purpose of reducing the risk upon realization of the asset.

Valuation of the collateral is performed periodically, determining the value of the asset and the appropriate rate of reliance thereon, which should not exceed the maximum rate determined by the procedure. In certain cases, financial covenants are imposed on the borrower. Compliance with such covenants is examined periodically, the violation of which constituting a cause for the immediate repayment of the loan or a demand for additional collateral.

Main types of collateral accepted by the Bank. The Bank accepts the following main types of collateral:

- "Eligible collateral" and guarantees available for netting – collateral used by the Bank for the reduction of risk assets in the credit field in accordance with Basel II instructions, which include:
 - Deposits pledged in favor of the Bank;
 - Bank guarantees provided to the Bank as security for credit granted;
- "Other collateral" – additional collateral used by the Bank as hedge for credit risks, which include:
 - Securities deposit and securities pledged in favor of the Bank;
 - The pledge on fixed assets, such as: motor vehicles, residential property, commercial property, machinery and equipment, floating pledge, negotiable instruments that include credit card vouchers and documentary credit.

The principles for the valuation of the various types of collateral are as follows:

- Liquid collateral – The Bank procedures determine the rate of reliance on liquid collateral in accordance with their type;
- Pledge on property – the valuation of real estate used as collateral for credit is made by the Bank's valuation department and/or on the basis of assessments by qualified appraisers. An updated valuation is required in accordance with the period of reliance thereon as specified in the Bank's procedures.

Bank procedures regarding pledges on real estate determine, among other things, the method of computing their value, the security spreads, the frequency of updating of the value and the authority for examination and approval

of valuations in respect of the granting of credit. Furthermore, the Bank's procedures determine the rates of reliance applying to the different assets, such as: income producing property, stores, residential property, industrial buildings, land of various types, etc.;

- Fixed pledge – Bank procedures include guidelines for the evaluation of a pledge on fixed assets of various kinds. The procedures detail the frequency of updating the value of the pledge and the rates of reliance on the different assets in accordance with the type of the asset, its age, the level of marketability and possibility of realization. This includes: the value of motor vehicles is based on a suitable independent price list that is regularly updated, while the value of machinery and equipment is based on their purchase price or on an assessment by an appraiser;
- Floating pledge – Bank procedure determine guidelines for the valuation of a floating pledge, frequency of updating the valuation, rates of reliance on the various assets included in the pledge and computation of the Bank's share in the pledge. A floating pledge is formed based on updated information, knowledge of the borrower's business, type of active assets and the possibility of their realization. In cases where the information at hand for the purpose of determining the floating pledge is insufficient, the rates for reliance are reduced accordingly.
- Marketable securities – the value of marketable securities is based on market price, the rate of reliance for the security being determined by the securities research department.
- Within the framework of the Bank's policy regarding the financing of acquisitions of means of control, rules have been determined for the valuation of the acquired shares for the purpose of securing such credit. A valuation of the acquired company is performed in accordance with the value of the transaction, market price, or according to a valuation assessment, as well as an examination as to the ability of the acquired company to pay dividends, being generally the source of funds for the repayment of the loan.

Redaction of credit risk

	December 31 2009		
	Total exposure ⁽¹⁾⁽²⁾	Credit risk exposure covered by eligible financial collateral ⁽³⁾⁽⁴⁾	Exposure covered by guarantees ⁽⁵⁾
in NIS millions			
Sovereigns debts	38,365	-	-
Public sector entities debts	11,956	2	211
Banking corporations debts	13,430	-	-
Corporates debts	115,733	3,642	743
Single retailer exposures	29,203	1,917	2
Small business loans	12,069	2,102	14
Residential mortgage	17,650	37	-
Securitization	341	-	-
Other assets	8,521	-	-
Total	247,268	7,700	970

Footnotes:

- (1) Off balance sheet credit risk is pre conversion to credit risk (pre multiplying by CCF coefficient).
- (2) Credit risk in respect of transactions in derivative financial instruments is presented in terms of credit equivalent (after netting effect and after multiplication by the "add-on" coefficient).
- (3) After balance sheet or off-balance sheet netting, when relevant, and after application of haircuts.
- (4) Including gold.
- (5) The amount of exposure covered by guarantees and transferred to the counterparty debts who gave the guarantee.

GENERAL DISCLOSURE REGARDING EXPOSURE RELATED TO CREDIT RISK OF A COUNTERPARTY

Over the counter derivatives. Counterparty credit risk is the risk that the counterparty to the transaction will be in default before the final settlement of the cash flows in respect of the transaction. The main source for the Group's exposure to counterparty credit risk is over the counter (OTC) derivative transactions.

The Bank's policy regarding the management of counterparty credit risk is established in the policy document approved by the Board of Directors every year. The policy document includes, among other things, principles for the identification, measurement and evaluation of the risk, requirements for the determination of combined limitations and for exposure reporting as well as definition of responsibilities and authorizations.

Exposure of the Group to counterparty credit risk is created mostly with respect to international banks and financial institutions.

The framework of exposure to international financial institutions is approved at Group level on the basis of an internal model. The approved framework is allocated by the Bank among the subsidiaries in the Group.

Activity in derivatives is conditional on the prior approval of the credit facility that determines limitations on counterparty exposure.

The framework of exposure to customers is approved in accordance with credit approval authorizations based on obtaining financial collateral only (government bonds, rated corporate bonds, shares and deposits), to the volume of the exposure framework. The credit committee is authorized to approve the acceptance of collateral in accordance with actual exposure only. Furthermore, the granting of a framework to a customer without collateral is possible in accordance with the facts of the case.

The monitoring of counterparty credit risk exposure is performed as follows:

- Exposure to foreign banks and financial institutions – the back office unit at the financial division performs, a comparison of actual exposure to the approved framework on a daily basis;
- Exposure to large customers and/or those having complex activities – The middle office unit at the financial division performs a comparison of actual exposure to the approved framework, on a daily basis, including application of extreme scenarios. As part of management and control over the utilization of the exposure framework, the information system produces a daily irregularity report, which, among other things, includes a list of customers whose actual utilization of the exposure framework is equal or exceeds 85%. The purpose of this report is to give warning to the responsible business factor as to the high utilization rate.

In addition, the Bank determined a set of internal limitations imposed on combined credit exposure of counterparties, such as: combined limitations according to currencies and types of products.

The methods used by the Bank for counterparty credit risk reduction, include:

- Daily monitoring of the customer's collateral situation, and where needed, a demand for additional collateral;
- A contractual "stop loss" clause – enabling the Bank to enforce the closing of a customer position, in cases where a deviation in loss terms from the "stop loss" amount determined for the customer exists;
- The signing of ISDA agreements and CSA annexes (for explanations regarding "ISDA agreement" and "CSA annex", see "Reduction of credit risk" above).

The method for determining counterparty credit exposure limitations. For regulatory reporting purposes the Group uses the "present exposure method", according to which the present cost of replacement is computed by the revaluation of agreements to market prices together with an "add-on" coefficient, in order to reflect the future potential exposure

over the remaining life time of the agreement. The future potential exposure, computed on the basis of the notional principal sum of the total counterparty file, is in accordance with the type of product and the remaining period to redemption, according to a coefficient table included in the Basel II guidelines

For counterparty credit risk exposure management purposes, the Group uses the "customer exposure model", based on the computation of exposure in equal value credit terms that includes a mark to market valuation of transactions together with the future potential exposure.

In the years 2008-2009, the Bank made changes to the future exposure coefficients use by it for assessing credit exposure involving derivative financial instruments (CCR), this following financial developments in these years. During 2008 exposure coefficients were raised and through 2009 they were reduced.

Policy for the protection of collateral, its valuation and management. According to the Bank's policy, the financial collateral is valued on a daily basis. The rate of reliance on such collateral is determined according to the risk volatility of its market price over time, and are secured in the policy document approved by the Board of Directors.

The effect of the amount of collateral that would have to be provided by the Bank in case of a reduction of its credit rating. Some of the collateral agreements to which the Bank is a party within the framework of the ISDA agreements, state that the threshold amount and the minimum transfer amount shall be reduced in the event that the credit rating of the Bank would be reduced. Accordingly, in such cases the Bank would be required to provide to the foreign bank collateral in higher amounts (in the event that the foreign bank has a profit on derivatives).

Disclosure regarding over the counter derivatives

	December 31 2009
	in NIS millions
Gross positive fair value of contracts ⁽¹⁾ :	
Interest rate contracts:	
Shekel/CPI	2
Other	881
Foreign currency contracts	769
Contracts on shares	139
Commodities and other contracts	218
Total Gross positive fair value of contracts	2,009
Potential off balance sheet exposure ⁽²⁾	1,564
Netting benefits	(1,283)
Current credit exposure after netting ⁽²⁾	2,290
Held collateral	(140)
Net derivatives credit exposure	2,150

Footnote:

(1) Including embedded derivatives in the amount of NIS 74 million.

(2) Potential off-balance sheet credit exposure with respect to derivative instruments is calculated based on the notional principal amount of the entire counter-party portfolio, multiplied by the "Add-on" coefficient.

ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

Note 20 to the financial statements presents details of operations in derivative instruments - scope, credit risk and maturities. Part 2 of the aforementioned Note presents details of credit risk with respect to derivatives by counter party, on a consolidated basis. Following are further details regarding data presented in part 2 of the aforementioned Note.

(1) Following are details according to rating of balances of assets derived from transactions in derivative instruments where the counterparty is a bank:

	On December 31, 2009	On December 31, 2008
	In NIS million	
Balances of assets deriving from transactions in derivative instruments where the counterparties are foreign financial institutions		
With an AAA rating	1	-
With an AA+ rating	184	-
With an AA rating	215	330
With an AA- rating	240	308
With an A* + rating	124	527
With an A** rating	237	570
With an A- rating	-	33
With a BBB rating	16	-
Not rated	5	-
Total against foreign financial institutions	1,022	1,768
Total against Israeli financial institutions	265	576
Total balances of assets deriving from transactions in derivative instruments	1,287	2,344

* December 31, 2008 - includes balances of 11 foreign financial institutions, the highest of which amount to NIS 112 million and NIS 109 million, respectively, and among the other institutions there is not one financial institution the balance of which exceeds NIS 74 million.

** December 31, 2008 - includes balances of 8 foreign financial institutions, the highest of which amount to NIS 190 million, NIS 148 million and NIS 110 million, respectively, and among the other institutions there is not one financial institution the balance of which exceeds NIS 87 million.

(2) Following are details according to rating of off balance sheet credit risk in respect of transactions in derivative instruments where the counterparty is a bank:

	On December 31, 2009	On December 31, 2008
In NIS million		
Balances of assets deriving from transactions in derivative instruments where the counterparties are foreign financial institutions		
With an AAA rating	23	-
With an AA+ [*] rating	1,755	-
With an AA ^{**} rating	1,416	963
With an AA- ^{***} rating	1,440	1,442
With an A+ ^{****} rating	684	1,812
With an A ^{*****} rating	1,184	1,365
With an A- rating	-	81
With an BBB+ rating	1	-
With an BBB rating	61	-
Not rated	19	-
Total against foreign financial institutions	6,583	5,663
Total against Israeli financial institutions	1,604	2,319
Total balances of assets deriving from transactions in derivative instruments	8,187	7,982

- * December 31, 2009 - includes an amount of NIS 923 million with Deutsche Bank and NIS 680 million with JP Morgan Chase.
- ** December 31, 2009 - includes an amount of NIS 898 million with HSBC Bank PLC and NIS 246 million with BNP Paribas.
- *** December 31, 2008 - includes NIS 786 million in HSBC Bank PLC.
- *** December 31, 2009 - includes an amount of NIS 438 million with Barclays Bank PLC, NIS 347 million with UBS and NIS 289 million with Commerzbank.
- **** December 31, 2008 - includes an amount of NIS 663 million with JP Morgan Chase.
- **** December 31, 2009 - includes an amount of NIS 446 million with Citibank.
- **** December 31, 2008 - includes an amount of NIS 453 million with Deutsche Bank, NIS 430 million with UBS and additional eleven foreign financial institutions, among which not a single one above NIS 231 million.
- ***** December 31, 2009 - includes balances of five foreign financial institutions, the highest of which amount to NIS 434 million, NIS 410 million, NIS 290 million, and none of the other institutions exceeds the amount of NIS 46 million.
- ***** December 31, 2008 - includes balances of eight foreign financial institutions the highest of which amount to NIS 358 million, NIS 317 million, NIS 309 million and NIS 269 million, respectively, and among the remaining institutions no one financial institution exceeds NIS 55 million.

(3) Following are details of the column "Other" according to the overall credit to the public risk per economic sectors:

	On December 31, 2009	On December 31, 2008
In NIS million		
Agriculture	15	17
Industry:		
Machines, electrical and electronic equipment	179	262
Mining, chemical industry and oil products	335	338
Other	107	200
Total industry	621	800
Construction and real estate:		
Acquisition of real estate for construction	6	238
Real estate holdings	59	280
Other	12	79
Total construction and real estate	77	597
Electricity and water	19	118
Commerce	206	267
Hotels, hotel services and food	2	13
Transportation and storage	84	57
Communications and computer services	99	101
Financial services:		
Financial institutions (excluding banks)	361	588
Private customers active on the capital market	1,003	359
Financial holding institutions	485	422
Insurance and provident fund services	162	106
Total financial services	2,011	1,475
Other business services	107	528
Public and community services	16	12
Private individuals - housing loans	-	-
Private individuals - other	210	90
Total	3,467	4,075

SECURITIZATION EXPOSURE

IDB New York invests in several types of securitized securities, in marketable mortgage backed securities (CMBS), in securities of the "trust preferred CDO" type and residential mortgage backed securities (RMBS).

IDB New York is an investor in securitized securities and is not the issuer of any securitized securities.

For the purpose of averaging the risk of securitization exposure, IDB New York makes use of ratings published by the international rating agencies Moody's, Fitch and S&P.

The securitization exposure included in the following Table does not include mortgage backed securities issued by GNMA, FNMA and FHLMC agencies, due to the fact that they do not include layers according to repayment order.

For additional details, see Note 3 to the financial statements and "Investment in asset backed securities" under "Developments of assets and liabilities" above.

Securitization exposure

December 31 2009	
Total exposure	
in NIS millions	
Mortgage-backed securities (MBS):	
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS)	325
Bond backed securities (TRUPS CDO)	16
Total mortgage and asset-backed securities	341

		December 31 2009	
		Total exposure	Capital requirements
		9%	
		in NIS millions	
Risk weights:			
20%		35	1
50%		44	2
100%		8	1
Deductions from capital		254	254
Total		341	258

Footnote: The above exposures do not include exposures issued by agencies operating under the auspices of the U.S. Government (GNMA, FHLMC, FMNMA).

CREDIT EXPOSURE TO FOREIGN FINANCIAL INSTITUTIONS

General

In view of the 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 second half of 2008. The bankruptcy of Lehman Brothers investment bank, constituted a negative landmark as regards the financial stability of banks and financial institutions. Following this case, the economic crisis, which had begun earlier on, intensified, and liquidity difficulties were evident 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.

The Bank's policy with regard to various exposures to foreign banks and financial institutions, has been re-examined, and is reflected in the following items:

- The Bank has adopted a conservative policy as regards management of exposure to foreign banks and financial institutions;
- The allocation of credit facilities to foreign banks is more strictly and conservatively conducted, using mathematical auxiliary tools that had been re-examined and modified to the lessons of the crisis;
- Deposits by the Bank are made on a very selective basis, at banks in the U.S. and Western Europe only, having a rating of "A+" at the least;
- The Bank has reduced the volume of deposits abroad;
- The Bank has adopted a policy according to which exposure to financial derivatives requires a signed ISDA agreement with every financial institution with which the Bank enters into transactions of this kind;
- The clearing risks facilities are individually examined, with the clear aim of significantly reducing clearing risks, while using the CLS tool, being a central tool for mutual dual clearing;
- A policy has been adopted regarding exposure to less developed countries (LDC). This policy defines exposure at low amounts and for relatively short terms;
- A methodical and close management with upgraded monitoring, supervision and control systems, and cooperation of all involved factors at the Bank and the Group;
- Development of an innovative, integrative and supportive information system, that will assist in the efficient and timely monitoring of warning signs regarding exposure relating to foreign banks and financial institutions.

It should be noted that in the course of 2009, the global banking industry has stabilized itself and many banks returned to show profits. Some of the large banks in the U.S. raised new capital and even repaid assistance funds that had been received from the U.S. Government during the crisis.

The Group's credit risk related to banks and foreign financial institutions is managed by the Corporate Banking Division, as follows:

- The credit facilities to foreign countries and banks are approved by the Board of Directors and credit committees of the Bank, in accordance with the recommendations of the international institutional banking department at the corporate banking division. This recommendation is based upon mathematical models determining the maximum credit facility to states and 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, while taking into consideration the country in which the banks operate and the size of the economy to which the Bank is exposed;
- 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, and the various units at the Bank, including the Bank's dealing room for which the Finance Division is responsible. 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;
- The financial institutions department at the Corporate banking Division received the Bank's exposure data regarding foreign financial institutions from the Finance Division, from various functions at the Bank and from the Bank's foreign subsidiaries and extensions. These data are consolidated at Group level and are reported to various factors at the Bank and to the Supervisor of Banks, as required.

In managing the clearing risks, the Bank in its considerations takes into account the level of exposures and their distribution among the foreign banks.

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 87% 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 and Great Britain. (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 108 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

	Balance sheet credit risk ⁽²⁾⁽⁴⁾⁽⁵⁾	Present off balance sheet credit risk ⁽³⁾⁽⁴⁾	Present credit exposure ⁽⁴⁾
in NIS millions			
As at December 31, 2009			
Present credit exposure to foreign financial institutions⁽⁶⁾			
External credit rating⁽⁷⁾			
AAA up to AA-	4,599	120	4,719
A+ up to A-	2,236	432	2,668
BBB+ up to BBB-	568	2	570
BB+ up to B-	291	-	291
Less than B-	-	-	-
Not rated ⁽⁸⁾	96	111	207
Total present credit exposure to foreign financial institutions	7,790	665	8,455
Of which credit exposure to foreign financial institutions:			
in the USA	3,234	15	3,249
Balance of problematic bonds	12	-	12
As at December 31, 2008			
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 ⁽⁹⁾	255	267	522
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 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 Moody's rating, and in its absence, the Fitch rating or S&P. (Until June 30, 2009, according to the S&P rating and in its absence, the Fitch or Moody's ratings).
- (8) Most of the off-balance sheet credit risk which has no rating is in respect of guarantees by private Swiss banks and Swiss banks owned by banks in Western Europe that are rated A- and above.
- (9) 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, 2009 and 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 6,582 million and NIS 5,663 million, respectively.

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 Banks exposure to leveraged finance according to the economic sector of the acquired corporation:

Sector	Balance sheet credit as of December 31,	
	2009	2008
	in NIS millions	
Agriculture	544	591
Industry	1,201	1,206
Construction and real estate	943	*973
Electricity and water	14	18
Commerce	42	12
Hotels, hotel service and food	-	15
Communications and computer services	324	610
Financial services	584	*665
Other business services	38	-
Total	3,690	4,090

* Reclassified.

Additional details:

Exposure to leveraged finance as of December 31, 2009 amounted to NIS 3,690 million, compared to NIS 4,090 million at the end of 2008, a decrease of 9.8%. The outstanding balance of exposure presented in the above table is net of a provision for doubtful debts of NIS 199 million at the end of 2009, compared to NIS 90 million at the end of 2008. After deducting qualified collateral (in accordance with Proper Banking Management Directive No. 311), the total balance sheet exposure in respect of leveraged finance as of December 31, 2009 amounted to NIS 3,417 million, compared to NIS 3,808 million at the end of 2008, a decrease of 10.3%.

The off-balance sheet exposure to leveraged finance as of December 31, 2009 amounted to NIS 257 million, compared to with NIS 287 million at December 31, 2008, and reflects a commitment to grant credit for the acquisition of means of control in a corporation.

In view of the volatility of the capital market, the Bank exercises extra care in providing credit for leverage finance. Upon the granting of credit, the Bank performs examinations as to the leverage level of the transaction and the repayment ability based on the pledged securities. Furthermore, an overall examination of the credit portfolio in respect of leverage finance was performed in the first quarter of 2009. This examination included a valuation of the pledged securities serving as collateral for leverage finance transactions.

MANAGEMENT OF MARKET AND LIQUIDITY RISKS

Market risk. Market risk is the risk of impairment of the Bank's equity and profitability 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.

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 material loss.

Market and liquidity risk management policy. The Bank has two policy documents on this subject, the one – market risk management document, and the other – liquidity risk management document. Both these policy documents have been approved by the Board of Directors.

The policy documents define the principles of risk management, the tools for measuring exposure and the limitations on exposure in relation to the Bank's overall activity, commercial operations, specific files and quantitative scope limitations on instruments that may be operated by the Bank. In addition, the document defines the responsibility of the various factors dealing with market and liquidity risk management, both as regards the determination of limitations and as regards deviation there from.

In the third quarter of 2009, the Board of Directors approved a new policy document in the matter of liquidity risks, in which a layout of indicators had also been defined, to be used in the identification of trends in the liquidity risk situation. This document also includes the preparedness program for liquidity crisis, which had also been updated recently. The principal subsidiaries also have policy documents for the management of market and liquidity risks. IDB New York and Mercantile Discount Bank have approved new policy documents during 2009, while ICC did so in 2008. Discount Mortgage Bank has not yet approved the draft policy document regarding market and liquidity risks.

No deviations in applying the determined policy were recorded in 2009 (except for several specific deviations of negligible scope). For details, see below.

STRATEGIES AND PROCESSES

The market risk policy is intended to reduce the level of financial risk created by the current activity of the Bank, alongside increasing the Bank's profits stemming from undertaking initiated and controlled exposure. The policy documents prepared by the Bank and the Group define the aims of risk management, risk propensity, the frameworks and restrictions, the authority determined to manage the different exposures and the nature of the monitoring and control over these frameworks. The exposure document submitted to the Board of Directors each quarter, reviews actual exposure, changes in policy and deviation from restriction, if any.

Group risk management. Proper Banking Management Directive No. 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 Boards of Directors of the banking subsidiaries have determined policies regarding the maximum exposure to market and liquidity risks, based on the Bank's policy. The subsidiaries manage their market and liquidity risk, each subject to the policy determined by its own Board of Directors. Notwithstanding, within the framework of the implementation of the Group policy for market and liquidity risk management, the Board of Directors has instructed the principal banking subsidiaries in Israel and abroad to modify, to the extent possible, their market risk management and measurement methodologies to those applied by the parent company, taking into consideration the specific characteristics of operations of each subsidiary.

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 and in linkage base exposure terms.

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. These reports are presented to the Board of Directors as part of the exposure document.

Market and liquidity risks are presented in this review on a Group basis, including the Bank, Mercantile Discount Bank, Discount Mortgage Bank, IDB New York and IDB (Swiss) Bank. Market risks at ICC are immaterial and therefore are not included in this review.

Main changes in exposure policy and risk management procedures

In the years 2008-2009, the bank has tightened the supervision over market and liquidity risk management at the principal banking subsidiaries, including actual exposure, policies and the appetite for risk.

In July 2009, the Bank's Board of Directors set a limit to the Group's exposure to linkage base risks. For details regarding linkage base risks, see hereunder.

STRUCTURE AND ORGANIZATION OF THE MARKET AND LIQUIDITY RISKS MANAGEMENT FUNCTION

The organizational structure for the management of market and liquidity risks, is composed of three control circles.

The Board's risk management committee. The Board's risk management committee serves as an extension of the Board for the market risks management issue. The committee holds a preliminary discussion on each subject related to market risk management within the Bank Group, and forms an opinion as well as recommendations, which are brought for discussion before the full board of Directors. In addition, the committee follows developments in risk exposure, including stress test scenarios, taking into consideration the market situation and the business environment of the Bank and the group. Furthermore, the committee examines the introduction of new limitations and of proposals for new operations while assessing market risks that such operations may create, the Bank's ability to manage, measure and control these operations' risks and the determination of limitations in accordance therewith.

Current management and supervision. Current management and supervision in the area of market and liquidity risks management are performed by four committees:

- **Asset and liability management committee (ALM committee).** This committee is headed by the CEO and meets once a month. The duty of the committee is to determine the goals of exposure to market risks based on a situation evaluation of expected developments in the market and subject to limitations determined by the Board of Directors,

to approve models for the management of market and liquidity risks and to update parameters included in such models. The committee is authorized to approve a temporary deviation from the limitations set by the Board;

- **The financial forum** is an internal committee of the finance division, headed by the head of the finance division. The forum meets on a weekly basis for the purpose of evaluating current developments in the markets and monitoring the implementation of guidelines issued by the ALM committee. Where necessary, the forum is authorized to approve a temporary deviation from goals set by the ALM committee;
- **The stress test forum** is headed by the head of the finance division and meets once in every quarter. The potential loss created in stress tests determined at the Bank and the Group is presented to the forum, and the forum makes decisions regarding stress tests to be examined within the framework of market risk management;
- **The liquidity forum** is headed by the manager of the asset and liability management department and meets on a weekly basis. The forum performs an ongoing follow-up of the liquidity situation and of the implementation of decisions made by executive factors.

INTERNAL CONTROL MECHANISM REGARDING THE PREVENTION OF DEVIATIONS FROM THE POLICY

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 finance division is in charge of all of the Bank's financial activities, which include on the one hand both the business factors and the back and middle office layouts as a first control circle, and on the other hand the risk management department constituting the secondary control circle.

The first control circle. 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.

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 second control circle. This circle includes the risk management department and the various committees. The market and liquidity risk management unit at the risk management department provides a situation report as to the market and liquidity risk level of the Bank and its principal subsidiaries and as to compliance with limitations. In addition, the market and liquidity risk management unit is engaged in defining the types of risk, in developing tools and methodologies for market risk management, as well as in providing guidance and information regarding market risks, and where required, support to the relevant units, to Management's risk managers committee, to Management and to the Board of Directors. The market risk management unit develops processes for the identification, reporting and measurement of exposure to market risk, within the authority approved by the Board. The unit prepares the exposure document, which presents an updated exposure situation as against limitations, as well as reports deviations from policy, procedures and limitations set by the Board. The unit is also engaged in the examination and implementation of recommendations by the regulatory authorities relating to risk management.

Another factor in the second control circle is the risk control unit headed by the market risk controller – an independent function

responsible directly to the Bank's CEO, and detached from factors responsible for the operation and management of trading in various financial instruments. Among the duties of this unit are: evaluation of the adequacy of the analytical models used by the Bank for risk exposure measurement, reviewing the level of compliance of Bank's operations and actual risk exposure with risk management principles and exposure limitations determined by the Board of Directors, a periodic examination of actual losses sustained by the Bank as a result of risk exposure compared to earlier forecasts by the analytical model.

Market Risk Controller also examines the exposure of the principal banking subsidiaries in the Group.

The third control circle includes the internal audit, which performs an overall evaluation of the risk management quality at the Bank. For this purpose it includes in its annual work plan appropriate audit operations. The internal audit checks, reviews and evaluates the implementation of policy and execution of Board decisions and guidelines in the matter of management, assessment and control of risks, compliance by the Bank with exposure limitations set by the Board, reliability and availability of management information and financial and operational reports submitted to the Board and Management of the Bank.

Organizational structure at the principal subsidiaries. The Organizational structure at the principal subsidiaries includes the functions and control circles described above, with certain changes appropriate to their size:

- Mercantile Discount Bank. The ultimate forum for the management of market and liquidity risks is the "extended nostro committee", which is headed by the CEO and meets on a monthly basis. Responsibility for the ongoing risk management lies with the "reduced nostro committee" headed by the head of the strategy and finance division, which meets on a weekly basis.
- IDB New York has a Chief Risk Manager, with a status of member of Management, whose sole responsibility is risk management. IDB New York has a Management committee for the management of market risks (the ALCO committee), which operates subject to the risk management committee of Management. Members of the committee are the CEO, senior members of Management and representatives of the treasury and risk management. The committee meets on a monthly basis. The committee discusses the exposure situation and the strategy for changing the exposure situation.
- Discount Mortgage Bank. The finance and economic department operates subject to the CEO and is responsible for managing the financial risks and for asset and liability management. A risk controller has recently been appointed at this bank. Discount Mortgage Bank has not yet approved the independent draft policy paper with respect to market risks. Notwithstanding, procedures have been defined for the determination of limitations on exposure to market risks at the general level of this bank.

CHARACTERISTICS AND SCOPE OF REPORTING AND RISK MEASUREMENT SYSTEMS

Measurement of exposure to market and liquidity risks, including the calculation of the various risk assessments is performed at the Bank on a weekly basis, using the "Riskpro" system. The system is used as a basis for financial data, which contains the financial information required for the purpose of risk management, and which refers to the range of financial instruments operated by the Bank, including embedded options, for market data (such as indices, exchange rates and interest rates), their volatility level and the statistical correlation between them, as well as financial and behavioral models.

The system is used for computing risk assessments and for simulations regarding the overall operations at the Bank and Group levels, regarding operations/files. Likewise, additional risk indices and interest rate exposure are computed and measured (it should be noted that the system is also used for fair value measurement for the purpose of the accounting report).

This system is also used by Mercantile Discount Bank in computing its exposure to market and liquidity risks.

IDB New York. Measurement of exposure to market and liquidity risks is made using an independent risk management

system integrated by this bank in the past year. This system provides a computation of risk assessments on a monthly basis. In addition, IDB New York uses the services of two external consultants who prepare stress tests, the result of which serve as a benchmark for the results of the internal model of IDB New York.

Discount Mortgage Bank measures and reports interest rate exposure levels using outsourcing services. DMB is in the midst of a preparation process towards the use of a risk management system that is used by the Bank.

HEDGING AND/OR RISK REDUCTION POLICY

Hedging of market risk policy. The policy of the Bank and its banking subsidiaries 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 exposures while defining the manner of operation and protecting it.

The means used for compliance with the determined limitations include:

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

MANAGEMENT AND MEASUREMENT OF MARKET RISKS

The Directive in the matter of risk management published by the Supervisor of Banks specified basic principles for the management and control of the various risks. Within this framework, a duty has been imposed on the Board of Directors to discuss the Bank's policy with respect to risk management and to approve it, intensifying the Board's involvement in these matters. Among other things, the Board discusses the exposure document that summarizes the total market risks to which the Group is exposed. According to the said Directive, the Bank is required to manage exposure to market risks through an information system based on an internal model.

(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. Exposure to linkage base risk is measured in the CPI linked segment and in the foreign currency segment (including Israeli currency linked to foreign currency).

The following is a summary of the net linkage balances⁽¹⁾:

As at December 31, 2009					
	Non-linked shekels	CPI linked shekels	Foreign currency ⁽²⁾⁽³⁾	Non-monetary asset	Total
in NIS millions					
Assets	86,825	28,323	66,287	6,382	187,817
Liabilities	80,726	23,286	72,916	597	177,525
Balance sheet difference	6,099	5,037	(6,629)	5,785	10,292
Derivative instruments	(89)	(4,773)	4,862	-	-
Options	(164)	146	16	2	-
Total Difference	5,846	410	(1,751)	5,787	10,292

As at December 31, 2008					
Assets	*76,007	27,061	72,181	6,582	181,831
Liabilities	*76,753	20,871	75,076	108	172,808
Balance sheet difference	(746)	6,190	(2,895)	6,474	9,023
Derivative instruments	3,859	(5,423)	1,564	-	-
Options	194	264	(458)	-	-
Total Difference	3,307	1,031	(1,789)	6,474	9,023

* Reclassified.

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 available 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 financial capital compared to the limitations (the data is presented in relation to the available economic capital):

2009						2008			
Segment of operations	Limitation	Year end	Range of exposure			Year end	Range of exposure		
			From	To	Average		From	To	Average
Non-linked Shekel	The balance	104%	88%	110%	99%	94%	70%	94%	85%
Linked Shekel	(40%)-80%	(7%)	(10%)	11%	1%	6%	6%	30%	15%
Foreign currency	(25%)-25%	3%	(2%)	4%	1%	-	(1%)	-	-

During the third quarter of 2009 the Board decided to reduce the limitations set on the Bank's exposure to linkage base in the foreign currency segment and in the CPI linked segment.

No deviations from the limitations were recorded in 2009.

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, 2009.

The capital sensitivity of the Bank of changes in exchange rates				
in NIS millions ⁽¹⁾				
Segment	10%	5%	-5%	-10%
USD	(47)	(30)	37	71
EUR	(15)	(7)	4	3
GBP	15	8	(8)	(15)
CHF	(9)	(5)	5	19
JPY	6	3	(3)	(6)

Note: The theoretical change in the economic value of the Group (in terms of present value) as a result of the scenario.

This effect has been computed on the basis of the expected change in the fair value of the Group in the various currencies, given the scenario determined by the Supervisor of Banks.

(2) INTEREST RISK EXPOSURE

A. General

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.

B. Sensitivity analysis to the effect of changes in interest rate based on the fair value of financial instruments

General. In June 2008, the Supervisor of Banks issued a new directive concerning "Disclosure of exposure to changes in interest rates". The directive changes the format of the disclosure as it existed in this respect, according to which, assets and liabilities exposed to changes in interest rates had been presented according to the anticipated future cash

flows produced by these items, discounted using the interest rate that discounts them to their stated values.

Exposure of the Bank to changes in interest rates according to the new directive shall be reported by the Bank as from the interim financial statements as at September 30, 2009. In addition, banking corporations are required to include in their Directors' Report information as to the volume of assets and liabilities exposed to changes in interest rates, in accordance with their fair value, and to also include a sensitivity analysis as to the effect of hypothetical changes in interest rates on the fair value of these financial statements.

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.

Hybrid financial instruments are debt instruments, in which are embedded derivative components that have not been separated there from. In providing information regarding fair value, the Bank is not required to classify financial instruments as hybrid financial instruments, because, according to the Bank of Israel's guidelines, the interest rate exposure of these instruments included the division of such transactions according to maturity dates, while separating the option component from these instruments. Following are details of the hybrid financial instruments, where in the disclosure regarding exposure to changes in interest rates, the separated option and the host instrument have been treated as standalone instruments (the effect on the financial statements is not material): deposits with the option of a fixed rate of interest or of a variable rate of interest, savings deposits linked to the CPI or linked to foreign currency with an option for changing the linkage base and an option securing the Shekel principal sum deposited, deposits and loans linked to the CPI or linked to foreign currency with an option for securing the Shekel principal sum.

For further details regarding the main methods and assumptions used in assessing the fair value of financial instruments, see Note 21 to the financial statements.

Fair value of the Bank and its consolidated subsidiaries' financial instruments, excluding non-monetary items (before the effect of hypothetical changes in interest rate)

	December 31, 2009					
	Israeli currency		Foreign currency**			
	Non linked	CPI linked	US\$	Euro	Other	Total
	In NIS millions					
Financial assets*	85,510	29,611	51,246	8,756	4,913	180,036
Amounts receivable in respect of derivative and off balance sheet financial instruments***	48,993	521	31,365	10,184	8,672	99,735
Financial liabilities*	(78,941)	(24,123)	(56,672)	(11,485)	(4,115)	(175,336)
Amounts payable in respect of derivative and off balance sheet financial instruments***	(48,820)	(5,920)	(28,541)	(7,531)	(9,420)	(100,232)
Net fair value of financial instruments	6,742	89	(2,602)	(76)	50	4,203

Effect of hypothetical changes in interest rate on the fair value of financial assets of the Bank and its consolidated subsidiaries, excluding non-monetary items

December 31, 2009									
Fair value of financial instruments, excluding non-monetary items****								Change in fair value	
	Israeli currency		Foreign currency**						
Change in interest rate	Non linked	CPI linked	US\$	Euro	Other	Offsetting effects	Total	Total	Total
	In NIS millions								in %
Immediate parallel increase of 1 %	6,685	159	(2,658)	(70)	46	-	4,162	(41)	(1%)
Immediate parallel increase of 0.1 %	6,783	103	(2,637)	(89)	49	-	4,209	6	-
Immediate parallel decrease of 1 %	6,921	36	(2,891)	(117)	53	-	4,002	(201)	(5%)

* Including complex financial instruments. Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Including Israeli currency linked to foreign currency.

*** Amounts receivable (payable) in respect of financial instruments, discounted at interest rates used to compute the fair value presented in Note 21 to the financial statements.

**** The net fair value of financial instruments presented in each linkage segment, is the net fair value in the segment, on the assumption that the change noted in all interest rates applying to the segment has in fact occurred. The total net fair value of financial instruments is the net fair value of all financial instruments (excluding non-monetary items) on the assumption that the change noted in all interest rates applying to all segments has in fact occurred.

C. Data used for the management of interest rate risk. The data presented in item "B" above, was computed on the basis of fair value, as required by the public reporting directives of the Supervisor of Banks and in accordance with the computation of Schedule "D" to the Management Review, hereunder.

The current management of exposure to interest rates applies to all the operations of the Bank, and takes into consideration additional data that represent the Bank's economic approach to the management of exposure of the economic value of the Bank's equity to changes in interest rates. Taken into special consideration are the following:

- Various future exposure which do not match the requirements for inclusion in the accounting computation approaches;
- Prices reflecting the alternative cost as seen by the Bank according to changes in market prices (and not in relation to changes in the credit risk of cash flows);
- Balances that have an economic effect that differs from their accounting effect (such as adjustments relating to tax hedging on investments in foreign subsidiaries).

This additional data leads to an assessment of the economic value and to assessments of the exposure to interest rate changes, which differ from the parallel assessments derived from the accounting data.

Following are details of the effect of hypothetical changes in interest rates of 100 base points on the Group's economic value:

December 31, 2009					December 31, 2008	
The change in interest rates	Unlinked	CPI linked	US dollar	Other foreign currency	Total	Total
In NIS millions						
An increase of 100BP in interest rates	(58)	57	(41)	2	(40)	31
A decrease of 100BP in interest rates	71	(66)	(227)	(4)	(228)	(136)

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 2009, the Bank and the Group complied with the determined exposure limits.

In addition to the scenario of a parallel shift in interest graphs. In July 2009, the Board of Directors approved additional limitations in terms of a change in the gradient of the graph.

Measurement of the risk at the Bank 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.

D. The characteristics of interest rate risk with respect to the banking book

The banking book contains most of the interest rate risks of the Group and includes the activity of the Bank in the granting of credit, in the purchase of securities and in attracting deposits and the issuance of capital notes. Such activity is affected by strategic considerations and by a long-term view of the Bank's interest rate risk propensity.

The Group's banking book in Israel is directed towards risking exposure to Shekel and CPI linked interest rate changes, while the banking book of the foreign subsidiaries includes exposure to foreign currency interest rate risks (primarily U.S. dollar interest rate), including the risk of early repayment of the Bank's assets and liabilities.

Following is the effect of a hypothetical change of 100 base points in the interest rate applying to the Bank portfolio:

December 31, 2009					December 31, 2008	
The change in interest rates	Unlinked	CPI linked	US dollar	Other foreign currency	Total	Total
In NIS millions						
An increase of 100BP in interest rates	(51)	31	(36)	(7)	(63)	49
A decrease of 100BP in interest rates	63	40	(233)	5	(205)	(153)

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:

As at December 31, 2009*			As at December 31, 2008			
Shekels		Foreign currency and foreign	Shekels		Foreign currency and foreign	
Non-linked	CPI linked	currency linked	Non-linked	CPI linked	currency linked	
Total Assets	134,503	30,132	115,136	72,016	27,061	72,181
Total Liabilities	127,761	30,043	117,764	72,762	20,871	75,076
Average maturity (years):						
Assets	0.99	3.69	0.86	0.64	4.63	0.57
Liabilities	0.74	3.83	0.73	0.50	4.09	0.85
Average maturity gap	0.25	(0.14)	0.13	0.14	0.54	(0.28)
IRR gap	3.04	0.59	2.50	1.46	0.61	2.77

* Data for 2009 include, for the first time, the effect of derivative financial instruments and off-balance sheet financial instruments.

(3) 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 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 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 nature and scope of the risk reporting and measurement systems. The VaR computation (at the Bank's level) is made by the Riskpro system. The 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 all the activity at the Bank level and on operations/portfolios, similarly additional risk indices and simulations are carried out and the interest rate exposures are measured.

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 all the activity at the Bank level 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. The VaR at the Group level is computed on a monthly basis.

Following are data regarding the assessment of Discount Group's VaR amount:

	2009				2008
	At year end ⁽¹⁾	Yearly average	Maximum	Minimum	At year end
in NIS millions					
Estimate of VaR amount (in NIS millions, Group)	144	191	223	144	239

(1) The VaR assessment in 2009 includes reference to share risk in respect of certain shares included in the Bank's securities portfolio, serving as collateral for a loan granted to a certain borrower. The Bank estimates that the addition to the VaR assessment in respect of this component as of December 31, 2008, is not material.

The weight of the VaR in relation to the shareholders' equity as of December 31, 2009 is 1.4%, compared with 2.7% at the end of 2008.

The sharp decline in the Group VaR assessment is explained mostly by the decline in interest rate exposure of the foreign extensions.

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.

Over the past two years, Back Testing examination has revealed two deviations (in the amounts of NIS 17 and 21 million), a fact that supports the validity of the model.

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

- The model assumes that the changes in risk factors are divided normally. While this assumption is required for approximation purposes, it does not necessarily reflect market performance;
- The computation of the VaR for a holding period of ten days assumes that the positions are realizable or could be terminated within that period. In certain market circumstances such an assumption may not materialize and the

loss would be greater;

- Utilization of a significance level of 99% disregards losses that may be realized beyond this level of significance (end distribution);
- Utilization of historical data may not include extraordinary events in the sample.

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

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

Global and domestic markets are subject to periodic instability resulting from extraordinary events. Such events may be related to a general crisis (e.g. war, political upheaval, natural disaster, etc.) or to turbulence in financial markets, and are reflected in material changes in interest rates exchange rates, and/or in exceptional fluctuations in these factors, which deviate from general historic behavior. The risk management process is intended, inter alia, to protect the Bank from an extreme loss that may be incurred as a result of such events. Even though the VaR is the most suitable measurement tool for assessing the overall exposure to market risk, it does not provide information as to losses that may occur in "abnormal" market situations, which exceed the clear levels which had been determined.

Stress tests enable the examination of the possible implications of such extreme events, thus constituting a complementary layer for the examination of exposure to market risks performed in accordance with the VaR model.

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 management 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, to the extent necessary, additional extreme scenarios which ought to be examined.

Following changes in the markets, new extreme scenarios were added in September 2008.

The Bank and its principal subsidiaries examine some fifteen extreme scenarios that include changes in interest graphs (corresponding and non-corresponding), changes in currency exchange rates and in the CPI and changes in the value of investments in corporate bonds.

Following are details of the main extreme scenarios implemented at the Bank:

- Scenarios of extreme changes in market data as from the year 2000;
- Scenarios of changes occurring in the markets during the crisis of October 1998;
- Scenario of deterioration in the security situation in Israel;
- Scenario of a financial crisis in the U.S.A. (a theoretical scenario examined in light of the crisis that occurred in the years 2007-2008, where the theoretical scenario is even more severe in certain parameters);
- Scenario of a global rise in prices;
- Scenario of a crisis in emerging markets;
- Scenario of an extreme event that includes severe assumptions as regards changes in interest rates.

The limit applying to the maximum damage to the economic value of the equity of the Bank in extreme scenarios, was determined so that it should not exceed 12.5% of the Bank's equity.

The Bank has complied with this limitation during 2009.

The Forum also determines extreme scenarios for the banking subsidiaries and examines the effect of these scenarios on their operations.

(5) 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 used for the management of exposure to interest rate risk of the Bank, but serves as a model for the management of exposure to interest rate risks at IDB New York, and at Mercantil Discount Bank.

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

Creditary current accounts spread model. For purposes of assessing the exposure to interest risks, the Bank assumes that a significant part of creditary 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.

Models for quantifying early repayment of assets risk – prepayment risk. The Group operates several models forecasting early repayments in its asset portfolio. The Bank also manages the early repayment risk of mortgage loans granted by Discount Mortgage Bank within the "Discount Outline". The model operated by the Bank is based on historical data of early repayments, similar to the model operated by Discount Mortgage Bank.

The subsidiary IDB New York makes use of models accepted in the U.S. for the forecasting of early repayment rates in the mortgage backed asset portfolio held by it.

(7) 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 activity of the dealing room. Computation of the interest rate risk is performed in accordance with the "period to redemption" method;
- 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. The computation is performed according to the "Delta plus" method.

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

Capital allocation			
	as of December 31, 2009	as of December 31, 2008	
	Basel II guidelines	Basel I guidelines	Basel I guidelines
In NIS millions			
The Bank: Interest rate risk	*69	102	73
Foreign exchange rate and inflation risk	*70	122	39
Share risk	-	-	-
Option risk	17	16	13
Total for the Bank	156	240	125
Total for subsidiary companies	64	66	47
Total for the banking Group	220	306	172
Allocation in risk terms	2,752	3,401	1,916

* Including a specific risk of NIS 0.3 million.

The allocation to market risks in risk asset terms comprises 2.6% of the total risk assets as of December 31, 2009, compared with 1.4% as of December 31, 2008.

The increase in the allocation of capital to market risks, in Basel I terms, stemmed from the fact that the computation in 2009 was made, for the first time, on the basis of fair value.

The allocation of capital in Basel II terms is lower than that in Basel I terms, mostly due to index exposures, which are not reflected within the framework of the first pillar of Basel II.

(8) 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. For the purpose of defining the regulatory capital and computations of capital allocation to market risks in the first pillar, the Bank has determined the positions to be included in the trading portfolio. Such positions comply with the requirements of Basel II guidelines and include financial instruments held for trading as well as instruments hedging other components of the trading portfolio. The Bank has defined that the portfolio shall include the activity of the dealing room as well as certain activities relating to bonds. The volume of the trading portfolio of subsidiaries is not material.

(9) 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 or indices and in the volatility of base assets. In addition, the dealing room procedures include limitations on maximum changes in the value of the option portfolio in terms of sensitivity indices ("GREEKS").

The boards of directors of the principal banking subsidiaries have also set limitations on the activity in options. No deviations from the limits set out by the Board of Directors were recorded in 2009.

(10) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

The Board of Directors has determined the mode of operation of the Bank in derivative financial instruments, maximum volume of activity and the range of financial instruments in which the Bank may engage (whether on behalf of its customers or of its own account). No deviations from the limits set out by the Board of Directors were recorded in 2009 except for one deviation from the operational limit determined for the nominal volume of foreign currency options. 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 set out by the Board of Directors, further internal limitations were fixed for the dealing room with regard to this area of operations.

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

The exposure created both with regard to linkage base and with regard to interest as a result of this activity, is included in the limitations set by the board of directors on exposure to linkage base, interest and options and as part of the limitation that was set on the combined exposure of all Bank customers to certain currencies as well as an operational limitation on the number of certain types of transactions at any given moment. The exposure is measured and controlled by the Middle Office on a current basis.

No deviations from these limitations were recorded in 2009.

Following are data as to the volume of operation in derivative financial instruments of the Bank and its consolidated subsidiaries

	As at December 31,	
	2009	2008
	in NIS millions	
Hedging derivatives	1,378	*1,460
ALM derivatives	84,663	91,998
Other derivatives	66,517	*43,099
Credit derivatives and SPOT foreign currency	4,630	6,134

* Reclassified.

Accounting aspects. The accounting policy with regard to the measurement of the value of derivative financial instruments and the results thereof is stated in Notes 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 reduction in the earnings from financing operations by NIS 188 million in 2009, compared with a decrease of NIS 15 million in earnings from financing operations in 2008.

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.

MANAGEMENT AND MEASUREMENT OF THE LIQUIDITY RISK

Liquidity is defined as the Bank's ability to meet its obligations in the usual course of business - to finance an increase in assets or repay liabilities without encountering difficulties and without sustaining a 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 risks on the basis of an internal model for the assessment

of liquidity risks, which examines the effect of various extreme scenarios, both as regards developments in assets and in liabilities and developments regarding the system as a whole with respect to the Bank's liquidity, as required by 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.

After having granted credit facilities to some of its subsidiaries in 2008, as part of efforts to overcome financial crisis, which broke out in that year, the said credit facilities were cancelled in 2009, in view of the improvement relating to the liquidity risk in extreme situations of the said subsidiaries.

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

The Board of Directors approved, in the third quarter of 2009, a new policy document for the management of liquidity risk, which upgraded the exiting policy. This, in continuation of the process of forming a new liquidity risk management methodology at the Bank, with the assistance of a leading international expert on the subject. This methodology includes, among other things, the modification of models and scenarios used in liquidity management to that accepted as "best practice" around the world. The paper includes a new methodology for the management of liquidity risk, defines the responsibility of the various agents involved in the management of liquidity risk, broadens the restrictions and defines indicators used to identify trends of liquidity risk. Furthermore, the alternative plan for the management of crisis situations has been redefined.

A Liquidity Forum is run by the Bank convening at least once a week discussing the liquidity situation and determining the specific measures to be taken.

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 higher than rates ever actually observed.

No deviations from the overall liquidity ratio were recorded at the Bank in 2009. However, isolated deviations from the foreign currency liquidity ratio have occurred, which were corrected within a few days. It should be noted that the liquidity ratio is being managed according to an extreme scenario that includes stringent assumptions with respect to the rates of withdrawal of deposits by the public, which are significantly higher than those actually experienced.

SHARES POSITION IN THE BANK'S PORTFOLIO

Strategy and processes

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 are details regarding investments in shares

Following are details regarding investments in shares		
	December 31, 2009	
	Equity value	Fair Value
	In NIS millions	
Investment in shares of affiliated companies⁽¹⁾:		
Marketable shares	1,632	1,683
Non marketable shares	163	163
Total investments in shares of affiliated companies	1,795	1,846
Shares in the available-for-sale portfolio:		
Marketable shares	53	53
Non marketable shares	650	650
Total shares in the available for sale portfolio	703	703
Total investment in shares	2,498	2,549

Footnote:

(1) for further information, see Note 6 to the financial statements.

Capital requirement regarding share position⁽¹⁾

	December 31, 2009
	In NIS millions
In respect of investments in venture capital funds, in private equity funds and in a fund of hedge funds ⁽²⁾	502
In respect of investments in other shares ⁽³⁾	218
With respect to owner's loans	124
Total risk assets in respect of stock positions	844
Investments deducted from capital	1,654

(1) The capital requirement was calculated on the basis of 9% and it does not include capital requirement in respect of investments in trading portfolio shares.

(2) These investments are averaged at a risk weight of 150%.

(3) These investments are averaged at a risk weight of 100%.

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, they endeavor to minimize the exposure to operational risk.

Organizational structure of the operational risk management function. Within the framework of the preparations for the implementation of the Basel II guidelines, which began towards the end of 2006, 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 Chief Risk Manager bearing the overall responsibility for the management of this risk at the Bank and the Group. Operating risk controllers have been appointed at all of the Bank's divisions and layouts, the duty of which, among other things, is to assist the division or layout head in managing operating risks, including identification of the risks, their measurement and formation of plans for reducing them. Operating risk controllers communicate with and report 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, the provision of tools for its application, formation of a methodology for identification and measurement of risks, monitoring and reduction of risks and reporting the results to the Risk Managers Committee, the Bank's Management and the Board of Directors. The department is also responsible for integrating the management of operating risks within the units of the Bank and the Group.

This structure of risk management enables the separation between those who take the risks at the various divisions and layouts who directly create the exposure to the risk and manage it, and those who engage and the factors engaged in the independent management of the risk, including: 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 have formulated 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 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 at the end 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 (business and operational activities) 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 at the Bank and Group levels, will 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 self evaluation of the operational risk management and their scale (RSA) 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.

Risk evaluation methodology. The risk evaluation methodology has been formed by the risk management department and is used by the Bank and its subsidiaries in their current evaluation, both of existing risks and of new risks involved in new work processes and new products.

Each manager of a risk center is responsible for identifying and evaluating the risks and controls existing in the work processes under his responsibility. The risk center manager is responsible for identifying and updating the various parameters related to risk evaluation, following changes in work processes or a change that affects the quality of the control environment.

The risk evaluation averages out the characteristics of the process and the volume of the damage that might occur as well as the effectiveness level of existing controls, based on defined parameters. The combination of risk evaluation and existing controls enables the evaluation of the residual risk in qualitative terms.

Allocation of capital. Allocation of capital in respect of operating risk is undertaken by the Discount Group according to the basic indicator approach. Under this approach, the capital allocation required in respect of the operational risk, is computed by multiplying the net gross income by a coefficient of 15%.

In accordance with guidelines of the Supervisor of Banks, banks using the basic indicator approach will be required to adopt the standard approach no later than the report for 2012. Under this approach, gross income is divided into eight business lines defined by Basel II, which are grouped into three groups of coefficients: retail banking income is multiplied by a coefficient of 12%; corporate and commercial banking income is multiplied by a coefficient of 15%; income from the financing of corporations in respect of mergers and acquisitions, dealing rooms operations and investment income are multiplied by a coefficient of 18%.

The Bank makes preparations in order to comply with the time table determined by the Supervisor of Banks.

Current management of operational risks. The Bank examines on an ongoing basis exposure to operational risks and implements measures for the reduction in the material risks level. The Bank's various divisions completed the formation of the plans for the reduction of operational risks during the first quarter of 2009, identified as material risks within the framework of the survey conducted in 2008. The risk centers (the reviewed units) are taking steps towards the implementation of the risk reduction plans and update on a quarterly basis, the information regarding the progress of implementation of the new controls. The performance status regarding the implementation of the reduction plans is reported to management and the Board of Directors on a quarterly basis.

Investigating and reporting failure events comprising an integral part of the current risk management in its framework, the managers of risk centers report and investigate failure events that have occurred, draw conclusions and improve and strengthen controls over the various processes. The pilot project regarding the new technological system for operational risk management was completed in the third quarter of 2009. The pilot project was conducted at the Bank and at Mercantile Discount Bank. The system will enable the management of operational risks at the Group level. The operating risks survey at the subsidiaries, which had been performed according to the methodology formed by the Bank, has also been completed. The subsidiaries have prepared for the formation and/or implementation of plans for the reduction of the principal and material risks identified within the framework of the survey.

Operating failure events. The Bank is setting up a data base concerning the realization of operating failure events based on reports by the different risk centers of the Bank. The Bank endeavors to achieve a wide and comprehensive data base of failure events, including events where no damage had been suffered by the Bank or which are considered "almost suffered". Such data base will enable the analysis of failure factors, the treatment of risk centers identified and the establishment of risk indicators that would allow, in the future, the monitoring of risks prior to their materialization.

Reducing exposure to operating risks through the purchase of insurance. The means applied by the Bank with a view of reducing exposure to operating risks, include, among other things, the purchase of a designated bank insurance policy within a responsibility limit of US\$100 million, that hedges a part of operating risks to which the Bank is exposed.

The Bank's insurance policy includes several relevant sections, namely: (1) Banking insurance section, focusing on events such as betrayal of trust by Bank employees, monies and valuable assets at the Bank's premises, monies and valuable assets in transit, forgery of checks, forged collateral and forged monies; (2) Computer offences insurance section, focusing on events such as fraudulent or malicious input of electronic data directly into the Bank's computer systems or of a service bureau, or into an electronic money transfer system or to a customer communications system, fraudulent or malicious change or destruction of electronic data; (3) Professional liability insurance section, intended to insure the Bank in respect of its legal obligations to third parties, considering a lawsuit or claim for damages in respect of a financial loss resulting from negligent action, error or omission or betrayal of trust on the part of a Bank employee; (4) Personal deposit boxes insurance intended to insure the Bank in respect of loss or damage to customers' assets, including cash and jewelry stored in personal safety deposit boxes provided on the Bank's premises within the boundaries of the State of Israel.

Furthermore, within the framework of the insurance policy issued to companies in the Discount Bank Group, the Bank had purchased insurance coverage for claims against Directors and Officers within a responsibility limit of US\$100 million.

The scope of the insurance coverage of the Bank has been examined with the assistance of an independent professional advisor and is in compliance with Proper Banking Management Directives Nos. 301 and 352.

Within the framework of the second pillar of Basel II, insurance may provide a better capital adequacy for the purpose of reducing risks and exposure to the frequency and/or severeness of default events.

INFORMATION TECHNOLOGY RISK MANAGEMENT

Information technology risk management concept. The basic principle of the information technology risk management concept is that the information technology managers have an overall responsibility for the systems under their control. As regards certain issues, such as aspects of information security, responsibility has been divided between the factors that provide professional guidance and the information technology managers. On the basis of this concept, the managers directly responsible for assets at risk, conduct the management of information technology risks, while the managing echelons conduct the control of the process.

Three main "risk groups" have been identified with respect to information technology: Risks pertaining to applicative development and computer infrastructure projects; risks pertaining to production systems and infrastructure components; and risks pertaining to across the board processes. The methodology of information technology risk management applies to all the different risks as described above, however its application and management tools are modified to each type of risk separately.

Information technology project risk management. Project risks are defined as risks which might prevent meeting project targets (contents, budget, and time tables). Such risks are managed as an integral part of the project management using development management tools. The project manager is responsible for the risk management and control process, and for each significant risk an employee responsible for the reduction of this risk is appointed by him. The risk management process includes:

- Identification and classification of the various risks;
- Evaluation of risks and their intensity;
- Determination of a management strategy – hedging, monitoring or acceptance;
- Performance control and re-evaluation.

Information technology production systems risk management. Risks related to production activity are managed in respect of software systems and infrastructure components participating in the current production activity. Such risks are defined as risks which might prevent meeting service level targets, including compliance with various regulatory requirements. These risks are managed with the use of a unique tool developed for this purpose.

This tool enables the identification of risks and evaluation of the exposure in their respect by means of answering a structured questionnaire and providing recommendations for risk reduction activities. Evaluation of software systems risks also includes the risks stemming from the infrastructure components on which it relies. From time to time, and at intervals that do not exceed one year, the answers to the risk questionnaire are refreshed in order to update the risk evaluation and its reduction, in view of the progress made in the implementation of the reduction plan. This tool will enable the future integration of risk reduction assignment in the work plan as well as a presentation of realization events.

The asset manager (the software system and/or infrastructure component) manages the asset risks for which he is responsible, including the maintenance of answers to the risk questionnaire and management of the risk reduction plan. In addition, the functions involved in risk management and control have been defined.

Information technology across the board processes risk management. The management of risks relating to information technology across the board processes are conducted within the framework of operational risk management using the tools for operational risks, being the responsibility of process managers. In cases where a certain process involves several factors, a single manager is appointed to take responsibility for the management of the risks involved in that process.

Reporting to Management and the Board of Directors. Information regarding information technology production systems risks is reported to Management and to the Board of Directors via a quarterly exposure report. An initial report,

limited in scope, has been submitted in respect of the last quarter of 2009. Starting with the report for the first quarter of 2010, the exposure report will also contain individual reference to risks of the information technology production systems as well as a status report of risk reduction operations.

Reports on irregularities are submitted to Management and the Board of Directors on an ongoing basis.

Information for Management and the Board of Directors (the computer committee) regarding project risks is reported from time to time by the computer manager to Management and to the computer committee of the Board within the framework of specific project discussions.

ENVIRONMENTAL RISKS

On June 11, 2009 the Supervisor of Banks issued a letter regarding the exposure to environmental risks and their management. The letter presents various possible aspects regarding exposure of banking corporation to environmental risks and emphasizes the need to relate to these risks individually.

These risks may be included within the framework of the other risks (such as: credit, market, operating, legal and liquidity risks). Environmental risk may derive from an impairment of collaterals when realized. Furthermore, the risk might be realized in an indirect manner as a result of deterioration in the financial condition of another party due to environmental costs resulting from regulations regarding environmental protection. A reputation risk may also apply as a result of a possible claim in which the bank is connected to an entity causing an environmental hazard.

The letter also clarifies that the identification and evaluation of environmental risks comprise a part of the proper process of identifying and evaluating risks involving banking corporation and accordingly banking corporations are required to include management of environmental risks within the overall risks managed by them, including by way of integrating procedures for the identification of material risks upon the granting of credit and by combining the evaluation of environmental risks with the periodic evaluation of the quality of credit granted to customers.

The boards of directors of banking corporations were required to approve by June 30, 2010, criteria and time table for the implementation of the requirements.

The Bank's Board of Directors approved, in December 2009, the credit policy for 2010, which includes reference to the credit aspect of environmental risks (further recommendations regarding other risk aspects will be brought for the approval of the Board in the course of 2010 within the framework of policy and/or risk management documents for the relevant risks). The said policy has implemented the directives of the Supervisor of Banks in the matter, with the view of managing and reducing the Bank's exposure to environmental risks. In this context, the method of evaluating the environmental risk relating to Bank customers as a whole has been defined, while referring separately to customers considered as having a high environmental risk.

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. According to the framework of Basel II, legal risk includes, though is not limited to, the risk arising from potentially unenforceable contracts, and also includes legal actions as well as risks stemming from operations performed without proper legal advice, or in accordance with deficient legal advice, which might affect the Bank's ability to enforce a contract.

Among the principal legal risks, which might affect the ability of the Bank to enforce a contract, the following may be mentioned:

- 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's chief legal adviser serves as legal risks manager and is responsible for the legal risk management at the Bank and the Group. As part of legal risk management, the Bank acts towards the collection and concentration of information relating to legal risks at the Bank and the Group, including information as to changes in legislation and/or updated court rulings that have material implications upon the Bank's operations, as well as information with respect to material legal actions and proceedings in which the Bank is involved. The Bank has a legal risk management policy intended to minimize exposure to legal risks. In this framework, the Bank acts towards pinpointing legal risk centers and the formation of processes, procedures and reporting routines for the purpose of monitoring such risks.

REGULATION RISKS

Regulation risk has been defined by the Bank as a loss stemming from non-compliance with various regulatory directives applying to the Bank and the Group, excluding directives relating to bank-customers relations, which are treated separately within the framework of the management of compliance risk.

The Bank's operations are regularized by various regulatory directives, under which various limitations are imposed on its fields of operation and sources of income and which impose on the Bank different duties applying to it due to its status as a "banking corporation". These directives include, among other things, the Banking Law (Licensing), 1981, the Securities Law, 1968, the Regulation of Engagement in Investment Consulting and in Investment Portfolio Management Law, 1995, the Anti Trust Law, 1988, Proper Banking Management Directives, including regulations, rules and additional duties imposed on the Bank by the various supervisory authorities to which the Bank is subject within the framework of its operations.

The Bank and the subsidiaries under its control are exposed to frequent changes in legislation and various regulatory directives, which at times apply retroactively and which expose the Bank and its subsidiaries to risks involved in frequent changes in work procedures and to costs involved in the preparations required for the implementation of the relevant directives. As part of managing the regulation risk, the Bank conducts an ongoing follow-up of changes in legislation and regulation that have a material effect on the Bank's operations, in order to prepare for the implementation of the directives applying to the Bank and its subsidiaries.

COMPLIANCE RISKS

Compliance risk has been defined by the Bank as a risk stemming from the non-compliance with the provisions of the law and regulations applying to the Bank with respect to bank-customer relations ("consumer instructions"). According to Proper Banking Management Directive No. 308, the compliance officer is responsible for compliance with the consumer instructions. The activity of the Bank and of its subsidiaries is subject to legislation in Israel and abroad 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. Non-compliance with consumer instructions exposes the Bank to legal actions as well as to enforcement power granted to the various regulatory authorities, to which the Bank is subject within the framework of its operations, including the authority to impose monetary sanctions in cases of violation.

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 of monetary sanctions in material amounts, as a result of non-compliance with regulations.

Supporting infrastructure. The Bank maintains an infrastructure of 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 in accordance with 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.

Compliance officer. A compliance officer is appointed at the Bank in accordance with 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 field of bank-customer relations ("consumer instructions") with a view of reducing exposure to lawsuits and to other sanctions that may be imposed on a banking corporation with respect to non-compliance with consumer instructions.

The compliance officer works under a management member - the Chief Legal Advisor, and reports directly to the President and CEO. 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. Other banking subsidiaries in Israel have also appointed compliance officers in accordance with the said instruction.

The Compliance Officer monitors the Bank's preparations for fulfilling the duties imposed on it under the consumer instructions, including verification of compliance by the Bank with the relevant consumer instructions as regards new activities of the Bank and 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 the Board of Directors as well as 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.

During 2008, a compliance infrastructure survey effected once every five years was conducted at the Bank, in accordance with the requirements of Proper Banking Management Directive No. 308.

The Bank is acting towards the absorption of a system designed to assist in compliance risk management, including elimination of gaps identified by the infrastructure survey.

Training software on the subject of compliance has also been integrated at the Bank, and the Bank's various units undergo instruction sessions intended to increase the awareness to the importance of the compliance issue.

In addition, the Bank acts to implement a "compliance trustee" program at various organizational levels. Such trustees

will be engaged in improving the control mechanism over compliance to regulation in the various units.

The officer in charge of money laundering prohibition was appointed in accordance with the Prohibition of Money Laundering Law and related regulations, and he is responsible for the fulfillment of the duties imposed on the Bank with respect to money laundering and the financing of terror activities. In accordance with the requirements of Proper Banking Management Directive No. 411. The relevant subsidiaries in Israel have also appointed officers in charge of this issue as required by law.

Non-compliance with directives applying to the Bank with respect to money laundering exposes the Bank to monetary sanctions, goodwill risks as well as to criminal proceeding, which may be brought against the Bank and its employees in respect of violation of the provisions of the law relating to this issue.

The officer in charge of the prohibition of money laundering is responsible for the writing of work procedures and the establishment of a computerized infrastructure required for the compliance with the provisions of the law applying to the Bank in this respect, as well as for the submission of reports to the Prohibition of Money Laundering Authority, in respect of operations subject to reporting in accordance with the law. The Bank is assisted by a computerized system in monitoring transactions that seem unusual and should be reported.

The Bank conducts ongoing instruction sessions at its various units intended to increase awareness and knowledge of this subject.

During 2009, the Bank continued to act towards the correction of deficiencies found by an audit with respect to money laundering carried out at the Bank by the Supervisor of Banks. In this respect, the Bank is acting towards the implementation of units "compliance trustees" program, who are to operate at the various units with the aim of improving the control mechanisms over compliance with procedures also in this field.

See "Prohibition of Money Laundering Law and Prohibition of the Financing of Terror Law" under "Legislation and supervision" below regarding legislation in the matter of money laundering.

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, therefore, 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 taken in examination of risk factors and evaluation of their impact, and in comparison between banks in this matter.

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	Medium	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. The updated evaluation of the risk effect, which has been increased to "medium", took into consideration the effect of the financial crisis on large borrowers and borrower groups in the market, as well as the volume of capital, which the Bank is required to allocate in respect of this risk.
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.

RISK FACTORS TABLE (CONTINUED)

The risk		Risk factor Impact	Risk description
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	Low	A risk of the impairment in the Bank's value of the Bank and its profitability as a result of changes in the market price of securities held by the Bank. The Bank owns a considerable amount of securities held as investments and not for trading. The Bank is of the opinion that with the passing of the peak of the financial crisis, the level of risk inherent in shares held by the Bank has declined.
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.
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.
5.1.	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.
6.	Reputation risk	Low	A risk for impairment in the business position of the Bank as a result of impairment in the Bank's image, resulting from various publications, whether correct or incorrect, in the eyes of customers, correspondent banks, investors, regulatory authorities and others. The Bank takes action to minimize this risk through ongoing supervision and control over the implementation of instructions and procedures as regards customers, suppliers and employees.

RISK FACTORS TABLE (CONTINUED)

		Risk factor	Risk description
The risk	Impact		
Additional risks relevant to the Bank:			
7.	Regulatory risk	Low	The risk stems from the fact that the Bank and its subsidiaries are subject to various regulatory instructions (legislation, secondary legislation and supervision by various regulatory authorities). Such instructions, which are subject to frequent amendments and updates, may limit the scope of activity of the Bank and its sources of income and require the allocation of considerable resources. Non-compliance with the regulations may expose the Bank, among other things, to sanctions imposed by the supervisory authorities, including monetary sanctions, to goodwill risk as well as to monetary claims. The Bank believes that the follow-up it conducts of changes in legislation and regulation and the preparations it makes to implement the same, significantly decrease this risk.
8.	Strategic risk	Low	The risk of a material deterioration in the earnings of the Bank, in its equity or in its goodwill, stemming from changes in the business environment in which the Bank operates, from entry into new activities, new markets or products, from erroneous strategic decisions, or from an improper implementation of these decisions.
9.	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.

Within the framework of preparing the ICAAP document (see hereunder), the Bank is studying the various risks and their effect on the Bank, using new methodologies. It should be mentioned that once the process is completed, it may turn out that the assessment of risks and their effect differs from the data presented in the above table.

BASEL II

GENERAL

The Basel Committee is an international body established in 1974 by the central banks of various countries. The decisions and recommendations of the Committee, though not legally binding, determine the supervisory principles according to which the authorities that supervise the banking systems in a significant number of countries around the world operate. In June 2004, the Basel Committee published new recommendations intended to ensure proper regulation with respect to capital adequacy of banks in the various countries (hereinafter: "Basel II"). In June 2006, the final and updated version of the instructions was published. The Basel II recommendations replace the previous instruction of 1988, named Basel I, which included capital requirements with respect to credit risks and was expanded in 1996 in order to include capital requirements also with respect to market risks.

While the Basel I guideline has been mostly concerned with the allocation of capital in respect of credit and market risks, the Basel II guideline extends the reference also to other types of risk and puts great emphasis on the quality of risk management. This, in order to increase stability of financial institutions also by way of integrating risk management and control practices. Accordingly, the Basel II instructions include, in addition to a material change in computing capital (the first pillar of the instruction), also two additional pillars, as detailed hereunder.

THE IMPLEMENTATION IN ISRAEL OF THE BASEL COMMITTEE RECOMMENDATIONS

The Supervisor of Banks published on December 31, 2008 rules for the implementation of the Basel II guidelines in Israel – according to the "standard approach", within the framework of the provisional instruction in the matter of "framework for measurement and capital adequacy", which came into effect on December 31, 2009.

The Basel II instructions are comprised of three pillars:

- First pillar – 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⁽¹⁾. The process of computing capital adequacy according to the first pillar is based upon a rigid set of guidelines that does not allow the banking corporation subjective considerations.
- Second pillar – Supervisory evaluation (SREP) emphasizes the supervision and control process, the quality of risk management as well as capital adequacy in relation to the risk profile of the banking corporation. Within the framework of the second pillar banking corporations are required to conduct an internal process designed to evaluate the appropriateness of capital adequacy and to adopt a strategy intended to ensure capital adequacy – Internal Capital Adequacy Assessment Process ("ICAAP"). As part of the ICAAP, banking corporations are required to re-evaluate their capital needs, both in respect of risks treated within the framework of the first pillar and in respect of material risks not so treated and to determine in a subjective manner what is the adequate level of capital required in respect of such risks (capital adequacy evaluation). The additional risks included in the second pillar are composed of risks, not treated within the framework of the first pillar, the scope of exposure to such risks and the capital allocation in their respect can be computed on a quantitative basis (such as: credit concentration risk, interest rate risk regarding the banking book⁽²⁾) and qualitative risks which are examined within the framework of the overall examination of capital adequacy (such as: reputation risk, compliance risk, strategic-business risk, etc.). Furthermore, within the framework of the second pillar banking corporations are required to prepare extreme scenarios for the examination of the capital position. This process of evaluation of the capital adequacy shall be performed regularly and on an annual basis.

The first ICAAP report in respect of 2009, shall be submitted to the Bank of Israel by the end of June 2010. The Supervisor of Banks is to perform a review and evaluation process of the ICAAP process made by each of the banking corporations, and will determine whether the capital and capital targets that had been determined are appropriate to the risk profile of each of the banks. In consequence of the supervisory review procedure, the Supervisor of Banks may require different capital adequacy requirements for each bank.

The Supervisor of Banks has stated that the overall minimum ratio of capital shall not fall below 8% in respect of the first pillar and an additional 1% in respect of the second pillar.

- Third pillar – "market discipline" – Banking corporations are required to provide proper disclosure and to expand public reporting with respect to risks involved in the Bank's operations in a manner that would enable the public to better understand the overall risks to which the Bank is exposed, the manner in which they are being managed, and the volume of capital allotted in their respect.

The Supervisor of Banks informed of his intention to change the weight of risk attached to indebtedness of banking corporations and the risk weight of banks, so that their risk level will be lower by one grade from the risk level of the

(1) Allocation of capital in respect of operating risks was not required under Basel I.

(2) Within the framework of the second pillar, banks are required to assess not only the interest rate risk applying to the trading portfolio but also the interest rate risk applying to the banking portfolio. This risk measures the exposures created in the course of the bank's asset and liability management by the ALM unit, except for the shekel trading portfolio being managed by it.

country. This differs from the present situation where the level of risk is determined according to the rating of each bank. It should be noted that the Supervisor of Banks may use his discretion with regards to additional matters, in respect of which he may modify the Basel II guidelines for the propose of their implementation in Israel.

Basel II – a draft document regarding tightening banking corporations' corporate governance. In March 2008, the Bank of Israel published a draft document in the matter of the tightening of corporate governance at banking corporations, as part of the implementation of the recommendations of Basel II. The purpose of the draft is to ensure the adoption and implementation of proper procedures of corporate governance by banking corporations. Among other things, it has been determined in the draft that the board of directors or senior management of a parent company are responsible for determining the strategy and general policies for the bank and its subsidiaries and have the duty to determine the structure of corporate governance that would contribute in the best manner to the formation of an effective chain of control for the group as a whole. It has been further determined that in fulfilling their duty towards proper corporate governance, directors of the parent company should be aware of material issues and risks that might affect the different entities in the organization. Accordingly, they have to exercise proper supervision over the activities of the subsidiaries. For details regarding the adoption of a corporate governance code, see "Corporate governance code for the Discount Bank Group" under "Miscellaneous" hereunder.

Discount Group's preparations for the implementation of the requirements of Basel II

General. A supreme Group steering committee headed by the President and CEO of the Bank with the participation of senior officers of the Discount Group leads 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 second pillar 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. In 2009, the Bank and the relevant subsidiaries completed the preparations for financial reporting according to the first and third pillars of Basel II.

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

First pillar. In the course of 2009, the Bank began to compute capital adequacy in respect of credit risk, market risk and operating risk in accordance with the Basel II guidelines, alongside computing capital adequacy in accordance with the Basel I guidelines.

The capital requirement in respect of credit risk is computed in accordance with the standard approach, on the basis of independent credit ratings.

The Bank completed in 2009 the establishment of a system for the computation of capital adequacy and credit risk management that enables the implementation in full of the Basel II requirements in respect of credit risk. The implementation plan has been activated by the entire Discount Group in Israel and abroad. Within this framework the

Bank has studiously improved and upgraded the data.

Furthermore, during 2009, the Bank engaged an international corporation specializing in credit rating for the performance of a project whereby the said corporation will develop for the Bank a number of models for credit rating of medium and large size customers in the real estate, industry, commercial and services fields. The products of these models will be used to improve the credit management procedures and will serve as foundations for future use by the Bank in computing capital requirements in respect of credit risk based on internal credit rating models, within the framework of the implementation of "advanced approaches" for measuring capital adequacy.

Capital allocation in respect of operating risks is computed according to the "basic indicator" approach, according to which gross earnings are multiplied by a fixed coefficient. Towards the year 2012, banking corporations will be able to compute the capital allocation according to the standard approach, whereby gross earnings from different business lines would be multiplied by a different coefficient for each line of business.

Second pillar. Preparation by the Bank in 2009, for the implementation of the second pillar, included:

- The continued formation and application of the internal process of capital adequacy assessment process (ICAAP) and its documentation;
- The submission to the Supervisor of Banks of a draft ICAAP report (in June 2009);
- Formation and updating of the risk management policy documentation;
- Formation of a comprehensive work plan for elimination of the differences identified in the survey performed by the Bank compared with the risk management principles required in the documents published by the Basel Committee (BIS);
- The starting of an extensive process for the elimination of the said differences.

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 ICAAP process is intended to secure the maintenance of adequate capital by banking corporations to support the overall risks inherent in their business and the application of adequate procedures for the management of such risks. Among other things, the process includes: identification and evaluation of risks that had not been identified within the framework of the first pillar (concentration of credit, interest rate of the banking book, goodwill, strategy and so forth), evaluation of the quality of risk management, the process of capital planning and determination of the risk propensity and an examination of the capital situation in extreme scenarios. 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 Supervisor of Banks required the banking corporations to submit a draft ICAAP document based on the December 31, 2008 data by the end of June 2009, for the purpose of its review. The Bank has submitted to the Bank of Israel on the required date, a first draft of the ICAAP document. This draft includes a work plan intended to eliminate the gaps discovered by the second pillar gaps review. As seen from the ICAAP computations submitted to the Supervisor of Banks the Bank has an excess reserve of capital to fall back on with respect to the risks to which it is exposed. A process of discussions and feedback with the Supervisor of Banks took place in January 2010, with respect to the submitted draft. Comments and clarifications provided to the Bank within the framework of this process will be embedded, to the extent possible, in the final ICAAP document to be submitted to the Supervisor by the end of June 2010, based on data as of December 31, 2009.

The Supervisor of Banks has clarified that in the interim period, until completion of the ICAAP document examination process by the Supervisor (the SREP process), banking corporations must also attain the capital targets as defined by them in terms of Basel I.

Third pillar. The Basel II guidelines broaden the disclosure requirements, both qualitative and quantitative, in the matter of management of exposure to credit risks, market risks and operating risks. In continuation of the "framework" dated December 31, 2008, the Supervisor of Banks issued in October 2009, a provisional instruction regarding "the application of disclosure requirements included in the third pillar of Basel II – in financial statements of banking corporations for 2009 and thereafter".

Qualitative and quantitative disclosure regarding the various risks is presented above in the Chapter "Exposure to risks and risk management". Additional qualitative and quantitative data is presented in this Chapter as well as in additional parts of the annual report. A table relating the disclosure requirements stated in the provisional instruction to the different parts of the annual report in which the required information is presented, appears at the end of this Chapter.

CAPITAL TRANSFERABILITY

Capital transferability is a key component in establishing capital adequacy for the Group. Discount Group regards a high level of capital transferability within the Group as supportive of Group capital adequacy, due to the capacity to transfer capital, if needed, between Group companies.

Capital transfer between Group companies may be achieved by issuing tier I and tier II capital between Group companies, purchase/sale of risk assets, or even by providing letters of indemnity so as to reduce the need for the actual capital transfer. Regulation and improvement of capital transfer procedures makes a material contribution to robustness of claims with regard to capital adequacy of the Group and of each individual subsidiary.

It should be noted that such capital transfer may be effected between subsidiaries, or from the parent company (the Bank) to subsidiaries. Indeed the Bank has, in fact, invested in capital and capital notes of certain subsidiaries, and has indemnified other subsidiaries. Capital transfer from subsidiaries to the parent company is not relevant. However, excess tier II capital in a subsidiary may serve the parent company in calculating capital adequacy, without an actual transfer.

TABLE RELATING THE DISCLOSURE REQUIREMENTS ACCORDING TO THE THIRD PILLAR TO THE DATA PRESENTED IN THE REPORT

With a view of grouping together the information required by the provisional instruction, banking corporations have been required to include in the report a table relating the disclosure requirements stated in the instruction to the sections in the Directors' report or to the Notes to the financial statements in which the information required to be presented in the annual report is included. The required information as above is reflected in the following table.

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Table 3a	Capital adequacy - qualitative disclosure	Capital resources - The Bank's capital adequacy	63-65
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MAIN DEVELOPMENTS IN ISRAEL AND AROUND THE WORLD IN 2009

DEVELOPMENTS IN GLOBAL ECONOMY

Towards the end of 2008, the global economy fell into a deep recession, reflected by the collapse of banks in the United States and other countries, by the sharp decline in volume of world trade, in the increase in the number of corporations in difficulties and by the number of unemployed, and by a sharp decline in demand and in investments. As a result, economic activity diminished sharply, particularly in the last quarter of 2008 and in the first quarter of 2009. However, despite the strong fear of economic recession at the end of 2008, signs of recovery began to appear already at the end of the first quarter of 2009 - first in the financial markets and subsequently in non-financial activity.

Following the sharp fall in securities prices in the first two months of the year (in continuation to the fourth quarter of 2008), a significant recovery in share prices around the world has been recorded since March 2009. The change took place despite the credit crisis and was made possible, among other things by the minimal monetary interest rates and the low returns on government bonds, which brought about a transition of investments from the solid government bond channel to the equity channel, as well as by measures taken by governments, which reduced uncertainties in the markets, encouraged demand and improved the performance of corporations. Improvement in the leading share indices continued until the end of the year, and on an annual basis the S&P 500 Index rose by 26.5%, the Nikkei 225 Index rose by 19% and the FTSE 100 Index rose by 22.9%.

Credit markets also presented an improvement, the yield spreads between corporate bonds and similar government bonds and the difference between the LIBOR interest rate and the return on the parallel U.S. government bonds (Ted Spread) being reduced to levels that prevailed prior to the outbreak of the financial crisis in September 2008. In consequence thereof, the ability of corporations to raise capital has increased. Notwithstanding, households and small and medium companies continue to face difficulties in raising capital and obtaining loans.

Following the financial markets, improvement has also been noticed in a growing number of non-financial fields of activity: industrial production, sales (especially motor vehicles), foreign trade volume, the labor markets and certain aspects of the housing market. Furthermore, sharp rises have been recorded in the consumer confidence indices and in business surveys (such as the supply management indices – ISM index) in various places in the world.

All these were reflected in the stabilization and even in the acceleration of the quarterly growth rates, starting already with the second quarter of the year. However, on an annual basis, the large developed markets recorded a decline, and the economies of the United States, the Euro Block and Japan declined by 2.4%, 4.1% and 5.0%, respectively. In contrast, part of the developing markets experienced a more moderate slowdown due to the increase in domestic demand and/or the reliance on the export of goods, the price of which has risen during the year. In this respect the economies of China and India may be mentioned, which grew this year at high rates, despite being highly exposed to Western economies.

Alongside signs indicating recovery, mitigating forces are still active, the effect of which tends to continue for a long time: the number of corporations facing difficulties or even bankruptcy is still high, high unemployment rates, which threaten the future of private consumption, government expenditure has created huge deficits and increased the national debt by tens of percentage points, and the high liquidity, created by the expansionary monetary policy, threatens to create inflationary pressures.

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY

GENERAL

Despite the extensive dependence of the Israeli economy on the global economy, due to the significant weight of the international trade in its total economic activity and its integration in the global capital market, it seems that the severe global crisis forced the Israeli economy into a merely limited crisis in depth and in duration. Examination of product development throughout 2009 shows a return to positive growth rates already in the second quarter of the year, which intensified further on during the year, reaching a 4.9% growth in the GDP and a 5.2% growth in the business sector product (in annualized terms). In the whole of 2009, the GDP recorded a positive growth of 0.7%, while the business sector product registered a decline of only 0.2%. Among the factors that contributed to the growth in 2009 were the continued growth of current private consumption, of public consumption expenditure, and the improvement in Israel's goods and services account (the decline in imports was sharper than that recorded in exports). These offset the sharp declines, the more prominent of which were in investments in economic sectors and in the consumption of durable goods. The per capita product in 2009 recorded a decline of 1.1%, compared with a growth of 2.2% in 2008.

The decline in economic activity has been reflected in the unemployment rate, which increased from 6.5% in the last quarter of 2008, to a record high of 7.9% in the second quarter of 2009. Since then, the employment market has recovered and a downward trend in the unemployment rate has been recorded, to a level of 7.4% in the last quarter of 2009.

Three international rating agencies that review Israel have ratified in the course of 2009, the rating of the long-term foreign currency government bonds. S&P (in July) and Fitch (in November) made no change in the "A" level rating, while Moody's (in August) made no change in the "A1" level rating. The forecasted rating of all the agencies remained as "stable".

MAIN DEVELOPMENTS IN ECONOMIC SECTORS

The macro-image reflected in the data of the different economic sectors. Industrial production continued to shrink in the first half of 2009, in continuation of the trend prevailing during the second half of 2008. However, the trend turned around in the middle of the year, and a recovery of the industrial production was noted from then on until the end of the year. In total, in 2009 industrial production fell back at an unprecedented high rate of 6.0%, though the production of hi-tech industry declined at a moderate rate of only 0.9%. Excluding the hi-tech industry, industrial production declined by an even sharper rate of 9.7%.

On the demand side, turnover data of the commercial and services sectors indicate that the sharp decline that started at the beginning of 2008 was curbed in the first quarter of 2009, being since then replaced by a recovery. Nevertheless, a decline on a yearly average of 2.7% was recorded with respect to these sectors turnovers. The wholesale and retail trading sectors, constituting some 60% of the sector as a whole, recorded a decline of 2.2% and 0.4%, respectively. Even a sharper decline was registered in the income of financial institutions and insurance brokers, in business services and in the hotel and food industries.

FOREIGN INVESTMENTS

Though direct investments in Israel, by foreign residents continued in 2009, amounting to US\$3.8 billion, these were about one third compared to the previous year in which they stood at US\$10.9 billion. In contrast, investments in

marketable securities, which were adversely affected in 2008, due to the global financial crisis, and which amounted to US\$1 billion, recovered in 2009, amounting to US\$2.5 billion.

Direct overseas investments by Israeli residents declined appreciably during 2009, reaching a level of US\$1.2 billion, compared with US\$7.2 billion in 2008. In contrast to the above, a significant increase in financial overseas investments of Israelis was recorded, which amounted to US\$7.6 billion, compared with investments of US\$2.0 billion in 2008. Institutional investors were dominant among Israelis investing abroad in 2009. This fact largely explains the increase in financial investments and the decline in direct investments, because institutional investors prefer investing through the capital market to direct investment in corporations.

DEVELOPMENTS IN FOREIGN EXCHANGE RATES AND INFLATION RATES

During 2009, the Shekel appreciated in value as against the U.S. Dollar at the rate of 0.7% and was devalued as against the Euro by 2.7%. The changes in exchange rates were, among other things, the result of changes in exchange rate of the different currencies in the world. The nominal-effective exchange rate, which offsets these effects, was devalued in 2009 by 2.5%. The trends in foreign currency trading were not identical in the course of the year. As from the beginning of the year and until the end of April (April 24), the Shekel weakened against the currencies basket by 8.5%. However, since then the trend was reversed and until the end of the year the Shekel appreciated in value against the basket by 5.5%.

During the first seven months of 2009, the Bank of Israel continued to intervene in the foreign currency market through the purchase of US\$100 million per day on average. In August, the Bank of Israel changed its policy and announced that the regular daily purchases of foreign currency are to be stopped and that it will take action in the foreign exchange market only in cases of exceptional fluctuations in the foreign exchange rate, that will not match the basic economic conditions, or in cases where the foreign currency market will not operate properly. Nevertheless, in the months from August to October 2009, the Bank of Israel continued to purchase foreign currency in the volume of US\$7 billion. On a yearly total, the Bank of Israel purchased foreign currency in an amount of US\$19.6 billion, in continuation to purchases of US\$12.1 billion in 2008.

The Consumer Price Index (CPI) rose during 2009 by 3.9%, similarly to a rise of 3.8% during 2008 – exceeding the targeted higher limit of the inflation rate of 3%. Among the causes of this deviation from the targeted range of inflation may be noted the rising fuel prices against the background of rising oil prices around the world, and the rise in privately owned housing prices. Eliminating these two items, the inflation rate would have reached 2.6%. The inflation rate in 2009 was also affected by the increase in Government taxes and fees in the middle of the year, when disregarding these, the CPI would have increased by 2.8%.

FISCAL AND MONETARY POLICY

Fiscal policy. Due to the General Elections, which took place in Israel in March, approval of the State budget for 2009 was deferred to July and the budgets for 2009 and 2010 were merged. The economic recession resulted in 2009 in a sharp drop of 6.1% in the collection of taxes (in real terms and net of legislation amendments). As a result and due to the increase in Government spending, the State deficit rose sharply in 2009, amounting to NIS 39.3 billion (excluding the net granting of credit), comprising 5.15% of the GDP. In comparison, the deficit in 2008 amounted to 2.1% of the GDP and a balanced budget was recorded in 2007.

However, it must be remembered that the planned deficit in the budget amounted to NIS44.4 billion, comprising 6% of the GDP. The reasons for a lower than planned deficit stem from a reversal in the downward trend of tax collection as from the end of the first quarter of the year (so that in comparison to the targeted income in the State budget, this item recorded a surplus of NIS 4.4 billion, mainly due to indirect taxes), from lower than planned interest expenses and from a higher than forecasted GDP.

Monetary policy. The first seven months of 2009 were typified by the massive monetary expansion by the Bank of Israel, as part of its efforts to assist economic recovery from the recession. The monetary recovery has been achieved by the sharp decrease in interest rates, from 2.5% in December 2008 to 0.5% in April 2009, by massive purchases of foreign currency to the tune of a daily average of US\$100 million, and by the purchase of government bonds from the public in an amount of NIS 18 billion.

As from August 2009, the Bank of Israel began a move of monetary reduction, which included increasing the interest rate by 25 base points in each of the months from September to December, terminating the purchases of government bonds and changing to the purchase of foreign currency only as necessary. The Bank of Israel's policy was reflected in the amount of liquid money supply (M1). In the first eight months of the year, the monetary base increased by 53.7% to a level of NIS 110.5 billion in August. In contrast, later on in the year, the monetary base decreased to a level of NIS 108.7 billion at the end of December.

THE CAPITAL MARKET

The year 2009 has been characterized by a trend of sharp price increases on the equity markets that was supported by price increases on world share markets and by local factors, principally, the discovery of large natural gas deposits along the Israeli coastline and in continuation, signs of recovery of non-financial activity and upwards updates of growth forecasts in Israel and around the world.

The general share index rose during the year at a rate of 78.8%, compared to a decline of 46.4% in 2008. The rate of increase in the general share index in Israel in 2009 was remarkably higher than the price increases on the leading securities markets around the world. The sharp increases in share prices covered all industries. Particularly high increases in prices were recorded in shares of oil companies and investment and holding companies. The TA 25 Index rose by 74.9%, the TA 100 Index rose by 88.8% and the Tel-tech Index rose by 92.7%. This, in contrast to trends in 2008, in which the TA 25 fell by 46.2%, the TA 100 Index fell by 51.1% and the Tel-tech Index fell by 60.9%. Trading turnovers recorded a certain moderation in 2009, though the daily average trading volume remained high at a level of NIS 1.7 billion, compared to NIS 2 billion in 2008.

The overall return on bonds index relating to all classes of bonds rose during 2009 by 15.5%, compared to a decrease of 0.7% in 2008. Notwithstanding, whereas government bonds recorded an increase of only 5.9%, corporate bonds enjoyed a sharp rise in prices at rates of about 32.5%, with a decline of return spreads between them and government bonds. Due to the expected increase in inflation rate, indices of CPI linked bonds on the government bonds market increased by 10.3%, while indices of the non-linked bonds rose at an average rate of 2.5% only. Vivid trade continued on the bond market in 2009, and the average daily volume of trade amounted to NIS 4.1 billion, similarly to 2008.

The improvement on the capital market was also reflected in the significant increase in the raising of capital through corporate bond offers on the Tel Aviv Stock Exchange, which amounted to NIS 35.8 billion, compared to NIS 22.1 billion in 2008. Of this amount, issues of marketable corporate bonds to the public amounted in 2009 to NIS 29.1 billion, compared to NIS 15.4 billion in 2008.

THE ASSET PORTFOLIO HELD BY THE PUBLIC

The value of the asset portfolio held by the public amounted at the end of December 2009 to NIS 2,302 billion, compared to NIS 1,887 billion at the end of December 2008, an increase of 22%.

Of the total asset portfolio, the securities portfolio amounted at the end of 2009 to NIS 740 billion, compared to NIS 400 billion at the end of 2008 (an increase at the rate of 85%). A large part of the increase in value of the securities portfolio stemmed from the rise in prices of the assets (according to the Bank of Israel, this component explains 76% of the growth) while the balance stemmed from the net increase in public investments in securities.

During the course of 2009, the weight of equity securities increase sharply in Israel alongside a moderate increase in the weight of equity securities abroad as well in the weight of marketable corporate bonds, this alongside a decline in the rest of the components.

Following are the changes in the composition of the portfolio recorded in 2009:

1. A sharp increase in the equity securities component from 14.4% at the end of 2008 to 23.4% at the end of 2009;
2. The non-linked assets component decreased from 35.4% to 31.6%;
3. The CPI linked assets component decreased from 35.0% to 32.4%;
4. The foreign currency linked assets component decreased from 15.1% to 12.5%.

PRINCIPAL ECONOMIC DEVELOPMENTS IN JANUARY-MARCH 2010⁽¹⁾

The International Monetary Fund (IMF) has raised the global growth forecast for 2010 to a level of 4%. Whereas, a slow growth is forecasted for developed countries, rapid growth of 6% is expected in developing countries, stemming from a growth in domestic demand.

In recent months, financial stability in Greece as well as in other peripheral countries of the Euro-block has been shaken, due to the global crisis and to the sharp increase in government deficit and debt. The European Union countries announced that they will come to Greece's aid, though the manner in which this would be done has not yet been decided upon.

The Government recorded a NIS 3.7 billion surplus at the end of January and a NIS 2.8 billion deficit at the end of February. Accordingly, the budgetary surplus since the beginning of the year amounts to NIS 900 million, compared to a deficit of NIS 1.8 billion in the corresponding period last year. Tax revenue data indicates stabilization in tax collection, following an upwards trend which began in April of 2009.

The CPI for January 2010 dropped more than expected, by 0.7%, due to a sharp decline in prices of housing and of apparel. The CPI for February was also negative: -0.3%.

The Bank of Israel increased the interest rate for January to 1.25%, as part of a gradual process of bringing the interest rate back to a normal level. Nevertheless, the level of interest rate for February and March remained unchanged, in view of the low CPI rates in December 2009 and January 2010, risk factors that continue to over cloud the global economy, and the low interest rates in leading economies.

The Bank of Israel combined index rose in January by 0.2%, in continuation to a rise of 0.3% in the months of November and December. The rise in the index stems from an increase in industrial production and in the income of

(1) All the data in this chapter refer to the period from January 1, 2010 to March 8, 2010.

the commercial and services sectors, though this increase was moderated by the curbed increase in exports of goods and in the import of consumer goods.

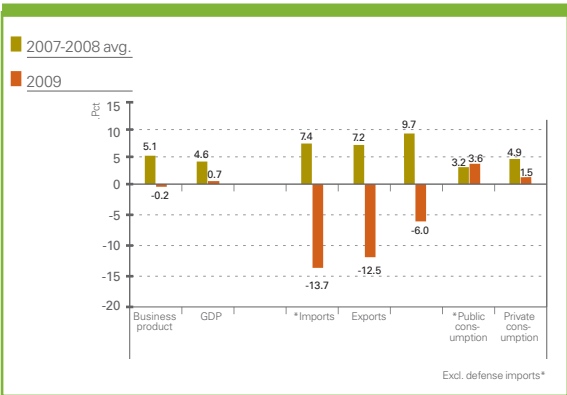
Since the beginning of the year and until March 8, the TA 25 Index rose by 5.4%, this despite the downward trend that characterized the second half of January and the beginning of February. At the same time, the S&P500 Index rose by 2.1%. The trends prevailing in the capital markets in recent months are to a large extent a function of the sharp increases recorded in 2009.

The Shekel return graph recorded a decline since the beginning of the year, against the background of the decline in expectations for inflation and assessments that the increase in the Bank of Israel interest rate would be more moderate than that expected by the market earlier on.

The exchange rate of the Shekel as against the U.S. dollar maintained stability since the beginning of the year and until March 8 (a revaluation of 0.3%), this despite the strengthening of the dollar in world markets (by 4.8% against the Euro). The Bank of Israel continued to purchase foreign currency from time to time.

The international rating agency S&P approved. Israel's long-term credit rating in foreign currency at the level of "A" with a "stable" horizon.

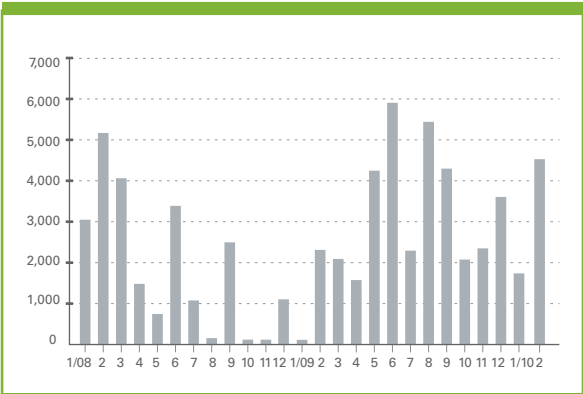
GROWTH IN ISRAEL



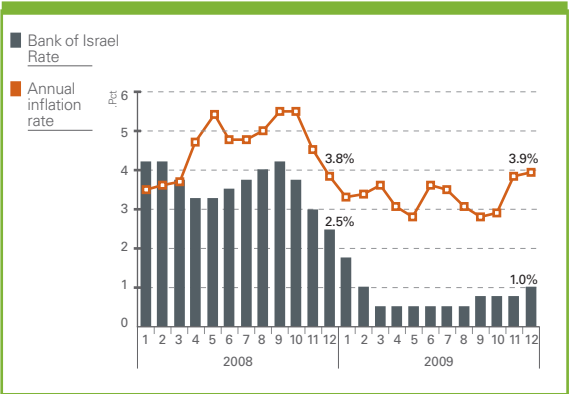
ISRAEL, U.S., AND EUROZONE GROWTH RATES



NONGOVERNMENT BOND ISSUES



ANNUAL INFLATION (TRAILING 12 MONTHS) AND BANK OF ISRAEL RATE



NIS/USD AND NIS/EUR EXCHANGE RATES



SELECTED EQUITY INDICES, CUMULATIVE CHANGE SINCE SEPT. 2008



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. Financial 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.

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, 2009							
Reported net income	176	215	323	32	26	151	923
Net income for Management reports	113	191	303	17	23	276	923
Difference	63	24	20	15	3	(125)	-
Following is the composition of the differences:							
Income (loss) from financing activities before provision for doubtful debts	3	5	(2)	4	-	(10)	-
Profit from severance pay funds	96	33	33	19	5	(186)	-
Total income that was transferred	99	38	31	23	5	(196)	-
Provision for taxes on operating income	36	14	11	8	2	(71)	-
Difference	63	24	20	15	3	(125)	-
For the year ended December 31, 2008							
Reported net income	224	211	268	54	76	(588)	245
Net income for Management reports	216	199	233	43	75	(521)	245
Difference	8	12	35	11	1	(67)	-
Following is the composition of the differences:							
Income (loss) from financing activities before provision for doubtful debts	13	19	56	17	2	(107)	-
Profit from severance 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)	-

The segment data presented below also reflects earnings and ROE disregarding certain components. The information for income or return on shareholders' equity excluding certain items is only present if such exclusion actually took place. For details of the disregarded components in the years 2008 and 2009, see table under "Income and profitability" above.

STRUCTURE ADMINISTRATIVE

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

The Bank's business operations in 2009 were conducted by three divisions: Retail Division, Corporate Banking Division and Finance Division. (The Customer Assets Division also operated until the beginning of 2009. For details regarding the change in the organizational structure, which was completed at the beginning of 2009, and within the framework of which the Assets Management Division was dissolved see "Human Resources" below).

The Retail Banking Division conducts business with households, VIP customers, small companies and businesses, foreign residents, private banking customers and customers of direct banking. The division is also responsible for the investment consulting services of the Bank – pension and securities consulting services.

The Corporate Banking Division is responsible for operations with the large and medium corporations (middle market) through business managers, business centers located all over the country, the Tel Aviv main branch, the foreign trade department Diamond, Exchange Branch and the London branch. Likewise, the Division is responsible for operations with segments of specific customers, such as: diamond companies, hi-tech companies, construction companies (real estate project financing), approved enterprises and large capital market operators.

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 (foreign currency, interest and securities), and for the management of market and liquidity risks. The division is also responsible for the management, development and operation of all the liability products, including securities.

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 2009, the Bank operated 146 branches across the country, organized within the framework of five regions. For details regarding the organizational change of the Retail Banking Division, see under "Human Resources" hereunder.

Mercantile Discount Bank operated 73 additional branches.

Opening of New Branches. 3 new branches were opened in 2009: A "Household Discount" branch at the Science Industry

Compound ("Matam") in Haifa; "Discount Your Way" branch at the Renanim Mall and the "Kanfei Nesharim" branch in Jerusalem. For details regarding the modification of the branch network, complementary services and the consultation layout, see "The household segment" hereunder. Mercantile Discount Bank opened two branch in 2009.

TARGETS AND BUSINESS STRATEGY

In 2004, the Bank adopted the people oriented 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 SEGMENTATION

Private Sector. Four principal segments of customers have been defined in the private sector: VIP banking, personal banking and general banking; 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 are 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;
- Multi-channel – enabling the customer to perform banking operations everywhere, at any time, in every channel and individually customized;
- Deployment according to spheres - teams that specialize in the customer sphere (rather than in the product sphere);
- Expert banking - provision of various professional services in the credit and investment sectors, including customizing the product to customers' needs and requirements;
- People oriented 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 integration of standards for handling customer approaches and the continued reduction in complaints;
- The allocation of resources based on the requirements of the customer and the Bank's priorities.

A customer focused support system was integrated at the Bank's service layouts. 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 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.

"LEAN ORGANIZATION" PROJECT - REMOVAL OF OPERATIONAL ACTIVITY FROM THE BRANCHES

Integration of the project at the branch layout is intended to achieve the following targets:

- a. The customer may choose between teller assisted banking services and self service banking;
- b. Extension of branch operating hour;

- c. Removal of all operations not essential for customer service from the branch;
- d. Simplifying and shortening the remaining processes at the branch;
- e. Focusing on the customer and his needs in order to improve the service experience;
- f. Reducing the amount of paperwork and filing at the branch;
- g. Savings in manpower and costs.

As of date of publication of the financial report all the Bank's branches have a self service banking area, where the customer is able to conduct most of his daily banking transactions, including cash and check deposits and effecting payments.

Three back offices have been established in Tel Aviv, Jerusalem and Haifa, to which over twenty operating activities were transferred, including: clearing examination, establishment of authorizations for charging accounts and managing them, deposits through teller machines, etc. In addition, the back office is taking over from the branches the filing and maintenance of basic documents as well as the daily paperwork and their input on to the central computer system within 72 hours. the removal of basic documents has been carried out at about thirty branches. It is expected that in 2010 this process will be completed at 20 additional branches and business units. The removal of the daily paperwork has been carried out at over twenty branches. The process is expected to be completed at all the Bank's branches in the course of 2010. This move has saved office space at branches, has reduced the use of paper, has shortened the time required for locating documents and reduces risks.

Since the beginning of this project, some 200 employees have been moved to the back office, while the total number of staff at the Bank was reduced by approximately 130.

RETAIL BANKING SECTOR - HOUSEHOLD SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as VIP customers (the definition excludes customers of the private banking centers). The segment also includes the household segment customers of the Mercantile Discount Bank - private customers of Mercantile Discount Bank, whose activities are typical of those of households, including credit of a volume not exceeding NIS 200 thousand and deposits of a volume not exceeding NIS 500 thousand.

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 a residential unit, 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 200 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.

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 2009 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 2009, 7 branches of the "Discount Your Way" line were in operation: 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, at the "Giva'tayim shopping mall" in Giva'tayim, at the "Malcha" Shopping Mall in Jerusalem, at the Renanim Mall in Ra'anana and at the Hebrew University Mount Scopus campus.

"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.: 8:00 - 20:00, 10 "Household Discount" branches operated at the end of 2009.

Plan for 2010. The plan for 2010 includes opening 6 "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.

Two investment center extensions were opened in 2009, which 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. The Bank is considered a leader in this field and provides pension consulting services to self employed and salaried employees all over the country. (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 create 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 people oriented service which they get from Bank employees;
- The continued positioning of the Bank as a leader in the pension consulting field;
- Emphasis on maintaining and intensifying activity with long standing and new customers;
- Shortening banking processes;
- The integration of processes for the removal of operational activities from the branches;
- Deployment of a queue management system;
- Multi-channel banking that would allow the customer to perform banking operations through any channel of his choice.

- 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 service experience at the branch and raising the bar for service quality;
- Reorganization of the retail layout.

COMPETITION

Competitors. The number of competitors in the household segment is the same as the number of banks operating in the market. 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;
- Preservation of customers by intensifying operations ,improving service and providing Bank customers with differentiated proposals of value;
- Providing mortgages within the framework of" Discount Layout "as a mechanism for attracting customers;
- As part of the overall proposal of value adapted to customer needs ,the Bank operates service systems specializing in investment consulting ,pension consulting and credit;
- Discount Bank was the first bank to extend the range of branches within the framework of improving the service and to launch unique concept branches. The activity includes 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 2009 in the characteristics of customers in this segment. At the same time, the trend of increasing banking operations through the direct channels continues. (ATM, Discount Telebank, the Internet and cellular banking).

Adapting private customers' credit facilities. Within the framework of the preparations for Basle II, the Bank and ICC have coordinated credit facilities for private customers, applying to overdrafts on current accounts and credit cards. The facilities have been modified in accordance with customers' needs based on their activity characteristics.

TECHNOLOGICAL CHANGES THAT MAY AFFECT THE SEGMENT

In the securities operations site. Improvements in existing questions have been made at the operations site and new information questions have been added, including: the "BULLS" system that provides extensive and up to date information in the Hebrew language regarding securities traded on stock exchanges in the U.S., as well as a mechanism

for searching for basket certificates, which enables identifying and screening basket certificates according to given parameters. Furthermore, additional possibilities have been added, such as the possibility to choose a branch where pre-ordered checkbooks will be delivered to customers, direct loans granted to State employees whose accounts complies with the required terms, transfer of foreign currency, etc.

In the field of pension consulting the Bank launched in May 2009 a pension consulting simulator – an interactive and user friendly application in the field of pension savings plans that provides a general image of pension savings data for retirement age by providing response to five questions. A pension information file was launched in June 2009, allowing a customer receiving consulting services to view, at the Bank's internet site the various pension products in accordance with information provided by the product suppliers. At present, the Bank presents information received from most of the product suppliers in the market, which includes data regarding pension, provident and further education fund products.

In the iPhone field. A service enabling the Internet access to the bank account through IPHones was launched in December 2009. The service was launched by means of the media and banners regarding downloading an iPhone application at preferred Internet sites (Ynet, Youtube). A service was launched in March 2010 allowing the transaction of securities operations on the Stock Exchange by iPhone instruments. Proximate to the date of publication of the financial statements, the Bank will launch an Internet access service for third generation instruments.

In the SMS field, the Bank established in 2009 SMS packages modified to customer needs, which include: basic notification package, current account package, capital market package and business package.

In the Information station field. The distribution of a new software version to the Bank's and Mercantile Discount Bank's information machines was completed in September 2009. This version is mainly characterized by a new monitor display that upgrades the interface with customers. An effort has been made in the development process of the new version to allow the easy and convenient operation of the monitor display, suitable also for the access requirements of handicapped 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 reputable 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.

PROVIDING SERVICES TO STATE EMPLOYEES

On April 1, 2007, the Bank was informed of its success in a tender issued by the Accountant General at the Ministry of Finance, for the granting of loans, credit facilities and other banking services to State employees (services provided until this point by Yahav Bank for State Employees Ltd.). The period of this engagement is for seven years beginning on January 1, 2008. On May 10, 2007 the Bank signed the agreement putting this into effect.

Within the framework of this tender, the Bank will establish a special deposit for seven years in the amount of NIS 1.036 billion, for the purpose of granting loans and credit facilities to State employees.

At the end of the period the principal amount of the deposit will be repaid to the Bank together with CPI linkage increments. (The Accountant General is entitled to interest in respect of the loans and credit facilities granted out of the deposit funds, as well as interest on the balance of the deposit). Loans to eligible State employees are granted under subsidized terms, at the Accountant General interest rate 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, whose opening has been delayed because of licensing problems. 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.

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.

Preparations by the Bank. 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.

In 2008 an emphasis has been placed on attracting State employees as Bank customers, and this activity has continued in 2009.

The approval of the Bank of Israel for the opening of 25 special branches was received on September 24, 2007, 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, subject to the various limitations determined in this permit. The validity of that permit has been extended to September 30, 2010, and this in view of the intention of the Supervisor of Banks to examine possible changes to its format.

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, 2009, 56,704 new accounts of State employees were opened of which 4,558 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 79,064 accounts of State employees.

PROVIDING SERVICES TO TEACHING STAFF

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.

In February 2009, the Bank signed an agreement with the Teachers Union, which, in the Bank's opinion, is expected to improve the accessibility to teaching personnel. Within the framework of the agreement, members of the teachers' organization, whose salary is deposited into their account at Israel Discount Bank, enjoy the benefits due to them as teaching staff and in addition enjoy preferred terms unique to members of the teachers union.

Until December 31, 2009, 17,884 new accounts of teaching staff were opened, of which 10,286 operational accounts used for providing loans to teaching staff only. As of a date proximate to the publication of the financial statements the Bank had 32,491 accounts of teaching staff.

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.

EFFECT OF THE CRISIS ON THE SEGMENT

Following the economic crisis, which also affected the Israeli economy, Changes have taken place in consumption and behavior patterns of retail customers in Israel. It is noticeable that customers plan their moves with great care. The

banking industry, on its part, continues to bind the granting of credit with a stricter and more elaborate review of needs as well as proven repayment ability.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

General. Most of the income from credit card issue operations is related to the household segment.

Income from financing operations amounted to NIS 1,210 million in 2009, compared to NIS 1,338 million in 2008, a decrease of 9.6%. The said decrease stems from erosion of the spreads on deposits due to the low interest rate.

Net income of the segment in 2009 amounted to NIS 176 million compared with NIS 224 million in 2008, a decrease of 21.4%. Disregarding certain components (see above), net income would have amounted to NIS 176 million in 2009, compared with NIS 118 million in 2008, an increase of 49.2%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 10.2% in 2009, compared with 15.1% in 2008. Disregarding certain components (see above), the return on equity would have been 10.2% in 2009, compared with 7.9% in 2008.

Provision for doubtful debts in this segment amounted in 2009 to NIS 249 million, compared with NIS 176 million in 2008, an increase of 41.5%.

Following are the principal data relating to the operations of the household segment:

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, 2009							
in NIS millions							
Income (Loss) from financing activities before provision for doubtful debts							
From external sources	(312)	275	10	173	146	7	153
Intersegmental	1,180	(59)	-	(64)	1,057	-	1,057
Total income from financial activity	868	216	10	109	1,203	7	1,210
Operating and other income	553	767	260	49	1,629	-	1,629
Total income	1,421	983	270	158	2,832	7	2,839
Provision for doubtful debts	159	77	-	-	236	13	249
Operating and other expenses	1,395	605	150	123	2,273	1	2,274
Operating Income (loss) before taxes	(133)	301	120	35	323	(7)	316
Provision for taxes on operating income	(68)	98	43	14	87	-	87
Net income (loss)	(65)	150	77	21	183	(7)	176
Return on equity (percentage)	(13.0)	36.5	-	2.7	10.6	(74.7)	10.2
Average Assets	8,964	7,682	7	14,879	31,532	141	31,673
Average Liabilities	61,914	1,396	-	1,760	65,070	25	65,095
Average Risk-assets	7,725	6,301	7	12,350	26,383	141	26,524
Average assets of provident and mutual funds	-	-	55	-	55	-	55
Average customers' securities	-	-	29,366	-	29,366	-	29,366
Average other assets under management	580	-	1,307	1,772	3,659	-	3,659
Components of income from financial activities:							
Margin from credit activity	438	216	-	106	760	3	763
Margin from deposits activity	397	-	-	-	397	4	401
other	33	-	10	3	46	-	46
Income from financing activities before provision for doubtful debts	868	216	10	109	1,203	7	1,210

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

	Domestic operations				Total domestic operations	International operations:	Total
	Banking and finance	Credit cards	Capital market	Mortgage		Banking and finance	
For the year ended December 31, 2008							
in NIS millions							
Income 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	710	212	50	1,408	-	1,408
Total Income	1,482	873	224	165	2,744	2	2,746
Provision for doubtful debts	125	51	-	-	176	-	176
Operating and other expenses	1,360	492	219	126	2,197	1	2,198
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	16	85	(6)	22	117	1	118
Return on equity (percentage)	4.1	50.4	-	3.3	15.2	7.0	15.1
Return on equity disregarding certain components (percentage)	4.1	22.5	-	3.3	8.0	7.0	7.9
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

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 4,544 (of which 757 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 4,475 positions in 2008 (of which 795 are managerial positions), an increase of 1.5%.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The Bank operates within the framework of laws regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings at 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. Following the amendment to the Banking Law (Customer service) in the matter of bank commissions (Amendment No. 12), the Supervisor of Banks published new commission tariffs, which came into effect in July 2008. Within this framework. 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 small businesses – among other, corporations the annual income turnover of which does not exceed NIS 1 million.

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.

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.

The Bank believes that customers have gradually adjusted 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.

There are several private bills proposing to abolish current account fees, as well as obligating banks to pay interest on credit balances on current accounts. 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.

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 (30 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 2009 two branches in areas having a potential for providing banking services to customers of this 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”. 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

Effect of the crisis on the segment. The effects of the global financial crisis and of the slowdown in economic activity in Israel upon the segment are reflected at several levels:

- Decline in turnover and volume of business operations of companies and small businesses;
- Increase in the setting-off of liquid collateral against bank credit as a result of the decline in the interest rates on deposits;
- A certain decline in payment ethics reflected in delayed payments.

In view of these changes, the Bank has updated its credit policy with respect to this segment, while adjusting and increasing the credit margins in conformity with the credit risk level. In addition, the Bank has intensified controls over credit portfolios while focusing on sectors that may be significantly affected by the crisis. A stricter examination has been performed regarding borrowers active in these fields and the Bank is acting to reduce exposure in their respect. Concurrently, the business factors have been instructed to provide close financial guidance to solid businesses, which suffered directly from the economic crisis and required suitable credit facilities to bridge over this difficult period, this in order to enable the continuation of their current operations.

It should be mentioned that indicators noticed in recent months show an improvement in economic conditions as well as initial signs of emerging from the crisis.

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 2009 amounted to NIS 215 million compared with NIS 211 million in 2008, an increase

of 1.9%. Disregarding certain components (see above), net income would have amounted to NIS 215 million in 2009, compared with NIS 205 million in 2008, an increase of 4.9%.

The return on equity in 2009, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 28.0%, compared with 26.9% in 2008. Disregarding certain components (see above), the return on equity would have been 28.0% in 2009, compared with 26.3% in 2008.

Provision for doubtful debts in this segment amounted in 2009 to NIS 191 million, compared with NIS 156 million in 2008, an increase of 22.4%.

Following are the principal data relating to the operations of the small business segment:

Domestic operations						
	Banking and finance	Credit cards	Capital market	Construction and real estate	Mortgage	Total
For the year ended December 31, 2009						
in NIS millions						
Income from financing activities before provision for doubtful debts						
- From external sources	688	15	3	84	45	835
- Intersegmental	16	-	-	(14)	(24)	(22)
Total income from financial activity	704	15	3	70	21	813
Operating and other income	370	93	42	17	2	524
Total Income	1,074	108	45	87	23	1,337
Provision for doubtful debts	169	-	-	19	3	191
Operating and other expenses	688	66	28	18	8	808
Operating Income before taxes	217	42	17	50	12	338
Provision for taxes on operating income	75	14	6	18	4	117
Net income	142	22	11	32	8	215
Return on equity (percentage)	23.5	99.7	-	51.9	10.1	28.0
Average Assets	11,318	305	3	1,693	1,262	14,581
Average Liabilities	12,369	1,064	-	686	87	14,206
Average Risk-assets	9,239	335	3	952	1,256	11,785
Average assets of provident and mutual funds	-	-	25	-	-	25
Average customers' securities	-	-	6,275	-	-	6,275
Average other assets under management	-	-	302	-	-	302
Components of income from financial activities:						
Margin from credit activity	578	15	-	58	18	669
Margin from deposits activity	74	-	-	4	-	78
other	52	-	3	8	3	66
Income from financing activities before provision for doubtful debts	704	15	3	70	21	813

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

Domestic operations						
	Banking and finance	Credit cards	Capital market	Construction and real estate	Mortgage	Total
For the year ended December 31, 2008						
in NIS millions						
Income from financing activities before provision for doubtful debts						
- From external sources	943	12	3	126	69	1,153
- Intersegmental	(228)	1	-	(59)	(37)	(323)
Total income from financial activity	715	13	3	67	32	830
Operating and other income	336	129	29	16	2	512
Total income	1,051	142	32	83	34	1,342
Provision for doubtful debts	133	-	-	24	(1)	156
Operating and other expenses	689	104	34	20	9	856
Operating income (loss) before taxes	229	38	(2)	39	26	330
Provision for taxes on operating income	79	10	(1)	14	9	111
Net income	150	20	(1)	25	17	211
Net income disregarding certain components	150	14	(1)	25	17	205
Return on equity (percentage)	24.4	88.5	0.0	39.3	20.2	26.9
Return on equity disregarding certain components ⁽¹⁾ (percentage)	24.4	65.2	0.0	39.3	20.2	26.3
Average Assets	11,553	239	3	1,535	1,318	14,648
Average Liabilities	9,957	1,197	-	666	122	11,942
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	13	-	51	33	643
Margin from deposits activity	120	-	-	8	-	128
other	49	-	3	8	(1)	59
Income (loss) from financing activities before provision for doubtful debts	715	13	3	67	32	830

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 1,853 (of which 317 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 1,842 positions in 2008 (of which 328 are managerial positions), an increase of 0.6%.

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. (For further information, see below, 'Corporate Banking Segment').

The Discount Fund for small businesses. This is a unique fund operated by the Bank, the purpose of which is the granting of loans to existing and new business customers, having an annual turnover of up to US\$5 million and which employ up to 70 employees. The volume of the Fund is NIS 250 million.

The loans granted are NIS 100 thousand per a business customer, and serve to finance investments and working capital for a period of up to 60 months. The loans are conditional, among other things, upon the presentation of a business plan and the provision of collateral in a predefined amount.

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 2009, 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.

It is the Bank's intention to reinforce in 2010 the layout of centers and to extend their disposition by establishing three additional centers: two in the central region and one in the Northern region.

The information presented above constitutes a forward-looking statement, which reflects Management's plans at date of publication of the financial statements. These plans may change as a result of changes to the economic environment or priorities in the Bank's investment plan, which might require updating the plan.

COMPETITION

The existing competition 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 30 branches of this bank belonging organizationally to the Acre 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.

Fund for granting loans to medium-size businesses. As part of the measures taken by the Government aimed at curbing the economic slowdown, the Government has established a fund for granting loans to medium-size businesses (the annual income of which ranges between NIS 15 million and NIS 400 million). The loans will be guaranteed by the Government (at the rate of 70% on condition that the total amount of Government participation shall not exceed 20% of the total amount of loans granted by the fund). In January 2009 the Accountant General at the Ministry of Finance issued a tender offering banks to participate in this fund up to a maximum amount of NIS 1.3 billion. The results of the tender revealed that Mercantile Discount Bank has been chosen as the principal financing entity of the fund (at a maximum volume of loans of NIS 600 million). Until December 31, 2009, Mercantile Discount Bank has approved loans by means of the fund in an amount of NIS 175 million.

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 2009

The economic activity in 2009 was greatly affected by world events, primarily in the developed markets. A review of the product development throughout 2009 indicates an intensification of the recession in the first quarter of the year, stabilization in the second quarter and acceleration in the second half of the year. In the fourth quarter of the year GDP grew by 4.9% while the business sector product grew by 5.2%. In total for 2009, the GDP registered a positive growth of 0.7%, compared to a growth of 4% in 2008. In contrast, the business sector product receded by 0.2%, following a growth of 4.5% in 2008.

The recession during the year was led by the following factors:

- The export of goods and services – Concurrently with the sharp contraction in the volume of world trade (approx. 12%), the export of goods and services from Israel contracted at a sharp rate of 12.5%, following an expansion of 5.2% in 2008. The sharp decline affected both the export of goods and of services. Notwithstanding the above, a positive and accelerated growth in exports was recorded since the beginning of the third quarter of the year;

- Investment in fixed assets – The decline in the domestic demand and in demand for exports and the concern regarding the future of economic activity, led to a significant decline of 6% in investments in fixed assets, compared to a growth of 4% in 2008. Nevertheless, while investments in residential construction continued to expand at the rate of 4.1%, investments in other economic sectors (machinery and equipment, non-residential construction and other construction work) recorded a sharp retraction at the rate of 9.4%.

On the other hand, the retraction was offset by a number of factors:

- Private consumption expenditure – the economic recession led to a significant decline in private consumption, particularly in the consumption of durable goods which shrank by 8.7%. Notwithstanding, private consumption increased in 2009 by 1.5%, due to the substantial growth of 2.5% in current consumption. In 2008, private consumption expanded by 3.6%;
- Public consumption expenditure – a growth of 3.6% in public consumption was recorded in 2009 (excluding defense imports) following a growth of 2.2% in 2008. Among the factors supporting the growth in public consumption expenditure this year, was the exceptional growth in Government spending (in excess of the permitted growth in real terms of 1.7% in relation to the previous year's budget) as part of Government efforts to moderate, to the extent possible, the adverse effects on the economy;

- The import of goods and services – concurrently with the decline in expenditure, a sharp decline of 13.8% was recorded in 2009 in the import of goods and services (excluding defense imports), compared to a growth of 2.5% in 2008.

Reviews of corporations performed by the Bank of Israel well reflected the business turnover during the year. In the first and second quarters of 2009, corporations reported a decline in activity. However, already in the third quarter corporations reported a more rapid recovery than expected in economic activity, which continued in the fourth quarter. On the financing side, corporations reported a halt in the severity of the financing limitation in the first quarter, with a continuing decrease in financing limitations as from the second quarter. These trends were reflected in the net balance reported by the corporations (the difference between the percentage of corporations reporting an increase and the percentage of corporations reporting a decrease), which was negative in the first two quarters of the year, zero in the third quarter and positive in the fourth quarter. This trend has characterized all economic sectors.

DEVELOPMENTS IN THE DEBT OF THE BUSINESS SECTOR

The fourth quarter of 2009 showed a decline of 0.4% in the debt of the business sector (excluding banks and insurance companies). In total for 2009, the debt of the business sector dropped by 1.1% amounting to NIS 735 billion. This, following an increase of 4.2% in 2008 (the rates of change are in nominal terms and are affected by changes in exchange rates and in the CPI).

The decrease in the debt balance of the business sector in 2009 is explained by a decline of 5% in the debt to the banks, following a rise of 8% in 2008. In parallel, the debt of the business sector to institutional bodies continued to drop at a high rate of 12%, in continuation to a decline of 2.4% in 2008. A large part of the decrease in debt to banks and to institutional bodies was offset by the significant increase at the rate of 73% in the debt of the business sector to households and corporations (in contrast to a decline of 3% in 2008). The growth trend started in the month of March together with the recovery in the markets, and reflects an accelerated investment of the public in corporate bonds.

As a result of these developments, the weight of the banks in the total debt of the business sector declined reaching 54% at the end of December 2009, similar to its weight at the end of 2007, and in contrast to 56% at the end of December 2008.

The decline in the volume of debt of the business sector to the banking industry in 2009, stemmed mostly from the following factors:

- A decline in current credit due to the decline in volume of activity and in working capital (mostly inventories and receivables);
- The shelving of investment plans by corporations as a result of the economic recession and the uncertainty as to when it will end;
- Increased selectiveness in the granting of credit due to the rise in the level of risk concerning certain customers, among which were a number of large borrowers operating mostly abroad;
- The requirement of the Supervisor of Banks for a capital adequacy target of 12% by the end of 2009;
- A decline in the volume of transactions for the acquisition of means of control during the first three quarters of the year;
- The accelerated raising of capital through bond issues, (excluding securities offerings by the financial sector) from NIS 10 billion during 2008 to NIS 26 billion during 2009;
- A decline in investments abroad by Israeli entities, which had partly been financed by the banking industry in Israel.

The Bank has adopted a policy of attending to and supporting its business customers during the slowdown period that characterized 2009. In certain cases, the Bank rescheduled debt repayment over longer periods in accordance with customer needs.

DEVELOPMENTS IN SEGMENT MARKETS

Activity in most economic sectors declined in 2009 compared to 2008, as a result of their exposure to various layers of the global recession, at both the financial and non-financial planes. However, since the third quarter of 2009, corporations have reported a slight recovery in business activity, with an accelerated rate of recovery in the fourth quarter of the year.

Following are directions of development at industry level in 2009 as compared with 2008:

- Export based industrial segments – a decline in the volume of exports in most electronics, software and chemical industries as well as in the traditional industries (mainly, textiles and apparel, metal, rubber and plastics, marine and air transportation services). The decline in the volume of activity of customers was accompanied by a decline in operating profitability spreads, the standstill in exchange rates also contributing to the strengthening of this trend. As from the third quarter of the year an increase has been noticed in the demand trend and in orders from abroad, mainly for electronics companies engaged in the manufacturing of components for the consumer electronic market and in the manufacturing of equipment and systems for the global communications market;
- The electronics segment - this segment has shown a moderate growth in the volume of operations, derived from a sharp increase in the export of electronic components to the tune of US\$2.3 billion, against the background of the beginning of operations of a certain enterprise constituting a leading factor in the said field of activity. Eliminating this effect, the segment would have recorded a decline in activity;
- The chemicals segment – exports of the chemicals segment, considered a profitable and financially sound field of operation, declined in 2009 by 24%, as a result of a decline in demand, falling prices and the accumulation of inventories. The said deterioration stemmed from the global surplus in production capacity and from the price determination on the international markets by the large "players" in this sector;
- Defense industries – the growth in foreign operations has continued against the background of large orders for weapons transactions;

- Domestic industrial segments – a decline in the volume of industrial production as a result of the slowdown in current consumption and in the domestic demand level, which affected most of the industries;
- Diamond segment – a decline in the activity of this segment was noted as from the second half of 2008, coupled by a reduction in expenses by operators in this industry (shutting down polishing workshops, dismissal of workers and shifting most of the activity outside Israel). The export of polished diamonds amounted in 2009 to US\$9.4 billion, a sharp drop at the rate of 39%, compared to 2008, net exports, after returns, amounted to US\$3.9 billion, a decline of 34%. Nevertheless, a recovery was noted in the third quarter of 2009, which continued in the fourth quarter of the year, which also continues in the first quarter of 2010.
- Commercial segments - A moderate decline in income and in profit spreads have been noted as a result of the slowdown in current consumption and a decline in demand on the local market. Starting with the second half of 2009, a significant recovery in demand has been noted. The main segments affected by the decline in volume of operations were motor vehicle importers, importers of electronic components, importers of food products, fashion and cosmetics brands and other goods;
- Services segment – Most of companies in this segment, with the exception of operating leasing companies, registered stability in their volume of income and operating profit spreads, this against the background of the low sensitivity of the segment to effects of the economic crisis. Food marketing and electric appliance chains reported a minute decline in volume of demand. The communications industry recorded a moderate increase in volume of operations, with an improvement in operating profit spreads following mergers, acquisitions and efficiency processes. The investment house sector recorded an increase in volume of operations against the background of the booming capital market.
- The hotel segment – Activity continued to decline compared to 2008, due to the decline of 20% in number of bed/nights of foreign tourists alongside the increase of 3% in the number of bed/nights of Israelis. The average nationwide occupancy of 60%, reflected a decline of 8% compared to 2008;
- In most of the economic segments, corporations recorded a decline in inventory levels and in investments in fixed assets.

ANTICIPATED DEVELOPMENTS IN THE SEGMENT'S MARKETS

A recovery is expected in 2010 in the activity of the business sector that will encompass most of the manufacturing, commercial and services industries. According to forecasts of the Bank of Israel, the business product is expected to grow in 2010 at the rate of 4.1%, compared to a decline of 0.2% in 2009.

Certain foreign markets expect a recovery in economic activity while other markets still experience different degrees of economic recession, though the prevailing evaluation is that such markets are already over the climax of the recession. Following are the main expected developments:

- A recovery in the export of goods and services as a result of the growth in the volume of global trading, which will bring about the return of a significant growth in a part of the developing markets, mainly India and China, and a moderate growth in some of the developed markets, including the U.S. market;
- Most of the improvement in exports is expected in the electronics industry (the production of components for the consumer electronic market and for systems for the global communication market), chemicals and traditional industries (mostly food products, paper, plastics and metal);
- An increase in the level of domestic demand in the industrial, commercial and services sectors against the background of the increase in private consumption of households as a result of a decline in the unemployment rates, the increase

in the population's appetite for consumption (against the background of improvement in personal wealth effect in view of the improvement in the capital market) and due to a low interest rate environment;

- An increase in the volume of investments and inventories of companies, against the background of the significant contraction during the years 2008-2009, while returning to the normative level of inventories and investments against the background of expectations for an increase in the volume of operations.

EXPECTED DEVELOPMENTS IN CREDIT TO THE BUSINESS SECTOR

A growth in the supply of financing resources is expected in 2010 that will be reflected in the expansion of banking and off-banking credit, as a result of the following developments:

- An increase in investments and in working capital needs, including higher levels of inventories, which had declined, of export based local companies, as a result of the improvement in their business environment and expectations for the continued growth in non-financial activities;
- Improvement of the capital adequacy of the banking industry over and above the required minimum;
- A decline in credit spreads and commissions following increased competition among the large banks;
- Increase in the volume of transactions involving the acquisition of means of control as a result of the utilization of business opportunities;
- The need for recycling of bonds in a significant amount, that is due for redemption during 2010;

Against the background of the above evaluations, banking credit is expected to grow at a rate similar to the growth rate of the business product (3.5%-4.0%), and perhaps even higher than that.

The off-banking credit. The raising of capital by corporations through bond issuance is expected to accelerate against the background of the low returns on corporate bonds, a low interest rate environment and demand on the part of the public and institutional bodies for new non-linked investment products at variable interest rate. The volume of bond issues is also expected to include, for the first time after a long standstill period, also the raising of capital on the primary market.

Despite that stated above, the delicate balance between the expected volume of capital raising on the off-banking credit market and the expected demand for bank credit, will be affected, in the Bank's opinion, by the extent to which the recommendations of the Hodek Committee would be implemented. Implementation of the Committee's recommendations in their present format, which, among other things, include requirements for obtaining collateral and conditions for negative pledges on corporate assets, the Trustee's consent for the distribution of dividends, changes in controlling interest and the sale of material assets, will change the balance in the direction of an increase in demand for bank credit at the expense of the off-banking credit market.

DIRECTIONS OF BUSINESS DEVELOPMENT IN THE SEGMENT'S MARKETS

In view of expectations for the continued positive trend in the activity of the corporate banking segment, which will be reflected in rising growth rates for sales to the domestic market and for exports, and in a vision of a positive horizon for developments in the capital market, the Bank has defined the following preferred fields of operations for the allocation of credit facilities:

- Preference to financing activities of corporations in the following areas:
- Industrial operations – electronics, software, chemicals, medical equipment, pharmaceuticals, defense industries, paper, food and beverages;

- Commercial operations – large corporations engaged in oil, natural gas and commodities trading, import of cellular instruments, importers of motor vehicles, large and medium food and electrical appliances marketing chains;
- Services – communications companies, business services, public transport, leasing companies with a relatively low leverage finance operating within the framework of a financially sound group;
- Leading or participating in large transactions for the finance of the acquisition of means of control in Israel and abroad;
- Current financing of large capital market operators, where the credit is secured by sound financial assets;
- Medium and long-term finance to exporters and/or their customers with respect to foreign trade transactions. Most of the credit is to be secured by credit insurance policies or other insurance companies having a high international investment rating (securing political and business credit risks). This activity is to be conducted by a specialized unit;
- Expanding business activity with medium and small groups of borrowers of financial soundness and growth potential with a view of reducing the concentration of the credit portfolio;
- Expanding business activity with operating companies having growth potential and reasonable profitability, owned by holding corporations financed by the Bank, with a view of increasing the yield component of related activity.

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 "Main developments in Israel and around the world in 2009". The foregoing may not materialize in case of a significant decrease in demand from overseas due to a noticeable decrease in the recovery and growth rates in certain overseas markets, a significant decrease in local demand due to deterioration of the security-political situation, a decrease in available financing resources on overseas and domestic financial markets, significant volatility in interest rates and exchange rates around the world and in the global economy, and other changes in macro-economic conditions, which are not under the Bank's control.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The Bank operates within the framework of laws, regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance, the 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. 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.

The Bank computes 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, 2009 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, 2009, there were no deviations from the said limitations.

Intensifying supervision. Following the economic slowdown, the Bank of Israel has approached the banking corporations requiring them to examine their credit portfolio, focusing on transactions for the finance of acquisition of means of control, credit to customers exposed to the crisis, and more. The Bank has performed the examination as required, partly under the supervision of the Bank's credit controller, and no exceptional findings have come to light.

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 1,096 million in 2009, compared to NIS 1,001 million in 2008, an increase of 9.5%. This increase stems from a 13.1% 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 from an increase in the financial margin on credit.

Net income of the segment in 2009 amounted to NIS 323 million compared with NIS 268 million in 2008, an increase of 20.5%. Disregarding certain components, net income would have amounted to NIS 323 million in 2009 compared with NIS 261 million in 2008, an increase of 23.8%. The increase in net earnings stemmed mainly from the increase in financing income and operating commissions.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 9.1% in 2009, compared with 8.1% in 2008. Disregarding certain components, the return on equity would have been 9.1% in 2009, compared with 7.9% in 2008.

Provision for doubtful debts in this segment amounted in 2009 to NIS 293 million compared with NIS 233 million in 2008, an increase of 25.7%.

Following are the principal data relating to the operations of the corporate banking segment:

	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, 2009									
in NIS millions									
Income from financing activities before provision for doubtful debts									
- From external sources	987	11	5	705	1,708	176	20	196	1,904
- Intersegmental	(413)	-	-	(383)	(796)	(12)	-	(12)	(808)
Total income from financial activity	574	11	5	322	912	164	20	184	1,096
Operating and other income	240	105	27	23	395	26	3	29	424
Total Income	814	116	32	345	1,307	190	23	213	1,520
Provision for doubtful debts	131	-	-	98	229	64	-	64	293
Operating and other expenses	385	72	17	79	553	140	10	150	703
Operating Income (loss) before taxes	298	44	15	168	525	(14)	13	(1)	524
Provision for taxes on operating income	101	15	6	59	181	10	1	11	192
Net income (loss)	197	20	9	109	335	(24)	12	(12)	323
Net income (loss) disregarding certain components	197	20	9	109	335	(24)	12	(12)	323
Return on equity (percentage)	10.1	270.3	-	9.4	10.7	(6.7)	21.5	(2.9)	9.1
Return on equity disregarding certain components ⁽¹⁾ (percentage)	10.1	270.3	-	9.4	10.7	(6.7)	21.5	(2.9)	9.1
Average Assets	27,996	422	14	13,136	41,568	5,904	880	6,784	48,352
Average Liabilities	19,255	1,508	2	1,894	22,659	1,993	-	1,993	24,652
Average Risk-assets	30,240	113	12	18,024	48,389	5,601	880	6,481	54,870
Average assets of provident and mutual funds	-	-	426	-	426	-	-	-	426
Average customers' securities	-	-	64,172	-	64,172	-	-	-	64,172
Average other assets under management	-	-	141	-	141	-	-	-	141
Components of income from financial activities:									
Margin from credit activity	491	11	2	278	782	137	19	156	938
Margin from deposits activity	45	-	-	6	51	27	-	27	78
other	38	-	3	38	79	-	1	1	80
Income from financing activities before provision for doubtful debts	574	11	5	322	912	164	20	184	1,096

Following are the principal data relating to the operations of the corporate banking segment (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, 2008									
in NIS millions									
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	141	26	18	325	41	2	43	368
Total Income	666	151	28	288	1,133	215	21	236	1,369
Provision for doubtful debts	97	-	-	121	218	12	3	15	233
Operating and other expenses	410	113	30	74	627	104	9	113	740
Operating income (loss) before taxes	159	38	(2)	93	288	99	9	108	396
Provision for taxes on operating income	56	10	(2)	31	95	18	3	21	116
Net income (loss)	103	17	(1)	62	181	81	6	87	268
Net income (loss) disregarding certain components	103	10	(1)	62	174	81	6	87	261
Return on equity (percentage)	5.7	218.8	-	6.0	6.4	20.1	9.7	18.7	8.1
Return on equity disregarding certain components ⁽¹⁾ (percentage)	5.7	130.2	-	6.0	6.1	20.1	9.7	18.7	7.9
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

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 1,248 (of which 290 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 1,302 positions in 2008 (of which 329 are managerial positions), a decrease of 4.1%. 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.

As abovesaid, a slowdown was noted since the second half of 2008 in the activity of the diamond industry, which is significantly financed by the Bank. The Bank follows closely the developments in this sector and assists its customers during the slowdown period in the industry. As a result of the decline in the volume of operations in the industry, the volume of financing provided by the Bank to this industry has also declined, though, notwithstanding, its share of the total financing to the industry has grown.

The Bank's approved enterprises unit, 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). 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 were 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. The slowdown, which began in the third quarter of 2008, continued in 2009 causing a decline in import and export operations in the economy. According to data of the Central Bureau of Statistics, the import of goods (excluding ships, aircraft and diamonds) decreased at the rate of 25.0%, compared to 2008, while the export of goods (excluding ships, aircraft and diamonds) decreased at the rate of 14.0% as compared with 2008.

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.

In 2009 the Bank continued expanding its business development activities in accordance with the devised 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, such operating hours allow the provision of rapid service also beyond regular operating hours at times of heavy work load.

During the first quarter of 2009, the Bank completed the process of concentrating the foreign trade operations at three central points – Tel Aviv, Haifa and Jerusalem, thus terminating the foreign trade operations at the independent branches.

Technological improvements. Since January 2009, the Bank has expanded foreign trade operations on the Internet. The Internet system allows customers to make direct payments for imports, to open import documentary credits and to make payments in respect of import documents for collection. Concurrently, the Bank conducts an extensive marketing effort with a view of increasing the foreign trade customer base who make use of these services.

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, until the breakout of the crisis. 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.);
- An ability to support and stand by the customer also in periods of slowdown and economic crisis;
- 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.

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 and support to customers during changes in economic conditions.

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.

A significant decline has been noticed since the second half of 2008, in the ability to raise off-banking financing resources, mostly on the part of medium and small sized customers, a trend that increased their dependence on finance provided by 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.

Starting with the second half of 2009, against the background of the improvement of business activity of corporations operating in the domestic and foreign markets, the availability of a part of the financially sound large customers to off-banking financing sources has increased.

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). 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 decline in the volume of the corporate banking segment's debt to the banking industry during 2009, including the acceleration in the issuance of bonds by corporations, resulted in a drop in the share of banking finance in the total debt of the corporate banking segment.

The corporate banking credit market is expected to be affected by the extent of implementation of the "Hodek Committee" recommendations. The complete implementation of these recommendations without any amendments thereto, will adversely affect the ability of corporations to issue bonds and is expected to reduce the share of off-banking finance in the total debt of the corporate banking segment.

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 2009, a continuous process of significant decrease in financial spreads and operating commissions has existed, typifying the segment as a result of the decrease in the level of credit risk relating to a part of the customers and the intensified competition between the two large banks in the country with respect to leading large financing transactions in the segment, particularly involving the finance of acquisition of means of control.

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.

The recent crisis increased the awareness of the corporate customer to the fact that it is beneficial for him to transact business with more than one bank, in view of the desire and necessity not to be dependent on financing facilities of only one bank. This increased awareness is advantageous to the Bank when attracting new customers.

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 demand for credit intended for the financing of mergers and acquisitions increased during the fourth quarter of 2009, against the background of the rise in the number of such transactions in the market, particularly in the communications field.

TARGETS AND BUSINESS STRATEGY

- The continued strengthening of corporate synergy and interface at Bank and Group levels in the matter of credit risk management and the preparations towards the implementation of "Basel II" in planning and managing the capital;
- The pricing of risk by way of focusing on risk adjusted return on capital and on the yield expected from the marginal transaction;
- 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;
- The continued priority to the Bank's existing and loyal customer populations in granting them finance and assistance;
- Intensifying the control, supervision and monitoring processes over extraordinary developments in customers' risk profiles;
- A selective and careful examination of new credit applications for the finance of current or investment operations by customers operating in foreign markets, where the deterioration in business activity is continuing;
- 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;
- Implementing Basel II committee;

- 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.

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 AA (3) 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 in 2009 to NIS 656 million, compared to NIS 624 million in 2008, an increase of 5.1%. The increase in earnings stemmed mainly from the growth in interest spreads on credit.

The income of the segment in 2009 amounted to NIS 32 million compared with NIS 54 million in 2008, a decrease of 40.7%. Disregarding certain components, the income would have amounted to NIS 32 million in 2009 compared with an income of NIS 51 million in 2008, a decrease of 37.3%.

The return on equity in 2009, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 2.4% compared with 3.7% in 2008. Disregarding certain components, the return on equity would have been 2.4% in 2009 compared with 3.5% in 2008.

Provision for doubtful debts in this segment amounted in 2009 to NIS 219 million, compared with NIS 198 million in 2008, an increase of 10.6%. 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:

	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, 2009										
in NIS millions										
Income from financing activities before provision for doubtful debts										
- From external sources	155	3	1	155	3	317	216	88	304	621
- Intersegmental	106	-	-	(73)	(2)	31	2	2	4	35
Total income from financial activity	261	3	1	82	1	348	218	90	308	656
Operating and other income	105	33	19	13	1	171	29	29	58	229
Total Income	366	36	20	95	2	519	247	119	366	885
Provision for doubtful debts	104	-	-	17	-	121	42	56	98	219
Operating and other expenses	293	23	12	25	-	353	182	61	243	596
Operating Income (loss) before taxes	(31)	13	8	53	2	45	23	2	25	70
Provision for taxes on operating income	(14)	4	3	19	1	13	15	7	22	35
Net income (loss)	(17)	6	5	34	1	29	8	(5)	3	32
Return on equity (percentage)	(3.7)	89.8	-	16.4	13.6	3.9	1.9	(2.4)	0.7	2.4
Average Assets	8,294	138	1	2,645	123	11,201	5,525	2,623	8,148	19,349
Average Liabilities	5,180	455	-	618	-	6,253	3,631	595	4,226	10,479
Average Risk-assets	7,443	109	1	3,082	123	10,758	7,073	2,757	9,830	20,588
Average assets of provident and mutual funds	-	-	83	-	-	83	-	-	-	83
Average customers' securities	-	-	8,014	-	-	8,014	-	-	-	8,014
Average other assets under management	839	-	679	-	-	1,518	-	-	-	1,518
Components of income from financial activities:										
Margin from credit activity	212	3	-	68	1	284	189	82	271	555
Margin from deposits activity	20	-	-	3	-	23	29	8	37	60
other	29	-	1	11	-	41	-	-	-	41
Income from financing activities before provision for doubtful debts	261	3	1	82	1	348	218	90	308	656

Following are the principal data relating to the operations of the middle market banking segment (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, 2008										
in NIS millions										
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	43	20	13	1	182	63	14	77	259
Total Income	368	46	21	72	3	510	297	76	373	883
Provision for doubtful debts	146	-	-	13	6	165	14	19	33	198
Operating and other expenses	346	36	18	22	-	422	172	50	222	644
Operating income (loss) before taxes	(124)	10	3	37	(3)	(77)	111	7	118	41
Provision for taxes on operating income	(51)	1	1	13	(1)	(37)	20	1	21	(16)
Net income (loss)	(73)	6	2	24	(2)	(43)	91	6	97	54
Net income (loss) disregarding certain components	(73)	3	2	24	(2)	(46)	91	6	97	51
Return on equity (percentage)	(13.4)	81.9	-	15.9	(19.4)	(5.8)	19.3	2.0	13.1	3.7
Return on equity disregarding certain components (percentage)	(13.4)	52.7	-	15.9	(19.4)	(6.1)	19.3	2.0	13.1	3.5
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

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 1,008 (of which 229 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 1,106 positions in 2008 (of which 299 are managerial positions), a decrease of 8.9%.

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 by means of the main business section 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

Customers of this segment are generally companies having a medium volume of operations, most of whose activity is in the local market and their exposure level to various layers of the crisis from the financial and non-financial aspects is relatively higher than that of large customers.

Activity of customers of this segment declined in 2009 in comparison to that of 2008. Starting with the third quarter of 2009, companies reported a moderate expansion in activity in general and in export business in particular. The accessibility of companies of this segment to financing resources through bond issues in the off-banking credit market was low.

Following are the main developments during 2009:

- 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 production, inventory levels and investments, with erosion in operating profit margins;
- Difficulties in obtaining credit from the banking industry for the continued support of the proper current operations, alongside a significant decline in the level of accessibility to the off-banking financing sources;
- Government aid funds to small and medium size businesses, operated by the banks, provided a partial solution

to the credit needs of these businesses, in view of strict review and approval mechanisms on the part of external factors and the banks, as a function of regulatory instructions and the relatively high risk profile that characterized their operations. As a result of the limited offer of financing resources that typified the segment during 2009, the use of factoring and/or note discounting increased in order to obtain the required finance resources.

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 AA (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 with financial wealth held with the Bank of US\$ 1 million and over, as well as foreign resident customers with financial wealth held at the Bank of US\$0.5 million and above. 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, according to a set profile. In addition the Division's Global Center supports operations of the Bank's overseas extensions, working in full cooperation with them. Among other things, this activity includes creating connections with the Bank's foreign extensions on behalf of customers who are interested in expanding their international operations, and providing information increasing the awareness of the branches and Head Office units to the services of the Group.

STRATEGIC EMPHASES

In the international private banking arena emphasis is placed on initiated overall banking service, and specialized, 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 2009 amounted to NIS 26 million compared with NIS 76 million in 2008, a decrease of 65.8%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 12.2% in 2009 compared with 27.1% in 2008.

Following are the principal data relating to the operations of the private banking segment:

	Domestic operations			International operations			
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	Total
For the year ended December 31, 2009							
in NIS millions							
Income from financing activities before provision for doubtful debts							
- From external sources	113	1	114	140	-	140	254
- Intersegmental	13	-	13	86	-	86	99
Total income from financial activity	126	1	127	226	-	226	353
Operating and other income	52	41	93	43	51	94	187
Total Income	178	42	220	269	51	320	540
Provision for doubtful debts	-	-	-	15	-	15	15
Operating and other expenses	111	28	139	266	40	306	445
Operating Income (loss) before taxes	67	14	81	(12)	11	(1)	80
Provision for taxes on operating income	25	4	29	21	4	25	54
Net income (loss)	42	10	52	(33)	7	(26)	26
Return on equity (percentage)	61.8	-	75.8	(23.3)	-	(18.7)	12.2
Average Assets	1,638	6	1,644	4,184	-	4,184	5,828
Average Liabilities	19,150	-	19,150	17,685	-	17,685	36,835
Average Risk-assets	1,198	6	1,204	2,073	-	2,073	3,277
Average assets of provident and mutual funds	-	308	308	-	-	-	308
Average customers' securities	-	9,041	9,041	-	9,677	9,677	18,718
Average other assets under management	-	1,284	1,284	135	-	135	1,419
Components of income from financial activities:							
Margin from credit activity	26	-	26	89	-	89	115
Margin from deposits activity	113	-	113	137	-	137	250
other	(13)	1	(12)	-	-	-	(12)
Income from financing activities before provision for doubtful debts	126	1	127	226	-	226	353

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

	Domestic operations			International operations			
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	Total
For the year ended December 31, 2008							
in NIS millions							
Income from financing activities before provision for doubtful debts							
- From external sources	(34)	1	(33)	435	-	435	402
- Intersegmental	165	-	165	(223)	-	(223)	(58)
Total income from financial activity	131	1	132	212	-	212	344
Operating and other income	*37	*40	77	*41	*54	95	172
Total Income	168	41	209	253	54	307	516
Provision for doubtful debts	-	-	-	7	-	7	7
Operating and other expenses	111	36	147	*219	*41	260	407
Operating income (loss) before taxes	57	5	62	27	13	40	102
Provision for taxes on operating income	20	2	22	3	1	4	26
Net income	37	3	40	24	12	36	76
Return on equity (percentage)	*40.4	-	43.2	13.2	-	19.5	27.1
Average Assets	1,631	6	1,637	2,909	-	2,909	4,546
Average Liabilities	20,059	-	20,059	15,875	-	15,875	35,934
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	-	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	123	-	123	145	-	145	268
other	(14)	1	(13)	-	-	-	(13)
Income from financing activities before provision for doubtful debts	131	1	132	212	-	212	344

* Reclassified.

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 572 (of which 114 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 602 positions in 2008 (of which 164 are managerial positions), a decrease of 5.0%.

The staff of the private banking centers receives banking training that includes professional and administrative courses in investments and credit fields, including 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 four 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.

In September 2009, the Bank inaugurated a private banking center in Tel Aviv, which was moved to a new location at the Azrieli Towers and which serves local and international private banking customers as well as serving as an additional layer in the preparations of the Bank for an appropriate service experience suited to customer populations at the Bank. The center offers overall banking solutions while focusing on investment products as well as on credit required for the diverse investment channels of these customers.

Additional private banking centers exist in Jerusalem, Haifa and Natanya, serving customers living in these areas, or serving foreign residents who prefer receiving service at these centers. At these centers the Bank also provides expert services both as regards investment products and as regards credit.

Business development department in private banking. The department assists in developing business with customers of this segment both in Israel and abroad. The department also contributes to the Bank's involvement with Jewish communities abroad, while maintaining close contacts with organizations operating there. Private banking is responsible for the operation of Bank's representative in France who also promotes the relations of the Bank with French speaking Jewish communities.

DEVELOPMENT IN THE SEGMENT’S MARKETS AND COMPETITION

2009 was characterized by the effects of the global financial crisis, which began in 2008 and by the gradual recovery of the markets. Under these circumstances, competition in the private banking sector was intensified in 2009, which was also reflected in the mobility of customers between a number of banks in Israel and abroad.

Most Israeli banks continued to strengthen 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 as well as at focused conventions for private banking customers. 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. Furthermore, as preferred customers, private banking customers enjoy the Bank's cultural and artistic activities in cooperation with the Discount Museum. 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.

MAIN 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

The income of the segment, excluding the activity of the non-financial companies sub-segment, in 2009 amounted to NIS 155 million compared with a loss of NIS 392 million in 2008. Disregarding certain components (see above), the income would have amounted to NIS 177 million in 2009 compared with a loss of NIS 392 million in 2008.

Total revenues amounted in 2009 to NIS 696 million, of which NIS 377 million from domestic activity, compared with a negative amount of NIS 69 million in 2008, of which NIS 23 million from domestic activity, and they include three major components:

1. Profits from the "Nostro" operations of the Bank (primarily from financial derivatives) in the amount of NIS 496 million, of which NIS 325 million from earnings on the sale of securities and from adjustments to fair value of trading securities, compared with NIS 71 million "Nostro" earnings in 2008, of which NIS 34 million from gains on sale of securities and from adjustments to the fair value of trading securities.
2. Net loss, from asset and liability management (management of positions and trading and brokerage in currencies and financial derivatives) in the amount of NIS 119 million in 2009, compared with a loss of NIS 94 million in 2008.
3. Income on international operations in the amount of NIS 319 million, compared to a loss in the amount of NIS 46 million in 2008.

The return on equity in 2009, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, reached a negative rate of 9.1%, compared with a negative rate of 23.4% in 2008. Disregarding certain components (see above), the return on equity would have reached a rate of 10.2% in 2009, compared with a negative rate of 23.4% in 2008.

Following are the principal data relating to the operations of the financial management segment:

	Domestic Operations	International Banking	Total	Domestic Operations	International Banking	Total
For the year ended December 31						
	2009			2008		
in NIS millions						
Income from financing activities before provision for doubtful debts	301	330	631	44	1	45
Operating and other income	76	(11)	65	(67)	(47)	(114)
Total Income	377	319	696	(23)	(46)	(69)
Provision for doubtful debts	-	31	31	-	10	10
Operating and other expenses	581	75	656	422	77	499
Operating Income (loss) before taxes	(204)	213	9	(445)	(133)	(578)
Net income	(19)	174	155	(279)	(113)	(392)
Return on equity (percentage)	(1.7)	29.1	9.1	(21.1)	(36.3)	(23.4)
Average Assets	48,882	18,619	67,501	42,098	15,854	57,952
Average Liabilities	14,158	12,217	26,375	13,768	10,455	24,223
Average Risk-assets	8,856	9,226	18,082	9,082	5,493	14,575

HUMAN CAPITAL

In 2009, the average number of positions in the segment amounted to 1,090 (of which 205 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 1,046 position in domestic operations, compared with 910 positions as aforementioned in 2008 (of which 182 are managerial positions), an increase of 19.8%.

GLOBAL TREASURY

In the course of 2007 the Bank established a Global Treasury unit in Tel Aviv, which is designed to implement the Group's management strategy, and within the framework of which the Bank is to promote Group cooperation in the dealing rooms and asset and liability management fields in the Group as a whole. During 2009, cooperation was intensified between the Bank and Group companies in the fields of liquidity management, capital planning and the raising of capital. During the year, the Bank began a process of Group capital management from a three-yearly viewpoint. Within the framework of this process, the capital allocation to the business units and to the subsidiaries is made on a combined basis, based on a group risk asset framework. The risk asset framework is computed on the basis of a conservative scenario, in a way that secures a capital support reserve for changing market conditions. The Global Treasury coordinates the capital management process within the Group.

Dealing room. The dealing room is engaged in four principal areas of activity: trade in currencies, trade in interest rates, trade in Israeli and 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 in the implementation of special transactions in foreign exchange, interest rates and securities. Dealing room customers include local and foreign banks, corporations, Private customers having a

large volume of activity and institutional entities. Dealers and professional traders Advanced technology and computer systems, enable the dealing room to provide customers with timely professional service.

During 2009, the Bank integrated reorganization, within the framework of which the Israeli securities dealing room merged with the dealing room, which included foreign currency, interest and foreign securities trading. This move enables the Bank's large customers to receive all trading services under one roof, uniform in standard of service and level of professionalism.

FOREIGN CURRENCY AND INTEREST RATE TRADING

The main transactions provided to customers by way of the customer desk at the dealing room, are: future contracts and currency, interest and index options (including exotic options), swap transactions and fixed and variable interest rate swap transactions.

Trading in securities

Following are details concerning fields of activity in securities trading;

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.

Israeli securities. The Israeli securities desk engages in the trading in bonds, shares, options and convertibles traded on the Stock Exchange. In addition, the desk provides brokerage services for marketable and non-marketable securities, executes sophisticated transactions in bonds, submits orders for the purchase of securities marketable and non-marketable and executes short sales of securities alongside the lending of securities. The staff of the dealing room maintains direct communication with institutional investors, large corporations and hedge market players active in daily trading activity.

LIQUIDITY AND DEPOSITS

The liquidity desk engages in managing the short-term liquidity (three months) of the Bank, both in shekel and foreign currency terms, through the open tenders of the Bank of Israel, deposits and loans. The desk supplies interest rate quotations for deposits in foreign currency and in shekels by large customers ("super jumbo"), and looks after satisfying the needs of the Bank (loans and transfers) with respect to any currency and at any point of time, including investment of surplus funds.

RISK AND LIABILITY MANAGEMENT

Following is information about operating segments in asset and liability management:

General. Following are details concerning fields of operation regarding asset 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.

Capital management. The asset and liability management unit is responsible for the control over capital adequacy, forecasting future capital adequacy requirements and performing sensitivity analysis as to such forecast. Based on

the forecast, the required scope for the raising of capital is determined. The asset and liability management leads the actual process for the raising of capital. The asset and liability management unit determines the parameters for the conservative scenario used to determine a framework for the increase in risk assets and is coordinating work in this respect with the subsidiaries.

Liquidity management. The asset and liability management unit manages the Bank's liquidity position using an internal liquidity model analyzes on an ongoing basis trends in the mix and volume of deposits and credit at the Bank. The asset and liability management is responsible for determining the required volume of liquid assets for the purpose of facing pressure scenarios.

Linkage base and interest rate exposure management. The asset and liability management unit receives information as to the market risk exposure in the Bank's balance sheet by means of a designated computer system, which downloads information from all operational systems at the Bank. The asset and liability management committee, headed by the Bank's CEO, makes decisions with respect to the Bank's exposure to various risks within the framework of limits determined by the Board of Directors regarding the risk propensity. The asset and liability management increases or reduces the risks in accordance with the decisions of the assets and liability management committee by managing the available-for –sale portfolio and by off-balance sheet transactions.

Financial spread and transfer cost management. The assets and liability management determines the Bank's transfer cost of credit and deposits. The prices are updated at daily intervals in accordance with developments in the money and capital markets. The transfer prices constitute a basis for computing profitability of all credit transactions and deposits taking place at the Bank.

COMPETITION

The financial management segment includes, as stated, the Group's activity in the dealing rooms. This area is typified by a high level of competition. The principal competitors in are the four large local banking groups. Additional competitive entities in this market are foreign banks, which have opened dealing rooms in Israel (Citibank, Deutsche Bank, HSBC, Barclays, BNP), and other financial corporations engaged in foreign currency and the Shekel interest markets, the involvement of which in these markets have grown significantly in recent years.

BUSINESS STRATEGY AND TARGETS

The strategic plan of the finance division for the coming years includes the continued absorption of the global treasury strategy 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, London and Switzerland). And this, mainly in the areas of capital management, liquidity management, exposure to base and interest risks management, management of the “nostro” securities portfolio and in the matter of absorbing joint standards of risk management and application of controls, including by means of market and credit risk management systems, in cooperation with the Bank. Thus, for instance, the Bank started to operate a Group liquidity management model and a central process for capital management in 2009, led by the asset and liability unit and by Global Treasury.

In 2010 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, 2009, the amount of the Bank's investment in non-financial corporations was less than the amount of the above restriction.

The Banking Law (Licensing) Amendment Bill. In July 2009, the Banking Law (Licensing) Bill passed its first reading. The Bill relates to a limitation according to which a banking corporation shall not be entitled to own more than one non-financial holdings corporation. The Bill proposes to change the limitation as follows:

- In addition to the permitted holding of one non-financial corporation, it would be possible to have an additional direct or indirect interest of up to one percent of a certain type of means of control in non-financial holding corporations;
- A banking corporation will be entitled to hold more than one percent of the means of control in only one insurer, the equity capital of which exceeds NIS 2,000 million;
- The term "acting indirectly" is to be defined so that a corporation shall be considered as acting indirectly in economic sectors if it holds 5% or more of a certain type of means of control in a corporation operating in that same economic sectors.

In the opinion of the Bank, if the Bill is passed, it will not have a material effect on the Bank's business.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

The loss of the sub segment in 2009 amounted to NIS 4 million, compared with a loss of NIS 196 million in 2008. Disregarding certain components (see above), the income would have amounted to NIS 13 million in 2009, compared with a loss of NIS 107 million in 2008.

The return on equity, 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 9.0% in 2009, compared with 249.3% in 2008. Disregarding certain components (see above), the return on equity would have reached a rate of 26.9% in 2009, compared with a negative rate of 137% in 2008.

Following are the principal data relating to the operations in the non-financial company segment:

	For the year ended December 31	
	2009	2008
	In NIS millions	
Loss from financing activities	(2)	(55)
Operating and other income	33	(32)
Total Income	31	(87)
Operating and other expenses	4	4
Operating Income (loss) before taxes	27	(91)
Bank's share in operating income of affiliated	(7)	(115)
Net loss	(4)	(196)
Net income (loss) disregarding certain components	13	(107)
Return on equity (percentage)	(9.0)	(249.3)
Return on equity disregarding certain certain components (percentage)	26.9	(137.0)
Average Assets	749	1,206
Average Liabilities	745	684
Average Risk-assets	749	1,206

HUMAN CAPITAL

In 2009, the average number of positions in the sub segment amounted to 4, 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 to 5 positions in 2008.

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. (sold in the meantime, 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. and in HOT Cable Communication Systems Ltd. (sold in the meantime – see Note 3 to the financial statements)

NON-FINANCIAL INVESTMENTS POLICY

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

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

Within the framework of the approved policy for investment in non-financial assets as above, an outline has, among other things, been determined as to the recommended volume of investments in the years 2007-2009. As abovesaid, within the framework of updating the strategic emphases for 2009, it has been decided that the Bank would focus on non-financial investments to which it had committed in the past and would not expand them at this stage.

INVESTMENTS OF THE GROUP IN PRIVATE EQUITY FUNDS AND IN VENTURE CAPITAL FUNDS

In the field of venture capital funds and private equity funds, the subsidiary DCMI participates in several funds, including:

Name of fund	Size of fund	Investment commitment	Invested	Balance of commitment	Additional information and remarks
	(In US\$ millions)*		For the year ended December 31, 2009*		
First Israel Mezzanine Fund (FIMI)	91	16	13.1	-	The Fund completed the realization of its remaining investment portfolio and started liquidation proceedings in accordance with the partnership agreement.
Vertex Israel II Fund	160	15	15	-	
Vertex Israel III Fund	150	13.5	10	3.5	
Vitalife Fund	50.3	10	9.6	0.4	Israel Discount Capital Markets and Investments has initiated the establishment of the fund, which specializes in investments in the bio-science field.
FIMI Opportunity II	293	50	39.5	10.5	
FITE - First Israel Turnaround Enterprise	129	12.5	3.1	-	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	509	50	9.4	40.6	The commitment for investment in the fund includes the balance of the commitment transferred from the FITE Fund.
Golden Gate Bridge Fund	6	2	1.7	-	The fund engages in providing bridge financing for hi-tech start-up companies. The fund completed its investments and no further investments are expected.
Plenus Venture Lending II	55	5	3.5	1.5	Engages in the granting of bridging loans and credit facilities to technology companies.
Stage One Venture Capital fund	46	17.8	16.4	1.4	The fund was established together with Bezeq and others and is engaged in investments in the field of communications and information technology.
Alon Fund	30	2	2	-	Of the Gaon Financial Management Group, which invests in late stage technology companies.
Fortissimo Capital Fund	78	5	3.8	1.2	
Edmond de Rothschild Euroopportunities	Euro 100 million	Euro 11.3 million	Euro 10 million	Euro 1.3 million	Of the Rothschild Group.
Apax VII	Euro 10 billion	Euro 7.4 million	Euro 3.5 million	Euro 3.9 million	A European private equity fund in the Apax Group, and is expected to operate mainly in Europe.
Plenus III	120	15	7.4	7.6	A venture lending fund of the Dovrat Group, and is engaged in granting loans and credit facilities to technology companies.
Brack Capital Group real estate fund	110	5	2.9	2.1	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.
European real estate fund	Euro 400 million	Euro 10 million	Euro 5 million	Euro 5 million	Managed by the French AXA group
Fortissimo Fund II	96.6	19.3	3.6	15.7	"Turn around" fund for technology based developed companies.

* The amounts are presented in U.S. dollars, unless otherwise stated.

The outstanding balance of DCMI's investments in venture capital funds, companies and in private equity funds amounted on December 31, 2009 to US\$132.7 million. As of that date, the balance of DCMI's investment commitments amounted to US\$185.9 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\$186 million had been invested by December 31, 2009.

Furthermore, Mercantile Discount Bank is committed to investments in five venture capital funds. As of December 31, 2009, the investment of Mercantile Discount Bank in these funds amounted to US\$3.4 million. As of December 31, 2009, 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, 2009, DCMI invested Euro 9.7 million in Mayer Real Estate Ltd. and an amount of Euro 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.

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.

Most of the investment in Mayer Real Estate is in respect of the holding in Habas Star, the main holding of which is a Dutch REIT owning income producing real estate in Western Europe.

Starting with the third quarter of 2008, Mayer Europe has made no investments and its operation in Hungary, being its only operation until now, is in the midst of realizing assets and a "run off" process. In May 2009, the Bank's Board of Directors approved the transfer of US\$4 million out of the Bank's commitment for investment in Mayer Europe, in favor of a sister company of Mayer Europe, in which DCMI will have an interest that will not entitle it to a material influence, and through which an investment in another motor company is to be made.

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. The investment transaction was consummated on December 31, 2007. The Bank provided KFS with a credit facility of up to Euro 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. A significant part of the credit was 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 Euro 451 million, compared to Euro 505 million following the acquisition of Discount Group's holdings in the company in December 2007, a decrease of 11%.

The original investment in KFS amounted to NIS 316 million.

Sale of investment in KFS. On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of its holdings in the shares of KFS in consideration for Euro 38.5 million. This amount is paid as follows: An amount of Euro 30 million was paid on March 31, 2009 and an amount of Euro 8.5 million is payable at the end of seven years from date of the agreement, without interest.

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 Euro 386 million together with interest of 5% per annum (subject to adjustments specified in the agreement). For the purpose of interest accumulation, exercise of the option in the course of the first two years, will be considered as though the option was exercised at the end of two whole years. 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.

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

In the financial statements as of December 31, 2008 and December 31, 2009, being cautious, the Bank did not take into account, in computing the provision for impairment, the economic value attributed to the option.

A further loss of NIS 18 million was recognized in the financial statements as of March 31, 2009, in respect of the realization of the investment in KFS (most of which was in respect of exchange rate differentials recorded in relation to this investment, from the investment date up to the realization date). This was on top of provisions for impairment in the amount of NIS 85 million, recorded in 2008.

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 of income participating interest in 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, 2009, guarantees have been provided in the amount of NIS 47 million.

In July 2007, DCMI signed an agreement for the acquisition of control in Menif, in consideration for an immaterial amount. Consummation of the transaction was subject, inter alia, to the approval of the Bank of Israel.

An amendment to the share purchase agreement was signed in August 2008, which, among other things, has been conditioned upon to obtaining the approval of the Bank of Israel and the Antitrust Commissioner until December 15, 2008.

As a result of the non-fulfillment of the conditions precedent specified in the agreement, DCMI informed on August 20, 2009, of the annulment of the agreement.

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 May 2007, Europort issued bonds to the public in a total amount of NIS 57 million, to finance its operations.

Realization of investments. For details of the realization of investments in HOT, Bezeq and Harel, which had been in the Bank's possession, see Note 3 to the financial statements.

FURTHER DETAILS AS TO ACTIVITY IN CERTAIN PRODUCTS

CREDIT CARD OPERATIONS

GENERAL INFORMATION ON THE CREDIT CARD FIELD

Discount Group's activity in the credit card field includes the activity of Israel Credit Cards Ltd. (hereinafter: "ICC"), a credit card company owned at a rate of 71.8% by the Bank, as well as the issue as co-issuers of ICC credit cards to customers of the Bank by ICC and 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").

STRUCTURE OF THE FIELD OF OPERATION

As estimated by ICC, 77% of the adult population of Israel uses credit cards as a means of payment, the Israeli consumer holding an average of 2.1 cards in his possession. ICC estimates the number of cards in Israel at December 31, 2009 at 6.3 million (of which 84% are active cards). Furthermore, some 68 thousand trading houses and marketing chains in Israel allow purchases using credit cards.

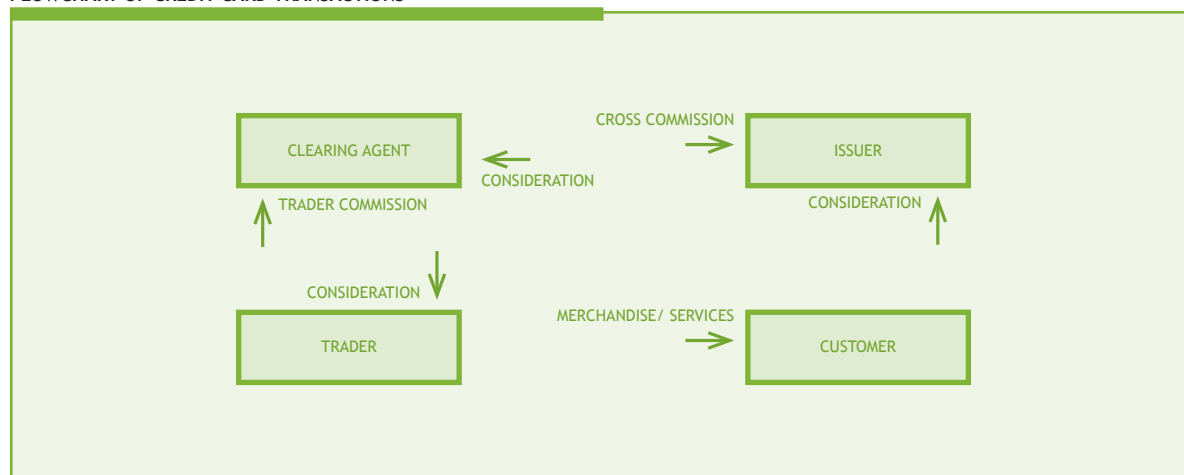
Use of credit cards is made possible by a contractual network covering four factors: an issuer, a clearing agent, a trader and a customer (the credit card holder), all of which are bound by separate and independent agreements (direct or indirect agreements, by virtue of the issuer and the clearing agent 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 and through Diners Club, a company under its control) 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.

In the issuance field, ICC issues (directly and through Diners Club, 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") such as: YOU Club card, jointly with the Dor-Alon Group, which is issued within the framework of a customer club and grants its holders benefits at the Dor-Alon Group chain of stores; Power Club Card, which grants its holders benefits, mostly at the chains controlled by the Fishman family; and the H&O Club card, which grants its holders benefits, mostly at the H&O stores.

ICC issues a variety of credit cards in addition to the deferred charge card, which at present is the most common credit card in Israel, among which the following cards may be mentioned:

- (1) "Active" – a rolling credit card enabling the customer, subsequent to effecting the transaction, to choose when to make payment, within the limits of the credit facility granted to him;
- (2) A VISA credit card, which is a virtual credit card ("a credit card without a card") that is prepaid and which had been developed jointly with VISA International and is marketed under the brand name WWWCARD. Within this framework, the customer contacts ICC receiving a personal number and a code, with which he is entitled to transact business (in an amount not exceeding the predetermined limit) without having to use an actual plastic card.
- (3) A VISA prepaid plastic card intended for use in Israel and abroad (in an amount not exceeding the predetermined limit).

In addition ICC offers customers holding off-banking cards, various credit lines for transactions made by them using their existing credit cards (mainly through the "Active" card).

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.

Clearing operations include both the clearing of credit card transactions and additional transactions involving trading houses, as described hereunder:

- (a) Clearing of credit card transactions made in Israel, by way of "Point of Sale" appliances (POS appliances) located at trading houses;
- (b) Clearing of electronic trade transactions abroad (mostly in Europe). As part of this operation ICC primarily performs clearing of Internet transactions for trading houses abroad which operate those Internet websites. These are transactions with no document.

In addition, ICC offers trading houses credit and related services, which include, among other things: discounting of credit card transaction vouchers, advance payments for transactions effected, granting loans on account of future payments to trading houses with which ICC has clearing contracts and factoring activity.

Following are quantitative data regarding the activity of ICC:

Number of valid cards ⁽³⁾				
As of December 31,				
	2009		2008	
	The total number of cards	Of which: active cards	The total number of cards ⁽⁵⁾	Of which: active cards ⁽⁵⁾
in thousands				
Bank cards ⁽¹⁾	1,043	892	993	842
Off-banking cards ⁽²⁾	524	421	506	401
Total	1,567	1,313	1,499	1,243

Following are quantitative data regarding the activity of ICC (continued):

Transactions turnover ⁽⁴⁾	For the year ended December 31,	
	2009	2008
	in NIS millions	
Bank cards	34,415	32,917
Off-banking cards	8,523	8,365
Total	42,938	41,282

Notes:

- (1) "Bank card" - A credit card issued jointly with the banks in the arrangement and under their responsibility.
- (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 2009 amounted to NIS 198 million, compared with NIS 234 million in 2008, a decrease of 15.4%. Disregarding certain components (see above), net income of the operations would have amounted to NIS 198 million in 2009, compared with NIS 112 million in 2008, an increase of 76.8%. Net earnings in 2008 included a non-recurring dividend income received following the public offering of VISA Europe (see hereunder).

The return on equity was 43.3% in 2009, calculated on the capital allocated to the operations on the basis of the average balance of the operations risk assets, compared with 55.8% in 2008. Disregarding certain components (see above), the return on equity would have been 44.4% in 2009, compared with 26.7% in 2008.

Provision for doubtful debts amounted in 2009 to NIS 77 million, compared with NIS 51 in 2008, an increase of 51.0%. The increase in the provision for doubtful debts stems from the increase in volume of the consumer credit and from the deterioration in the economic situation in 2009.

Following are the principal data relating to the credit cards operations:

Domestic operations					
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
For the year ended December 31, 2009					
In NIS millions					
Income from financing activities before provision for doubtful debts					
- From external sources	275	15	11	3	304
- Intersegmental	(59)	-	-	-	(59)
Total income from financial activity	216	15	11	3	245
Operating and other income	767	93	105	33	998
Total income	983	108	116	36	1,243
Provision for doubtful debts	77	-	-	-	77
Operating and other expenses	605	66	72	23	766
Operating Income before taxes	301	42	44	13	400
Provision for taxes on operating income	98	14	15	4	131
Net income	150	22	20	6	198
Return on equity (percentage)	36.5	99.7	270.3	89.8	44.4
Average Assets	7,682	305	422	138	8,547
Average Liabilities	1,396	1,064	1,508	455	4,423
Average Risk-assets	6,301	335	113	109	6,858
Components of income from financial activities:					
Margin from credit activity	216	15	11	3	245
Income (loss) from financing activities before provision for doubtful debts	216	15	11	3	245

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

Domestic operations					
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
For the year ended December 31, 2008					
In NIS millions					
Income from financing activities before provision for doubtful debts					
- From external sources	222	12	10	3	247
- Intersegmental	(59)	1	-	-	(58)
Total income from financial activity	163	13	10	3	189
Operating and other income	710	129	141	43	1,023
Total Income	873	142	151	46	1,212
Provision for doubtful debts	51	-	-	-	51
Operating and other expenses	492	104	113	36	745
Operating income (loss) before taxes	330	38	38	10	416
Provision for taxes on operating income	84	10	10	1	105
Net income	191	20	17	6	234
Net income disregarding certain components	85	14	10	3	112
Return on equity (percentage)	50.4	88.5	218.8	81.9	55.8
Return on equity disregarding certain components ⁽¹⁾ (percentage)	22.5	65.2	130.2	52.7	26.7
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	13	10	3	186
other	3	-	-	-	3
Income (loss) from financing activities before provision for doubtful debts	163	13	10	3	189

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 as well as blocked shares of Visa International. VISA Europe has distributed the proceeds to member companies of the organization, including the Bank and ICC. 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.

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.

Likewise, ICC is bound to operate in accordance with the rules of the international organizations of which it is a member (VISA International organization, MasterCard Worldwide organization and Diners Club International). These rules are updated from time to time and determine international standards.

In addition, clearing operations outside Israel of international trade transactions may be subject to foreign legislation and regulations.

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 Tribunal, 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. ICC has prepared to act in accordance with the requirements of the amended Order. As from September 2007, the Order has come into effect in stages when, as of March 12, 2009, the transitional periods determined by the Order came to an end and all the provisions of the Amendment came into effect. In complying with the Order, ICC is, among other things, obligated to employ extensive means in familiarizing itself with the customer in the process of attracting new customers.

For details as to the extension of the obligations in this field, by way of an amendment to Proper Banking Management Directive No. 411, see “Prohibition of money laundering and prohibition of financing of terror activities under “Legislation and Supervision” below.

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. The Supervisor of Banks has applied similar reporting requirements to those applied to banks to credit card companies, including a Directors’ Report, Management Review and declarations as to disclosures in the financial statements.

Reform regarding commissions. Within the framework of the comprehensive reform regarding commissions, the Bank of Israel published a tariff list that includes a section relating to credit cards, and has reduced considerably the list of commissions that ICC may collect from its customers holding credit cards. In accordance with this amendment, ICC has

revised its tariff list. In June 2008 the new tariff list was published and since July 1, 2008 ICC collects commissions from its customers in accordance with the new tariff.

A committee for the examination of market failures in the credit card field. In February 2007, the report of the inter-ministerial committee, 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 committee recommended that the clearing market should be regularized by way of the Banking Law (Licensing). According to the recommendations of the committee, 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 committee, 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.

The Banking Law (Licensing) (Encouragement of competition in the credit card market). In the wake of the said Inter-ministerial Committee and a private Bill which followed it in March 2007, the Ministry of Finance issued in April 2008 a law memorandum of the Banking Law (Licensing) Amendment, 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.

The private Bill is not identical in its scope and details to the said Bill Memorandum, however its principles are similar. In June 2008, the private Bill passed its preliminary reading by the Knesset.

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.

Legislation initiative for the separation of credit card companies from the Banks. With the renewal of the activity of the Knesset, following the election of the 18th Knesset, and the establishment of the new Government, a private Bill was tabled once more, in April 2009, according to which a bank shall not be permitted to have an equity interest in a company that issues credit cards. The Supervisor of Banks has in the past opposed a legislation initiative of this type and the Government refrained from supporting such legislation. At this stage, it is not possible to assess whether proposals of this nature will be promoted by the Government and what the arrangements established in this area, if at all, will be.

Legislation initiative regarding the amendment of the Credit Cards Law (Amendment – discontinuation of charges due to defect), 2009. A private Bill was tabled before the Knesset in May 2009, which deals with the right of a credit card holder to instruct the credit card company to discontinue charging him due to a defect occurring in the basic

transaction between the credit card holder and the trading house with which the transaction had been made.

Penal Code Amendment Bill and the Charge Card Law Amendment Bill. A private Bill for the amendment of the Penal Law (Prohibited games, restrictions and gambling on the Internet), 2010, has recently been tabled before the Knesset. The Bill includes a proposal for the amendment of the Charge Cards Law, according to which an issuer shall not be permitted to knowingly pay a supplier the consideration for transactions made by a customer constituting participation in prohibited games, including gaming on the Internet. Furthermore, a clearing agent shall not be permitted to knowingly transact business with a supplier engaged in prohibited games, including on the Internet. According to the Bill, an issuer and/or a clearing agent who will violate the provisions of the law will be liable to a fine as stated in Section 61(a)(4) of the Penal Law. It should be noted that from the explanatory notes to the Bill, it could be deduced that the intention of the Bill is not to damage the international clearing business of ICC. It should be further noted that ICC operates today in line with the spirit of the said Bill.

Management of risks related to the use of credit cards. The Supervisor of Banks issued on June 9, 2009, a letter regarding "Clarifications with respect to the management of risks relating to the use of credit cards in illegal transactions of a missing document, in which a credit card has not been presented on the Internet". The letter clarifies several issues regarding the honoring of gambling transactions as well as other illegal transactions. As part of the letter, the Supervisor states that the credit company may not approve a transaction involving a missing document where a credit card has not been presented, if one of the following doubts arise: (a) the transaction is illegal in the location it was made; (b) the charge is to be made based on a credit card of an Israeli resident or of a foreign resident who according to information at hand is staying in Israel. In addition, credit companies may not engage in a clearing agreement with a trading house which, according to information held by the credit card company, the field of operation of that trading house constitutes a violation of the law applying to it.

Draft circular regarding the clearing of transactions. In October 2009, the Supervisor of Banks issued a draft circular regarding the clearing of illegal transactions, within the framework of which it is stated that credit card companies are to refrain from clearing transactions with customers whose activity might constitute "a violation of the law applying to all parties to the transaction". Following the distribution of the draft, several meetings were held between the Supervisor of Banks and the credit card companies in Israel. The final version of the circular on this subject has not yet been published.

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 MasterCard Worldwide 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"). As from January 1, 2005, (hereinafter: "date of transition"). In order to induce issuers and trading houses to convert to the use of "smart cards", the international organizations determined rules concerning the assignment of responsibility in the case of misuse of a credit card under certain circumstances, starting with the transition date. These rules state that in case of forgery/misuse of a card:

- (1) If a "smart card" has been cleared by a trading house where a "smart" clearing appliance is not installed, costs will be borne by the trading house;
- (2) Where a credit card which is not a "smart" card has been cleared by a trading house where a "smart" clearing appliance is installed, costs will be borne by the issuer.

In accordance with these directives, the Company commenced preparations for introduction of the smart card. The issuance aspect mainly includes upgrading of the technology acquired by the Company in the past and its adaptation for issuance of smart cards, and upgrading and/or acquisition and/or development of sophisticated POS (point of sale) instruments and their installation in various businesses with which ICC has clearing agreements. ICC is issuing “smart cards” on a current basis. ICC has not yet begun preparations with respect to clearing activities and it believes that such preparations require cooperation between all credit card companies for the installment of “smart” clearing appliances at trading houses.

In ICC’s opinion, the said provisions regarding the assignment of responsibility do not have a material effect on the company’s business results.

Upgrading of the information systems. ICC is in the midst of an advanced examination processes with respect to a comprehensive and advanced ERP solution provided by one of the leading software houses in the world. This system is intended to replace ICC’s existing information, accounting and logistics systems. If this solution is chosen, ICC will begin a comprehensive project which will take several years to complete. The estimated cost of this project, if executed, may reach tens of millions of dollars.

CRITICAL SUCCESS FACTORS

- An operating network including technological information systems, teleprocessing and advanced infrastructures;
- A developed and effective risk management system.

The issuance field:

- Authorization to issue brand name credit cards under a franchise granted by the international organizations;
- Cooperation with banking corporations;
- Consummation of agreements for the establishment of consumer clubs;
- Ability to offer customers attractive credit products;
- The ability to borrow funds from financial institutions at attractive terms.

The clearing field:

- Cross clearing agreements between credit card companies in Israel;
- The ability to attract trading houses and maintain relations with them by an extensive marketing layout.

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;
- Compliance with conditions for receiving guarantees. The Bank has granted VISA International a guarantee unlimited

in amount in respect of the operations of ICC. Likewise, the Bank has issued a guarantee of US\$16 million in favor of MasterCard. These guarantees are in effect so long as ICC has a valid license from the respective entities;

- 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.

The clearing field. Since April 2009, ICC offers its customers discounting services through its subsidiary ICC Factoring.

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, MasterCard or Diners credit cards. Additional customers in the clearing field are trading houses that look for advance payments services (the discounting of vouchers or invoices).

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. In the field of clearing Internet transactions, the engagement with traders around the world is made through a small number of "mediators" (Internet Payment Service Providers).

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 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 the financial statements, the volume of operations of IsraCard in the issuance of VISA credit cards is rather limited in comparison with the volume of its operations in issuance of "MasterCard" credit cards, which constitutes most of its operation under this brand in Israel. American Express is issued by an affiliated company of IsraCard (exclusively).
- **LeumiCard**, a private company controlled by Bank Leumi (and which is also held by Kanit – Managing, Investments and Finance Ltd.) issues VISA and 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 of LeumiCard) in respect of clearing MasterCard credit cards in Israel has increased. In June 2007 ICC began clearing MasterCard credit cards in Israel after activating the joint interface. Following the signing of the new agreement, Isracard joined the local agreement for cross clearing between ICC and LeumiCard with respect to the VISA brand name (for further details see below).

DEVELOPMENTS IN THE SEGMENT IN 2009

Developments in the field of clearing of international electronic trading transactions. Following the large number of returned charges in respect of the cancellation of transactions, mostly in the food additives field, that had been cleared by a subsidiary of ICC, ICC International, VISA Europe Organization imposed monetary sanctions in the amount of US\$18 million, in respect of the said returned charges that were recorded until the end of 2009. It should be noted that according to agreements with the trading houses, ICC International is entitled to charge the relevant trading houses with the cost of the monetary sanctions.

In September 2009, VISA Europe precluded ICC International from entering into engagements with new trading houses for a period of three months ended on December 15, 2009. For the time being, though the said date has passed, ICC does not enter into agreements with new trading houses. ICC is in the midst of a reorganization process designed to return it to the regular lines of operation, and its intention is to renew attracting new trading houses as from the second quarter of 2010.

In November 2009, Visa Europe Organization informed ICC International that it expects it to take stringent and vigorous measures for the treatment of the deviations and to adopt a plan to which it is committed for the reduction of risk, and this within a period of three months beginning December 1, 2009. In the event that ICC does not fulfill its commitments and deviates from the rules of the Organization, revocation of its international clearing license might be considered and in most extreme cases even termination of its membership in the Organization.

ICC has adopted and is adopting a series of measures in order to secure compliance with the rules of VISA Europe Organization and with the risk reduction plan. Among other things, ICC's board of directors in its meeting of November 12, 2009, decided on the immediate suspension of certain executives of ICC International. No monetary sanctions in respect of cancelled charges have been imposed with respect to the months of December 2009 and January 2010.

Several trading houses and groups have recently voiced demands with respect to having been charged with monetary sanctions in recent months, as well as with respect to reduction in the activity of ICC International with certain trading houses. Such demands may result in legal proceedings.

In February 2010, the MasterCard Worldwide organization (hereinafter: "MasterCard") approached ICC indicating a series of prima facie deviations from the rules of MasterCard by trading houses (mainly in respect of gambling transactions). ICC objected to the assertions included in MasterCard's approach. On March 22, 2010, MasterCard announced that it would charge ICC, in accordance with rules of the organization, some US\$3.6 million for the aforementioned deviations. In its announcement, MasterCard expressed its appreciation of the immediate action taken by ICC upon receiving the

previous notice with regard to deviations from MasterCard rules. ICC believes it is entitled to charge the cost of these sanctions to the relevant trading houses, in accordance with the agreements with them. Notwithstanding, the value of collateral held by ICC does not cover the full amount of the monetary sanctions as assessed above, and a certain exposure, non-material, might arise in this respect.

ICC acted immediately towards the implementation of a reduction plan in order to comply with the requirements of the international organizations, within the framework of which the following steps were taken:

- Organizational changes, within the framework of which the business activity of ICC International was separated from risk management, the ICC's risk management department taking responsibility for risk management at ICC International;
- Discontinuing operations with trading houses having a high rate of cancelled charges, resulting in a significant decline in clearing turnover and in the rate of cancelled charges;
- Conducting a renewed underwriting process with trading houses operating in the electronic clearing field by means of an outside company, in accordance with the requirements of the international organizations;
- Consideration of engaging an external company to perform on behalf of ICC, monitoring processes, similar to those performed by MasterCard;
- Formation of work procedures with respect to clearing operations of international electronic trading transactions;
- Formation of a committee of the Board of Directors for supervising and monitoring treatment of this subject.

Furthermore, ICC has adopted measures for compliance with rules of VISA Europe and MasterCard Worldwide, in addition to terminating engagement with a number of trading houses, which caused most of the exposure. The contribution of the trading houses, with which relations have been terminated, to the net earnings of ICC is approximately US\$7 million.

With the aim of reducing the risk involved in clearing operations of international electronic trading transactions, ICC's board of directors decided to terminate the clearing of transactions made by trading houses engaged in content areas defined as "adults only".

In view of the above, ICC believes that the prospects of the risk of losing the international clearing license for VISA credit cards and the risk of losing its membership in the International VISA Organization, actually materializing, are remote. Adequate provisions, based on the assessments of ICC's management, are included in the financial statements in respect of the various monetary exposures described above.

Several internal audits conducted at ICC International in recent months by the internal auditor of ICC and ICC International, produced findings that indicate deficiencies in various areas, among other things, in the authorization process with respect to ICC's engagement with trading houses regarding the clearing of international electronic trading transactions. The findings indicate deficiencies regarding risk management, improper maintenance of controls and documentation, non-compliance with the rules of the international organizations and the prima facie neglect of duties arising from regulation with respect to money laundering prohibition. These findings are being studied by ICC, and various actions with respect to a number of them have already been taken.

The Internal Auditor continues the review of various aspects related to ICC's operations, including alleged improper operations by organs.

For details as to the merger between ICC and ICC International, see Note 33 A to the financial statements.

For details as to material weaknesses in ICC, including a material weakness regarding the control layout relating to the clearing of international electronic trade transactions, see below "Israel Credit Card Company Ltd." under "Main investee companies".

Announcement of the CEO of ICC as to termination of office. On February 18, 2010, Mr. Boaz Chechik, the CEO of ICC for the last six and a half years, announced his decision to retire from office. Until the transfer of his duties, Mr. Chechik will assist ICC to the extent required.

Appointment of a new President and CEO. On March 21, 2010, the Board of Directors of ICC decided to appoint Mr. Israel David, deputy CEO of Israel Discount Bank, as President and CEO of ICC. Mr. David is to replace Mr. Chechik. The said decision is subject to approval by the Supervisor of Banks.

The appointment is to take effect on April 1, 2010, or from the date of obtaining the approval of the Supervisor of Banks to the appointment, the later of the two.

Agreement for joint issuance with Yahav Bank. ICC and Yahav Bank signed an agreement on September 22, 2009, for the joint issuance of VISA, MasterCard and Diners Club credit cards. The agreement covers all operational arrangements and the granting of services to credit cards issued by ICC and distributed by Yahav Bank to its customers.

Until now, Yahav Bank has issued IsraCard credit cards only.

Directives of the Supervisor of Banks with respect to ICC's "Active" charge card. The "Active" card is a roll-over charge card issued and marketed by ICC since 2005. The card enables the customer to defer charges, in respect of which he is charged with a higher rate of interest than the regular rate. The card requires the customer to review his account on a current basis and inform ICC as to which charges he is interested in deferring.

Following complaints that had been received regarding the "Active" card, the Supervisor of Banks requested ICC, in August 2009, for information regarding this card. After providing the information and following discussions with the Supervisor of Banks, ICC was instructed by the Supervisor to perform changes in the "Active" card and in the manner in which it is marketed.

The Supervisor of Banks' findings related to the period ended December 31, 2008. The Supervisor's requirements came into effect as of February 2010, after ICC had made preparations for their implementation. The requirements related to allowing ICC customers to determine, upon becoming customers, the amount of the monthly repayments, an explicit disclosure of the interest rate applying to the rolling credit, and reimbursement to customers affected by nondisclosure. ICC has implemented the Supervisor's requirements in full. The monetary reimbursement by ICC related to a small number of customers and the expense involved was not material.

Acquisition of factoring operations. In April 2009, following the fulfillment of conditions precedent to the transaction, the transaction for the acquisition of the factoring operations of Psagot Factoring Finance was consummated. The purchased operations will be conducted under a new company (hereinafter: "ICC Factoring") jointly owned by ICC (75%) and Psagot Factoring Finance (25%). In consideration for the operations transferred from Psagot Factoring Finance, ICC Factoring will pay the net amount of customers' debts to suppliers and the amount of working capital loans less certain expenses as detailed in the agreement. In addition, ICC Factoring will pay Psagot Factoring Finance an amount of NIS 1 million in consideration for the goodwill and the fixed assets, all these amounts being financed by ICC. Furthermore, as part of the agreement, ICC will provide ICC Factoring with a credit facility not to exceed NIS 150 million (as stated in the permit of the Supervisor of Banks), renewable for a short-term of 180 days at ICC's exclusive judgment.

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 determined in the agreement (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 ICC Factoring, in accordance with the formula determined in the agreement.

The permit by the Supervisor of Banks concerning holding the means of control in ICC Factoring is effective through 2013. The said acquisition allows ICC direct entry into the factoring market, thus expanding its operations in the off-banking business credit market.

MATERIAL AGREEMENTS

A joint issuance agreement with Mizrahi-Tefahot Bank. In November 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 (for further details see Note 33 to the financial statements).

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 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. (for further details see Note 33 to the financial statements).

Agreement with the First International Bank. In November 2007, ICC and the First International Bank signed a joint issuance agreement for the joint issue of VISA credit cards to customers of the First International Bank. This agreement was signed for a period of three years, following which it is renewable for an additional period of three years, unless any of the parties gives a prior notice of six month of his wish to terminate the agreement. The said agreement replaces a prior agreement of August 1, 2000.

The establishment of the YOU customer club and the sale of the means of control in Diners. According to an agreement from November 29, 2005, ICC sold Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together: "the Purchasers") 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter: "Diners"). Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The transaction was consummated on December 18, 2006.

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 (for further details see Note 33 A to the financial statements).

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 Tribunal (hereinafter: "the Tribunal") 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 Tribunal 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.

Over the years, the Tribunal has granted the Appellants provisional and temporary permits for the charging of issuer commissions at agreed rates. Concurrently, the validity of the general exemption has been extended from time to time.

The Tribunal proceedings in the case have been divided in two, firstly, determination of the proper methodology for determining the issuer commission, and only afterwards the Tribunal will be required to its implementation.

Within the framework of the Tribunal 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 Tribunal handed down a ruling regarding the methodology for the determination of the Cross Clearing Commission (hereinafter: "the methodology decision"), while adopting the principal points of the Commissioner's position on the matter. On February 1, 2007, the Appellants filed an appeal with the Supreme Court against the ruling of the Tribunal.

Concurrently with the procedures in Tribunal, 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 Tribunal on October 31, 2006, and will expire on July 1, 2013 (hereinafter: "the period of the agreement") unless the Tribunal rules otherwise at a prior date.

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 Tribunal 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.

The arrangement has been submitted for approval of the Antitrust Tribunal, and five opposing motions have been submitted to the Tribunal in this respect. On October 31, 2006 the Antitrust Tribunal issued a provisional permit for the agreement. This permit has been extended by the Tribunal from time to time, most recently until June 30, 2010. On November 23, 2009, a letter from the Commissioner was received informing that upwards deviations from the average maximum commission permitted by the tripartite agreement had been found, which had not been offset in subsequent periods. Management of ICC believes that no material monetary exposure exists as a result of the approach of the Commissioner.

Appointment of an expert. According to the methodology ruling, the Tribunal decided that in order to examine whether the tripartite agreement brought for approval is compatible with public interest, an expert is to be appointed to examine the rate of issuer commission, issuer commission categories and the rate of its amortization. The Tribunal has decided that the expert shall perform the examination in accordance with the methodology determined in previous proceedings (see above), the expert being appointed and supervised by the Antitrust Authority.

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 Tribunal 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 Tribunal 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 Tribunal; 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.

The parties including ICC have, at this stage, waived the interrogation of the expert and the submission of the claim sum-up briefs, and the Tribunal has been asked to instruct the expert to continue his work to the second stage, until submission of his final opinion. Accordingly, the Tribunal ruled on June 4, 2009, that the date for cross examining the expert, fixed for June 7, 2009, be cancelled.

On February 24, 2009, two documents (hereinafter: "disclosure requests") were submitted to the Antitrust Tribunal, as follows: the one, a notice and request regarding the expert opinion, within the framework of which the Tribunal was motioned to instruct the three credit card companies and their controlling banks to support the factual basis as presented to the expert by legally prepared and verified depositions. The other, a motion for disclosure of documents, within the framework of which the Tribunal is motioned to instruct the expert to deliver all the information, documents and records received from the applicants for the certificate, and which relate to matters detailed in an annex to the motion.

On May 27, 2009, the Tribunal dismissed all the said petitions for disclosure, ruling that they are not in accordance with the decision of the Tribunal for the appointment of an expert.

On December 28, 2009, the Commissioner filed a notice with the Antitrust Tribunal, according to which, in view of the fact that the expert had been appointed Chairman of Discount Bank, he would not be able to complete his final opinion. Accordingly, all the material assembled by the expert is currently being transferred, in an orderly fashion, to the

Antitrust Authority. The Commissioner is considering alternatives that would allow the completion of the expert's work in an expedient and efficient manner. These alternatives will be presented to the Antitrust Tribunal for decision.

Appeal against the decision on the methodology. As stated, on February 1, 2007, the Appellants filed an appeal with the Supreme Court against the methodology decision. On December 24, 2009, the Appellants and the Commissioner filed in agreement a motion for granting the compromise agreement on the appeal the power of a Court ruling (hereinafter, respectively, "the motion" and "the compromise agreement"). According to the motion, the Appellants and the Commissioner agree to postpone the hearing of the arguments of the Appellants regarding the methodology for determining the cross commission, as this is expressed in the decision on the methodology, until the hearing of an appeal, if submitted, against the first Tribunal ruling given with respect to a cross clearing arrangement, in any proceedings conducted at the Antitrust Tribunal, following the termination of the tripartite arrangement framework. It was further agreed that if, at the end of the day, an appeal is lodged against the methodology decision, the arguments of the parties regarding the methodology would be only those detailed in the appeal. On December 27, 2009, the Supreme Court ruled that the compromise agreement is to have the power of a Court ruling.

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.

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.

BUSINESS 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 is taking steps towards developing and market additional products to be offered to traders, in addition to discounts and the advancement of payments offered at the present time. The acquisition of factoring operations by ICC Factoring, which engages in the discounting invoice field, forms part of the said strategic move.

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, and pension products. The activity includes the Bank's operations in the securities field, pension layouts, 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 year 2009 can be divided into two periods regarding trends in the capital market: the first two months and the remaining ten months of the year.

The first two months of the year were characterized by the continued trend of declining prices on the equity markets and the increasing spreads on the credit markets, which characterized the period from September to December 2008. These stemmed from apprehension as to the future of the financial system and fear of the global economy sliding into a long-term economic recession. This, despite the formation of emergency plans by the different governments for the curbing of the financial crisis, reduction in interest rates, and a sharp drop in oil prices. In Israel, share indices remained relatively stable during that period due to the discovery of large natural gas deposits along the Israeli coastline.

The period from March to December 2009 was characterized by a sharp and continuous upward correction – increases in world leading share indices, in particular in emerging markets, and a decline in spreads of corporate bonds. This, due to investor optimism that the U.S. Administration and other governments will not allow anymore large banks to collapse, the low levels of monetary interest rates and the return of government bonds, the low prices of shares and to the large spreads on corporate bonds.

Furthermore, foreign investors returned in 2009 to the Tel Aviv Stock Exchange, this trend accelerating during the year. The total investment of foreigners in shares traded on the Tel Aviv Stock Exchange totaled US\$1.8 billion in 2009, compared to realizations of US\$1.8 billion in 2008. Investments in government bonds and in short-term government loans (MAKAM) on the Tel Aviv Stock Exchange also accelerated during the year, reaching a total US\$1.7 billion, compared to net realization of US\$1.5 billion in 2008.

In total for 2009, all indices of the Tel Aviv Stock Exchange recorded fair increases: the TA 100 Index rose by 88.8%, the Ma'of Index rose by 74.9%, The Real Estate 15 Index rose by 125.2%, the Tel-tech 15 Index rose by 84.1%, the Financial 15 Index rose by 126.9%, the Bank Shares Index rose by 114.0% and the Tel-dividend 20 Index rose by 157.5%.

The mutual funds market. The mutual fund market increased since the beginning of the year by NIS 21.4 billion, from a level of NIS 110.95 billion at the end of December 2008 to a level of NIS 132.4 billion at the end of December 2009. All classes of funds, except for the monetary funds, registered new deposits in 2009.

The funds specializing in bonds increased in the said period by NIS 28.8 billion, assets of the Shekel funds increased by NIS 4.5 billion, assets of the funds specializing in shares increased by NIS 1.9 billion and the assets of funds specializing in foreign investments increased by NIS 621 million. In contrast, assets of the monetary funds decreased by NIS 15.2 billion.

The increase in the value of assets of the shares and bonds funds stems from the increase in prices on the share and bond markets in Israel. Furthermore, the low level of market interest rates and the publication of positive macro-economic indicators pointing to beginnings in market improvements, contributed to the increase in value of bond and share funds assets. In contrast, the decline in value of assets of the monetary funds stemmed mainly from the low returns of the short-term Shekel investments channel and the transition to investment channels characterized by higher risk levels, such as shares and corporate bonds.

The provident fund market. The provident fund market achieved in 2009 a positive return at an average rate of 29.4%. The said increase reflects the sharp increases in the various indices of the Stock Exchange in 2009.

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 2009 amounted to NIS 279,833 million, compared to NIS 218,383 million at the end of 2008, an increase of NIS 61 billion (28%).

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 2009 a net negative accumulation in the amount of NIS 2,600 million. This compared to a net negative accumulation of NIS 7,927 million in 2008. The said data also reflect the sharp increases in the various indices of the Stock Exchange during 2009.

The basket certificate market. According to data issued by the Stock exchange, about 70 new basket certificates were issued in 2009, of which 40 basket certificates were based on local share indices and 30 basket certificates were based on local bond indices. Concurrently, 20 basket certificates were removed from the trading list. The total number of basket certificates in Israel reached 345 at the end of December 2009. During 2009 the Stock Exchange launched the Tel-Bond Index based on Shekel bonds bearing fixed interest. This resulted from the increase in volume of non-linked corporate bond issues and from the demand for additional indices based on corporate bonds.

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. 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 markets 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. With respect to the large banks, it has been decided that as from January 1, 2009, they will be permitted to provide insurance fund consulting services to customers living in peripheral areas and in the Arab sector, though their entry into the pension consulting services to salaried employees living in the center of the country has been postponed until August 2010. On March 29, 2009, the Commissioner of the Capital Market, Insurance and Savings announced that the said entry date had been advanced to April 1, 2009.

Amendment of the law regulating the investment consulting business. An Amendment to the Law was published on March 3, 2010 regulating the investment consulting business, the marketing of investments and the management of investment portfolios, (Amendment 14). The Amendment determined that basket certificates are to be included in the definition of financial assets, 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, but rather only as an investment marketing agent. In light of the said Amendment, the Bank will have to act towards severing its ties with companies issuing basket certificates and/or sell its holdings therein, until August 2013. For details as to the move for the sale of the basket certificates operation, see below.

LEGISLATION AND REGULATION AMENDMENTS CONCERNING PENSION SAVINGS

Provident funds operating fees. The Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance published a directive, effective as from September 2006, according to which a pension consultant who provides operating services to a provident fund, may not charge the management company operating fees in excess of 0.1% per annum of the total assets of the fund accepting services from him as above. A transitional provision is

in effect with respect to operating agreements signed prior to February 2006, which allows, under certain conditions, the charging of higher management fees. This directive limits the rate of operating fees that a bank may charge as a pension consultant.

Compulsory pension. 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).

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.

Cancellation of the requirement for employer's signature. An amendment to the provident fund circular in the matter of the signature of the employer on the form for joining a provident fund was published on July, 30, 2009. The Amendment cancelled the requirement for the signature by the employer on the form, which a salaried employee has to submit upon joining a provident fund. The Amendment may facilitate the process of implementing decisions taken in the matter of a provident fund member within the framework of pension consultation received by the Bank.

Homogeneous interface. Towards the end of 2008 and at the beginning of 2009, the Ministry of Finance began to take action in order to coordinate the operations of banks and other player in the pension market (product managers, insurance agents, etc.) with the aim of establishing homogeneous interface for the communication of information between managers of pension products and other players in the market and banks acting as advisors.

A circular was issued in August 2009 in the matter of “Uniform reduced structure for the transfer of data from an institutional body to a license holder”, which came into effect on February 1, 2010, as the first step in creating the said uniform interface.

Pension clearinghouse. In July 2009, the Ministry of Finance appointed a steering team to examine the establishment of a company that would run a clearinghouse through which the various operators in the pension market will be obliged to exchange information. The Ministry of Finance offered all interested parties to sign a memorandum of understanding and join this initiative. The Bank has joined this initiative and actively participates in discussions on this matter.

Circular regarding the contents of the conclusions document. A circular was published in February 2009 regarding the contents of a conclusions document that is to be provided to the customer following each pension consulting act, including delivery of certain parts of this document to the management company that had been chosen by the customer to manage his pension savings by way of its products. The Bank and Mercantile Discount Bank have undertaken preparations for the implementation of the provisions of the circular, which will come into effect on January 1, 2010.

Personally managed provident funds. Supervision over Financial Services Regulations (Provident funds) (Personally managed provident funds), 2009, were published in October 2009. These Regulations allow depositors to manage their funds in their further education funds and in their second layer of provident funds in a personally managed provident fund, as well as impose certain restrictions on the manner of investments of such funds. According to the Regulations, personally managed funds will not be charged with a distribution commission. At this stage it is not possible to assess the impact of the Regulations upon investment consulting services offered to the Bank’s customers.

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”.

Since the year 2008, the Securities Authority and the Ministry of Finance are promoting a comprehensive amendment to the Mutual Investment Trust Funds Law, 1994, that will allow, among other things, the offer of foreign trust fund certificates in Israel.

In addition to and alongside that above stated in the matter of Amendment 14 to the Law for the Regulation of Engagement in Investment Consulting, the Israel Securities Authority is promoting an additional amendment to the Mutual Investment Trust Law, in the matter of basket certificates and basket funds, the purpose of which is to adjust the regulation existing in the basket certificates and similar products markets to the existing regulation with respect to mutual funds, this in order to prevent regulatory arbitrage between products that are similar in their characteristics

and in the investment purpose therein. Accordingly, it is proposed within the framework of the law amendment, to determine that the Mutual Investment Trust law shall apply to every arrangement the purpose of which is a mutual investment in securities and in currencies and the earning of profits there from or from any transaction therein, which is not supervised by any other law, also including basket certificates.

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.

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.

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.

An amendment of the Investment Consulting, Investment Marketing and Investment Portfolio Management Law, 1995 (Amendment 13) was published in the Official Gazette on February 16, 2010, that will enable foreigners qualified in their countries of origin to engage in investment consulting, investment marketing or portfolio management, to offer their services also in Israel without the need to apply for a license, subject to the provisions determined in the Law. Within the framework of the Amendment, the list of factors defined as "eligible customers" has been extended, to whom investment consulting and marketing services may be offered without a license, to include, among others, private customers owning a large asset portfolio (NIS 12 million and over), as well as additional amendments.

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in 2009 amounted to NIS 119 million, compared with NIS 9 million in 2008.

Following are the principal data relating to the operations in the capital market:

Following are the principal data relating to the operations in the capital market:								
Domestic operations							International operations:	Total
Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking		
For the year ended December 31, 2009								
In NIS millions								
Income from financing activities before provision for doubtful debts								
- From external sources	10	3	5	1	1	20	-	20
- Intersegmental	-	-	-	-	-	-	-	-
Total income from financial activity								
	10	3	5	1	1	20	-	20
Operating and other income								
	260	42	27	19	41	389	51	440
Total Income								
	270	45	32	20	42	409	51	460
Operating and other expenses								
	150	28	17	12	28	235	40	275
Operating Income before taxes								
	120	17	15	8	14	174	11	185
Provision for taxes on operating income								
	43	6	6	3	4	62	4	66
Net income								
	77	11	9	5	10	112	7	119
Average Assets								
	7	3	14	1	6	31	-	31
Average Liabilities								
	-	-	2	-	-	2	-	2
Average Risk-assets								
	7	3	12	1	6	29	-	29
Average assets of provident and mutual funds								
	55	25	426	83	308	897	-	897
Average customers' securities								
	29,366	6,275	64,172	8,014	9,041	116,868	9,677	126,545
Average other assets under management								
	1,307	302	141	679	1,284	3,713	-	3,713

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

	Domestic operations						International	Total
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	operations:	
							Private Banking	
For the year ended December 31, 2008								
In NIS millions								
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	*40	327	*54	381
Total Income	224	32	28	21	41	346	54	400
Operating and other expenses	219	34	30	18	36	337	*41	378
Operating Income (loss) before taxes	5	(2)	(2)	3	5	9	13	22
Provision for taxes on operating income	11	(1)	(2)	1	2	11	1	12
Net income (loss)	(6)	(1)	(1)	2	3	(3)	12	9
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

* Reclassified.

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS:

Securities. On December 31, 2009, the balance of securities held for customers amounted to NIS 101.2 billion, including NIS 9.7 billion of non-marketable securities, compared to NIS 81 billion as at December 31, 2008, including NIS 9.7 billion of non-marketable securities, an increase of 25%. 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, 2009, amounted to NIS 11.3 billion, an increase of 32%, compared with December 31, 2008.

Investment portfolio management. On December 31, 2009, Tachlit was managing 1,531 investment portfolios,

which together were valued at approximately NIS 2,169 million, as compared to 1,463 portfolios valued in total at approximately NIS 2,174 million as at December 31, 2008. The above data point to an increase of 4.6% in the number of portfolios managed and to a decrease of approximately 0.2% 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, 2009 the total monetary value of managed portfolios was approximately NIS 1,631 million, an increase of approximately 18.8% in comparison to December 31, 2008.

Basket certificates. The companies of the Michael Davis Group, in which Tachlit Investment House Ltd. has (directly and indirectly) a 20% equity interest, expanded their activities and issued additional basket certificates in 2009. The total position held by Tachlit in basket certificates amounted, at the end of 2009, to NIS 12,119 million, compared with NIS 7,667 million at the end of 2008, an increase of 58.1%. For details regarding an amendment to the law, according to which the Bank will be compelled to sell its holdings in companies that issue basket certificates, see above "Amendment of the law regulating the investment consulting business."

Pension advisory services. 2009 was the second 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 45 thousand customers. The accumulation of customer assets, to whom advice has been provided, amounted to NIS 5.2 billion, in the said period. (For details regarding the extent of consulting services at Mercantile Discount Bank, see below under "Capital market activity of Mercantile Discount Bank").

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.

On May 19, 2009, the Capital Market Division at the Ministry of Finance approved an additional payment of NIS 15 million, by the purchasers to the Bank, in respect of additional services provided to the members of the provident funds that had been sold in the period from 2008 and until a notice of termination of such services is given by either of the parties.

Distribution of mutual funds. The Bank has entered into distribution agreements with most of the companies managing mutual funds in Israel, for the purpose of distributing their mutual funds to its customers, in consideration for distribution commissions in respect of mutual fund units held by these customers, in accordance with the regulations in this matter. In addition, the Bank is in the early stages of preparation for the signing of distribution agreements with foreign mutual fund managers, once they are permitted by law to offer units of mutual funds in Israel managed by them.

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.

The Bank provides pension consulting services regarding provident funds, pension funds and further education funds by means of financial consultants stationed at branches and investment centers.

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.

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.

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.

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 of 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.

A draft audit report by the Securities Authority in the matter of investment consulting systems at the Bank. In December 2009, the Bank received from the Securities Authority a draft audit report, following an audit conducted by them with respect to the consulting services systems at the Bank and the auxiliary tools used by the consultants in

choosing mutual funds and basket certificates.

The draft report notes that with respect to mutual fund consulting, the consultants are provided with adequate support from the mutual fund rating system. The draft report further notes the cooperation existing between representatives of the consulting and research segment at the Bank and their endeavors to improve the consulting system.

The draft report details deficiencies found in the mutual fund's Rating System, and in the basket certificates consulting operations, stemming from a shortage of decision supporting tools. In this respect, the Securities Authority has concerns regarding that the consultant's ability to comply with the requirements of the law. In addition, details were given as to deficiencies found by chance in the "Yahalom" system. The Authority noted that nothing in its report purports to exhaust the enforcement measures, which it might adopt with respect to the deficiencies detailed in the draft report.

The Bank responded to the draft report on January 14, 2010, and detailed the measures taken by it for correction of the deficiencies and the upgrading of the systems supporting the consulting activities of the Bank. The audit report was submitted to the Bank in February 2010.

Approach by the Antitrust 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.

Sale of the basket certificate operations. During the month of February 2010, the Bank approached potential purchasers with the aim of receiving proposals for the purchase of the Bank's holdings in a group of basket certificate companies, held by the Bank through Tachlit, in partnership with the Michael Davis Group.

Providing securities services to American customers. Following changes in the enforcement policy of the U.S. Authorities regarding bank accounts managed outside the U.S., the Bank has re-examined the provisions of the U.S. law relevant to this issue. In view of the findings of the examination, the Bank intends to terminate the provision of securities services to U.S. related customers (both existing and new), and to prohibit the use of American means of communication for the purpose of providing securities services to customers staying in the U.S. The Bank intends to issue guidelines in this matter, which shall apply to the Bank's operations and those of subsidiaries in the Group.

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.

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.

Income received from pension consulting requires the existence of a valid pension consulting agreement between the consultant or the marketing entity and the customer. Accordingly, fierce competition over customers is expected, trying to create with them a long term relationship, since in the event that the customer will sign a pension consulting agreement with another entity, the producer of the pension instruments will pay the commission since that date to that other entity. In cases where the customer has not signed an agreement with the marketer or consultant, the producer of the pension instruments is not required to pay any commission at all. Accordingly, 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 2009, all the banks, including the two largest banks, began operating in this field.

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 permission, 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. 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"). Within the framework of the agreement, the purchasers granted Mercantile two option, as detailed in the agreement.

Following the sale, Mercantile Discount Bank holds 49% of the new company, Hadas Mercantile Provident Funds, established under the agreement and which took over its provident fund activity. The remainder of the shares are held by the purchasers' group.

Within the framework of the agreement, the validity of the guarantee given in the past to members of "Mercantile Central Severance Pay Fund" has been extended (see Note 19 C 19 to the financial statements). Under the agreement the guarantee shall expire no later than at the final exercise date.

Mercantile Discount Bank's share in the earning of Hadas Mercantile Provident Funds amounted in 2009 to NIS 4 million, compared to NIS 3 million in 2008.

On July 8, 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. Until December 31, 2009, Mercantile Discount Bank provided pension advisory services to approximately 3,500 customers, whose portfolio of pension assets amounts to NIS 620 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 2009.

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. Expansion in the activity of the construction and real estate industry was recorded in 2009 compared to 2008, this against the background of a growth in the field of residential construction alongside a decline in construction for other purposes. Investments in residential construction increased by 4%, compared to a decline of 3.6% in 2008. A decline of 4.0% was recorded in non-residential construction and other construction work, compared to a decline of 3.6% in 2008. The following developments occurred in the various operating segments in 2009:

Residential construction. An increase at the rate of 10% in the number of new residential units sold by private entrepreneurs compared to 2008.

- About 35% of the residential units sold were in the central region (excluding Tel Aviv), which experience a decrease of 10.2% in the volume of sales of new apartments compared to 2008;
- The Haifa and Jerusalem regions recorded an increase of 29.5% and 18%, respectively, compared to 2008;
- At the end of 2009, the inventory of new apartments constructed by private entrepreneur was 27% lower compared to the end of 2008.

The increase in demand for new apartments in demand areas both in central and peripheral regions alongside the decline in supply resulted in price increases, though the rate of increase in prices was toned down in the last quarter of the year.

Luxury apartments. A trend of improvement in demand has been noticed, mainly on the part of local investors, primarily in the Jerusalem and Tel Aviv regions, coupled by price increases following the decline in prices in 2008.

Income generating real-estate - office buildings. A decline in demand for office space in the Tel Aviv area has been noticed coupled by a 5% decline in rental prices, compared to 2008, due to corporations and institutional bodies moving out their offices to satellite towns in the Dan Region, with a view of reducing the high rental costs characterizing the Tel Aviv area.

A significant increase in rental costs of 27%, 26% and 22%, has been recorded in the satellite towns of Rehovot-Ness Tziona, Haifa and Nataniya, respectively. The increase in these towns is a direct result of population growth, growth of the residential real estate market and the relatively low rental prices.

Income generating real-estate - commercial buildings. Stability in demand , on the part of institutional entities and private investors, 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, accompanied by stability in prices.

Real-estate activity abroad. a significant decline was recorded in investments by Israeli corporations in entrepreneurial and income generating real estate abroad due to the following developments:

- A decline in financing resources on the part of overseas financial institutions, both as regards real estate corporations and as regards potential purchasers of real estate assets;
- Increased selectivity by local banks in providing finance for leveraged real estate corporations operating in foreign markets, which experienced a deterioration in their business environment;
- The need for providing shareholders' equity at higher rates than in the past, in order to finance investments in real estate or the refinancing of income producing assets;
- A decline in the value of properties in certain areas in the USA, Britain, Euro -block countries, Central and Eastern Europe and in Russia, accompanied by the difficulty to realize assets at fitting prices.

DEVELOPMENTS IN THE SEGMENT'S FINANCING RESOURCES

In 2009, an improvement was recorded in the raising of funds through corporate bonds issues by corporations in this segment, the total amount raised being NIS 6.2 billion, compared to NIS 4.9 billion raised during 2008. Most of the acceleration in bond issues occurred in the second half of the year.

The bonds were issued by the large real estate corporations having a high rating, supported in certain cases by providing securities. With respect to medium and small size real estate companies, the standstill concerning the raising of capital through bond issues continued. Most of the bond issues served to recycle debts as well as for acquisitions and expansion of operations.

The increase in volume of capital raising stemmed mostly from the following:

- A low interest rate environment;
- The possibility to issue bonds at low costs due to a significant decline in returns on most of the corporate bonds;
- A significant demand on the part of mutual funds for investment in bonds bearing variable Shekel interest against the background of expectations for rising interest rates;
- Improvement in the business performance of real estate companies operating in the local market and signs of stabilization of the business environment of corporations operating in certain foreign markets.

EXPECTED DEVELOPMENTS IN THE SECTOR IN 2010

It is expected that the volume of operations of the real estate industry will grow in 2010 as a result of increased investments in standard residential construction and in infrastructure projects.

Following are the expected developments in the various operating segments:

Residential construction. A stabilized demand level in preferred areas in central and peripheral regions, coupled by a moderate increase in prices, this due to the declining inventories of new apartments, limited supply of land for construction and a significant rise in the volume of mortgage loans.

Luxury apartments. A decline in demand for luxury apartments and in their prices, primarily in Tel Aviv and Jerusalem is possible, following the increase in prices in 2009.

Income generating property - office space. Stabilization in the demand for office space in preferred areas in central Israel, accompanied by stability in prices due to the balanced supply and demand.

Income generating property - commercial space. Stabilization in demand for quality commercial property, coupled by price stability as a result of demand on the part of institutional bodies for commercial property having long-term stable return rates.

Infrastructure. Growth is expected in the volume of investments in this field as a result of the finalization of financing agreements between promoters and the banks and institutional bodies with respect to a large number of water desalination, energy, natural gas infrastructure and transportation projects.

Financing of foreign operations. The continued decline in the volume of investments by Israeli corporations in promoting real estate projects in the residential units and income producing property fields. Concurrently, there are budding signs of beginnings of investments in certain markets, where it is possible to exploit business opportunities for the acquisition of property at low prices, the continued low availability of financing resources for potential purchasers of real estate in some of the markets, difficulties in the refinancing of part of the properties the value of which had been eroded during the crisis compared to the amount of credit granted to finance them, and the continued stabilization in the value of properties in some of the markets, which in previous years experienced a deterioration in their business environment.

Developments in finance resources. In the course of 2010, corporations in this segment are expected to increase the volume of bond offerings as a result of the low returns, low interest rates environment, significant demands on the part of investors for new investment products, and the need for available finance resources to recycle capital notes in the amount of NIS 25 billion that is due for redemption.

The raising of capital will expand to middle market companies, characterized by a relatively high risk profile, and is expected to include, following a long period of standstill, also offerings on the primary market by large and stable corporations.

DIRECTIONS OF BUSINESS DEVELOPMENT IN THE SEGMENT'S MARKETS

In view of the relatively high financial stability shown by the industry during the crisis period and the expectations for the continued growth in 2010, the Bank has defined the following fields of activity as the preferred fields for the granting of credit facilities:

- Establishment of residential building projects, excluding the luxury apartments field, in demand areas in central Israel and in peripheral areas, by contractors or entrepreneurs with whom the Bank has had prior positive experience regarding completed projects;
- Land available for construction in demand areas in central Israel and in peripheral areas, in respect of which the Bank intends to finance residential and/or commercial construction projects in the format of closed project financing;
- The granting of medium-term finance for current and/or investment operations to large and well established

real-estate companies showing financial stability;

- Financing the construction of income producing assets primarily in the fields of shopping malls and open commercial centers in preferred areas, securing in advance a part of the rental income potential;
- The financing of national infrastructure projects, in cooperation with other banks and/or institutional bodies, giving preference to projects in essential fields, such as: power stations, water (including desalination plants), transportation projects, including the construction, maintenance and renovation of roads. The projects are to include an identified and settled source for the recovery of the investment, including income secured by the Government.

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;
- The financing of residential construction projects and income generating real-estate projects is to be executed by the "construction loan" method, which allows close supervision of the project being financed;
- The allocation of credit facilities to project financing will be conditional upon minimum equity capital invested by the promoters at the stage of purchasing land and at the financing stage, and upon minimum profitability rates of the projects that should not fall below the standards determined by the Bank in this respect;
- Release of surplus funds shall be made subject to concurrent compliance with sales rates and minimum construction completion rates as well as a reasonable coverage spread for the repayment of the debt;
- The allocation of credit facilities secured by pledges on income producing projects and rental income will be conditional upon the debt servicing repayment ability over a maximum period of fifteen years.

DEVELOPMENTS IN REAL ESTATE AND CONSTRUCTION ACTIVITIES

The Boards of Directors of the Bank and of Discount Mortgage Bank have decided to transfer all the construction project finance operations from Discount Mortgage Bank to the Bank as well as to discontinue providing finance for new construction projects by Discount Mortgage Bank, excluding acquisition groups, and to concentrating these operations at Discount Bank only, this excluding projects completed or in final stages, which would continue to be managed by Discount Mortgage Bank through their completion.

In this regard, the Bank signed an agreement with Discount Mortgage Bank in September 2009 for the transfer of a number of projects amounting to total credit of NIS 26 million, guarantees in a total amount of NIS 309 million and commitments for the granting of credit in a total amount of NIS 64 million.

Mercantile Discount Bank will continue providing project finance as in the past.

SCALE OF OPERATIONS AND NET INCOME

General. In view of the increased activity in the field of residential construction in 2009, the Bank has expanded its business activity with construction companies. As reported with respect to most of the projects being built, the rate of sales exceeded the rate of construction progress, a fact that increased exposure to guarantees granted under the Sales Law against the utilization of the banking loan facility.

Net income from the operations in 2009 amounted to NIS 182 million compared to income of NIS 123 million in 2008, an increase of 48.0%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 10.9% in 2009 compared to a rate of 7.8% in 2008.

Provision for doubtful debts amounted in 2009 to NIS 190 million, compared with NIS 180 in 2008, an increase of 5.5%.

Following are the principal data relating to the construction and real estate operations:

	Domestic operations				International operations			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
For the year ended December 31, 2009								
In NIS millions								
Income from financing activities before provision for doubtful debts								
- From external sources	84	705	155	944	88	20	108	1,052
- Intersegmental	(14)	(383)	(73)	(470)	2	-	2	(468)
Total income from financial activity	70	322	82	474	90	20	110	584
Operating and other income	17	23	13	53	29	3	32	85
Total Income	87	345	95	527	119	23	142	669
Provision for doubtful debts	19	98	17	134	56	-	56	190
Operating and other expenses	18	79	25	122	61	10	71	193
Operating Income before taxes	50	168	53	271	2	13	15	286
Provision for taxes on operating income	18	59	19	96	7	1	8	104
Net (loss) income	32	109	34	175	(5)	12	7	182
Return on equity (percentage)	51.9	9.4	16.4	12.2	(2.4)	21.5	3.0	10.9
Average Assets	1,693	13,136	2,645	17,474	2,623	880	3,503	20,977
Average Liabilities	686	1,894	618	3,198	595	-	595	3,793
Average Risk-assets	952	18,024	3,082	22,058	2,757	880	3,637	25,695
Components of income from financial activities:								
Margin from credit activity	58	278	68	404	82	19	101	505
Margin from deposits activity	4	6	3	13	8	-	8	21
Other	8	38	11	57	-	1	1	58
Income from financing activities before provision for doubtful debts	70	322	82	474	90	20	110	584

Following are the principal data relating to the construction and real estate operations (continued):

	Domestic operations			International operations				
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
For the year ended December 31, 2008								
In NIS millions								
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	14	2	16	63
Total Income	83	288	72	443	76	21	97	540
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	7	9	16	185
Provision for taxes on operating income	14	31	13	58	1	3	4	62
Net income	25	62	24	111	6	6	12	123
Return on equity (percentage)	39.3	6.0	15.9	8.9	2.0	9.7	3.7	7.8
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 deposits 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

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, 2009 amounted to 19.66% (19.02% at the end of 2008).

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.

Draft circular regarding “acquisition groups”. On February 18, 2010, the Supervisor of Banks issued a draft circular, against the background of the significant increase in the volume of operations of property acquisition groups, turning it into a very material component in the field of residential construction beginnings. In the draft, the Supervisor of Banks points out the high risk involved in the operations of acquisition groups compared to the risk involved in providing credit to “standard” residential construction operations, and which creates concern for a material deterioration in the quality of credit provided by banking corporations.

According to the draft, during the period of construction and until its completion, credit (both balance sheet and off-balance sheet) granted to an acquisition group, intended for the constructing of ten or more residential units, shall be classified as indebtedness of a real estate corporation (even if the acquisition group is not so incorporated). Respectively, the said credit shall be averaged at the rate of 100% in computing the ratio of capital to risk assets (instead of a ratio of 35% according to the Basel II rules, had such credit been considered as a loan for housing purposes).

Based on preliminary assessments, Discount Mortgage Bank estimates that the expected effect of the said Directive, if approved, on the ratio of capital to risk assets of Discount Mortgage Bank, in Basel II terms, will be approximately 0.7%.

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 the local market. In addition the financing operations of the segment are also conducted by business managers at the large corporations department.

In 2007, a unit was established for the handling of complex transactions for the finance of investments in national infrastructure projects on the local market (electric power stations, desalination plants, toll roads, BOT and PPP projects, etc.). The unit studies the projects and structures suitable financing packages, in cooperation with institutional investors (who have advantage in raising long-term financing sources) or in cooperation with other banks in financing the transaction.

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;
- Offering competitive terms from the aspect of the project financing terms, the volume of required shareholders' equity, the release of surplus funds and financing costs and commissions;
- The finance of construction companies that have the ability to complete a construction project within the framework of the related budget and within the agreed time table;
- 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;
- Locating and financing projects in preferred areas.

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 them, 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 companies and/or promoters is 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.

As from the second half of 2009, against the background of the improvement in business performance of corporations operating in the local market and the thriving capital market, the availability of part of the large and financially stable customers to off-banking financing resources has increased. Nevertheless, medium and small size customers are still highly dependent upon the banking industry in obtaining finance for their operations. Furthermore, it should be noted that activity has begun for raising capital backed by real estate collateral.

STRUCTURE OF THE COMPETITION PREVAILING IN THE OPERATIONS AND CHANGES THEREIN

Most of the competition in this activity takes place within the 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.

The competition in the finance of infrastructure projects is against the local banks and institutional bodies. 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 residential construction 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 in rare cases – investments abroad;
- Providing guarantees under the Sales Act to purchasers of residential units and to the rights of owners in land in the context of combination transactions;
- The granting of credit for national infrastructure projects at the construction and operating stages.

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.

DEVELOPMENTS 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 2009, excluding credit out of State funds, reached an amount of NIS 39,758 million, excluding internal refinancing, compared to NIS 34,313 million in 2008, an increase of 15.8%.

The downwards trend in the volume of credit granted out of State funds continued in 2009, reaching NIS 678 million, compared to NIS 1,468 million in 2008, a decline of 53.8%.

The volume of housing loans out of bank funds granted by the mortgage banks in 2009, reached an amount of NIS 34,622 million, excluding internal refinancing, compared to NIS 30,168 million in 2008, an increase of 14.8%.

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.

Supporting 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. The insurance agency first became profitable in 2008. In 2009, the insurance agency's income amounted to NIS 1,779 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, continued activity within the framework of "Discount outline" financing of acquisition groups and gradual expansion of its activity in granting credit for any purpose secured by a mortgage on a residential unit (see hereunder).

SCALE OF OPERATIONS AND NET INCOME

The volume of housing loans granted. In 2009, the volume of housing loans granted amounted to NIS 4,183 million, compared to NIS 4,427 million in 2008, a decrease of 5.5%. The above amount includes some NIS 232 million of loans recycled in 2009, compared to NIS 119 million in 2008, an increase of 95.0%.

Net income from the operations in 2009 amounted to NIS 30 million, compared with NIS 37 million in 2008, a decrease of 18.9%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 3.4% in 2009, compared with 4.7% in 2008.

Provision for doubtful debts in 2009 to NIS 3 million, compared with NIS 5 in 2008, a decrease of 40%.

Following are the principal data relating to the mortgage and housing loan operations:

Domestic operations				
	Households	Small Businesses	Middle Market Banking	Total
For the year ended December 31, 2009				
In NIS millions				
Income from financing activities before provision for doubtful debts				
- From external sources	173	45	3	221
- Intersegmental	(64)	(24)	(2)	(90)
Total income from financial activity	109	21	1	131
Operating and other income	49	2	1	52
Total Income	158	23	2	183
Provision for doubtful debts	-	3	-	3
Operating and other expenses	123	8	-	131
Operating income (loss) before taxes	35	12	2	49
Provision for taxes on operating income	14	4	1	19
Net income	21	8	1	30
Return on equity (percentage)	2.7	10.1	13.6	3.4
Average Assets	14,879	1,262	123	16,264
Average Liabilities	1,760	87	-	1,847
Average Risk-assets	12,350	1,256	123	13,729
Average other assets under management	1,772	-	-	1,772
Components of income from financial activities:				
Margin from credit activity	106	18	1	125
Other	3	3	-	6
Income from financing activities before provision for doubtful debts	109	21	1	131

Following are the principal data relating to the mortgage and housing loan operations (continued):

Domestic operations				
	Households	Small Businesses	Middle Market Banking	Total
For the year ended December 31, 2008				
In NIS millions				
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
Return on equity (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 (loss) from financing activities before provision for doubtful debts	115	32	2	149

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, 2009, reached a rate of 12.1%.

The Board of Directors of Discount Mortgage Bank resolved that the ratio of capital to risk assets of that bank, computed in accordance with Basel I principles shall not fall below 10%.

On December 22, 2009, Discount Mortgage Bank issued a non-marketable subordinate capital note to the Bank in the amount of NIS 100 million, which was recognized as tier II capital of Discount Mortgage Bank, subject to Proper Banking Management Directive No. 311.

On December 31, 2009, the Bank invested NIS 160 million in the share capital of Discount Mortgage Bank Ltd. This investment was intended to support the capital adequacy of Discount Mortgage Bank and to enable it to continue in developing its business.

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, 2009, the said rate at Discount Mortgage Bank amounted to 1.42%, therefore no provision was required.

Reform of 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.

Ruling by the Uniform Contracts Court. See Section “Legislation and supervision” hereunder for details regarding the ruling given in the matter of prejudicial terms in a loan contract of the First International Bank. Discount Mortgage Bank believes that this ruling may have a material effect upon it.

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 70 counters located inside branches of Israel Discount Bank Ltd. or in their vicinity. Likewise, Discount Mortgage Bank operates a telephone center where loan applicants may receive immediate approval in principle for loans.

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.

Housing loans in Mercantile Discount Bank are granted through specialized branches of this bank.

A MORTGAGE MARKETING CAMPAIGN - “DISCOUNT LAYOUT”

The Bank in conjunction with Discount Mortgage Bank launched in July 2007 an attractive interest rate mortgage layout intended to enlarge the credit portfolio of Discount Mortgage Bank and its share in the mortgage market.

The Bank determines who is entitled to the Discount layout and issues them a confirmation entitling them to the interest terms of the layout.

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. At the beginning of 2010, in view of the excess financial resources accumulated by Discount Mortgage Bank, it has been decided that Discount Mortgage Bank will be able to grant credit within the framework of the outline, also from its own resources.

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 a minimum amount of 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.

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 volume of credit offered by Discount Mortgage Bank has significantly increased following the outline, from an amount of NIS 1.4 billion in the first half of 2007 to NIS 3.6 billion in 2009. According to the Bank of Israel data, the market share of Discount Mortgage Bank has increased from 5.6% in the first half of 2007 to 9.4% in 2009 (12.6% in 2008). 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 2009 amounted to NIS 3,020.0 million. The total credit for housing purposes granted outside the framework of the "Discount layout" in the said period amounted to NIS 247.7 million. The total deposits made by the Bank within the framework of the "Discount layout" amounted to NIS 2,891.3 million in 2009.

	CPI linked	Non-linked	Foreign currency linked	Total
In NIS millions				
"Discount layout" housing loans	834.1	2,182.1	3.8	3,020.0
Non-"Discount layout" housing loans	82.7	155.9	9.1	247.7
Deposits provided by the Bank	786.0	2,102.0	3.3	2,891.3

An additional amount of NIS 128.7 million was deposited at the beginning of January 2010, of which NIS 48.1 million in the CPI linked segment, NIS 80.1 million in the non-linked Shekel segment at variable prime interest rate and NIS 0.5 million in the foreign currency linked segment.

The average interest rate on loans granted within the framework of the "Discount layout" in the CPI linked segment

was 3.0% in 2009. 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 1.39% in 2009.

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. EMI is rated by Midroog at “Aa2” rating with a negative horizon, and by Ma’alot at “A+” rating. The said ratings have been determined against the background of the reduced rating of the parent company – AIG. In view of the said ratings, 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. Therefore, banking corporations are required to weigh the housing loans secured by EMI at the rate of 100% instead of the 50% as in the past. (the above is stated in Basel I terms. Under Basel II terms, it is required to average the loans at 75%).

On September 17, 2008, Discount Mortgage Bank stopped issuing approvals for new loans secured by EMI guarantees. Discount Mortgage Bank allowed the utilization in full of loan amounts approved prior to September 16, 2008.

The outstanding housing loans of Discount Mortgage Bank secured by EMI as of December 31, 2009, amount to NIS 1.8 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, 2009, amounts to NIS 547 million.

Discount Mortgage Bank is presently considering renewal of the granting of loans insured by EMI.

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, 2009, the calculated rate of exposure of the Bank with respect to overseas extensions stood at 23.07%, as compared to a rate of 31.47% on December 31, 2008. 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, from the increase in the capital amount serving in the computation as well as from the relative reduction in the risk assets of foreign extensions.

The Bank monitors, on a monthly basis, the development of the exposure rate in respect of its operations in overseas extensions.

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 propensity 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.

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. The Bank applied to the Supervisor of Banks for a short deferment of the implementation date of the new Directive, up to July 15, 2009. On July 8, 2009, the Board of Directors approved the policy document, within the framework of which restrictions have been set on the operations of the Bank’s foreign extensions. On November 24,

2009, the Supervisor of Banks announced that the Bank is required to make certain revisions to the policy document, no later than the end of February 2010, continuing to act in accordance with the regulation letter until such date.

The Bank asked the Supervisor of Banks for a postponement of the implementation of the requirements included in his letter of November 24, 2009, regarding the following aspects:

- Definition of the risk propensity and determination of the limitation layout for the overall exposure to the activities of foreign extensions are in fact derived from the Basel requirements (second Pillar) and from the ICAAP process in respect of capital adequacy. These processes are to be completed within the framework of the Bank's general preparations for the implementation of the Basel II requirements. A preliminary reference has been included as part of the ICAAP draft, whereas the final document will be submitted to the Supervisor of Banks at the end of June 2010. In view of the above, a postponement to the end of June 2010 has been requested.
- Updating the individual limitations for all of the Bank's foreign extensions and for each extension separately is to be completed and submitted to the extensions committee of the Board, and if required to the full Board of Directors, by the date to be determined by the regulator, following a request for a postponement until April 15, 2010.

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 2009 amounted to NIS 132 million, compared with NIS 108 million in 2008, an increase of 22.2%.

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 7.3% in 2009, compared with 6.2% in 2008.

Provision for doubtful debts amounted in 2009 to NIS 221 million, compared with NIS 65 in 2008, an increase of 240%.

Following are the principal data relating to the international operations:

	Households	Corporate Banking	Middle Market Banking	Private Banking	Other	Total
For the year ended December 31, 2009						
(in NIS millions)						
Income from financing activities before provision for doubtful debts	7	184	308	226	330	1,055
Operating and other income	-	29	58	94	(11)	170
Total Income	7	213	366	320	319	1,225
Provision for doubtful debts	13	64	98	15	31	221
Operating and other expenses	1	150	243	306	75	775
Operating Income (loss) before taxes	(7)	(1)	25	(1)	213	229
Provision for taxes on operating income	-	11	22	25	39	97
Net (loss) income	(7)	(12)	3	(26)	174	132
Return on equity (percentage)	(74.7)	(2.9)	0.7	(18.7)	29.1	7.3
Average Assets	141	6,784	8,148	4,184	18,619	37,876
Average Liabilities	25	1,993	4,226	17,685	12,217	36,146
Average Risk-assets	141	6,481	9,830	2,073	9,226	27,751
For the year ended December 31, 2008						
Income from financing activities before provision for doubtful debts	2	193	296	212	1	704
Operating and other income	-	43	77	95	(47)	168
Total Income	2	236	373	307	(46)	872
Provision for doubtful debts	-	15	33	7	10	65
Operating and other expenses	1	113	222	260	77	673
Operating Income (loss) before taxes	1	108	118	40	(133)	134
Provision for taxes on operating income	-	21	21	4	(20)	26
Net income	1	87	97	36	(113)	108
Return on equity (percentage)	7.0	18.7	13.1	19.5	(36.3)	6.2
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

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

Asset-Backed Securities. For details as to the Group's investments in asset backed Securities, see above "Securities" under "Developments of Assets and Liabilities".

SERVICE TO SEGMENT CUSTOMERS

Europe. 2009 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.

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).

The Bank has a branch in London that provides commercial and private banking services to Israeli and Jewish customers and to corporations, in Britain and Western Europe. The main activity of the branch comprises the granting of credit to the hotel industry and the financing of foreign trade. In addition, the branch is also engaged in private banking. The branch provides foreign trade services that include, documentary credits and the discounting of bills. The branch operates under the corporate banking division and is supervised and controlled by the supervision and control unit of the Bank's foreign extensions at the Head Office in Israel, as well as by the internal audit and the Bank's credit controller.

United States. As aforementioned, IDB New York ("IDB Bank") is 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 New York operates mostly in the middle market finance for companies operating in various business fields niche, 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. 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.

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 - This activity serves a wide range of diverse companies in many different industries. One of the Division's strengths is its ability to custom-design a factoring package to suit each client's needs.

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 - Related credit and trade finance letters 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 - IDB Bank 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 67% 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 - 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.

Deposits - About 61% of IDB New York's customer deposits 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.

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, 2009, amounted to NIS 10.1 billion, compared with NIS 9.0 billion on December 31, 2008.

Following is the distribution of net income (loss) by the Group's structure:

	Contribution to Group's results		Contribution Disregarding the effects of coverage of investment ⁽¹⁾	
	2009	2008	2009	2008
In NIS millions				
Banking Activity:				
Commercial banks:				
In Israel - the Bank (including branches overseas)	296	(14)	278	(39)
- Mercantile Discount Bank	180	149	180	149
- First International Bank	⁽²⁾ 161	43	⁽²⁾ 161	43
Overseas - Bank offices	112	55	130	80
Discount Mortgage Bank	30	27	30	27
Other Activities:				
Israel Credit Cards	153	191	153	191
Other financial services	11	(196)	11	(196)
Total operating income	943	255	943	255
Loss from extraordinary operations	(20)	(10)	(20)	(10)
Net income	923	245	923	245

Notes:

(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 IDB (Swiss), 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 2009, the shekel was revalued in real terms as against the U.S. dollar by 0.7%, compared with an appreciation of 1.1% in 2008. In 2009, the shekel was devalued in real terms against the Swiss Franc by 2.9%, compared with a devaluation of 4.2% in 2008. The said net revaluation, in 2009, resulted in an increase in the Bank's net operating income after tax in Israel by NIS 17 million, compared with an increase of NIS 25 million in net operating income in 2008. Concurrently, there was a decrease/increase in the positive contribution by overseas extensions to the results of the Bank.

(2) Including a reversal of a provision for tax in respect of the Bank's share in the earnings of the First International Bank, in the amount of NIS 10 million (see Note 6 D to the financial statements).

GROUP MANAGEMENT

Proper Banking Management Directives regulate, among other things, the Group conduct of the banking corporation as regards various issues. Proper Banking Management Directive No. 301 requires the Board of Directors of a bank to determine a policy with respect to exposure to various risks (credit risks, market risks, operational risks, liquidity

risks, legal risks, etc.) concerning its subsidiary companies and foreign extensions. Furthermore, the Bank's Board is required to determine a policy concerning everything relating to its involvement in determining employment and retirement terms for employees of the subsidiaries of the banking corporation and to verify that the subsidiaries' boards of directors discuss the said terms. The Board of Directors has to ensure that any new activity is approved by it only after it had studied the risks involved in the new operation, it had examined the mechanisms to be used by it in managing, measuring and controlling the risks, it had determined quantitative limits and verified that human resources, financing resources and mechanized and technological infrastructure are available in order to ensure proper absorption and management of the new operation and its compatibility with the banking corporation's existing operations. The Board of Directors must also set guidelines to ensure that corporations controlled by the banking corporation will provide the banking corporation the information it requires in order to maintain at the Group level an ongoing follow-up, supervision and control over the business of the Group and the scope of risks involved. These guidelines shall include the establishment of a central head office unit that will analyze the said information and will report to the management of the banking corporation the condensed data and its recommendations, in accordance with a reporting format approved by the Board. Proper Banking Management Directive No. 313 requires implementation of borrower and group of borrowers credit limits on a consolidated basis.

On June 16, 2009, the Increasing Economic Efficiency Bill (Legislation amendments for the implementation of the economic program for 2009 and 2010), 2009 was published in the Official Gazette. The Bill (known as the "Arrangements Bill") included a proposal for the amendment of the Banking Ordinance. According to the proposed amendment, the Supervisor of Banks shall have the authority to instruct banking corporations and banking corporations controlled by a banking corporation, to transfer information regarding their customers to a central data base to be established in this respect by the banking group for the purpose of managing the credit risks of the banking group as a whole. In the course of the discussions of the Bill and after it had been approved in first reading, this part was separated from the Arrangements Bill and the continued legislation process is expected to be conducted separately.

For details regarding the group risk management, see "Strategy and processes" in the item "Management of market and liquidity risks" under "Exposure to risk and risk management" above.

For details regarding Basel II instructions in the matter of strengthening corporate governance at banking corporations, see "The implementation in Israel of the Basel committee recommendations" under "Exposure to risk and risk management" above. For details regarding the duty to set a policy with respect to employment and retirement terms at subsidiary companies, see "Remuneration policy in a banking corporation" under "Human resources" below.

MAIN INVESTEE COMPANIES

At the end of 2009, 23.0% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 22.1% were assets of overseas consolidated companies and branches. The contribution to the net income by the consolidated companies in Israel amounted to NIS 363 million in 2009 (in 2008 the contribution amounted to NIS 174 million). The contribution to the net income by overseas consolidated companies totaled an income of NIS 112 million in 2009 (in 2008 the contribution amounted to an income of NIS 55 million), and the contribution to the net income by affiliated companies amounted to NIS 153 million in 2009 (in 2008 the contribution amounted to NIS 40 million). The total contribution by both domestic and overseas investee companies to the net results of the Bank amounted to NIS 628 million in 2009, compared with NIS 269 million in 2008, an increase of 133.5%.

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 2009, would have been NIS 646 million, compared with 294 million in 2008, an increase of 119.7%.

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 (the data presented hereunder in this section have been taken from Bancorp's audited financial statements).

Total assets at the end of 2009 amounted to US\$9,520 million, compared with US\$9,450 million at the end of 2008, an increase of 0.7%.

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 2009 was US\$3,491 million, compared with US\$3,937 million at the end of 2008, a decrease of 11.3%.

Total deposits stood at US\$6,208 million as at the end of 2009, compared to US\$6,205 at the end of 2008.

Shareholder's equity amounted to US\$710 million at the end of 2009, compared with US\$624 million at the end of 2008, an increase of 13.7%.

The ratio of capital to risk assets, computed according to the principles applying in the U.S. to this matter, was 14.9% as at December 31, 2009, compared with 12.1% at December 31, 2008. In December 2008, IDB New York issued to the Bank a subordinated capital note in the amount of US\$75 million.

Net income in 2009 amounted to US\$43.8 million, compared with US\$35.0 million in 2008, an increase of 25.1%.

The increase in income was effected primarily from a US\$28.2 million decrease in provision for other than temporary impairment loss on securities, a US\$11.1 million increase in operating income, primarily due to income from realized securities, and a US\$6.4 million increase in income from interest and dividend. On the other hand, the provision for doubtful debt increased by a significant US\$22.8 million, and tax expenses increased by US\$8.2 million.

Return on equity was 6.6% in 2009, compared with 5.5% in 2008.

The contribution of the Bank's investment in Bancorp to the net results of the Bank reached an amount of NIS 120 million in 2009 (after deducting a provision for additional taxes of NIS 24 million that applies to the Bank in Israel), compared with income of NIS 55 million in 2008 (after deducting provision for additional taxes of NIS 25 million that applies to the Bank in Israel).

The said contribution is comprised of Bancorp's net income in 2009 (after deducting the provision for tax as aforesaid) of NIS 141 million disregarding exchange rate differentials on the investment of NIS 21 million, compared with net income of NIS 88 million (after deducting a provision for taxes as aforesaid) and disregarding exchange rate differentials on the investment of NIS 33 million in 2008.

Alongside the exchange rate differentials on the said investment, the Bank in Israel recorded financing income/expenses

in 2008 and financing income/expenses in the preceding year, in respect of the surplus foreign currency liabilities that the Bank created as coverage for the investment in Bancorp.

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.

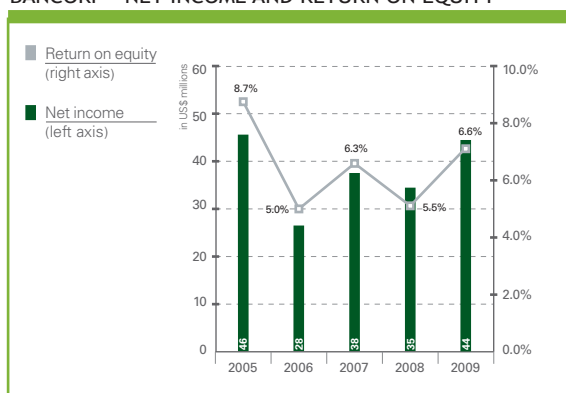
In the framework of these investigations, IDB New York was also examined. To the best of the Bank's knowledge, the investigation findings ascertained that IDB New York did not act in accordance with regulations relating to the prohibition on money laundering, did not properly document customer details 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"). The actions required by the cease and desist orders have been completed. On June 3, 2009, the regulatory authorities in the United States informed IDB New York of the withdrawal of the Cease and Desist Orders issued with respect to IDB New York on December 15, 2005.

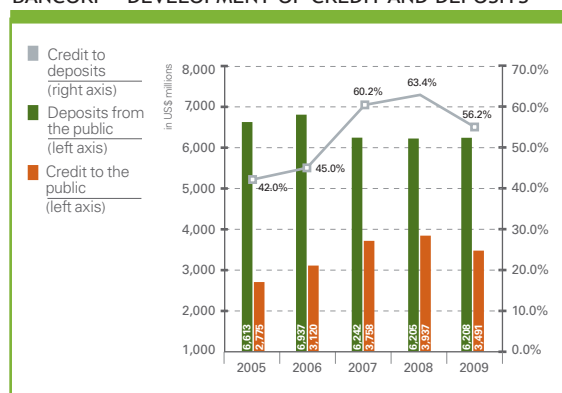
The withdrawal of these Orders was followed by a resolution of IDB New York's Board of Directors pertaining to matters whereby IDB New York is to intensify the supervision and control measures relating to the prevention of money laundering.

Demands by the former Chairman of the Board of IDB New York. In March 2009, Mr. Len Grunstein, the former Chairman of the Board of IDB New York, approached the present Chairman of IDB New York with a request for certain payments (including salary, severance pay and expenses) for himself and another person who had acted as a director of IDB New York, in respect of their tenure of office as directors of IDB New York. Subsequently, the parties conducted negotiations in the matter and on May 19, 2009 the Board of Directors of IDB New York decided to approve a settlement agreement, whereby Mr. Grunstein and the other director will be paid an amount of US\$925 thousand, in full and final settlement of their claims against IDB New York.

BANCORP - NET INCOME AND RETURN ON EQUITY



BANCORP - DEVELOPMENT OF CREDIT AND DEPOSITS



MERCANTILE DISCOUNT BANK LTD.

Mercantile Discount Bank Ltd. ("Mercantile Discount") is a wholly-owned subsidiary of the Bank. At the end of 2009, Mercantile Discount Bank operated through 73 branches, compared with 71 branches in 2008.

Total assets at the end of 2009 amounted to NIS 21,807 million, compared with NIS 20,311 million at the end of 2008, an increase of 7.4%.

Total credit granted to the public at the end of 2009 was NIS 13,848 million, compared with NIS 14,326 million at the end of 2008, a decrease of 3.3%.

Total deposits from the public at the end of 2009 amounted to NIS 18,178 million, compared with NIS 17,037 million at the end of 2008, an increase of 6.7%.

Shareholder's equity at the end of 2009 amounted to NIS 1,695 million, compared with NIS 1,479 million at the end of 2008, an increase of 14.6%.

The ratio of capital to risk assets computed according to Basel II principles amounted to 12.3% on December 31, 2009. The ratio of capital to risk assets, computed according to Basel I principles, was 13.1% as at December 31, 2009, compared with 12.4% as at December 31, 2008.

Net income was NIS 180 million in 2009, compared with NIS 148 million in 2008, an increase of 21.6%.

The principal factors affecting the business results of Mercantile Discount Bank in 2009, as compared with 2008: an increase in the income from financing activities before provision for doubtful debts (an increase of NIS 21 million, 3.1%); a decrease in the provision for doubtful debts (a decrease of NIS 9 million, 7.3%); an increase in operating and other income (an increase of NIS 81 million, 24.5%), an increase in operating and other expenses (an increase of NIS 42 million, 6.4%) and an increase in the effective tax rate.

The increase in financing income stemmed mainly from the increase in other financing income due to the rise of NIS 35 million in gains on the sale of bonds.

The increase in operating and other income stemmed mainly from a 5.6% increase in income from operating commissions. The increase in operating and other expenses stemmed mainly from a 6.3% increase in payroll and related expenses, due to the increase in the number of positions and a current growth in wage rates.

Return on shareholders' equity in 2009 was 11.1%, compared with 10.3% in 2008.

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 11.2 to the financial statements.

For details as to the motion for a declarative ruling in the matter of charging the debtor's account with violation interest, see Note 19 C item 11.8 to the financial statements.

MERCANTILE - NET INCOME AND RETURN ON EQUITY



MERCANTILE - DEVELOPMENT OF CREDIT AND DEPOSITS



DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank is a subsidiary of the Bank. As of December 31, 2009, the Bank held all of its equity and of its voting rights.

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 70 counters located all over the country within branches of the Bank or adjacent to them (compared with 67 counters and branches at the end of 2008). 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 2009 amounted to NIS 15,884.4 million, compared with NIS 14,297.4 million at the end of 2008, an increase of 11.1%.

Total credit granted to the public amounted at the end of 2009 to NIS 15,294.1 million, compared with NIS 13,742.1 million at the end of 2008, an increase of 11.3%.

Shareholder's equity amounted to NIS 1,090.1 million at the end of 2009, compared with NIS 899.1 million at the end of 2008, an increase of 21.3%.

Net income amounted to NIS 31.0 million in 2009, compared with NIS 28.4 million in 2008, an increase of 9.2%.

The business results of Discount Mortgage Bank for 2009, were affected, inter-alia, by a decrease in income from financing activity (an amount of NIS 14.0 million, 10.9%), by a decrease in the provision for doubtful debts (an amount of NIS 16.2 million) and by a decrease in operating and other expenses (an amount of NIS 4.5 million, 3.6%), primarily in respect of payroll expenses.

Return on shareholders' equity in 2009 was 3.4%, compared with 3.2% in 2008.

The ratio of capital to risk assets computed according to Basel II principles amounted to 19.3% on December 31, 2009. The ratio of capital to risk assets, computed according to Basel I principles, was 12.1% as at December 31, 2009, compared with 10.8% as at December 2008. On December 31, 2009, the Bank invested NIS 160 million in the share

capital of Discount Mortgage Bank Ltd. This investment was intended to support the capital adequacy of Discount Mortgage Bank and to enable it to continue in developing its business.

The Contribution of the Bank's investment in Discount Mortgage Bank to the net results of the Bank amounted to NIS 30.0 million in 2009, compared with NIS 27.4 million in 2008, an increase of 9.5%.

See Note 19 C article 11.9 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, article 11.10 in the matter of the linkage mechanism as specified in an annex to the loan agreement, article 11.11, regarding the charging of a premature redemption commission in the case of realizing a life assurance policy of a deceased borrower and article 12.2 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, 2009, the Bank held 26.4% of its share capital and 11.1% of its voting rights.

Net income amounted in 2009 to NIS 568 million, in comparison with NIS 161 million in 2008, an increase of 252.8%.

The Bank's share in the net income of FIBI in 2009 amounted to NIS 161 million, compared with NIS 43 million in 2008.

Return on shareholders' equity in 2009 was 9.7%, compared with 2.9% in 2008.

The ratio of capital to risk assets computed according to Basel II principles amounted to 14.03% on December 31, 2009. The ratio of capital to risk assets, computed according to Basel I principles, stood at 14.18% on December 31, 2009, compared with 12.27% at the end of 2008.

Public issuance by FIBI. In an immediate report dated March 13, 2007, FIBI announced that its Board of Directors decided to act towards the possibility of increasing its share capital through issuance of rights to shares and/or issuance of rights to other securities, which would improve its capital structure, to be offered to all its shareholders, including a possible benefit component relative to the market price of its shares. It should be noted that in view of its share capital structure and the provisions of the Securities Law, FIBI may issue and list for trading on the Stock Exchange only shares and/or rights to shares of NIS 0.01 par value each, which are the class of shares with preferred voting rights.

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 arrangement with the Bank of Israel, whereby, as a shareholder of FIBI, it would be able, under certain circumstances, to purchase shares offered to it under the Prospectus (for additional details regarding the said arrangement, see Note 6 D to the financial statements).

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. The period in which publishing of a shelf offering pursuant to the aforementioned prospectus was possible has expired. On November 30, 2009, FIBI published a shelf Prospectus, according to which, among other things, it may issue shares of a par value of NIS 0.01 each as well as option warrants, whether by way of a rights issue or by way of an offer to the public.

Following the above, the parties conducted negotiations, which 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.

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.

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 the above, there was no certainty at that date that the assumption of the continued holding of this investment would be materialized in full, and accordingly 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 that stage, no arrangement of any kind had been formed and the ideas introduced 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. Under these circumstances, the Bank estimated no change in its holding stake in FIBI in the foreseeable future and therefore, the Bank has reversed the provision for taxes in the financial statements as of June 30, 2009, amounting to NIS 130 million made, as stated, in its financial statements as of December 31, 2007.

For additional details regarding the matters discussed above, see Note 6 D to the financial statements.

Formation of understandings with FIBI Holdings. In the middle of February 2010, the Bank, FIBI and the controlling shareholder of FIBI renewed their discussions with a view of reaching an agreement with respect to the holdings of the Bank in FIBI and the rights attached thereto.

In the second half of March 2010, the Bank reached an understanding with FIBI Holdings Ltd. (hereinafter: "FIBI Holdings") regarding the Bank's holdings in FIBI. The said understanding is subject to the signing of an agreement between the parties (hereinafter: "the Agreement") and to obtaining the approvals of the Boards of Directors of the Bank and of FIBI Holdings.

Following are the main points of the understanding:

- The Agreement will contain conditions precedent to the validity of the Agreement (hereinafter: "the conditions precedent"), which are: approvals by the Supervisor of Banks and the Antitrust Commissioner and completion of

the distribution of a dividend in the amount of NIS 800 million by FIBI to its shareholders.

- FIBI Holdings will act to the best of its ability towards the unification of the share capital in FIBI ("unification of the capital"), and Israel Discount Bank shall support such an action, subject to the completion of the dividend distribution or obtaining all the approvals for its distribution.
- Soon after the said unification of the share capital is completed, if and when completed, Israel Discount Bank shall deposit with a trustee all its shares in FIBI, the voting rights attached to them exceeding the rate of voting rights existing at present in Israel Discount Bank's hands. Israel Discount Bank shall not use the voting rights attached to the deposited shares.
- Until the end of six months from the date of completion of the said unification of the share capital, and subject to the fulfillment of the conditions precedent and subject to the completion of the unification of the share capital, Israel Discount Bank shall take action to sell 6% of its shares in the capital and voting rights in FIBI to third parties, on condition that market conditions will allow a sale at a price that is not lower than the stated value of the shares being sold in the financial statements of Israel Discount bank.
- Starting with the date on which all conditions precedent are fulfilled, the arrangement existing between FIBI and Israel Discount Bank regarding the right of first refusal for the purchase of shares in FIBI will be cancelled, and any transfer or sale of shares of FIBI by FIBI Holdings or by Israel Discount Bank, shall not be subject to such a right.
- Until December 31, 2013 (hereinafter: "the determining date"), Israel Discount Bank shall be entitled to have FIBI Holdings continue to cause the appointment of one quarter of the Directors of FIBI from among candidates recommended by Israel Discount Bank (subject to Directives regarding the prevention of conflict of interests), this with no consideration to the number of shares held by Israel Discount Bank. Subsequent to the determining date, the existing arrangements between FIBI Holdings and Israel Discount Bank shall be void, including the said arrangement regarding the appointment of Directors. The determining date may be postponed in the event that all conditions precedent are not fulfilled, or if the unification of the capital is not completed within periods to be specified in the Agreement.
- The said understandings are subject to approval of the Boards of Directors of Israel Discount Bank and of FIBI Holdings and to the signing of an Agreement. The validity of the agreement shall be subject to the conditions precedent stated above.

In view of the above, the Bank has included in the financial statements as of December 31, 2009, a provision for taxes in the amount of NIS 120 million, in respect of its holdings in FIBI.

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 13 to the financial statements. For details regarding a motion for approval of an action as a class action suit filed against the First International Bank in the matter of the ruling of the Antitrust Commissioner that restrictive arrangements have existed between the banks, see Note 19 C to the financial statements, item 12.4.

ISRAEL CREDIT CARDS LTD.

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2009, the Bank owned 71.8% of the equity and 79.0% of the voting rights in ICC. ICC issues and operates "VISA", "Diners" and "MasterCard" credit cards.

Total assets amounted, at the end of 2009, to NIS 8,579 million, compared with NIS 7,286 million at the end of 2008, an increase of 17.7%.

Shareholder's equity amounted to NIS 1,056 million at the end of 2009, compared with NIS 811 million at the end of 2008, an increase of 30.2%.

On March 15, 2009, the Board of Directors of ICC adopted a policy according to which ICC will not distribute dividends out of retained earning that had accumulated or that will be accumulated by ICC until December 31, 2009.

The ratio of capital to risk assets computed according to Basel II principles amounted to 13.7% on December 31, 2009. The ratio of capital to risk assets, computed according to Basel I principles, at December 31, 2009, was 22.8%, compared with 21.1% at the end of 2008.

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 in 2008 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 2009 to NIS 1,157 million, compared with NIS 1,129 million in 2008, an increase of 2.5%.

Net income amounted in 2009 to NIS 249 million, compared with NIS 279 million in 2008, a decrease of 10.8%.

Return on equity reached 26.3% in 2009, compared with 44.5% in 2008.

The contribution of the Bank's investment in ICC to the net results of the Bank in 2009, amounted to NIS 153 million, compared with NIS 191 million in 2008 (the difference between the said contribution and the product of multiplying the net earnings of ICC by the rate of the Bank's holdings stems mainly from the fact that ICC has restated its financial statements – see below).

Material weaknesses in the internal control over financial reporting. ICC reported two material weaknesses found in the internal control over financial reporting, as described below:

1. In the course of an audit performed in recent months by ICC's internal auditor, certain material deficiencies had been found in the control environment of ICC International, a subsidiary of ICC, through which the clearing of international electronic trading transactions had been made until December 31, 2009. In view of the findings of the internal audit and of developments in the field of clearing international electronic trading transactions (for additional details see Note 33 A to the financial statements), ICC has adopted and is adopting a series of measures, including a decision taken by the Board of Directors in November 2009, regarding the immediate suspension of certain officers of ICC International. Against the background of the above, management of ICC has evaluated the internal audit over financial reporting layout at ICC International, with reference to clearing operations of international electronic trading transactions. The said evaluation indicated the existence of a material weakness in the control layout at the organization level relating to clearing operations of international electronic trading transactions. This weakness stems from the lack of supportive control processes and a proper control environment at ICC International, required to assure that the accounting entries relating to such operations would be properly recorded, processed, summarized and reported with a reasonable measure of assurance as to their reliability. The control components at the organization level are: control environment; risk evaluation process at organization level; information and communication; supervision and follow-up. Deficiencies had been found in most of the said components, which together amount to a material weakness. As stated above, the management of ICC adopted and is adopting various measures, including steps for the strengthening and improving control processes relating to this activity.
2. Against background of the findings of the internal audit of ICC, management of ICC has evaluated the internal control over financial reporting with respect to the recording of expenses, in particular marketing and advertising. The said evaluation indicated the existence of a material weakness stemming from the lack of effective internal

control required in order to ensure that the accounting entries relating to expenses, and in particular marketing and advertising expenses, would be properly recorded, processed, summarized and reported with a reasonable measure of assurance as to their reliability.

The management of ICC is preparing for the strengthening of the control relating to this item, including: definition of controls verifying the period of benefit, in order to assure a correct allocation to reported periods ("accounting cut-off"); refreshing ICC procedures in everything related to the recording of expenses and making payments.

ICC is preparing to complete the remediation and integration of controls in the said areas of operation and the examination of their effectiveness. Management of ICC is of the opinion that the integration of controls would be completed by date of publication of the financial statements as of June 30, 2010.

It should be emphasized that the management of ICC has performed additional comprehensive examinations in the areas of operation described above, with respect to which material weaknesses had been identified, at a scope required in its opinion to achieve a reasonable level of assurance that its financial statements are presented fairly in all material respects.

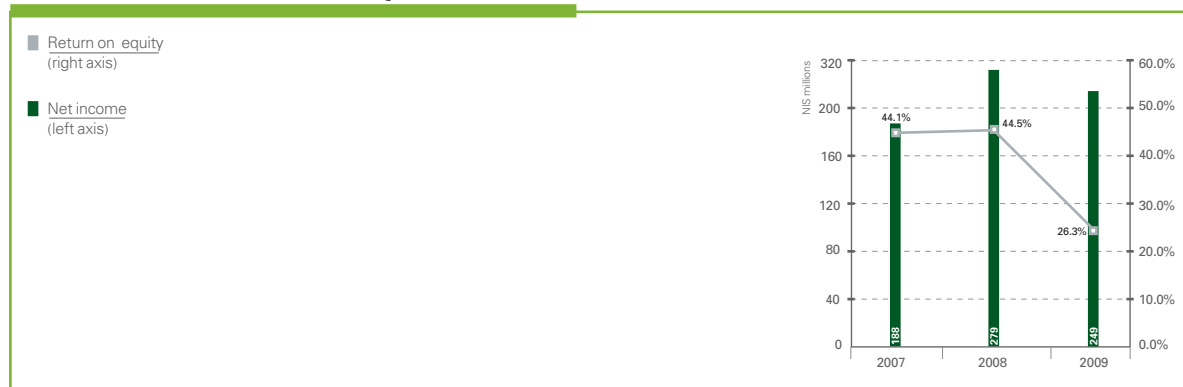
It should be noted that ICC's financial statements for the years 2007-2008 and for interim periods in the years 2007-2009, have been restated in order to reflect retroactively the correction of an error made in the measurement of certain components of the company's marketing and advertising expenses, and of an error made in the measurement of certain components of clearing commissions received from trading houses with respect to clearing operations of international electronic trading transactions.

In their opinion regarding internal control over financial reporting, the independent auditors of ICC stated that, in view of the material weaknesses identified by the management of ICC, as described above, ICC has not maintained an effective internal control over financial reporting as of December 31, 2009, based on criteria determined by the combined framework of internal control of COSO.

The auditors of ICC further noted that the above mentioned material weaknesses had been taken into consideration in determining the type, timing and scope of audit procedures employed by them in performing the audit of the consolidated financial statements of ICC for the year 2009, and that the report on the internal control over financial reporting did not affect their audit report on the annual financial statements, which included an unqualified opinion on the said financial statements.

For details regarding the activity in the credit card field, including developments in the field of clearing of international electronic trading transactions, see "Credit Card Operations Activity" under "Further details as to activity in certain products" above and note 33 to the financial statements. For details of a claim and a motion for approval of an action as a class action suit filed against ICC and other credit card companies, dismissed in January 2010, see Note 19 C, article 11.12.

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 companies, 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, 2009 amounted to NIS 690 million, compared with NIS 723 million at the end of 2008, a decrease of 4.6%.

The net income in 2009 amounted to NIS 7 million, compared with a loss of NIS 191 million in 2008.

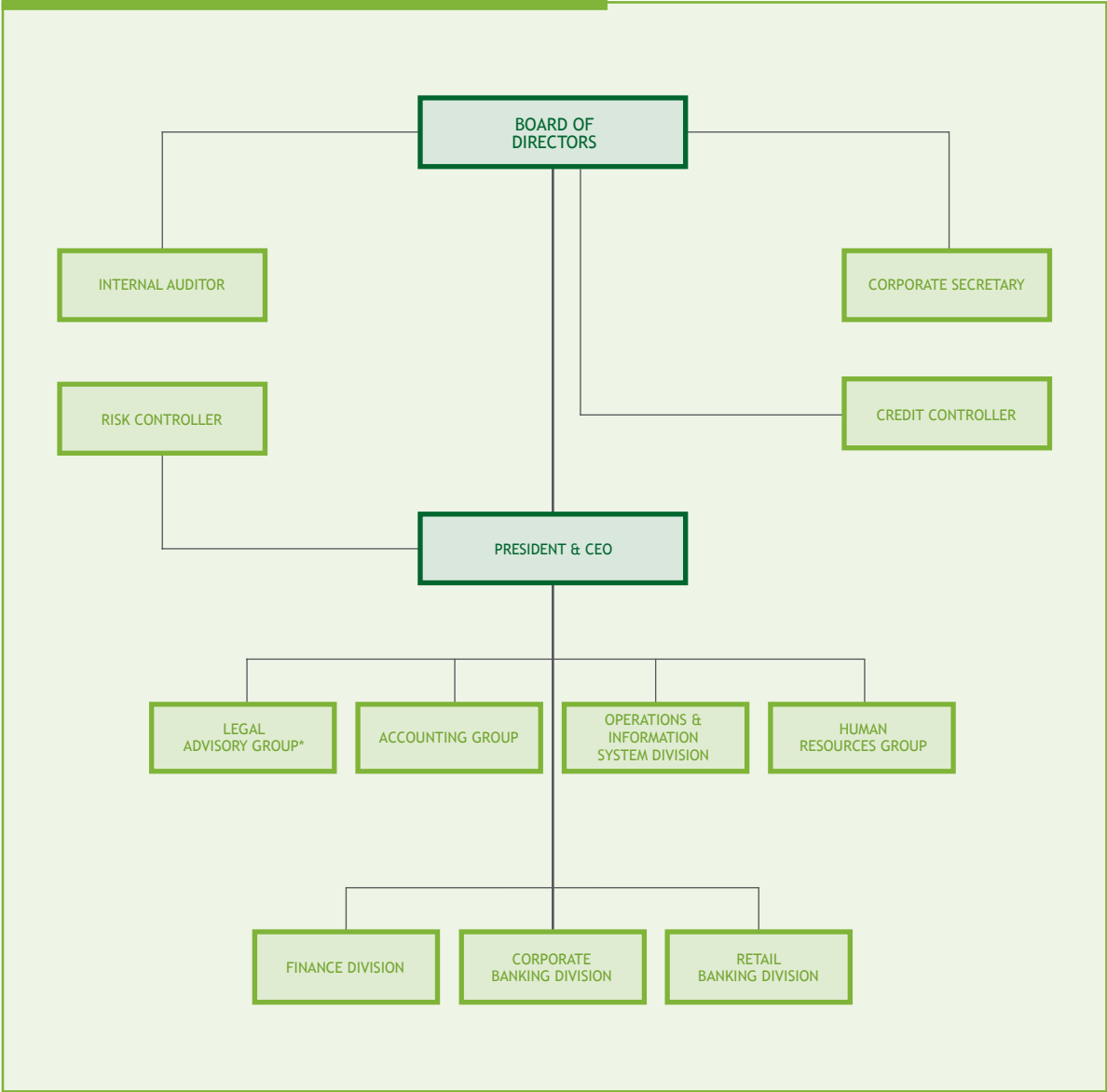
The loss in 2008 stems primarily from write-offs and provisions for impairment of investments in the amount of NIS 150 million and from financing expenses.

Contribution of the Bank's investment in DCMI to the Bank's results amounted in 2009 to a loss of NIS 2 million, compared to a loss in the amount of NIS 191 million in 2008 (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 2009, DCMI, through a subsidiary, participated in 15 public offerings of securities (all of which with no underwriting) with a total volume of approximately NIS 8.5 billion (5 public offerings with a total of approximately NIS 2.7 billion in 2008), and in three private placements of securities with a volume of approximately NIS 0.6 billion (one private placement with a total volume of approximately NIS 0.1 billion in 2008). Of the said issues in 2009, four public issues of a total amount of NIS 1,771 million and one private placement of an amount of NIS 102 million, were issued made by the Discount Group, compare with public offerings in a total amount of NIS 1,967 million and one private placement in the amount of NIS 135.5 million in 2008.

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

CHANGES IN THE ORGANIZATIONAL STRUCTURE (2010)

At its meeting dated March 24, 2010, the Board of Directors decided on the following changes in the organizational structure:
Organizational change in the Retail Banking Division. The Board of Directors decided to reorganize the Retail Banking

Division, so as to better align its structure with future challenges and provide better and more professional service to the Bank's clients.

The change involves the elimination of 5 regions and creation of 10 "lean" regions, to closely manage service and business development in over 140 branches. In conjunction with this change, the division headquarters is being aligned with the branch structure, so as to provide direct service, both functional and on matrix basis, in areas such as credit and investments, to all branch clients.

This innovative change is in continuation of the ground breaking steps taken by the Bank in recent years in the retail banking field. This change is a further step in leadership of retail banking.

Organizational change in the Operations and Information Systems Division. The Operations and Information Systems Division would be divided into two divisions, each headed by a member of Management at Executive Vice President level: The IT & Planning Division and the Operations & Logistics Division.

IMPLEMENTATION OF THE PLAN FOR ORGANIZATIONAL CHANGE (2008)

The implementation of the plan for a change in the Bank's organizational structure was completed at the beginning of 2009. This plan had been approved by the Board of Directors in its meeting of November 30, 2008.

The objectives of the change were maximizing efficiency as part of the implementation of the long range strategic program, reduced labor costs, concentration of specialization and increased customer focused.

The principal changes included:

- 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. Subjection of the strategy, spokesman for the Bank, marketing and advertising fields to the office of the 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 Systems Division.
- g. The transfer of responsibility for part of the subsidiaries to the legal consulting layout.

The reorganization, in addition to the changes carried out in the computer layout (see above "Information and computer systems") brought about a reduction the Bank's labor force, in the course of 2009, by about 351 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 - see hereunder).

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 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 6,110 employees in full-time positions in the Bank in Israel (not including the Bank's branches abroad) at the end of 2009, compared with 6,065 at the end of 2008, an increase of 0.7%.

The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas

branches) rose in 2009 and amounted to 6,132, as compared to 6,120 in 2008, an increase of 0.2%.

There were 10,290 full-time positions in the Group in Israel and abroad at the end of 2009, compared with 10,264 at the end of 2008, an increase of 0.3%.

The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2009, was 10,319, compared with 10,220 at the end of 2008, an increase of 1.0%.

Following are the labor force data of the Group and the Bank, in terms of positions⁽¹⁾:

	As of December 31		Monthly average in	
	2009	2008	2009	2008
The Bank in Israel	6,110	6,065	6,132	6,120
Domestic subsidiaries	3,335	3,296	3,324	3,183
Group total in Israel	9,445	9,361	9,456	9,303
Overseas branches	34	35	35	37
Overseas subsidiaries	811	868	828	880
Group total overseas	845	903	863	917
Group total overseas and Israel	10,290	10,264	10,319	10,220

(1) The number of positions includes conversion into overtime positions with the addition of positions of software house employees who provide services to the Bank and after deduction of positions the payroll cost in their respect has been capitalized to fixed assets.

Following are details of the cost per position, in NIS thousands⁽¹⁾:

	2009	2008	Change in %
The annual average direct cost per employee position in the Bank in Israel	215	203	5.9
The total annual average cost per employee position in the Bank in Israel	332	331	0.3
The average annual overall payroll cost per employee of the Group in Israel and abroad	308	304	1.3

(1) Payroll costs also include the cost of software house employees, as stated in the footnote to the preceding Table, less payroll costs capitalized to fixed assets.

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, namely, its extension by one year at a time beginning on March 31, 2011, unless the

Bank's management informs the Employees' Representative Committee otherwise, or the Employees' Representative Committee informs the Bank's management, by advance written notice, three months prior to the said date.

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 the Committee 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, 2009, there were 3,924 tenured employees in the Bank (December 31, 2008: 3,875 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, 2009, there were 1,893 temporary employees in the Bank (December 31, 2008: 2,033 temporary employees). Furthermore, in accordance with an agreement between the Bank and the employees' representatives signed in 2002, 252 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, 2008: 265 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, 2009, the Bank employed, in practice, 63 personnel (including members of management) under personal employment agreements (December 31, 2008: 66 employees engaged under personal contracts).

In addition, the Bank acquires services of manpower company employees and software houses.

As of December 31, 2009, 14 manpower company personnel were employed by the Bank. These employees serve mainly as tellers hired as reinforcement following the transition to a shortened work week (as of December 31, 2008: 71 manpower company personnel).

It should be noted that in recent years the number of temporary staff has risen while the number of workers supplied by manpower companies has decreased, this as a result of completing the implementation of Section 12(a) of the Manpower Companies Law, namely, that workers supplied by manpower companies may not be employed for periods exceeding nine months.

As of December 31, 2009, 747 software house personnel were employed in the Bank. These employees are engaged mainly in software development tasks (as of December 31, 2008: 947 software house personnel).

Following is a summary of employment data in the various categories and the changes therein:

Employees	Tenured employees, personal contracts and members of management ⁽¹⁾	Temporary employees ⁽¹⁾	Manpower companies	Software house ⁽²⁾	Total
December 2007	3,878	1,729	524	1,114	7,245
December 2008	3,941	2,033	71	947	6,992
December 2009	3,987	1,893	14	747	6,641
Difference (December 2009 vs. December 2008)	46	(140)	(57)	(200)	(351)
Difference (December 2008 vs. December 2007)	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
December 2009	4,041	2,025	13	827	6,906
Difference (December 2009 vs. December 2008)	(10)	70	(18)	(119)	(77)
Difference (December 2008 vs. December 2007)	42	114	(269)	(305)	(418)

Notes:

(1) Including the positions of Bank employees the cost of which has been capitalized to fixed assets: 2009 - 126 positions, 2008 - 162 positions, 2007 - 92 positions.

(2) Including positions of software house employees included in the Bank's manpower data: 2009 - 157 positions, 2008 - 162 positions, 2007 - 92 positions.

DEVELOPMENTS IN LABOR RELATIONS

Labor disputes. The New General Federation of Labor announced, on December 29, 2009 a labor dispute relating to the Bank's clerical staff in the matter of "a demand for signing a wage agreement and the determination of a selective wage increase for the year 2009 in respect of the clerical staff".

By virtue of this dispute, the employee representative committee was entitled to apply sanctions as from January 14, 2010, and this was indeed done. The sanctions were withdrawn on January 18, 2010. The wage agreement has not yet been signed.

Following discussions held between the Bank's management and the employee representative committee (including the Managers' Representation Committee), at the request of the New Federation of Labor, the latter declared on January 31, 2010 a labor dispute in the matter of the demand of the clerks' representative committee to sign a collective agreement regarding the scope of engagement of outsourcing staff and against their continued employment instead of tenured Bank employees and using them as strikebreakers, which in the opinion of the representative committee cause damage to the organized labor force of the Bank. Furthermore, as claimed by the committee, the Bank's management refrains from supplying details regarding the engagement of outsourcing staff and of provisional employees. Based on this dispute the Employees' Representation Committee is entitled to apply sanctions as from February 16, 2010, onwards. The parties have conducted discussions in the matter.

On February 17, 2010, the employee representative committee started implementing sanctions, employed intermittently at the Bank's various units.

On March 2, 2010, the Bank's Management received a notice from the Bank's national employee representative committee that it intends to call on the next day, a meeting of employees during regular working hours. Management informed the employees that it cannot condone a partial and disrupted working day, and accordingly it instructed the employees not to come to work at all.

Management has made a maximum effort to reduce the damage to Bank's customers and held a meeting with the employee committee during the night between March 2nd and 3rd, but the position of the employee committee remained unchanged. Accordingly, on March 3, 2010, the bank's branch layout closed down. Notwithstanding, 40 service stations at the "Discount Rapid" and "Concept" branches provided service by temporary staff. Furthermore, the direct banking channels (Internet, TeleBank and the dealing room) operated in the usual manner.

Within the framework of the said sanctions, the employee representative committee instructed on March 8, 2010, the staff of the Bank's Accounting Group to refrain from any activity related to the preparation of the annual financial statements of the Bank for December 31, 2009, this until further notice.

At the end of an intensive meeting with the Bank's Management on the night of March 10, 2010, the employee representative committee decided to suspend the sanctions until Passover Eve, a period in which the negotiations between the parties are to continue with the aim of reaching an agreement.

Wage agreement for clerks. 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.

Wage agreement for managerial level Bank employees. 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.

Employment of temporary staff. 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.

Changes in the employment ordinance. In October 2009 the Bank's management approached the representative committee of the Bank's employees in writing proposing a series of discussions (in continuation of several prior discussions in the matter), with a view of making changes in the employment ordinance adjusting it to the Bank's present and future needs, ensuring the Bank's economic stability and securing the present and future employment of the staff.

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, 13th month salary and long term service award. Likewise, there exists an additional payment at the rate of 4% under a collective agreement of January 2006, payable to those entitled to split-time payment. Part of the employee's remuneration is linked to the CPI. In cases where the change in the CPI is a negative figure, the employees' wages are not reduced and the drop in the CPI is setoff against the rise in the CPI in following months. 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, which are similar to those to which regular employees are entitled.

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.

Reduction in wages in 2009. The salary of employees engaged under various personal and provisional agreements, having an inclusive salary level of at least NIS 10 thousand, has been reduced by 5.5%, with effect as from February 2009, for a period of twelve months, with no effect on the level of salary used to compute social benefits. In accordance with agreements with the committee of the managerial staff, employees belonging to the managerial level have waived their right to a thirteenth month salary for the year 2009, where under certain circumstances, the reinstatement of 40% of such salary will be considered at the beginning of 2010. According to agreements with the clerks committee, employees of the clerical level have waived their right to five days of paid vacation and to the payment by management in respect of a Jewish New Year present.

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, 2009, the staff of the managerial grade numbered 1,224 (December 31, 2008: 1,168 employees).

OFFICERS AND SENIOR MANAGEMENT MEMBERS GROUP OF THE CORPORATION

Members of this group of employees are subject to an advance notice period longer than the period set by the law, and to the period of the occupational limitation (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, see Note 13 D to the financial statements.

AWARD PLAN TO EMPLOYEES AND MANAGERS OF THE BANK IN 2008

For details regarding an award plan for members of management, see Note 16 to the financial statements. The budget for the plan would be determined on the basis of the annual return to capital of earnings from ordinary operations. The awards would be granted according to the rate of return. The aim of the plan is to create a structured relation between the success of the Bank and the remuneration of employees and managers in the short and long term.

Award in respect of 2008. The return on capital in 2008 did not establish the right to a bonus in respect of the year 2008, in accordance with the bonus plan for that year. In March 2009, the Bank's Board of Directors 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. The work of computer workers on duty on such days requires a special permit obtained by the Bank and which is extended from time to time. The work of security personnel is performed in accordance with a general permit.

RETIREMENT OF EMPLOYEES

In accordance with the labor charter, any reduction in the number of staff at the Bank is not made forcibly (i.e. dismissal), but by mutual consent with the retiring employee. The Bank encourages the early retirement of employee, 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.

Following are details regarding the number of employees who retired from the Bank in the years 2006-2009:

The year	The total number of retired employees (including early retirement)	The number of employees who has elected early retirement
2009	37	3
2008	86	28
2007	172	103
2006	262	205

LEGISLATIVE RESTRICTIONS, REGULATIONS AND ARRANGEMENTS

General. In addition to the labor charter, the various collective agreements existing from time to time, the Bank operates within the framework of laws and regulations applying to all entities in the economy. A short description of the principal restrictions applying to the Bank with respect to its labor relations is given hereunder.

Amendment 24 to the wage protection law, 1958. Amendment 24 to the Wage Protection Law came into effect on February 1, 2009, according to which an employer is required to provide his employees a monthly pay slip detailing the payment made to the employee. The amendment requires the pay slip to include certain details concerning the composition of wages. It is also required to state the number of days on which the employee actually worked, as well as the number of hours actually worked, including overtime, in accordance with the record keeping alternatives provided by the Law. The amendment set forth criminal sanctions and civil remedies.

The Bank is preparing to adapt the structure of the pay slip issued by the Bank to the format required by Amendment 24 to the Wage Protection Law.

Amendment of the Employment of Workers provided by Manpower Companies Law, 1996. On January 1, 2008, Section 12A of the said Law came into effect. The Section states that the maximum period in which a worker provided by manpower companies may actually be employed by the same employer is nine months.

At the end of this period, the actual employer may elect to engage the worker as his own employee, to apply to the Ministry of Industry, Trade and Labor for an extension of the employment period (a maximum of six months) or return the worker to the manpower company employing him.

In the event that the actual employer has engaged the worker at the end of the nine month period, the beginning of the period of work of the worker at the actual employer will not be date of his engagement as a direct employee, but, retroactively, the date at which he had begun work with the actual employer.

The said provisions do not apply to employees of manpower companies engaged on computer work at the actual employer and to employees of utility companies providing security and cleaning services.

The Bank has reduced to a minimum the number of manpower company employees, so that at the end of 2009 only 14 such employees worked for the Bank.

Extension Order in the matter of compulsory pension for every employee and the Provident Funds Law Amendment.

The Extension Order in the matter of compulsory pension for every employee and Amendment No. 3 to the Provident Funds Law came into effect on January 1, 2008. According to the Extension Order, the Bank is required to make provisions for employees' personal severance pay funds up to a maximum rate (in effect from January 1, 2013 onwards) of 5% of the wage of the employee or of the average wage in the economy, the lower of the two. According to the Provident Funds Law Amendment, the Bank will be required to create provisions for severance pay outside the framework of a central severance pay fund, as hitherto was the case, in respect of new employees as from January 1, 2008, and in respect of other employees as from January 1, 2011. In practice, the Bank provides the maximum rate in respect of temporary employees as from January 2008 and in respect of permanent employees in accordance with the effective Order (2.5% as of date of preparation of the financial statements). The requirements of the Order issued in respect of provisions for provident fund, have, at the Bank's initiative, also been implemented in the past.

Economic Efficiency Bill (Legislation amendments for the implementation of the economic program for the years 2009 and 2010). On July 14, 2009, the Knesset approved the Economic Efficiency Law (Legislation amendments for the implementation of the economic program for the years 2009 and 2010), 2009, which, among other things, includes provisions that prohibit the dismissal of an employee during the period in which he is entitled to sick pay accumulated in his respect, provisions regarding the duty of the Minister of Labor and Welfare to consult with the largest labor union in the country prior to acting on his authority vested in him by the law regarding the engagement of workers through manpower companies, as well as new administrative and criminal sanctions imposed on an employer in respect of violation of labor laws.

The Bill determines, among other things, instructions regarding the duty to negotiate with the representative labor union, as well as new administrative and criminal sanctions with respect to the violation of labor laws.

REMUNERATION POLICY IN A BANKING CORPORATION

A report issued in April 2008 by the FSF regarding the fortification of the capital and economic markets, referred to the negative influence which an inappropriate remuneration policy might have upon the volume and type of risks taken by banking corporation. Accordingly, the report contained a recommendation relating to the need to adjust the remuneration policies of companies operating in the financial sector to the long-term overall organizational profitability of the company.

On April 5, 2009, the Supervisor of Banks announced that as part of the adoption of the FSF recommendations and with a view of reducing risks emanating from inappropriate incentive structures, banking corporations and companies under their control are required to adopt no later than December 31, 2009, appropriate remuneration policies. The policy is to be determined by the board of directors based on wide overall organizational considerations (total payroll cost, desired wage differentials between various employee grades, etc.) and on the following principles:

- Remuneration incentives shall be adjusted to overall organizational profitability and to the long-term goals of the banking corporation;
- Remuneration incentives should not encourage taking risks over and above the banking corporation's appetite for risk;
- The payment of remuneration incentives shall be based on profit commensurate with the risk and cost of capital;
- Remuneration incentives shall include a component representing the effect which the contribution of the business unit has on the total value of other business units, and should not treat the business unit as being disconnected from the banking corporation as a whole;
- Remuneration incentives shall include a component representing attainment of the general objectives of the banking corporation in the area of risk management and in the area of compliance with legislation, regulatory instructions and procedures of the banking corporation;
- A banking corporation shall maintain strict procedures for the supervision and control over the remuneration policy;
- Agreements pertaining to retirement benefits to senior member of management shall take into account actual performance over time as well as the reason for retirement;
- Remuneration of officials involved in supervision and control processes including financial reporting, shall be determined according to appropriate standards that take into consideration the importance and sensitivity of those officers' duties;
- The methodology, principles and targets of the remuneration incentives shall be transparent with respect to the various stakeholders of the banking corporation.

The remuneration policy should be a general policy pertaining to all employees of a bank, special emphasis being put on the remuneration of senior members of management and of officers who influence the risk taking by the banking corporation. Banking corporations are required to examine existing employment agreements in light of the remuneration policy to be determined and to the extent possible, to act towards changing/updating agreements that do not comply with such policy. The Bank's Management had completed the drafting of the remuneration policy document, which was brought for approval of the Board of Directors at its meeting of January 11, 2010. The Board adopted the principles of the remuneration policy and directed the Bank's Management to submit a work plan for the implementation of the said principles.

The Board has determined that within the framework of the discussions of the remuneration plans and/or the update of the remuneration plans, the need for the uniformity of the parameters entitling the various employee populations to the right to an award, should be considered.

The Board noted that the remuneration policy document would be presented to the subsidiary companies, with a recommendation by the Bank that the principles of the remuneration policy should also be adopted by them. During 2010, the human resources layout in coordination with the subsidiary companies is to examine the agreements and/or remuneration plans existing at the Bank and/or at the subsidiaries with the principles of the remuneration policy, and if it transpires that an agreement and/or a remuneration plan are not in line with the principles of the remuneration policy, the human resources layout in coordination with the subsidiary companies, as the case may be, will act to make the necessary adjustments, to the extent possible.

It has also been decided that at least once a year, the remuneration policy document will be brought before Management and thereafter before the Board of Directors, for validation and reapproval.

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 developing a strategy supportive managerial leadership, having a business orientation (service, profitability and value growth) and human resources development and cultivation, in four channels:
 - Preliminary planning of the "Top talent" program – a multi-annual personal development framework for the Bank's talented personnel. A dynamic building of knowledge and study, evaluation, personal experience and transition between positions with respect to managers demonstrating excellence and identified as having a potential for performing senior executive duties. Launching of the project is planned for 2010;
 - Training reserves for position appointments (junior management, intermediate management);
 - Development of middle class executive staff by means of:
 - (1) "An executive training room" - a practical-applied exercise environment, subject focused, to strengthen the variety of managerial abilities and qualifications of branch managers and of department managers, and to improve the field-head office mutual perception.
 - (2) Positioning the "Branch Managers Forum" - a professional forum that enhances the organizational positioning of the post and increases the managers' ability to lead changes. In addition, the forum serves as a colleague meeting place for joint learning;
 - Training both with respect to professional-banking aspects and with respect to managerial-behavioral aspects, adapted to the needs of managers in the various divisions (The Retail Banking Division, the Corporate Banking Division, Finance Division and Operations Department);

Personal development is achieved by a variety of methods designed to improve qualifications, evaluation and feedback:

 - A consulting-personal escort to managers, both upon entry into a new position and while performing duties;
 - Sociometry and emotional intelligence as part of executive training and within the framework of developing managerial teams and organic units;
 - "Bottom-up appraisal" (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 (Coaching).

A process of "Bottom-up appraisal" was completed during 2009 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, and a second measurement of "Bottom-up appraisal" has begun among them.
- **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;
 - A comprehensive development policy for investment consultants - application of a professional-hierarchical advancement course, a training and qualification program at the various stages of the course and preservation and remuneration mechanisms;
 - Structuring a development course for economists in the asset field;

- A comprehensive action for the strengthening of the professional proficiency of those employees fulfilling core functions: credit officers, service team bankers and tellers.
- **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 (Development of managers and of teams, etc.), service, training and organizational culture. The activity basket is the product of a comprehensive organizational survey.
During 2009, 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, such as would induce customers to continue and choose Israel Discount Bank as their bank. 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 service concept was updated and validated in 2009. This concept serves as an indicator for the Bank's overall activity, being a customer oriented organization. In addition a process of translating the updated concept into a written theory, classified in accordance with the various segments of the Bank's customers has begun.

The concept of cultivating the customer experience at the Bank's investment centers was formulated and integrated in 2009 including new measurement tools. A similar process was performed with respect to part of the Head Office units. A parallel process has begun concerning the Retail Banking Division's management, which included the construction of a service toolbox for branch managers.

Among other things, contents to be included in the Bank's various professional training courses have been defined, and study contents, classified according to professions have been developed.

Measurement of service quality. The measuring tools were updated in 2009 and control reports were developed for use at all levels of management at the Retail Banking Division. Measurement data is provided to the managers of the business units as soon as the findings are received and serve as a basis for drawing conclusions from cases of failure or success in providing response to customers. In cases where immediate intervention is required, the unit manager addresses the customer in providing a personal response.

Handling complaints. The reduction in the number of complaints was defined as a system objective in 2009, with a focus on organizational learning and the qualification of branch customer complaint officers and service and sales representatives. This, while maintaining the commitment and managerial responsibility all along the managerial backbone.

A steering committee headed by the head of the Retail Banking Division acted during the year in outlining an improved

procedure for addressing customer approaches at the branch, with a view of improving service. Within the framework of the said activity, the Bank improved the process of drawing conclusions and organizational learning in everything involving failures which came to light as a result of customer complaints. Work procedures regarding the handling of complaints have been improved and the computer application used to manage the subject has been updated.

As a result of the above, among other things, the number of complaints received through the bank-customer relations department of the Supervisor of Banks at Bank of Israel has declined significantly, from 413 complaints in 2008 to 346 complaints in 2009, a 16.7% decline. Furthermore, the rate of complaints found justified had dropped from 38% in 2008 to 25% in 2009. The grade awarded to the Bank by the Supervisor of Banks regarding the quality of complaint handling was 89.3% in 2009, compared to 90.6% in 2008. For comparison, the average grade of the five large banks was 86.7% in 2009, compared to 86.1% in 2008.

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 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 activity in aid of the community and accessibility of the Bank, 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.

Activities of drawing conclusions, apprenticeship processes and the transfer of duties are also accompanied by designated know-how management tools. Additional applications provide the use of computerized forms, the distribution of procedures and circular letters and competitive data management.

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 2009 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 the information communities - the forum for information sharing regarding methodology and tools, has continued alongside studying developments in this field at other organizations in Israel.

Drawing conclusions. Within the framework of promoting organizational learning and integrating risk management concept, the Bank cultivates a culture of drawing conclusions in order to expand organizational knowledge, information sharing, duplicating success and avoiding failure.

Two steering teams lead the integration in the Corporate Banking Division and in the Human Resources Group. The teams form a policy in the matter of drawing conclusions and lead its implementation, namely, promoting the carrying out of enquiries, assistance in implementing the studied conclusions, distribution of the information derived from such enquiries to other relevant factors, identification of repeated patterns and performing learning inclusion.

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 people oriented banking vision of: the love of humanity, professionalism, integrity, initiative and commitment.

The process of integrating the code in the organization has been intensified in 2009, 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 are 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.

Initiative. Within the framework of forming an innovative organizational culture that includes initiative and creativity at all levels of activity at the Bank the "Headquarter initiative" competition took place also in 2009. This relates to the promotion and execution of 33 projects beneficial to the Bank's profitability, to its customers, employees, the community and the environment, focusing on initiative and professionalism.

Work-life balance. In 2009, the Bank initiated a move towards promoting an organizational culture of balancing work-life that respects Bank employees' major life events. Ten senior managers, who had received coaching training on this subject, will form the leading forum for building and integrating the concept at the Bank.

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, meetings at various levels are conducted, discussion groups and feedback processes, including:

- Round table – a meeting of the CEO or of one of management members with managers and employees;
- "Head Office paying attention to the field" – a designated day, during which senior managers of the Head Office work at the Bank branches, in order to obtain a deeper understanding of the requirements in the field;
- Monthly tours of management members at branches and field units accompanied by senior managers from their headquarters;
- Intra-organizational surveys, including an "organizational feedback" (survey of employee viewpoints).

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 2009, 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 2009 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 2009, 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 2009 strategic moves at the Bank were addressed at the training level, including:

- Integrating the concept of customer focused promotional service, among bankers and team heads at the "TeleBank" center;
- Training of employees of the branch layout and of Head Office units for carrying out the operational activity of the "back office" (which is being removed from the branches and transferred to the operations department);
- 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.
- Green construction – designated training for architects, engineers and maintenance and operations staff that provide services to the Bank, in order to qualify as "green construction escorts". The training was provided in cooperation with the Standards Institution of Israel and graduates of the course received the qualification from the Institution.

A special move has been made towards the qualification of service team bankers for the purpose of attaining the Bank's strategic targets in the fields of service, professionalism, risk management and operational savings.

An additional employee population that was targeted in 2009 with respect to training was the employee population engaged in credit operations. The training was provided within the special framework of filling in know-how and professionalism.

This move included the following principal components:

- Training for the core of the position with a focus on qualification;
- Prompt and position focused training in order to improve business performance (competence) and elimination of performance differences (excellence);
- Renewal of the format for teller qualification – the future cadre for work within service teams;

The training for the position has been conducted by means of learning capsules focusing on professional activities during work at the branch and within group learning. It should be noted that the training concept at the base of the said move,

will be presented at the annual international convention of the American Society for Training and Development.

The process of training investment consultants also continued this year within the framework of their careers at the Bank.

Retail. 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.

Training sessions were prepared in 2009 in respect of two versions of software launched in this year, on the following topics: payment orders (part II), the issue of personal checks, incoming foreign currency clearing, financial instruments and authorized signatories system (management and observation of holders of power of attorney). Head office units supporting these processes have also been trained.

Scope of training. The number of training days in 2009 reached 34,127 compared with 31,157 training days in 2008. This data indicates a rise of 9.5%. The data regarding the number of trading days relate to actual training days on the College premises, and does not reflect individual study activity that was widely implemented with respect to a variety of subjects and sectors.

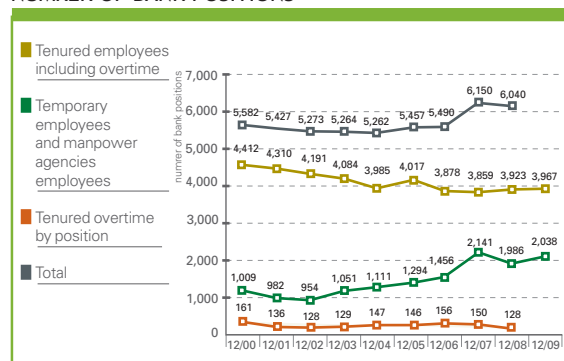
INVESTMENT IN TRAINING.

The Bank's investments in training and in the development of human resources amounted to NIS 16.7 million in 2009, compared with NIS 20.1 million in 2008. 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, rent and building maintenance. The amount does not also include the relative part of employee payroll in respect of the participation of the staff in providing training courses, in the training framework of the Bank, in self study by means of the distant learning computer systems and participation in outside training frameworks.

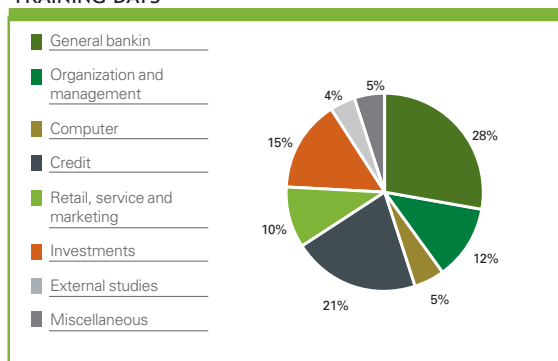
Furthermore, for the purpose of conducting the training, the Bank appoints mentors and training partners who are Bank employees and who, in addition to their regular work, assist in training and in the preparation of training material. The cost in this respect is not included in the above amount.

The decrease in 2009, compared to 2008, is explained by the exceptional expenses recorded in 2008 with respect to the comprehensive move of integrating the ethical code, the completion of the "Ofek" project and the provision of coaching for the managerial backbone at the branch layout and at the Head Office business units.

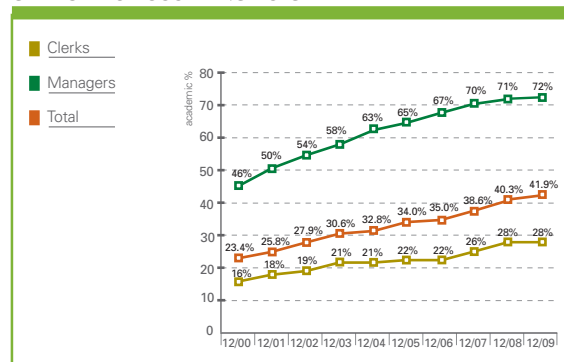
NUMER OF BANK POSITIONS



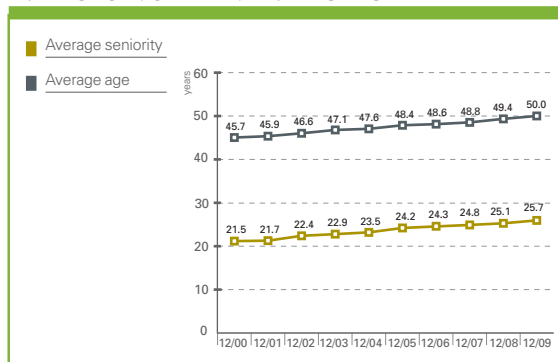
TRAINING DAYS



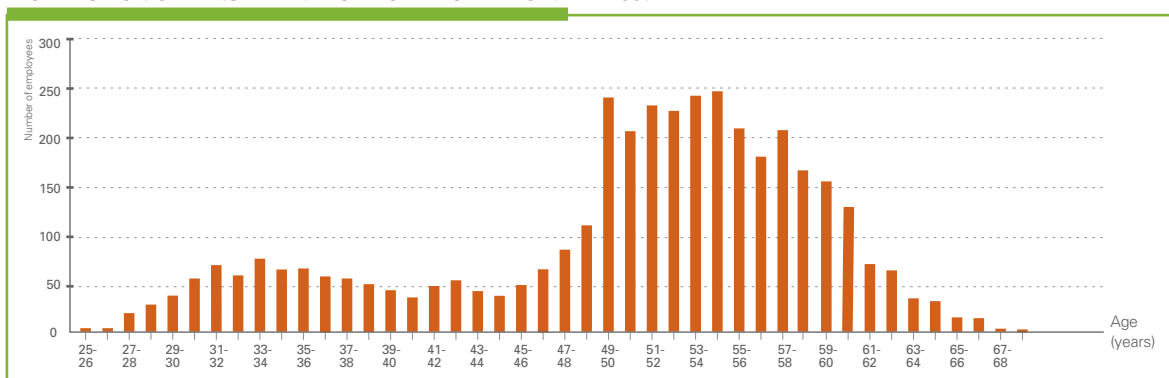
THE RATE OF UNIVERSITY GRADUATES ACCORDING TO GRADE



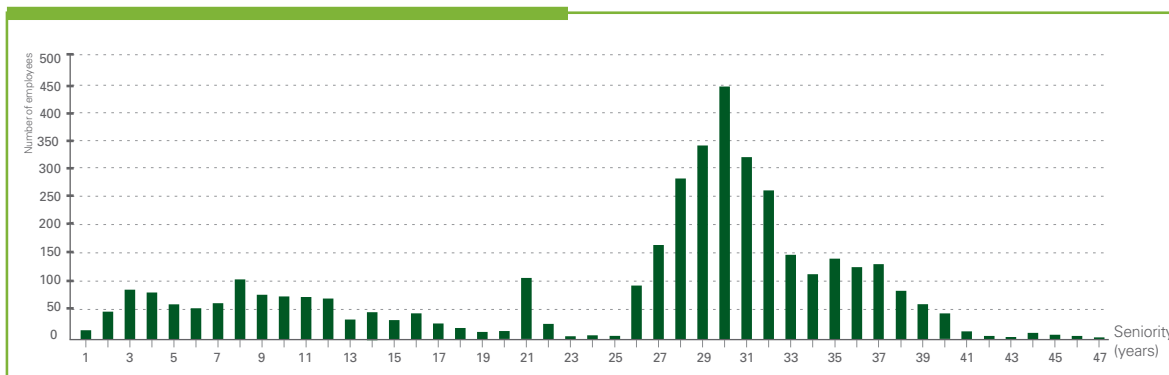
AVERAGE SENIORITY AND AVERAGE AGE



DISTRIBUTION OF TENURED EMPLOYEES BY AGE - DECEMBER 2009



DISTRIBUTION OF TENURED EMPLOYEES BY SENIORITY - WORK FORCE AT DECEMBER 2009



CONTROL OF THE BANK

GENERAL BACKGROUND

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 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, the 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 (as defined hereunder) the Bronfman-Schron Group holds 254,966,194 ordinary A Shares of NIS 0.1 each par value of the Bank (hereinafter: “the ordinary shares”), 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 the Bank, 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. In January 2010 the State sold additional shares comprising 5% of the issued share capital of the Bank (see hereunder).

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.

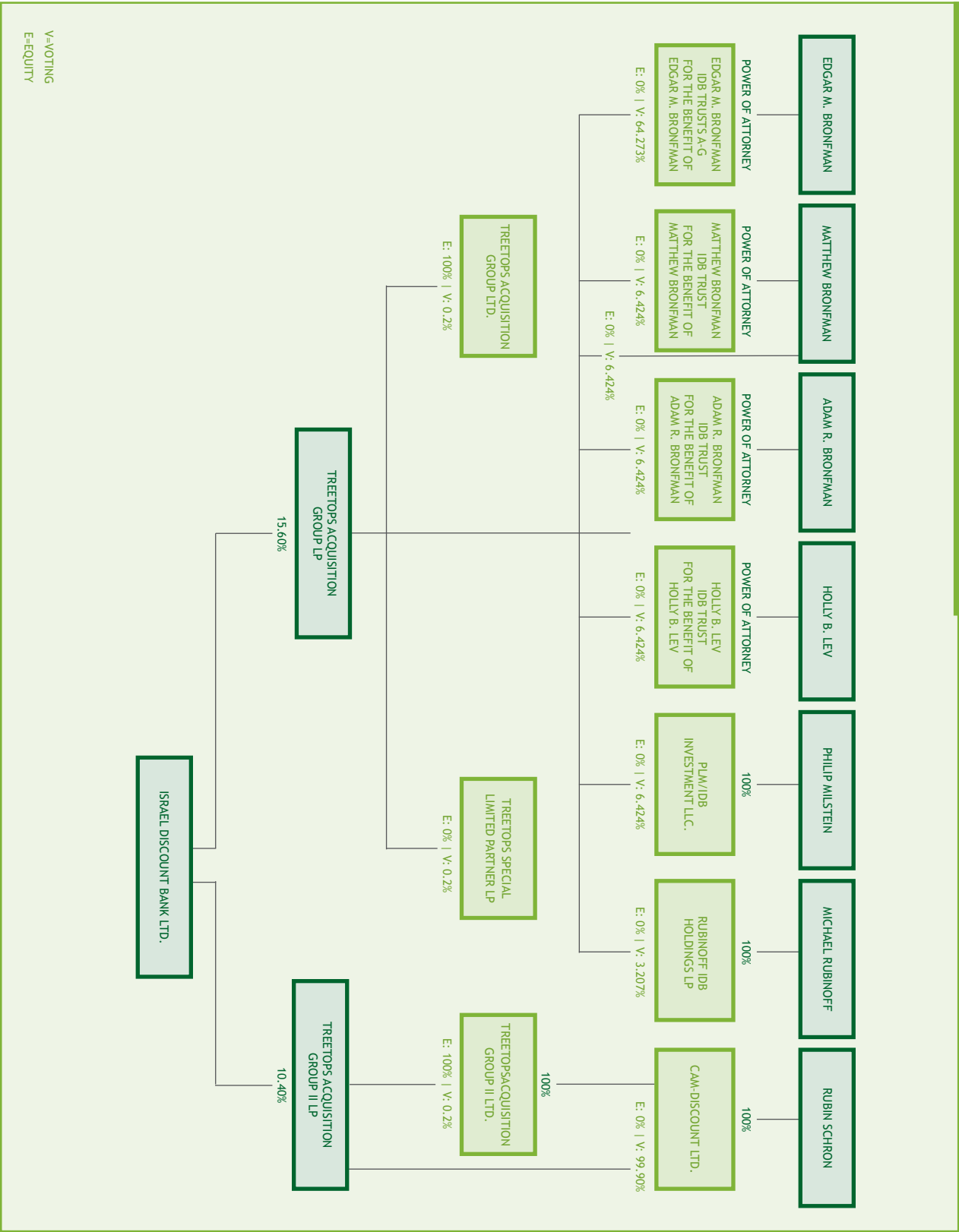
Treetops' general partner, that holds approx. 0.2% of Treetops, is Treetops Acquisition Group Ltd (hereinafter: "Treetops Ltd."), a company incorporated in the Cayman Islands. The means of control in Treetops Ltd. are held by the Bronfman Group members, in accordance with the ratio of their holdings 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.

CONTROLLING SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD.



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, furthermore, the computation does not include the conditional additional consideration, as detailed below).

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 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.
The Group shall reserve, at all times, the minimum percentage.
2. If the Bank issues, after the grant of the permit, rights to shares or any other security convertible into shares, the Group shall maintain the minimum percentage holdings, computed on the basis of full dilution.
3. (a) For a period of five years subsequent to the date of the grant of this permit, the Group shall not directly or indirectly sell or transfer means of control in the Bank, if as a result thereof it is left with means of control of any type in a percentage lower than the minimum percentage. Any one of the Group’s members may sell means of control from the additional percentage exceeding his or her share in the controlling interest, provided that a minimum of six months have elapsed since the last purchase affected by such Group member (in such regard, the exercise of the option from the government shall not be deemed a purchase act).
(b) Five years from the date of the grant of this permit, the Group may sell or transfer its means of control, provided that it sells or transfers the entire means of control constituting the minimum percentage, to an individual or a Group that has duly received a permit for the control and holding of the aforesaid means of control.

In the Supervisor of Bank’s letter annexed to the permit (hereinafter: “the letter annexed to the permit”) it was stated that in the event that after five years from the date of the grant of the permit a decision is made by the Buyers to sell means of control in the Bank from the controlling interest such that after the sale none

of the Group's members or the buyers require a permit for the control or holding of the means of control in the Bank, pursuant to the law, the following provisions shall apply:

- The two Buyers shall approach the Governor of the Bank of Israel, notify him of their decision and detail the manner of the sale planned by them;
 - Before the sale of the means of control, as aforesaid, the Buyers shall make a preliminary with the Governor of the Bank of Israel, regarding the arrangements that shall be made, including the modification of the permit and the trust instrument, in order to allow them to effect the sale of the shares within a reasonable period of time (hereinafter: "the transitional period"), taking into account, inter alia, the implications on the Bank's management and transfer thereof, business relations with the Bank, the market conditions and the quantity of shares being sold, and the format of holding and voting in respect of the Bank's shares constituting a holding of more than 5% of the means of control in the Bank during the transitional period (without such derogating from the Buyers' fundamental right to effect the sale, as aforesaid).
- (c) Notwithstanding the abovesaid, an additional member may be added to the Group and each of the Group's members may, at the end of five years as aforesaid, transfer or sell the means of control held by him and constituting his share of the minimum percentage, or part thereof, provided that the transferee or buyer cooperate on a regular basis with the rest of the Group pursuant to the Summary of Principal Terms entered upon by the Group as aforementioned, or another agreement approved 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 set forth and specified in paragraph 4 and in the addendum in respect of each of them, and shall not sell or otherwise transfer to another, including to corporations or other entities controlled by them, directly or indirectly, means of control in the Bank or in any of the entities detailed in these paragraphs, even if such sale or transfer does not require a permit pursuant to section 34 to the 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 the permit. 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 identical 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 grant of the permit, on the fulfillment of all the following conditions:

- (1) The sale derives from legal requirements governing the Bank;
- (2) The distribution of dividend from profits from a sale of such assets does not result in a reduction in the minimum capital ratio of the Bank existing prior to the sale of the said assets;
- (3) The Bank's board of directors approves the distribution after examining the Bank's needs and its business plans;
- (4) The Supervisor gives his prior written approval to an aforesaid distribution, after examining the Bank's capital adequacy and the board of directors' decision and the basis thereof.

9. (a) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not engage in any business, in Israel or abroad, of receiving deposits - even from less than 30 people, or granting credit, or any other financial business in Israel that is such as to compete with the Bank's business.
- (b) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not be interested parties, directors or senior managers in corporations engaging in business of the type mentioned in sub-paragraph (a) above; in such regard, "interested party" means someone holding 5% or more of any type of the means of control.

10. 100% of the total balance sheet assets of each of the purchasers is to be financed from capital. Notwithstanding, the purchasers will be entitled to finance the acquisition of the controlling interest by way of a debt to the Government of Israel. Financing of the purchase of the means of control in the Bank, including the grant of guarantees for financing as aforesaid, shall not be provided, directly or indirectly, by the Bank or by banking corporations under its control.
 11. The Bronfman and Schron Group shall reduce their liability to the Bank in order to comply with Proper Banking Management Directive No. 312 concerning a banking corporation's business with related persons, unless otherwise approved by the Supervisor, in advance and in writing.
 12. The Group shall do the utmost to ensure that the memorandum, articles of association and all the procedures of the Bank will match and conform with, insofar as required and at any time, with the provision of the permit.
- 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 whereof four directors who were proposed for election by the Government and nine directors who were proposed for election by the Buyers shall be appointed (and if the Government's holdings in the Bank fall below 10%, two directors proposed by the Government for election and 11 directors proposed by the Buyers for election shall be appointed). It was also prescribed with regard to determining the identities of the candidates to serve as outside 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, (of which the Government and M.I. Holdings shall inform the Buyers from time to time) 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 (authorized 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 outside 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

Activating the cooperation arrangements upon termination of the "support period". 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. 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.

Activating the cooperation arrangements upon termination of the "restriction period". As stated, in accordance with the agreement for the sale of the controlling interest in the Bank, the "restriction period" specified in the agreement came to an end on December 31, 2009. On February 1, 2010, the Bank received a notice from the controlling shareholders in the matter of the extension of the period, in accordance with the agreement for the sale of the controlling interest in the Bank. According to this notice, the provisions of the amended agreement for the sale of the controlling interest in the Bank dated February 15, 2009, shall continue to apply even after the termination of the period of agreement and shall remain in effect until March 16, 2010. Furthermore, the provisions of Section 10.4 of the agreement for the sale of the controlling interest in the Bank in the matter of the commitment of the Buyers not to conduct certain transactions and to act to the best of their ability to prevent the Bank from conducting such transactions (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 the control in the Bank"), shall apply even after the termination of the restriction period and until March 16, 2010.

An additional notice by the controlling shareholders was received on March 16, 2010, according to which the said provisions will continue in effect until May 15, 2010.

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"). At present, in accordance with the agreement for the sale of the controlling interest, the Bronfman Group is entitled to appoint five Directors of the Bank and the Schron Group is entitled to appoint four Directors. 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. Likewise, terms have been fixed in respect of the exercise of the option.

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 option 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 option 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.

Section 34 determines provisions retarding responsibility and indemnification relating to implementation of transactions according to Sections 28-33 of the Law.

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 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, for a period not exceeding 13 months, 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.

Pursuant to the Accountant General's request of March 1, 2009, the Bank provided on April 27, 2009 certifications by the relevant corporations in the Discount Group, including the Bank, regarding awards granted to entitled employees, as well as the payments made to tax authorities in this respect. This was accompanied by a special confirmation (verification) rendered by the respective independent auditors of the said companies.

To the best of the Bank's knowledge, M.I. Holdings approached the Tax Authorities in December 2009, and presented

its position, backed by a legal opinion, whereby the Bank should not have withheld tax and paid payroll tax and profit tax in respect of the State's share in the payment to Bank employees (and therefore the Bank is entitled to a refund of the said tax payments from the Tax Authorities, and on the other hand the Bank has no claim against the State for the refund of the said tax payments), requesting the Tax Authorities to review the case.

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.

THE SALE OF SHARES OF THE STATE IN THE BANK

The price of the transaction for the sale of the Bank shares held by the State. Pursuant to a notice received by the Bank from the State of Israel, on January 14, 2010, the State sold shares comprising 5% of the issued share capital of the Bank. The price of the transaction was determined at NIS 8.871 per share.

Sale of the remaining Bank shares held by the State. Following the said sale, the State owns shares constituting 20% of the Bank's issued share capital. To the best of the Bank's knowledge, the State intends to sell in the course of 2010, the remaining Bank shares held by it.

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. This framework is based mostly on the Israeli law and its various layers, however, the Bank's conduct in certain areas is also affected by the provisions of foreign law, to the extent that these have an extraterritorial effect relating to its operations.

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

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

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

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

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

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.

The Bank and its subsidiaries are taking steps towards complying with the duties imposed upon them under the said provisions of the law.

Within the framework of the legislation passed in the wake of the Bachar Committee, 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

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 period since then, various regulations and rules have been published, intended to complement the arrangements by subsidiary legislation, information and operative letters.

The new legislation brought 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 activity which existed until then in the field of provident and mutual funds.

For further details regarding Standards amendment and regarding the Bank's operations following the reform of the capital market structure see "Operations in the Capital Market" under "Further details regarding activity in certain products".

REFORM OF THE DEBT EXECUTION LAW

In November 2008, a comprehensive amendment to the Debt Execution Law, 1967, was published. The said amendment came 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 Debt 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 Debt 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 and on banks operating in this market as well as on income from mortgage activity.

The Amendment further stipulates that the Chief Debt 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 not yet repaid. The amendment came into effect on October 16, 2009. The Bank took steps to implement the computer changes derived from the said Amendment.

PROHIBITION OF MONEY LAUNDERING AND PROHIBITION OF THE FINANCING OF TERROR ACTIVITIES

Prohibition of money laundering. The Prohibition on Money Laundering Law, 2000 (hereinafter – "Prohibition of Money Laundering Law") came into effect on August 17, 2000, and various regulations and orders have been enacted under it. Concurrently, the Supervisor of Banks issued Proper Banking Management Directive No. 411. This set of regulations imposed upon banks the duty of identifying, verifying, reporting and maintaining records with respect to bank customers and the accounts maintained by them. Furthermore, criminal sanctions and the authority to impose sanctions as well as the forfeiture of funds have been determined with respect to violation of the law and related regulations.

The addition of predicate offenses. The Prohibition of Money Laundering Order (change of the first addendum to the Law), 2009, came into effect on February 13, 2010. This added several offenses to the list of predicate offenses under the Prohibition of Money Laundering Law, including piracy and various offenses relating to the environment. The meaning of this amendment is, that a transaction involving assets that had been acquired while performing these offenses in order to disguise the origin of the assets, or being aware that the asset is prohibited, constitutes an offense under the Prohibition of Money Laundering Law.

Extension of the application of Proper Banking Management Directive No. 411. The amendment to Proper Banking Management Directive No. 411 will come into effect on July 1, 2010, expanding the duties imposed on banking corporations with respect to everything relating to the prevention of money laundering and the financing of terror activities and identification of customers. Among other things, this amendment details measures that the board of directors of a banking corporation must consider when determining the policy of "get to know your customer", strengthens the independent status of the officer responsible for fulfilling the duties according to the Prohibition of Money Laundering Law, and extends the duties of monitoring, supervising and current follow-up of accounts and/or transactions, which involve high risk. Furthermore, the amendment determines that foreign subsidiaries and branches of a banking corporation shall comply, as regards money laundering, with the provisions of the local law or of the Israeli law, the stricter of the two, to the extent that these are not in contradiction of the local law.

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 within the framework of the Bill, among which, extension of the list of predicate offenses (the addition of several offenses under the VAT Law as predicate offenses), changes in the level of punishment in respect of the offenses specified in the Law, extension of the term "control" (with respect to corporations) over and above the definition specified in the Securities Law, erosion in secrecy and in the confidentiality pertaining to the identity of the reporting entity, (in a manner that might expose the identity of the bank officer who reported the transaction), the addition of various segments as reporting entities and extension of the jurisdiction of the Money Laundering Authority.

In July 2009, the continuity rule was applied to this Bill, and the Knesset Constitution, Law and Justice Committee is presently discussing this Bill.

Prohibition of the financing of terror activities. The Prohibition on Terror Financing Law, 2005 (hereinafter: "Prohibition on Terror Financing Law"), came into effect at the beginning of August 2005. This Law specifies directives prohibiting the finance of terror activities, and various regulations and orders have been enacted under it imposing on banking institutions additional duties of identification and examination of customers based on published lists of terrorist organizations and activists. Furthermore, criminal sanctions and the authority to impose sanctions as well as the forfeiture of funds have been determined with respect to violation of the law and related regulations.

Banks within the Palestinian Authority. 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.

Since that date and until the end of 2008, the Bank informed, on several occasions, of the cessation of services and operations, and has been requested by the Bank of Israel to continue providing certain services.

In January 2009, the Bank terminated banking operations with banks in the Gaza Strip, 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 has also terminated operations with banks in the West Bank, with the exception of the clearing of checks, transfer of funds into Israel through the central bank clearinghouse and the transfer of foreign currency into Israel.

The Bank's preparations. Implementation of the legislation concerning money laundering and the financing of terrorism, obliged the Bank to reorganize computer wise, with respect to training and study courses for employees and managers at the Bank, and for the formation of work procedures. The Bank continues integrating the handling of money laundering prohibition and financing of terrorism prohibition regulations among all relevant staff of the Bank. Within this framework, the Bank has been developing and improving on an ongoing basis the computerized control systems for identifying and pinpointing customers and activities and reporting of such to the authorities.

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.

EXEMPTION FROM A BINDING ARRANGEMENT WITH RESPECT TO THE HOLDING AND JOINT ACTIVITY WITHIN THE FRAMEWORK OF ABC AND CBC

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 Automatic Bank Services Ltd. ("ABS") and Bank Clearing Center Ltd. ("BCC"). 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 BCC. 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, ABS 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 fulfillment 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 had agreed in advance and in writing to the consortium; the customer shall be entitled to negotiate separately with the member banks of the consortium; and where both Bank Leumi and Bank Hapoalim are members of the consortium - the minimum amount of credit to be granted is to be greater than NIS 150 million. In addition, banks are entitled to apply under specific exemption proceedings of a certain joint credit transaction.

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.

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). To the best of the Bank's knowledge, the Commissioner intends to extend the exemption.

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.

VERDICT IN THE COURT OF LAW FOR UNIFORM CONTRACTS

On May 5, 2009, a verdict was handed down at the Court of Law for Uniform Contracts, with regard to depriving conditions in a residential loan contract of the First International Bank of Israel ("FIBI"). A decision in the motion to postpone the implementation was also given on October 1, 2009.

The Court ruled that the loan agreement includes clauses that are discriminating clauses that should therefore be eliminated and also directed the amendment of other clauses.

Although the verdict was given in reference to a housing loan agreement, it includes statements which may also affect other contracts in use in the banking system. On January 10, 2010, the First International Bank filed an appeal with the Supreme Court against the ruling of the Uniform Contracts Court.

The Bank is reviewing the verdict and its implications and is monitoring development of these proceedings.

DECISION ON AN APPEAL AGAINST THE RULING OF THE UNIFORM CONTRACTS COURT

On February 18, 2010, the Supreme Court gave a ruling in the appeal submitted by Bank Leumi against the decision of the Uniform Contracts Court from June 10, 2004, in the matter of the uniform contract of Bank Leumi with its customers regularizing the terms of opening a current account with the bank. It has been ruled that it is the prime interest of the bank and, in a direct manner, of the public in general to maintain the economic stability of the bank, while strictly collecting customer debts and preventing exposure to liquidity crisis. This interest of the bank and of the public, constitutes a major consideration in the overall circumstances in which the uniform contract between the bank and its customers is to be examined, and a significant component in the balance required for the purpose of determining whether a certain term in the agreement constitutes a discriminating term or not. Among other things, it has been ruled that there is no flaw or discrimination in the section that entitles the bank to cancel or reduce a credit facility in cases where the bank may face a risk of not being able to collect the debt, due to a deterioration in the repayment ability of the customer, and the bank does not have to give prior notice, but may inform the customer at the time of cancellation or reduction. The Bank is studying the implications of the said Court ruling upon the terms of engagement with its customers.

LEGISLATION AND REGULATION WITH RESPECT TO THE PROTECTION OF THE ENVIRONMENT

In June 2009, the Supervisor of Banks issued a letter in the matter of environmental risks management by banking corporations. For further details, see "Environmental risks" under "Exposure to risks and risk management" above. Concurrently, various legislative and regulatory initiatives were brought up. A private Bill in the matter of polluted lands was tabled for the second time in June 2009. This Bill includes some of the arrangements proposed in the previous private Bill and/or in the Bill memorandum submitted by the Government, and within the framework of which the financing entities may be held responsible for soil pollution and among other things, for the prevention and discontinuation of the pollution. The Bank believes that legislation and arrangement initiatives regarding the environment, both governmental and private, are expected to continue also in the future.

COMPANIES LAW AMENDMENT BILL - CORPORATE GOVERNANCE

On January 24, 2010, the Ministerial Committee on Legislation approved a Companies Law Amendment Bill, drafted by the Ministry of Justice and the Securities Authority. According to the explanatory notes to the Bill, the Bill is intended to improve corporate governance of Israeli corporations and to modify it to the reality in Israel as well as to principles that are in practice in this area around the world.

Within the framework of the Bill it is proposed to determine recommended norms as regards corporate governance, based on the recommendations of the Goshen Committee for the examination of the corporate governance code in Israel with respect to the structure of boards of directors, their composition and operation. Furthermore, it is proposed to specify in the law norms regarding the remuneration policy of corporate officers, as well as to increase the majority

voting required at general meetings of shareholders with respect to the approval of related party transactions and the appointment of outside directors.

It is further proposed to alleviate the requirements applying to a plaintiff wishing to file a derivative action and to authorize the Securities Authority to impose monetary sanctions in respect of a series of violations of the Companies Law.

Most of the requirements included in the Amendment Bill with respect to corporate governance, are already being applied by the Bank virtue of the Proper Banking Management Directives applying to it, and which are compatible with the principles of corporate governance approved by the Bank (see in "Miscellaneous" hereunder).

MEMORANDUM REGARDING THE COMPLEMENTARY ENFORCEMENT BY THE SECURITIES AUTHORITY LAW (LEGISLATION AMENDMENTS), 2009

The Memorandum had been prepared by the Securities Authority, distributed by the legal advisor for the Ministry of Finance and approved by the Ministerial Committee on Legislation on December 6, 2009. The objective of the Memorandum is to add two additional enforcement mechanisms to the existing enforcement mechanisms, viz., the criminal enforcement mechanism and the mechanism for imposing monetary sanctions intended mostly for technical violations. The two proposed additional mechanisms are: an administrative enforcement mechanism, which includes quasi legal proceedings before an administrative panel headed by the staff of the Securities Authority; and a "conditional stay of proceedings arrangement" mechanism, which includes avoidance of completing proceedings by way of obtaining the consent of the violating entity for the impositions of sanctions of the kind to which he was exposed had the proceedings been completed in full. Such enforcement mechanisms are intended to apply with respect to violations of the Securities Law, the Mutual Investment Trust Law, the Law regularizing engagement in investment consulting, marketing of investments and the management of investment portfolios, and the regulations enacted under these laws.

ABUNDANCE OF LEGISLATION INITIATIVES

The year 2009, 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 2009 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, 2011 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 AA (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, 2009:

	Quoted prices in an active market	Other
	in NIS millions	
Assets		
Trading securities	2,155	-
Available-for-sale securities	14,412	17,782
Debitory balances in respect of derivative financial instruments	234	1,676
Liabilities		
Creditory balances in respect of derivative financial instruments	254	2,292

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 71 million, while a decrease of 1% in the discount rate would result in an increase in liabilities in the amount of approximately NIS 71 million.

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 C 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

- 1) 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.

In May 2009 the bank applied to the Court for instructions as to the investment of the attached funds and for a decision regarding which accounts are subject to attachment, whereas the Bank is holding funds in amounts larger than the amount of the attachments applying to accounts managed in the name of various legal entities. Furthermore, some of the accounts managed at the Bank are accounts of customers of companies within the Lehman Group. The Court has not yet given a decision in the matter.

On December 10, 2009, the Bank received notice of a motion for contempt of Court that had been submitted to the Bankruptcy Court in New York by Lehman Brothers Inc., against Bank Leumi and Israel Discount Bank.

As part of the motion filed in New York, Lehman brothers Inc. petitioned for the following relief:

- (a) To apply the stay of proceedings order issued in New York to Bank Leumi and to Discount Bank and to instruct them to stop all proceedings against Lehman Brothers Inc. in Israel, to cancel the attachments on its funds and to allow the Trustee to perform receivership on all its assets in Israel.
- (b) To determine that Bank Leumi and Discount Bank had committed a contempt of the U.S. Court in that they willfully violated the stay of proceedings order, and to charge them with all damages and expenses caused as a result of the violation of a U.S. Court order.

A ruling in the matter has not yet been given.

- 2) **Approach according to Section 194 of the Companies Law.** On May 13, 2009, the Bank received an approach in accordance with Section 194 of the Companies Law, 1999, according to which the Bank is requested to file an action within 45 days, against members of the Board of Directors of the Bank who held office during the past seven years, against the President and CEO of the Bank, against various officers of the Bank past and present, against employees of the Bank and against the controlling shareholders of the Bank.

The request was submitted by a corporation that holds shares in the Bank. According to the approach, the Bank is requested to submit a claim against all the aforementioned entities for the reimbursement of any amount that the Bank may be required to pay, if and when the Court so rules, or if it is so settled in a compromise agreement within the framework of one of the actions filed or which may be filed against the Bank in the matter of a binding arrangement with respect to coordinating commission charges and/or coordinating interest rate charges.

On June 17, 2009, the Bank's Board of Directors rejected the demand and informed the petitioner accordingly. It should be noted that the claims being the subject of the case have not yet been individually discussed and therefore no decision has been taken in their respect. For further details regarding the said claims, see Note 19 to the financial statements, sections 11.3, 11.4 and 11.5.

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN 2009

1. 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 Mercantile Discount Bank 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 was 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 plaintiff raised 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. The plaintiff also alleges that, at a later stage, the Bank enabled the manipulation in the price of the shares.

The claimant argued that the connection of Mercantile Discount Bank to the damage claimed results from the credit granted by that 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.

The total amount of damage stated in the request for approval of a class action suit against Mercantile Discount Bank and the Bank together, was 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.

2. 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 claimed 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 argued that the damage caused is a loss of interest or a charge of interest in case the customer's account is in debit.

Due to lack of information the amount of the action against all the banks involved was set at NIS 115 million. The relief requested was 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.

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.

3. 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.

The counterclaim was based on the argument that the Bank had breached 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 was 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 for loss of earnings as a result of the failure of the transaction to purchase that other company, and at least US\$200 million for loss of earnings as a result of the collapse of the company. Punitive damages were also claimed in an amount not estimated by the plaintiff.

The Bank petitioned 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. On April 10, 2009, the Court of Appeals dismissed the appeal.

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 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 argued that the U.S. Court has no international jurisdiction and that the forum in the United States not appropriate. All the banks argued that no possibility exists of filing a third party notice in actions based on anti-terror legislation.

In a response filed by Arab bank, it was argued, among other things, that the US judiciary system has a judicial authority with respect to Discount Bank and Mercantile Discount Bank, due to the fact that IDB New York constitutes an extension of IDB New York, which is sufficient to apply authority to the entire Discount Group.

The Plaintiffs also oppose the motion for a third party notice in these claims.

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 Israel Defense Forces (IDF), citizens of the United States, who were injured during their military service in the IDF. The arguments of Arab Bank were similar to those presented in previous claims, although in this case, additional arguments have been raised according to which the Israeli banks knew that certain bank transfers had been forbidden and were intended for informal purposes, or that the banks negligently turned a blind eye to such information. The banks also filed a motion for an in limine dismissal with respect to the said third-party notices.

On April 2, 2009, the Court in New York admitted the motion filed by the Bank, the said subsidiaries and by Bank Hapoalim and dismissed in limine the claim of the Arab Bank against them due to lack of cause of claim.

An appeal against the decision has not yet been filed. Notwithstanding, Arab bank has the right to appeal the decision upon completion of all proceedings in this case, within the framework of an appeal against the final verdict in the principal case.

On May 22, 2009, the New York Court dismissed Arab bank's motion for the disclosure of documents filed against the Bank and Mercantile Discount Bank, which has been filed prior to the filing of a third party notice within the framework of the principal claim. The motion against IDB New York has in part been admitted.

5. 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 was based on the argument that the Bank has unduly charged his customers with a commission on the purchase/sale of securities. The plaintiff claimed that the Bank had 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.

On September 30, 2009, the Court approved a settlement agreement, the principal items of which are the granting of an exemption from a minimum commission in respect of securities transactions to the group members for a period of one year and a payment to the claimant of NIS 450 thousand.

6. A lawsuit was filed on September 25, 2007, with the Tel Aviv District Court together with a motion for the approval of the lawsuit as a class action suit, which under the instruction of the Court was divided into five separate suits. In September 2009, the Court approved the withdrawal of the Claimant from the motion for approval of a suite as a class action suite, submitted on the grounds of over-charging minimum management fees in securities accounts. In October 2009 the Court approved the withdrawal of the claimant from the motion for approval of a suite as a class action suite, submitted on the grounds of the Bank not granting a rebate on the minimum commission charged for securities transactions made on the Internet, by a customer belonging to a group of customers entitled to such a rebate. (an additional motion is described in Note 19 C to the financial statements, item 11.4; two additional motions do not meet the disclosure threshold determined by the Bank).

For details regarding significant legal proceedings concluded at the beginning of 2010, see Note 19 C to the financial statements, article 11.6.

It should be noted that the Bank did not include in Note 19 to the financial statements certain legal claims included therein in prior reporting periods, even though these had not been settled, because such claims fell below the determined minimum materiality level for disclosure (items 11.3 and 11.10 in the financial statements as of December 31, 2008).

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 33 to the financial statements and "Credit card operations" under "Further details as to activity in certain products".
2. For details regarding the decision of the Antitrust Commissioner, given under Section 43(a)(1) of the Antitrust Law, 1988, according to which the Commissioner states that binding arrangements had existed between the Bank, Bank Hapoalim, Bank Leumi, Mizrahi-Tefahot Bank and the First International Bank regarding the communication of information with respect to commissions and in respect of the Supervisor's ruling that in accordance with Section 43(e) of the said Law, the said statement serves as prima facie evidence for everything determined therein in any legal proceedings, see Note 19 C 14 to the financial statements.
3. For details regarding the Securities Authority's request for information regarding investment consulting activity in general and basket certificates in particular, and regarding an audit report by the Securities Authority in the matter of the investment consulting system at the Bank see "Operations in the capital market" hereunder under "Further details as to activity in certain products".
4. For details regarding an approach by the Antitrust Commissioner, within the framework of an examination performed by her as to certain aspects relating to Bank's holdings in the First International Bank, see Note 6 D to the financial statements.

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.

For details regarding understandings reached with FIBI Holdings Ltd. regarding the Bank's holdings in the First International Bank and the rights attached thereto, see Note 6 D to the financial statements.

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 7 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 7 L 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.

LABOR CHARTER

The labor charter for Israel Discount Bank Ltd. employees was signed in 1974 and it incorporates employment terms, instructions regarding discipline, etc. For details see "Labor relations" under "Human resources" above.

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 "Retail 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, CPA(Israel) 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., DCMI and its subsidiaries, Tachlit, 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.

(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.

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 accordance with 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 lodging comments and elucidations.

The Board of Directors' Audit Committee discusses the work plan and on the basis of its recommendations the plan is brought before the Board for approval.

The work plan allows the internal auditor discretion for a 15% deviation as regards the use of human resources. A higher deviation requires prior approval of the Audit Committee.

The planned work programs for the material subsidiaries, at which the Bank's internal auditor serves also as their internal auditor, are combined with the annual work program for the internal audit of the Bank, while addressing each subsidiary separately. The scope of the work program for each subsidiary as above, is discussed by the audit committee of each subsidiary, and/or by the Board of Directors.

Most of the audit reports are graded on the basis of the audit findings. The range of grades moves from "very good" (1) to "very weak" (5). Among other things, the grade of the report serves to indicate the level of management involvement of which is required in addressing the report's findings.

Each audit report is submitted by the internal auditor to the President and CEO of the Bank and to the Bank's auditors. The Chairman of the Board and the Chairman of the Audit Committee of the Board receive each audit report, except for audit reports relating to branches highly graded, in respect of which they receive an executive summary. All the audit reports with respect to low graded branches (grades 4 or 5) are submitted in full to the Chairman of the Board and 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 of investee corporations in Israel and abroad. 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 Group in the reported period numbered 125.1 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 average number of positions in 2009 engaged in internal audit at the Bank and in investee companies in Israel and abroad (the scope of positions manned by outsourced manpower is given in parenthesis)

The Bank itself, including outsourcing and overhead	70.9	(1.5)
Investee companies in Israel audited by the internal auditor of the Bank (including outsourcing and overhead)	16.9	(1.5)
Investee companies in Israel where the audit (including outsourcing and overhead) is performed by an independent internal auditor	20.5	(1.8)
Investee companies abroad where the audit (including overhead) is performed by an independent internal auditor	16.8	
Total	125.1	(4.8)

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. A copy of the report is also delivered to the Auditors. 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 2008, submitted on February 8, 2009, and discussed by the Audit Committee on March 29, 2009.
- Annual report on the activities of the internal audit in 2008, submitted on March 4, 2009, and discussed by the Audit Committee on April 5, 2009 and by the Board of Directors on May 25, 2009.
- Report on the activities of the internal audit in the first quarter of 2009, submitted on May 12, 2009, and discussed by the Audit Committee on June 28, 2009.
- Report on the activities of the internal audit in the second quarter of 2009, submitted on August 12, 2009, and discussed by the Audit Committee on September 24, 2009.
- Report on the activities of the internal audit in the third quarter of 2009, submitted on November 12, 2009, and discussed by the Audit Committee on December 28, 2009.
- Report on the activities of the internal audit in the fourth quarter of 2009, submitted on February 16, 2010 and discussed by the Audit Committee on March 24, 2010.

The annual report on the activities of the internal audit department in 2009, was presented on March 14, 2010, 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 set out for internal audit at the Bank.

Independent quality evaluation of the internal audit layout. A qualified surveyor on behalf of the Israel Internal Auditors Organization has performed a quality evaluation of the Bank's internal audit layout for 2009. Following this survey, the internal audit layout received from the In Israel Internal Auditors Organization a quality certificate, indicating proper professional standards.

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.

Retirement from office of the Internal Auditor

Mr. Shlomo Pitchon, Senior Executive Vice President and Internal Auditor, informed on December 13, 2009, of his decision to retire from office as the Internal Auditor of the Bank and of a number of the Bank's subsidiaries. The date of his retirement from office has not been decided at that date.

On January 27, 2010, the Internal Auditor informed that he responded favorably to the request of the newly appointed Chairman of the Board, Dr. Joseph Bachar, and to the request of the President and CEO Mr. Giora Offer, to postpone his retirement from office as internal auditor of the Bank and some of its subsidiaries until the end of 2010.

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 2009, in this context, volunteer Bank employees act out the Bank's vision of people oriented 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 2009 in the culture and arts field, providing sponsorship and donations. In 2009, the Bank continued the trend of supporting children and youth in various states of distress, and Art seeking youth.

Monetary scope of activity. The total volume of activities of Discount group in 2009, including the Lema'an Project, amounted to NIS 7,311 thousand, compared with NIS 6,901 thousand in 2008. 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 1,148 thousand in 2009, compared to NIS 532 thousand in 2008. Furthermore, direct current cost associate with the Visitor Center (tour guide personnel and building maintenance) amounted in 2009 to NIS 3,343 thousand. Miscellaneous expenses, including expenses for production of the Corporate Social Responsibility Report, participation by Bank Management in financing of the "March for the living" visit to Poland, and financing staff visits to the capital Jerusalem, amounted in 2009 to NIS 1,057 thousand, compared to NIS 1,341 thousand in 2008.

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 2009, noteworthy are those granted to following associations: Yad Ezer Lachaver, Warm Home for Children requiring Artificial Respiration, Yad Sarah, Chimes, Ilan, Akim, The Institute for Advancement of Education in Jaffa, College for All, Alut – the Israeli Society for Autistic Children, the Israel Multiple Sclerosis Society 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 the course of 2009, the effort was focused on volunteer activities in aid of children and youth at risk and distress situations, senior citizens, the sick, special needs and more.

Presented below is a selection of examples of the projects and activities within the framework of the "Lema'an" Project:

"Hadassa Youth" youth village. Cooperation between the Operations and Information Systems Division and the Human Resources Group with the school, with a view to expand the variety of courses and seminars offered to students:

- Internet site construction course: a project begun in 2008 and continued in 2009. Tutorials were given by the staff of the Operations and Information Systems Division in a specially designated classroom at the Sharon Area Administration. 15 students in ninth to eleventh grades participated in the course.
- Daily economic management course: The course was provided by Discount College to high school students majoring business management in eleventh and twelfth grades. The course was devised to respond to the special needs of the

student population and, will among other things, provide students with basic economic tools in the following areas: management and balancing of a current account, account commissions. The course included, among other things, a visit to the Bank's Natanya Branch, a tour of the branch's various departments and a meeting with the Branch Manager.

Unit volunteer activity. During the year, additional units at the Bank joined the volunteer activity within the framework of the unit, including:

- "Geha Mental Health Center" Hospital. The Petach Tiqva Branch joined in the voluntary activities of Bank employees and elected to adopt the patients of the "Geha" Hospital at Petach Tiqva;
- Senior citizens clubs – Planning and Organization Department employees elected to adopt the "Gundar House" Senior Citizen Club in the Tel Aviv Yad Eliyahu neighborhood. The Internal Audit Department staff decided to adopt the Senior Citizens House in the Tel Aviv Shapira neighborhood (this after taking on the "Ma'amatz" Youth Club in Tel Aviv's Hatikva neighborhood, for eighteen months).
- Toddlers club – The staff of the Human Resources Unit at the Corporate Division Administration chose to adopt the "Lilach" Toddlers Club at the Hatikva neighborhood in Tel Aviv.
- Hospital Pediatrics department – The staff of the Bank's Human Resources Group chose to adopt the pediatrics department at Wolfson Hospital.

"Tu Be'shvat" holiday activities. The Bank purchased packages of dried fruit for distribution by Bank employees who engage in voluntary work at the following centers: children clubs, senior citizen clubs, hospitals, etc.

"Purim" holiday activities. Volunteer Bank employees organized Purim celebrations at centers at which they are active.

Hanukkah events at volunteering venues. Bank employees conducted Chanukah parties at 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. Within this framework the Bank decided to continue its adoption of "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. A meeting was held in August 2009 at the base of Squadron 916, in which commanding officers of the squadron and representatives of the Bank including the president & CEO participated. Three years of patronage were reviewed at the meeting, and it was agreed in principle on the continued support for an additional period of three years.

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. Among other things, the squadron's servicemen were invited to visit the Discount Visitors' Center and enjoy an interactive tour of the place (see below "HerzLilinblum").

Bazaar for items produced by the handicapped. This is the third consecutive year in which, towards the Jewish New Year and Passover holidays, the Bank assists in setting up a bazaar (on the Bank's permits) at which Bank employees can buy items created by members of the IDF rehabilitation center and other associations employing handicapped persons ("Alut", Chimes", a school 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 third year running. Approaches in the matter of health received by the Bank 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.

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 and NIS 300 each, respectively, 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 Hezek" project participants and additional families from the Haifa area in conjunction with Haifa Radio.

A project in aid of Holocaust survivors. As part of the activity of helping needy Holocaust survivors families, 120 volunteers from among the Bank's employees from all over the country were recruited to aid Holocaust survivors once a month by providing them with foodstuffs and a coupon for purchasing medication. The project operates in collaboration with the "Latet" Association.

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.

Launching of the "For the Community" website. The "For the community" website was launched this year on the employee Intranet site. The site includes up-to-date contents regarding the activities of the Bank in aid of the community, details regarding volunteer work performed by the Bank's various units as well as details regarding additional areas of volunteer work which may be joined.

"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 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, in his last post serving as Executive Vice President head of the Commercial Banking Division. Within the framework of the Fund, the Bank grants 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. 10 scholarships were granted in 2009.

"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 2009.

Activities as part of the adoption of youth belonging to "Discount Start-up" Association. As part of the cooperation with the Davidson Institute at the Weitzman Institute of Science, the Bank funded two visits to the place by the "Hezek" students. The visits included study, practical experience and an active tour of the Institute, while focusing

on areas of biology and physics. The visit highlighted excellence and high achievement as goals among youth with a potential for higher studies.

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 2009, some one thousand children from Tel-Hashomer, Schneider, Dana and Assaf Harofeh hospitals as well as children of AKIM – Israel National Association for the Habilitation of the Mentally Handicapped were invited to the event.

Renovation of AKIM children's clubs. ICC has initiated a project for the renovation of AKIM children's clubs. The first club to be renovated was the AKIM club in Kiryat Malachi, with the aim of making the stay of 30 young adults who spend their afternoons at the club more pleasant.

A start-up project in the Arab sector. In 2009, Mercantile Discount Bank continued the educational project launched in 2008, jointly with "Sprint for the Future" Association, within the framework of which this bank granted 68 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 0.6 million in 2009.

"A computer for every child". Mercantile Discount Bank, through the "A computer for every child" Association (under the patronage of the Government of Israel) has donated 50 computer kits to children of low income families.

Participation in an educational project. Mercantile Discount Bank has been participating in a project conducted by "Yad Eliezer" Association, within the framework of which this bank has granted 400 scholarships to Yeshiva students in consideration for their commitment to serve as tutors to children of disadvantaged families in the ultra-orthodox sector.

"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 thousands 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. Discount Mortgage Bank has decided to continue adopting the Regiment for an additional period of three years.

Volunteer activities at Discount Mortgage Bank. During the Jewish High Holidays, employees of Discount Mortgage Bank distributed pre-paid magnetic cards for the purchase of foodstuff to needy families all over the country. In addition, for the past two years discount Mortgage Bank is engaged in a joint project with the Mishluma for the development of Jaffa (an agency of the Tel Aviv-Jaffa Municipality focused on the development of Jaffa). As part of the project, Discount Mortgage Bank operates on a weekly basis, a learning assistance station for the benefit of children of the Ethiopian community in Jaffa.

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

"HERZELILINBLIM" - BANKING AND TEL AVIV NOSTALGIA MUSEUM

In May 2009, the Bank opened "HerzLilinblum" - the first museum of its kind for banking and nostalgia on the corner of Herzl and Lillienblum streets in Tel Aviv. The museum provides the possibility of a close study of the history and economics of Israel since the beginning of the last century. The opening of the museum is combined with the 100th anniversary celebrations of the city of Tel Aviv and reflects the combination of the Tel Aviv nostalgia and the beginning of the city's vibrant commercial life of the city.

"MA'ALEH" RATING FOR 2009

In June 2009, "Ma'aleh" published its rating for 2009. The Bank was rated among the top ten of "Ma'aleh's" rating, in the Platinum Category. The Bank has also been presented as one of the organizations which made a significant improvement of over 15% compared to the rating for 2008. The "Ma'aleh" rating relates to the largest public and private corporations being in the market, and is based on their social responsibilities characteristics. The rating measures the corporations in five areas: business ethics, human rights and employment environment, involvement with the community, environmental protection and corporate governance.

62 corporations took part in the rating in 2009, the total financial turnover of which comprised 44.3% of Israel's business product.

"THE MARCH OF THE LIVING"

In April 2009, a delegation of Discount Bank employees participated for the seventh 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 80 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 of the Bank's staff is expected to participate in 2010 in the "March of the Living".

PUBLICATION OF A SECOND CSR (CORPORATE SOCIAL RESPONSIBILITY) REPORT

The Bank published in October 2009 its second CSR report for the years 2007-2008. The event held for the publication of this Report is the first in a series of events celebrating the 75th anniversary of Israel Discount Bank, which since its establishment and all through the years of its operation has led community involvement.

Collecting and processing the material for the Report was performed under the social management code of the Ma'aleh Organization, which sets criteria for examining the commitment of business entities to the social responsibility field in Israel. Furthermore, in order to be considered among the world leading corporations and organizations, the Report has also been written according to the reporting principles of the GRI (a non-governmental organization operating for over a decade in cooperation with the United Nations and other organizations around the world in order to develop and assimilate global social reporting indices by organizations the world over).

According to commitments to the said reporting principles, the report has been modeled according to a new reporting framework of the GRI (G3), which contains all indicators of the industry addendums for the financial sector.

The Bank's CSR report has undergone an assurance procedure by an objective outside entity - the corporate social responsibility department of BDO Ziv Haft Consulting and Management Firm, which stated that the Bank had conformed to the requirements of GRI for grade B reporting. As a result of the said assurance procedure, the Report was rated at a B+ reporting level.

Ma'aleh emblem for 2009. The emblem was awarded at a special ceremony held during the Ma'aleh convention for 2009. The emblem was awarded to 16 corporations, including the Bank, which had published a Corporate Social Responsibility Report for the years 2007-2009.

ARTS

Lending works of art. Cooperation with various museums continued in 2009. Within in this framework the Bank lent the following works from its art collection: three works were lent to the Tel Aviv Museum of Art for a retrospective exhibit of the artist Alima Rita "Between a frame and a window"; the work "Butterfly" was lent to an exhibition by the artist Dortzin; a work by Pavel Wolberg was lent to an exhibition "Pictures from family life" at the Israel Museum; a work by the artist Sigalit Landau was lent to an exhibition at the University Gallery of the Ben Gurion University; a work of the artist Eli Shamir, be a new acquisition in the Bank's collection, was lent to the artist's an exhibit currently held at the Tel Aviv Museum of Art.

Exhibits from the Bank's collection. An exhibit showing works from the 1960's that are part of the Bank's collection is now presented in the "Herzlilinblum" Museum. An exhibit, titled "Blue brown" with the works by the artist David Meital is shown at the Feinberg House in Hadera.

Exhibit of the works of the artist Moshe Kupferman. An exhibition of the works of Moshe Kupferman was opened in September 2009 at "Herzlilinblum", Israel Discount Bank's Banking and Nostalgia Museum. The exhibit was presented in the two spaces dedicated to art at the Museum. In one of the spaces works of the artist from the Bank's art collection were exhibited, while in the other works on paper from the late artist's estate were presented in collaboration with the Kupferman Collection Association.

Mr. Kupferman, one of the founders of the Ghetto Fighters' Kibbutz, an important artist and Laureate of the Israel Prize for painting in 2000, passed away in 2003.

The Discount Museum website. The art collection of the bank is considered one of the quality collections of Israeli art. The Bank attributes great importance to the maintenance and cultivation of its art collection and is proud to exhibit a selection of the works included therein to the public at large through the Discount Museum website. The works selected for presentation are arranged according to themes in a manner that enables the public to learn about the structure of the collection and the contribution of the Bank to cultural and community life in Israel.

The address of the site is: <http://www.discountbank.co.il/museum>.

SPONSORSHIPS

During 2009, the Bank granted sponsorship to entities and activities promoting social, health, sporting, cultural, artistic and educational and business goals.

CULTURAL, ARTISTIC AND EDUCATIONAL SPONSORSHIPS

Testimony Theatre. For the second year running, the Bank has granted its sponsorship to the Testimony Theatre project, which commemorates, on stage, the stories of Holocaust survivors, in an inter-generation encounter with school children.

The project is of an educational and therapeutic nature and is conducted by Ezra and Irit Dagan.

Caesarea Jazz Festival. This is the fifth consecutive year in which the Bank has been granting sponsorship to the Festival, held in June. Some of the best jazz musicians in the world came to Israel and participated in the three day festival.

Leonard Cohen. The Bank sponsored Leonard Cohen's solo performance in Israel. The concert, which took place at the Ramat Gan Stadium on September 24, 2009, was attended by 50,000 spectators, the great majority of whom were Bank clients, who benefited from a preliminary sale of tickets for reserved seats. The moving concert, considered one of the best to have ever taken place in Israel, was the first stage in implementing the marketing campaign with the slogan "it's good to be a Discount client".

Tel Aviv Museum of Art. Sponsorship of a Business Corporation Club soirée focusing on Ya'acov Durchin's exhibition "Iron folds and line gestures", which opened at the Tel Aviv Museum in July 2009. This event, which also featured a talk by the artist, was also attended by select clients of the Bank's private and business banking units.

Tel Aviv Museum of Art. Sponsorship for the exhibition of the works of Menachem Shemi, opened in September 2009.

The Carmiel Dance Festival. For the 21st time, the Bank has sponsored the annual international festival, attended by official troupes from around the world, and Bank clients are invited to participate.

Arik Einstein's Songs. Sponsorship by means of purchasing tickets for the performance "You and I in the Park" - the best of Arik Einstein's songs at the Hayarkon Park, the income of which was dedicated to supporting the "Pitchon Lev" Association's "Touch the Horizon" project.

SPORTS SPONSORSHIPS

Sponsorship of the Tel Aviv University Sports Club. For over ten years the Club has been sponsored by the Bank. Within this framework the Bank promotes awareness of sports activities among students and the population at large.

Athletics Association. Sponsorship for the Association and the Israel Athletics Championship held at the Hadar Yoseph Stadium.

Kosel Center. Sponsorship for the activities of the Hebrew University Sports Center.

HEALTH SPONSORSHIPS

Sponsorship of "NATAL" (Israel Trauma Center for Victims of Terror and War). The Bank took part in sponsoring a convention on the subject of the treatment of trauma by means of art held at the Israeli extension of Lesley University, which qualifies graduates in the field of treatment and education by means of art, and by the "NATAL" Association which treats terror and war trauma victims.

Sponsorship of an international conference of the Israeli Medical Association. The conference was held in April with the participation of some 600 senior physicians from Israel and around the world.

Israel Cancer Association. Sponsorship of a fundraising event of the Association in Hod Hasharon.

ENVIRONMENTAL PROTECTION, SCIENCE, AND BUSINESS SPONSORSHIPS

Sponsorship of the Central and Northern Arava Research and Development Fund. For several years the Bank has been providing sponsorship and participating in a convention which presents the achievement of the agricultural research and development in the Arava region. The convention held this year marked 50 years of settlement and agriculture in the Arava region. Among the participants were representatives of the Beer Sheva City Center Branch which provides services to many of the region's farmers.

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			
	2009	2008	2009	2008
For Auditing⁽³⁾:				
To the joint auditors	17,707	*17,792	7,315	*7,753
For Other Services:				
Audit related services ⁽⁴⁾ :				
To the joint auditors	2,913	1,155	2,363	911
Taxation Services ⁽⁵⁾ :				
To the joint auditors	3,231	3,631	586	998
Other Services:				
To the joint auditors	454	*1,661	79	*1,567
Total	6,598	6,447	3,028	3,476
Total Auditors' Remuneration	24,305	24,239	10,343	11,229

* 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

REMUNERATION OF THE CHAIRMAN OF THE BOARD AND OF SENIOR OFFICERS

2009

Details of the recipient				Remuneration * for services							Loans granted under regular terms
Name	Position	Extent of position	Rate of holdings in the corporation's capital	Salary *	Awards *	Employer's payments and provisions ⁽¹⁾	Supplemental reserve ⁽²⁾	Total payroll, awards and employer's payment ⁽³⁾	Share based payment ⁽³⁾	Total	
Shlomo Zohar	Chairman of the Board	100%	0.02%	2,119	3,985	2,216	16	8,336	(477)	7,859	-
Giora Offer	President and CEO of the Bank	100%	0.02%	2,119	3,985	1,131	212	7,447	1,715	9,162	135
Reuven Shpiegel	President and CEO of IDB New York	100%	-	2,885	2,201	1,831	-	6,917	-	6,917	-
Boaz Chechik	President and CEO of ICC	100%	-	1,322	3,005	322	-	4,649	-	4,649	49
Jacob Tennenbaum	President and CEO of Mercantile Discount Bank	100%	-	1,697	950	768	26	3,441	-	3,441	-
Noam Hanegbi	Senior Executive Vice President, Head of Information Systems Division	100%	-	986	⁽⁶⁾ 1,214	295	31	2,526	395	2,921	-
Isreal David	Senior Executive Vice President, Head of Retail Banking Division	100%	-	1,034	⁽⁶⁾ 844	361	38	2,277	395	2,672	-
Shlomo Pitchon	Senior Executive Vice President, Internal Auditor	100%	⁽⁵⁾ -	974	⁽⁶⁾ 706	339	119	2,138	329	2,467	-

* 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.

(5) Mr. Pitchon holds shares of the Bank in a negligible amount of NIS 21,583 par value.

(6) The differential component existing in awards to be granted to members of Management in respect of 2009, is included in the above Table in accordance with the decision of the President & CEO, which has not yet been approved by the Board of Directors (see Note 16 G to the financial statements).

2008

Details of the recipient				Remuneration* for services							
Name	Position	Extent of position	Rate of holdings in the corporation's capital	Salary*	Awards*	Employer's payments and provisions ⁽¹⁾	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 outside 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. Since March 14, 2010, Dr. Sarir serves as Chairman of the Board of Discount Capital Markets. The remuneration to be paid to him in respect of his duties will be brought for approval of the relevant authorized organs.
- (e) For details regarding insurance, exemption and indemnification of directors and other senior executives, see Note 19 C (7) (k) and (l) to the financial statements.

Dr. Joseph Bachar – serves as Chairman of the Board of Directors since January 3, 2010, however at this stage no remuneration has been paid to him in respect of his said services. On January 11, 2010, the Board formed an ad-hoc committee in the matter of the remuneration to the chairman of the Board. The committee was entrusted with forming a remuneration plan for the chairman and bringing its recommendation before the authorized organs of the Bank.

Mr. Shlomo Zohar, acted as Chairman of the Board in the period from January 31, 2006 to December 31, 2009. Mr. Zohar was engaged under a personal engagement agreement. The period of the engagement agreement was five years as from February 6, 2006 (date on which the Chairman of the Board took office) and until February 5, 2011 (hereinafter: "the determining date"). The position of Mr. Zohar was a full time position and he was not permitted to accept another paid position, without the prior consent of the Board of Directors. His monthly gross salary amounted to NIS 178,700, which was adjusted in each quarter according to the rise in the CPI as compared to the CPI published on January 15, 2006. The engagement agreement specified that in each of the years from 2006 to 2010, the Bank will grant Mr. Zohar a special award not to exceed twice the amount of his annual salary (hereinafter: "limit of the annual award"). The annual award has been computed on the basis of five indices, as detailed in the agreement, and has been granted only with respect to years in which the Bank's financial statements reflected net earnings. In 2009, the said indices have been complied with and Mr. Zohar is entitled to an award of NIS 4 million in respect of this year. According to the terms of the plan, Mr. Zohar received an award of NIS 2.3 million in respect of the year 2008.

In addition to the above, the engagement terms also included a share option plan. According to this plan, 8,090,275 option warrants have been allotted to a trustee on behalf of Mr. Zohar, each of such option warrants is exercisable into one Ordinary "A" share of the Bank. The exercise price of the option warrants is NIS 8.455, subject to adjustments, based on the closing price of the Bank shares on the day prior to the date of approval of the plan by the General Meeting of Shareholders, linked to the CPI. The option warrants are divided into five equal annual parcels in respect of each of the

years 2006 to 2010 (for additional details, see Note 13 D (2) to the financial statements). In view of the termination of office of Mr. Zohar, 1,618,055 option warrants included in the parcel for 2010, have expired.

Entitlement to the option warrants has, among other things, been conditional upon the total shareholders return on the Bank shares in a given calendar year, so that it would reach at least 85% of the average return on shares of other banks for the same period. The said condition has been fulfilled with respect to the years 2006 and 2007 and in 2009 in respect of 2008 and 2009 and accordingly, Mr. Zohar is entitled to the yearly parcel of option warrants for those years.

Among other things, the plan specifies various instructions regarding the exercise of the option warrants, the shortening of the exercise period in case of termination of office, the manner of adjustment of the option warrants upon the occurrence of certain events, as well as the tax aspects relating to this plan. The expense with respect to the expired portion was eliminated in the report for 2009, and as a result, payroll expenses were reduced by an amount of NIS 477 thousand (an expense in the amount of NIS 3.25 million, in 2008).

Mr. Zohar was entitled to paid vacation, sick leave, recreation pay, an appropriate motor vehicle, entertainment expenses, social benefits (severance benefits, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. The agreement also included instructions regarding the duties imposed upon Mr. Zohar, among which instructions regarding a cooling off period of three months and the duty of confidentiality (for additional details concerning the engagement terms, see Note 22 H to the financial statements).

According to the engagement agreement, Mr. Zohar is entitled, under certain circumstances, to agreed compensation, in an amount equal to his full salary including related benefits and provisions, as detailed in the agreement, in respect of the remaining period until the determining date, or, under other circumstances, to an award in an amount equal to 12 monthly salaries, but in any event he is not entitled to double compensation, as stated.

In February 2009, Mr. Zohar informed that he agrees to forgo 10% of his salary (excluding as regards provisions and related benefits) for a period of 12 months starting in February 2009.

On October 30, 2009, Mr. Shlomo Zohar, the then Chairman of the Board, informed the Bank that the Bank's controlling shareholders, the Bronfman-Schron group, had approached him orally requesting that he terminate his office by the end of 2009. As abovesaid, the engagement agreement between the Bank and the Chairman of the Board was set for a period of five years, starting on February 6, 2006 and ending on February 5, 2011. On November 11, 2009, Mr. Zohar informed the Bank that in view of the circumstances that have arisen he announces his termination of office as Director and as Chairman of the Board of Directors of the Bank and of the subsidiaries of the Bank in which he acts as Director or as chairman of the board, with effect as from January 1, 2010.

According to information detailed to the Bank, a consultation agreement has been signed between Mr. Zohar and a company of the Bronfman Group, whereby upon termination of office at the Bank, Mr. Zohar will provide that company business and financial advisory services for a period of two years, for a total consideration of US\$1 million.

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 waived 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. Tennenbaum 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 months following the termination of employment, unless otherwise agreed by the parties. Mr. Tennenbaum 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. In 2009, Mr. Tennenbaum waived 7% of his annual remuneration.

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 indeterminate 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 was entitled to a special award in respect of foreign operations conducted by Israel Credit Card (International) Ltd. (hereinafter: "ICC International"; formerly 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 International 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 would have been entitled to an award equaling 4% of the betterment of ICC International 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. Following the merger of ICC International into ICC (see Note 33 A to the financial statements), the said remuneration plan has been cancelled.

As stated, on February 18, 2010, Mr. Chechik informed of his decision to terminate his office at ICC. In view of Mr.

Chechik's announcement of his retirement from office, negotiations with him regarding the financial aspects involved in his retirement will be held.

do not include exposures issued by agencies operating under the auspices of the U.S. Government.

Mr. Israel David, employed by the Bank as Deputy 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 waived 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. David is expected to terminate his office at the Bank upon taking office as President and CEO of ICC (for further details, see hereunder "Changes in the Board of Directors and Management" under "Board of Directors and Management").

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 waived 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009. On October 28, 2009, the Board of Directors decided to approve a special award of NIS 500 thousand to Mr. Hanegbi in appreciation of his unique contribution in leading the Ofek project – one of the largest and most complex computer projects ever undertaken in Israel, and in bringing it to its successful completion.

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. All the option warrants under the plan expired in the course of 2009.

Mr. Pitchon waived 7.5% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting with 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)

TRANSACTIONS WITH CONTROLLING SHAREHOLDERS.

NEGLIGIBLE TRANSACTIONS

General – Amendment of the Securities Regulations – Immediate report regarding transactions with controlling shareholders. According to law, the Bank must submit immediate and periodic reports with respect to any exceptional transaction entered into by the Bank. The Companies Law states that an "extraordinary transaction" is "a transaction not in a company's ordinary course of business, a transaction that is not undertaken in market conditions or a transaction that is likely substantially to influence the profitability of a company, its property or liabilities".

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 as of September 30, 2008 (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.

Disclosure and reporting outline. The Securities Authority has issued a guideline to the Bank with respect to the disclosure to be included in a Prospectus of the Bank and thereafter in annual financial statements, in the following format:

- (a) With respect to banking transactions with controlling shareholders that are not considered extraordinary transactions, the Bank shall report in the Prospectus as well as in periodic reports the balances of credit granted and of deposits made in accordance with the format appearing in the following tables;
- (b) As from the annual financial statements for 2009, the Bank is required to disclose the highest balance during the period of deposits made by controlling shareholders;
- (c) As from the annual financial statements for 2009, the disclosure provided in the credit table should be given separately for the balance of credit granted to a controlling shareholder and the balance of credit granted to relatives of the controlling shareholder (on a cumulative basis). Disclosure as to credit granted to each reporting corporation related to a controlling shareholder shall be provided on a consolidated basis at the level of each such reporting corporation.

Criteria for extraordinary and for negligible transactions. For the purpose of implementing the guideline of the Securities Authority, as stated above, the Bank is required to determine criteria for the definition of a "negligible transaction" – with respect to non-banking transactions, "negligible transaction" – with respect to banking transactions and "market terms", as well as to the manner of approval and disclosure of debt transactions to which Proper Banking Management Directive No. 312 does not apply. Accordingly, the Audit Committee of the Board of Directors decided on August 27, 2009, as follows:

"Negligible transaction" – a transaction, other than a banking transaction that complies with the criteria detailed hereunder, is considered a "negligible transaction":

- (1) A transaction for the purchase of retail products from a controlling shareholder or a transaction for the purchase of retail products in which the controlling shareholder has a personal interest – a transaction in the ordinary course of

business undertaken in market conditions the volume of which does not exceed NIS 2.5 million, provided that the total of the transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity as defined in Directive No. 312 of Proper Banking Management Directives (hereinafter: "regulatory shareholders' equity"). The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.

- (2) A transaction for the purchase of services from a controlling shareholder or a transaction for the purchase of services in which the controlling shareholder has a personal interest, provided that it is not an engagement with a controlling shareholder or his relative concerning the terms of his office and employment, in the ordinary course of business undertaken in market conditions, the volume of which does not exceed NIS 2.5 million, provided that the total of the transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity. The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.
- (3) Transactions for the rental of space from a controlling shareholder or transactions for the rental of space in which the controlling shareholder has a personal interest, that have been approved in any one calendar year in the ordinary course of business, undertaken in market conditions, the total of which does not exceed 0.1% of the regulatory shareholders' equity.
- (4) Reimbursement of expenses of a controlling shareholder in the ordinary course of business and under market conditions, incurred for the purpose of participating in events representing the Bank or in customer conventions of the Bank and its subsidiaries by their invitation – expenses of up to US\$100,000 per annum.
- (5) Any other transaction in the ordinary course of business undertaken in existing market conditions the volume of which is up to NIS 250,000, provided that the total of transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity. The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.

"Extraordinary transaction"

- (a) Regarding banking transactions that are debt transactions – a debt transaction shall be considered as material if in consequence thereof the total indebtedness of the controlling shareholders will exceed 5% of the regulatory shareholders' equity, or if the increase in the indebtedness of a single borrower of the group, following such transaction, exceeds 2% of the said equity. In the event that several debt transactions have been approved to the same single borrower during any calendar year, the said debt transactions are to be measured on a cumulative basis. For this purpose, measurement of the total indebtedness shall be made separately in respect of the Bronfman Group (on a cumulative basis), with respect to the Schron Group (on a cumulative basis) and with respect to any other corporation the volume of credit granted to it is not restricted in accordance with Section 5 of Proper Banking Management Directive No. 312, at the corporation's level on a consolidated basis, so that the total indebtedness of each of those shall not exceed 5% of the said equity.

"Controlling shareholder group" - a controlling shareholder together with the private companies related to him, within the meaning the term "related party" as stated in Proper Banking Management Directive No. 312 and together with the relatives of the controlling shareholders being members of the group and the private companies related to them. In this respect: the definition of a "controlling shareholder" according to the provisions of the Securities Law includes his next of kin living with him or where the livelihood of one depends on the other; the definition of "relative" according to the Banking Law (Licensing) includes a sibling, a parent, offspring, offspring of the spouse, and the spouse of each of these. Starting with the financial statements for 2009, the disclosure provided should be given separately for the balance of credit granted to a controlling shareholder and the balance of credit granted to relatives of the controlling shareholder (on a cumulative basis).

Furthermore, any specific provision for doubtful debts or the writing off of an amount in respect of the indebtedness of a controlling shareholder or of a corporation related to him shall be considered a material transaction.

- (b) A transaction representing the acceptance of a deposit – the acceptance of a deposit made by a controlling shareholder shall be considered a material transaction if in consequence thereof the total amount of deposits made by that group of controlling shareholders exceeds 2% of the total deposits at the Discount Bank Group. The acceptance of a deposit from a company considered a "related party" to the controlling shareholder and which is not a company under his control, shall be considered a material transaction if in consequence thereof the total amount of deposits of that company, on a consolidated basis, exceeds 2% of the total deposits at the Discount Bank Group according to the most recent annual financial statements of the Bank.
- (c) In respect of a transaction in securities or a transaction in foreign currency (which are not a debt transaction or a deposit transaction as described above) – Securities transaction or foreign currency transactions, the annual commission earned in their respect is equal to or exceeds 2% of the total annual operating income of the Discount Group (net of income from investment in shares) according to the most recent annual financial statements of the Bank.

A temporary deviation from the volumes specified in subsections (a) to (c) above, and for a period which does not exceed thirty days, shall not constitute cause for changing the classification of the transaction into an "immaterial transaction", and such deviations shall be disclosed in the annual report. It should be clarified that any change in a material transaction is in itself considered a material transaction and an immediate report shall be submitted in its respect.

"Market conditions" – conditions that are not preferable to the conditions according to which transactions similar to the transaction in question are being effected by the Bank with persons or with corporations that do not constitute controlling shareholders of the Bank, or with persons where a controlling shareholder has no personal interest in transactions with them. Market conditions with respect to banking transactions are determined in comparison to the conditions under which transactions of the same type and similar in volume are being effected, as is the practice when comparing transactions with related parties in accordance with Proper Banking Management Directive No. 312 with transactions made with customers of the Bank who are not related parties or with entities in which a controlling shareholder has no personal interest therein; market conditions with respect to transactions that are not banking transactions shall be compared with transactions of the same type entered into by the Bank with suppliers and/or with offers of other suppliers examined prior to the decision regarding the engagement. In cases where the Bank does not have other transactions of the same type, market conditions shall be compared to transactions of the same kind effected on the open market, provided that the transaction is in the ordinary course of business and that transactions of this kind have a ready market where similar transactions are effected.

Debt transactions to which Proper Banking Management Directive No. 312 does not apply – in the event that the Bank becomes aware of a debt transaction to which Proper Banking Management Directive No. 312 does not apply, the Bank is obliged to bring such transaction for approval in accordance with Proper Banking Management Directive No. 312 and to disclose it in its annual report. The definition of "negligible transaction" and "extraordinary transaction" with respect to the said transactions will be similar to the definition determined by the Bank for transactions to which Proper Banking Management Directive No. 312 apply.

Hereunder are summarized data regarding banking transactions considered transactions with controlling shareholders.

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.

December 31, 2009										
Credit	Balance of credit		Balance of unutilized credit facility		Guarantees granted by the Bank to secure credit to a controlling shareholder or to a related party therein		Guarantees granted by a controlling shareholder in favor of a third party		Indebtedness of a controlling shareholder regarding transactions in derivatives	
	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period
in NIS millions										
The Bronfman group	33	45	11	11	-	-	16	23	0.5	0.5
Reporting corporations related to the Bronfman group:										
Isralom properties Ltd	13	13	7	7	-	-	-	-	-	-
Shufersal Ltd	1	11	7	7	36	52	-	-	0.8	2
Total for reporting corporations	14	24	14	14	36	52	-	-	0.8	2
Total for the Bronfman group	47	69	25	25	36	52	16	23	1.3	2.5
Schron group	7	7	-	-	3	3	-	-	-	-

Deposits

Balance of deposits	
Balance at end of period	A high balance during the period
Controlling shareholders, including reporting corporations related to the controlling shareholders	152 233

(1) 10% of the balance of a future transaction with the addition of mark to market.

(2) The nominal value at end of period of the aforementioned transactions amounted to NIS 13 million, while the highest balance for the period amounted to NIS 25 million.

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, instruct and guide them during the establishment stage of the project for the preparations towards the signing of the declaration, as required.

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 Accounting 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.

Proper Banking Management Directive No. 309 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, as mentioned, together with an independent accounting firm that assisted the Bank in the establishment of 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.

During 2009, the Bank conducted a process of validation and updating of existing processes and addition of new processes, by means of the SOX unit established within the Accounting Layout.

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, except for the changes at Mercantile Discount Bank and IDB New York, which may be considered material even at the Group level, as detailed below, and except for changes at Mercantile Discount Bank and at the Bank, as detailed above.

Changes in internal control at Mercantile Discount Bank. During the reported period, Mercantile Discount Bank integrated new local information systems replacing those used by it in the past, as follows:

- The General Ledger system (G.L.), which constitutes the central system for the management of Mercantile discount Bank’s accounting records and for the production of financial statements.
- A system for the management and reporting of problematic debts and provisions for doubtful debts (the “Hotam” system).

Mercantile Discount Bank believes that the new systems improve the flow of financial data, the ability to query such data, include more detailed information (in the General Ledger system) and improve controls over reporting and managing problematic debts (in the "Hotam" system).

During the integration process of the said systems, Mercantile Discount Bank applied control measures designed to ensure the proper conversion of the systems. Integration of the systems involved organizational changes and changes in work procedures, and accordingly the new work procedures include controls designed to ensure the appropriateness of the information produced by the new systems.

It should be noted that the Bank has integrated identical systems since January 2007 and since December 2006, respectively.

Changes in internal control at IDB New York. During the reported period, IDB New York integrated new local information systems replacing those used by it in the past - the General Ledger system (G.L.), which constitutes the central system for the management of IDB New York's accounting records and for the production of financial statements.

IDB New York believes that the new systems improve the flow of financial data, the ability to query such data and include more detailed information.

During the integration process of the said systems, IDB New York applied control measures designed to ensure the proper conversion of the systems. Integration of the systems involved changes in work procedures, and accordingly the new work procedures include controls designed to ensure the appropriateness of the information produced by the new system.

Changes in internal control at the Bank and at Mercantile Discount Bank. During the reported period, the Bank and Mercantile Discount Bank assimilated a new management information system designated, operation and measurement of transactions in derivative financial instruments (the Treasury System), which replaced the previous information system on this subject based on the Unisys computer environment.

In addition, the Bank and Mercantile Discount Bank have put into operation for the first time a new information system for the measurement of credit risks, as required for the purpose of the first and third pillars of Basel II.

The Bank and Mercantile Discount Bank believes that the new systems improve the flow of financial data, the ability to query such data, and improve controls over reporting and managing capital adequacy.

During the integration process of the said systems, the Bank and Mercantile Discount Bank applied control measures designed to ensure the proper integration of the systems. Integration of the systems involved organizational changes and changes in work procedures, and accordingly the new work procedures include controls designed to ensure the appropriateness of the information produced by the new systems.

Material weaknesses in ICC. For details as to material weaknesses found at ICC, see above "Israel Credit Card Company Ltd." under "Main investees companies".

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, Senior Executive Vice President - Chief Legal Adviser and Legal Risks Manager; Ms. Dorit Bensimon, Senior Executive Vice President - Head of the Finance Division and Risk Manager of the Bank; Mr. Ehud Arnon, Senior 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 Accountant 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 plan for the years 2007-2011, the Bank is preparing to adopt the "Corporate governance code" for the Discount Bank Group. The purpose of adoption of the code is to maintain a policy of "best practice" of corporate governance principles at Group level, which will guide the Discount Group in its operations. Among other things, this code has been formulated in light of the following rules and principles and adjusted to the characteristics and unique needs of the Discount Group:

- The provisions of the law and regulations applying to the Bank;
- The Goshen Committee recommendations issued by the Securities Authority in January 2006. The Goshen Committee

report included, among other things, recommendations regarding the composition of the Board of Directors and its work, including improvement of its independence, composition of the Audit Committee and its work, approval of transactions with controlling shareholders and the creation of additional control mechanisms;

- Basel II guidelines with respect to strengthening corporate governance in banking corporations - in March 2008, the Bank of Israel published a draft document in this matter, which states that corporate governance relates to the manner in which the business and issues of banking corporations are managed by their Boards of Directors and senior managements. The said draft includes a number of principles for proper corporate governance that apply to the composition of the Board of Directors, the need to approve strategic targets and values at the Bank Group, reporting responsibility at the Bank Group, supervision over management, controls, remuneration of Directors and of senior management and transparency;
- Proper Banking Management Directives - Over the years, the Supervisor of Banks has issued instructions regarding proper banking management with respect to various issues, which apply to banking corporations and which form part of the corporate governance code, such as: Proper Banking Management Directive No.301 regarding the board of directors of a bank, Proper Banking Management Directive No.339 regarding risk management, Proper Banking Management Directive No.357 regarding information technology management, etc;
- Accepted practice in other countries around the world.

Within the framework of implementing the corporate governance plan, the Bank is acting, among other things, to determine supervision and control mechanisms intended to ensure the proper and efficient performance of the Discount Group, including with respect to the following items: activity and transactions with related parties; supervision by the Board of Directors over companies in the Group; reorganization and structural changes; formation of a group risk management policy (including Basel II); prohibition of money laundering and finance of terror activities, compliance policy, etc.

In August 2007, the Board of Directors adopted a legal opinion rendered by a prominent legal expert, according to which transactions between interested parties in the Bank and its subsidiary companies shall be approved in accordance with procedures determined by the Israeli Law with respect to approval of transactions with the Bank itself.

In April 2009, an ad hoc committee of the Board of Directors was established, which proceeded to promote and complete the corporate governance code.

On September 23, 2009 the said committee completed its discussions with respect to the proposal of a corporate governance code and recommended the Bank's Board of Directors to approve in principle the proposed code. The corporate governance code of the Discount group and the declaration of principles of corporate governance at the Discount Group were approved by the Board in its meeting of October 28, 2009. The Board's resolution specified that the said documents be examined once a year in order to determine whether they are in accordance with the Bank's business and the business and regulatory environments in which it operates.

The actual implementation of a corporate governance code involves the formation of procedures intended to regularize the activity of the Board of Directors and its committees, approval of related party transactions, as well as work processes involving subsidiaries. The Bank is acting towards the formation of such procedures, and once these are developed, they will be brought before the Bank's Board of Directors for approval. The Bank expects that the process of formulating the corporate governance procedures will be completed by the end of 2010.

PREPARATIONS BY THE BANK FOR CONTINUED BUSINESS OPERATIONS DURING EMERGENCIES

The Bank's Business Continuity Plan ("BCP") is designed to ensure the continuation of regular banking operations and services defined as vital, during periods of emergency on national and local levels. The plan covers and supports vital business operations from one end to the other: infrastructure, computer, hardware, software, communications, human resources, etc. All these are designed to secure a reasonable level of service to customers and continued business operations of the Bank in extreme situations.

Layouts and services supporting the corporate and retail networks are at the disposal of customers, as follows: countrywide core branches that are prepared and equipped to continue and provide service during emergencies, backup branches for those damaged, direct banking channels through telephone and internet communication. All these are designed to provide 24 hours a day banking services at any place, a "hot-line" for customers of closed branches and countrywide automatic banking machines that enable self-service banking operations. In addition, the Bank is able to operate mobile bank branches in emergency situations.

At the basis of the preparations for continued business operations is the backup system established by the Bank for the vital technological infrastructure. The backup system is based on: "hot backup" for the central computer system established at a designated distant location, a backup location for the dealing room, a backup location for direct banking operations/Discount Telebank, an active "hot backup" for the vital information systems, backup of the clearing layout through backup arrangements with other banks, and more.

The Bank implements an emergency scenario drill routine on an ongoing basis. Such drill routine comprises a vital component of the examination of the Bank's readiness to face threat scenarios and to secure compliance with the targets of service levels. A drill of the Bank's Management was conducted in 2009, which included the removal of Management offices to the emergency location and simulation of an emergency situation. Also drilled were the operations of the dealing room at the emergency location, the deployment of a mobile branch, the clearing of negotiable instruments at banks with which backup arrangements exist, the operations of Discount Gemel Ltd., and more.

In 2009, the Bank put into operation the emergency measures with respect to the following events:

- During "Operation Cast Lead", the Bank operated in some 20 locations under threat of rocket fire from the Gaza Strip. The Bank established a 24 hours a day situation room and provided support and means of protection to its employees. The Bank's branches continued their uninterrupted operations all through the operation.
- Swine flu – since April 2009, the Bank started preparations in accordance with the epidemic situation plan. In this respect a designated plan of operation was put into action.

BOARD OF DIRECTORS AND MANAGEMENT

GENERAL

A list of the members of the Board of Directors 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

Dr. Joseph Bachar – Serves as Director of the Bank since January 1, 2010, and as Chairman of the Board since January 3, 2010. Dr. Bachar acts as Chairman of the Credit Committee, Chairman of Manpower and Social Responsibility Committee, Chairman of the ad-hoc Price of Raising Capital Committee, Chairman of the Assets and Insurance Committee, Member of the Financial Statements Committee, the Computer Committee, the Risk Management Committee and the ad-hoc Committee in the matter of Corporate Governance.

Has accounting and financial expertise as well as professional qualifications.

Dr. Bachar is an Israeli Certified Public Accountant having an academic education – Bachelor of Economics and Accounting Hebrew University, Jerusalem. Master of Business Administration (specializing in finance), Berkley University, California and Ph.D. in Business Administration (specializing in finance) from Berkley University, California.

Serves as Chairman of the Board of Directors of Mercantile Discount Bank Ltd. (as Director since January 5, 2010 and as Chairman since January 25, 2010), as Director of Discount Bancorp Inc. (since January 7, 2010), as Director and Deputy Chairman of the Board of Israel Discount Bank of New York (since January 14, 2010). Also serves as Chairman of the Executive Board of the Haifa University (since October 2007), As CEO and Chairman of Dr. Yossi Bachar Business Consulting and Investment Promotion Ltd. (since July 2007), and Chairman of Bachar Yossi Certified Public Accountants (since June 2002).

Served as Director General of the Ministry of Finance (November 2003 - January 2007), Head of the Tax Authority (provisional appointment) (January 2007 - April 2007), Chairman of the Advisory Committee of Klirmark Capital Ltd. (April 2009 - November 2009) and non-executive Chairman of Stonehage (Israel) Financial Services Ltd. (October 2007 - December 2009).

Betzalel Eiger - Serves as director of the Bank since January 31, 2006. Member of the Credit Committee, and in the ad-hoc Price of Raising Capital Committee.

Serves as an Outside Director according to Directive No. 301 of Proper Banking Management Directives and has financial and accounting expertise as well as professional qualifications.

Mr. Eiger has an academic education - Bachelor of Business Administration from Bar Ilan University and Master of 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. (since April 2008) and beforehand as Director (since November 2005).

Served as Director of Comsec Ltd. (until December 2009), Outside Director in Adanim Mortgage Bank Ltd. (until January 2006) and as CEO of Giron-Development and Building Ltd. (until March 2005).

Ilan Biran - Serves as Outside Director of the Bank since October 29, 2008. Member of the Audit Committee, Credit Committee, Financial Statements Committee, and in the ad-hoc Price of Raising Capital Committee, computer committee,

and Chairman of the ad-hoc Committee for the Remuneration of the Chairman of the Board.

Acts as an Outside Director under the Companies Law, 1999 having 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. and Centriton Ltd. and as Chairman of the Management Committee, Kinneret College on the Sea of Galilee (R.A.).

Served as Venture Partner Consultant, The Challenge Fund - Etgar L.P. (until December 2009), 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. (2004 – November 2008), as Director and Chairman of the Strategic Research and Development 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.)

Gittit Guberman - Acts as Director of the Bank as from August 27, 2009. Member of the Financial Statements Committee, Foreign Extensions Committee and the Risk Management Committee.

Acts as an Outside Director under Directive No. 301 of the Proper Banking Management Directives and has accounting and financial expertise and professional qualifications.

Ms. Guberman is a lawyer with academic education – Bachelor of Law from the Hebrew University, Jerusalem, Bachelor of Mathematics and Economics from the Hebrew University, Jerusalem, L.L.B. Degree from the Hebrew University, Jerusalem, Master of Economics and Master of Business Administration (specialization in finance) from the Hebrew University, Jerusalem.

Acts as CFO of Micronet Ltd. (since 2007) and as an Outside Director of RoboGroup T.E.K. Ltd. (since 2008) and in Cham Food (Israel) Ltd. (since January 2009).

Acted as Outside Director of the Tel Aviv Stock Exchange Ltd. (December 2002-2008) and as Director (2006-2008) and CFO in IncrediMail Ltd. (2002-2005)

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, Computer Committee and the ad-hoc Committee in the matter of Corporate Governance.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directives and has financial and accounting expertise as well as professional qualifications.

Mr. Granit has an academic education – Bachelor of Agriculture from the Hebrew University in Jerusalem, Faculty of Agriculture in Rehovot, and a professional diploma from the Business School of the Hebrew University, Jerusalem.

Acts as a Management Consultant and Member of the Audit Committee, The Friends of Kaplan Medical Center (R.A.).

Mr. Granit was member of management of Ilan - Israeli Association for Handicapped Children (until 2009), a voluntary consultant of Nitzan Association (until 2009) and a voluntary consultant of the Rehovot Community Center Company (until 2006).

Prof. Ben-Zion Zilberfarb - Serves as Director of the Bank since January 31, 2006. Chairman of the Risk Management Committee and member of the Credit Committee, Financial Statements Committee, ad-hoc Price of Raising Capital Committee, Insurance and Property Committee and ad-hoc Committee for and ad-hoc Committee for the Remuneration of the Chairman of the Board.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directives and has financial and accounting expertise as well as professional qualifications.

Prof. Zilberfarb has an academic education - Bachelor of Economics and Business Administration from Bar-Ilan University and Master of 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 Bar-Ilan University.

Serves as Outside Director of Delek Group Ltd., Perrigo Company (a U.S. corporation) and Director of Prof. Ben-Zion Zilberfarb Economic and Management Consultant Ltd. in Tamares Hotels Ltd. and in the Company for Locating and Retrieving Assets of People who were killed in the Holocaust 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 2008), Fundtech Ltd. (until December 2007), Clal Finance Provident and Education Fund Ltd. (until April 2006), Partner Communications Company Ltd. (until February 2006) and Direct Capital Investments Ltd. (until May 2009).

Edith Lusky - Serves as Outside Director of the Bank since March 25, 2009. Serves as member of the Audit Committee, Personnel and Social Responsibility Committee, Overseas Operations Committee, Risk Management Committee, Insurance and Property Committee, the ad-hoc Committee in the matter of Corporate Governance and ad-hoc Committee for the Remuneration of the Chairman of the Board.

Serves as an Outside Director in accordance with the Companies Law, 1999. Has financial and accounting expertise and professional qualifications.

Ms. Lusky has an academic education – Bachelor of Economics and Statistics and Master of Economics from Tel Aviv University.

Served as senior executive vice president and member of management of Union Bank of Israel Ltd. (February 2004 – December 2008) and as a Director of Igud Leasing Ltd. (March 2007 – December 2008), and as a Director of Igudim Insurance Agency (1995) Ltd. (September 2005 – December 2008), Igudim Ltd. (September 2005 – December 2008) and Livluf Insurance Agency (1993) Ltd. (February 2004 – December 2008).

Jorge Zafran - Serves as Director of the Bank since January 31, 2006. Chairman of the Overseas Operations Committee (since February 19, 2009. Prior to that, committee member), Member of the Audit Committee and the ad-hoc Committee in the matter of Corporate Governance.

Has professional qualifications.

Mr. Zafran has an academic education – Master of Business Administration and Accounting (specialized in accounting and business administration in the marketing track) from the National University Of Buenos Aires, Argentina, Faculty of Economic Science.

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. and as Joint Managing Director and CEO of T.M. Intertrom 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 - Serves as Director of the Bank since October 29, 2008.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directives. Has accounting and financial expertise as well as professional qualifications.

Dr. Ovadia has an academic education - Bachelor of Economics and Accounting from Tel Aviv University and Master of Business Administration from Tel Aviv University. Ph.D. in Economics from the University of Pennsylvania U.S.A.

Serves as Chairman of 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., Managing Partner, Shamrock Israel Growth Fund Advisors Ltd. Acts as 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 Ltd., Polar Investments Ltd., Intercure Ltd., (prior to that acted as chairman) I. Q. S. Shalev Ltd., I.Q.S Hydraulics Ltd., Maxtech Technologies Ltd., Maxtech Communication Networks Ltd., Mantisvision 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. and 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 – April 2008), as Chairman of the Board of Exatend Ltd. (2005-2007), NVR Labs Ltd. (April 2000 – August 2008), Techtium Ltd. (until 2007), Peninsula Finances Ltd. (March 2007 – July 2008), Israel Phoenix Insurance Company Ltd. (September 2003 – March 2006). As Director at Israel Discount Bank Ltd. (July 1998 – July 2006), in Paycard Ltd. (April 2005 – July 2008) Hadar Ltd. (until 2005), Mehadrin Ltd. (July 2002 – April 2007) and Tadiran Communications Ltd. (November 1999 – August 2005).

Ilan (Eilon) Aish - Serves as Director of the Bank since November 1, 2008. Chairman of the Audit Committee (since February 19, 2009. Prior to that, committee member) and the ad-hoc Committee in the matter of Corporate Governance. Member of the Credit Committee, Financial Statements Committee, ad-hoc Price of Raising Capital Committee, Overseas Operations Committee and the Risk Management Committee.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directive and has accounting and financial expertise as well as professional qualifications.

Mr. Aish is a Certified Public Accountant having academic education - Bachelor of Economics and Accounting from Tel Aviv University.

Serves as Joint CEO and Director Harvest Capital Markets Ltd.

Served as Chairman General Partner of Tuff L.P. (until December 2008), Chairman of the Board of Tuff Merom Golan (2000) Ltd. (until December 2008), as Outside Director and Chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd. (December 2003 – September 2007), as Outside Director and Chairman of the Risk Management Committee of Mercantile Discount Bank Ltd. (November 2000 – October 2006), as Director of Golan Fine Crafts (1977) Ltd. (July 2005 – August 2005) and Harisha Tuff Lanka Private (Limited) (until December 2009).

Itshak Forer - Serves as Director of the Bank since December 18, 2007. Chairman of the Financial Statements Committee, member of the Personnel 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 – Bachelor of Economics from the Tel Aviv University.

Serves as Chairman of the Board of IHGST Properties LLC, K&G Properties Inc., (in voluntary liquidation) Shir Tal Holdings and Management Ltd., P.H.Y. Holdings Ltd. and Y.F.S.R. Management Services Ltd. as Outside Director of AlonyHetz Properties and Investments Ltd. and Director of Otzar Hityashvuth Hayehudim B.M., Biomass Ltd., Conference on Jewish Material Claims against Germany Inc and Sensible Medical Innovations Ltd. Member of the Advisory Committee of Tamir Fishman Investments Ltd. (April 2007 – April 2008), Chairman of Ernst and Young Israel Accounting Firm (Kost Forer Gabbay and Kasierer) (until March 2007), Managing Partner of Ernst and Young Israel Accounting Firm (Kost Forer Gabbay and Kasierer) (1979 – 2000), acted in various positions in the Firm since 1959.

Joseph Ciechanover-Itzhar - Serves as Director of the Bank since June 3, 2009. Member of the Credit Committee,

Financial Statements Committee and the ad-hoc Committee for the Remuneration of the Chairman of the Board.

Has financial and accounting expertise as well as professional qualifications.

Mr. Ciechanover-Itzhar has an academic education – Ph.D. in Philosophy and Jewish Studies from Boston University in continuation of studies at the Jewish Theological Seminary, Boston University; has an LL.M. from the Faculty of Law, Berkley University, California; Magister Juris from the Hebrew University in Jerusalem; studies towards a Masters in business Administration department, Hebrew University, Jerusalem (without qualifying); Ministry of Education Teaching Qualification, Department of Education, Hebrew University, Jerusalem.

Acts as president of I.Y.Z. Investments Ltd. (since 1995), President of Atidim-Etgar Nihul Kranot Ltd. (Since 1995) and Director of Harel Insurance Investments and Financial Services Ltd. (since 1995) and of the Israel Museum (since 2003). Deputy chairman of the Board of Hillel - The Israel Center for Jewish Campus Life (PBC) (since 2008). Member and Treasurer of the Elie Wiesel – Foundation of Humanity (since 1995). Chairman of the Dr. Jacob Isler Association for Assisting the Handicapped and Bereaved Families (since 1971). Member of the Rashi Foundation, a Registered Association (since 1990).

Served as Director of Nova Measuring Instruments Ltd. (until May 2007).

Prof. Dafna Schwartz - Serves 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 Directive No. 301 of the Proper Banking Management Directives and has financial and accounting expertise as well as professional qualifications.

Prof. Schwartz has an academic education - Bachelor of Economics (Statistics) from Tel Aviv University, Master of Agricultural Economics and Management, PhD in Economics from the Hebrew University, Jerusalem. Professor, member of Faculty of the Guilford Glazer School of Business & Management, Ben-Gurion University in the Negev.

Economic and business consultant. A faculty member and Head of the Entrepreneurship and High-Tech Management Specialization at the Department of Business Administration and Manager associate of the Bengis Center for Entrepreneurship and High-Tech Management, Guilford Glazer School of Business and Management, Ben Gurion University in the Negev.

Serves as an Outside Director of Oil Refineries Ltd., Giron-Development and Building Ltd. and Strauss Group Ltd. (since June 2008).

Served as Director of Rotem Industries Ltd. (February 2002 – November 2008), Phoenix Holdings Ltd. (until December 2007), Phoenix Insurance Company Ltd. (until December 2007) and Leumi Securities and Investments Ltd. (until August 2007) and as Outside Director in Orda Print Industries Ltd. (until July 2007).

Zvi Streigold - Serves as Director of the Bank since January 31, 2006. Member of the Credit committee, Audit Committee, Personnel and Social Responsibility Committee, Financial Statements Committee, Computer Committee, Insurance and Property Committee, the ad-hoc Committee in the matter of Corporate Governance and the ad-hoc Committee for the Remuneration of the Chairman of the Board.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directives and has professional qualifications.

Mr. Streigold is a lawyer with an LL.B. Degree from Tel Aviv University. He also studied economics there without graduating.

Mr. Streigold practices law and serves as Director of Zvi Streigold-Law Company Ltd. and Clal Finance Trust 2007 Ltd. (since March 2008). Served as Chairman of the Board of UBank Trust Company Ltd. (until January 2006) and Director of UBank Underwriting and Consulting Ltd. (until June 2005). Chief Legal Counsel, head of Specialized Finance Division

and member of senior management of UBank Ltd. (until June 2005).

Dr. Yitzhak Sharir - Serves as director of the Bank since December 24, 2006. Chairman of the Computer Committee and member of the Personnel and Social Responsibility Committee, Overseas Operations Committee, the ad-hoc Committee in the matter of Corporate Governance and the ad-hoc Committee for the Remuneration of the Chairman of the Board. Has professional qualifications.

Dr. Sharir has an academic education – Bachelor of Mechanical Engineering from the Haifa Technion, Master of Materials Engineering from Ben Gurion University in the Negev and PhD in 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.

Dr. Sharir engages in business and private investments. Serves as Outside Director of Tzur Shamir Holdings Ltd., Chairman of the Board of Revolutionaire Ltd. (since September 2007), and Chairman of the Board of Discount Israel Capital Markets and Investments Ltd. (since March 14, 2010), Director (since April 2008), and in M.A. Sharir Management Ltd. (since April 2009).

Served as Chairmen of the Board of Lia Chocolate Gourmet Ltd. (April 2008 – September 2008), as President and CEO of Sapiens International Corporation N.V. (November 2000 – November 2005) and as Director of Israel Discount Bank Ltd. (October 1999 - August 2002).

DETAILS REGARDING MEMBERS OF MANAGEMENT

Giora Offer - Serves as President and CEO of the Bank since March 2, 2001.

Mr. Offer has an academic education - Bachelor of Economics and Master of Industrial Management (Engineering and Management) from Ben Gurion University, in the Negev.

Mr. Offer serves as Chairman of the Board of Israel Credit Cards Ltd. (Director and Chairman since January 14, 2010), Chairman of the board of Discount Bancorp Inc. (Director since April 2001, Temporary Chairman since April 2007, Chairman since May 2009), Chairman of the Board of IDB (Swiss) Bank Ltd. and Director of Israel Discount Bank of New York. Served as Chairman of the Board of Israel Credit Cards Ltd. (until March 2006).

Israel David - member of management since February 1, 2002, Deputy President, Head of the Retail Banking Division.

Mr. David has an academic education - Bachelor of Economics and Business Administration from Ben Gurion University in the Negev and Master of Business Administration from Bar-Ilan University. He has also taken a course in guidance management at Bar-Ilan University.

Serves as Chairman of the Board of Discount Mortgage Bank Ltd., Director of Israel Credit Cards Ltd., Israel Credit Cards (International) Ltd. (in voluntary liquidation), Bayit Meniv Israel Ltd. and in IDB (Swiss) Bank Ltd. (since March 2010). 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 Division at the Bank (February 2002 - March 2006).

Mr. David is expected to terminate his office at the Bank upon taking office as President and CEO of ICC (for further details, see hereunder "Changes at the Board of Directors and Management" under "Board of Directors and Management").

Ehud Arnon - member of management since May 13, 2007, Senior Executive Vice President, Head of the Corporate Banking Division.

Mr. Arnon has an academic education - Bachelor of Social Sciences - Economics and International Relations and Master

of 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).

Managed the corporate department and was member of Management of the Israeli branch of HSBC Bank PLC (2001 – May 2007), Director of Beyachad Fund (2006 – January 2009).

Dorit Bensimon - member of management since April 2, 2006, Senior Executive Vice President, Head of Finance Division and the Bank's Chief Risk Manager.

Ms. Bensimon has an academic education - Bachelor of Social Sciences - Economics and General Studies and Master of Business Administration (specializing in finance) from the Hebrew University, Jerusalem.

Serves as Chairperson of the Board of Discount Manpikim Ltd. (since April 2006) and Chairperson of the Board of Bet Lamed Dalit Ltd. (since January 2007).

Served as Director of Discount Reinsurance International Limited, Guernsey (2006 – March 2008) and of Ma'alot - The Israel Rating Company Ltd. (April 2006 – November 2007) (The current name of the company is: M.H.L.D.N. Ltd.).

Served as General Manager of Gmulot and Head of the provident funds asset management unit at Bank Hapoalim Ltd. (February 2001 – January 2006).

Joseph Beressi - member of management since April 1, 2000, Senior Executive Vice President, Comptroller - Chief Accounting Officer and Head of the Accounting Layout of the Bank.

Mr. Beressi is a Certified Public Accountant and has an academic education – Bachelor of Accounting and Economics from 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 2008).

Served as Chairman of the Board of Discount Gemel Ltd. (until December 2008).

Amnon Gideon - member of management since March 1, 2006, Senior Executive Vice President, Head of the Human Resources of the Bank.

Mr. Gideon has an academic education – Bachelor of Political Sciences and Psychology from Bar-Ilan University, studies towards a Master of Human Resources Management (thesis not submitted) from Derby University. He has also taken professional courses in: Business Administration and General Management (Bar-Ilan University), Export Import Management (Berkley University, California, U.S.A) and Human Resources Management (Berkley University, California, U.S.A).

Served as Director of Discount Gemel (March 2006 – January 2008) and as VP Human Resources at Partner Communications Company Ltd. (2001 – 2006).

Esther Deutsch - member of management since June 1, 2006, Senior Executive Vice President, Chief Legal Adviser and Head of the Legal Advisory Layout of the Bank.

Ms. Deutsch is a lawyer with an LL.B. Degree from the Hebrew University, Jerusalem.

Acts as Chairperson of the Board of Discount Trust Ltd. (Chairperson since February 2008 and Director since January 2008). Served as Manager of the Bank's Legal Consulting Department (2000 – June 2006) and as Director of the Tel Aviv Stock Exchange Ltd. (July 2007 – June 2009).

Noam Hanegbi - member of management since November 15, 2000, Senior Executive Vice President, Head of the Operations and Information Systems Division of the Bank.

Mr Hanegbi has an academic education - Bachelor of Economics and Computer Sciences from Bar-Ilan University.

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 2008), Nidbach Real Estate and Investments Ltd. (since February 2009, prior thereto served as Director), Chairman of the Board of Tzir Trading Company Ltd. (since August 2009) and Chairman of the Board of Har Levy Properties Ltd. (since August 2009). Director of Mercantile Discount Bank Ltd. (since July 2006), Israel Credit Cards Ltd. (since March 2001). 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. (July 2007 – March 2009; Director since November 2000), Chairman of the Board of Automatic Bank Services Ltd. (July 2007 – March 2009; Director since November 2000) and as Director of Diners Club Israel Ltd. (until December 2006).

Shlomo Pitchon - Internal Auditor of the Bank and some of the Bank's subsidiaries. Senior Executive Vice President since September 1, 1994.

Mr. Pitchon is a Certified Public Accountant having an academic education - Bachelor of Economics and Accounting from Tel Aviv University.

REPORT ON DIRECTORS HAVING ACCOUNTING AND FINANCIAL EXPERTISE

According to Section 92 (a)(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.

Dr. Joseph Bachar - is a Certified Public Accountant, Bachelor of Economics and Accounting, Master of Business Administration (specializing in finance) and Dr. of Business Administration (specializing in finance).

Served as Director General of the Ministry of Finance (November 2003 – January 2007) and as Head of the Tax Authority (provisional appointment) (January 2007 – April 2007).

Since April 1995 to November 2003 acted as partner and manager of Luboshitz Kasierer Accounting Firm (formerly

Arthur Andersen and later Ernst and Young).

Since January 2010, Dr. Bachar acts as Acting Chairman of the Board of the Bank, as Chairman of the Board of Mercantile Discount Bank Ltd., as Director of Discount Bancorp Inc. and as Director and Deputy Chairman of Israel Discount Bank of New York. Dr. Bachar acts as member of the financial statements committee.

Betzalel Eiger - Bachelor of Business Administration and Master of 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 Chairman of the Board of Ortam Sahar Engineering Ltd., also a public company.

Served as Outside Director in Adanim Mortgage Bank Ltd. (December 2001 – January 2006). Served as Director in Neot Aviv Ltd. (1987 – September 2003) and Comsec Ltd., (until December 2009). Served as CEO of Giron - Development and Building Ltd. (May 2002 – 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 - Bachelor of 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).

Serves as Director General of the Ministry of Defense (1996-1999) and Bezeq the Israel Telecommunications 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. (2004-2008) 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), as a consultant at Al Cielo Ltd. (2006-2007) and Venture Partner Consultant, The Challenge Fund - Etgar L.P. (until December 2009).

Mr. Biran serves as member of the Audit Committee and the Financial Statements Committee.

Gittit Guberman - lawyer, bachelor degree in law, mathematics and economics and Master of economics and business administration (specialized in finance).

Acts as CFO of Micronet Ltd. (since 2007). Acts as Outside Director of RoboGroup T.E.K. Ltd. (since 2008). and of Cham Food (Israel) Ltd. (since January 2009).

Served as external Director and Chairman of the Audit Committee of the Tel Aviv Stock Exchange (December 2002 – 2008). Investment banker and legal counsel of Quality Capital Markets Ltd. (1994-2002) and deputy Department manager at the Securities Authority (1987-1993) where as part of her duties she participated in the examination of prospectuses issued by banks. Economist at the Treasury's budget department – referral officer at the Ministry of finance (1986-1987) and as economist at the Government Companies Authority (1981-1986).

Served as CFO (2002-2005) and as Director (2006-2008) of Incredimail Ltd. Acted as Director of many companies on behalf of the Government Companies Authority (with no voting rights), including: Israel Electric Corporation Ltd., Paz Oil Company Ltd. and Malam Systems Ltd. (1981-1986).

Ms. Guberman serves as a member of the Financial Statements Committee.

Ben-Zion Granit - Bachelor of Agricultural Sciences from Hebrew University with a minor in Agricultural Economics. Studied senior business management at the Business School of the Hebrew University and took courses on 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 addition 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 - Bachelor of Economics and Business Administration and Master of 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 committee of Delek Group Ltd. Serves as an Outside Director of Perrigo Company (an American company).

Acts as Director in Tamares Hotels Ltd. and in the Company for Locating and Retrieving Assets of People who were killed in the Holocaust Ltd.

Served as Outside Director and member of the audit committee of Fundtech Ltd. and Direct Capital Investments 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 committee 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.

Edith Lusky - Bachelor of Economics and Statistics and Master of 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 retail 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. (November 1995 – March 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.

Dr. Arie Ovadia - Bachelor of Economics and Accounting, Master of 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. (July 1998 – July 2006).

Ilan (Eilon) Aish - Certified Public Accountant, Bachelor of Economics and Accounting.

Serves as Joint Managing Director, Harvest Capital Markets Ltd.

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. (December 2003 – September 2007), and as Outside Director and chairman of the Risk Management Committee of Mercantile Discount Bank Ltd. (November 2000 – October 2006). In addition acted as Director of Harisha Tuff Lanka (Private) Ltd., (April 2007 – December 2009), Golan Fine Crafts (1977) Ltd. (July 2005 – August 2005), Ilran Holdings Ltd. (in voluntary liquidation) (April 1998 – April 2004). Chairman and General Partner in Tuff Industries (April 2002 – December 2008) and as Chairman of the Board of Tuff Merom Golan (2000) Ltd. (April 2002 – December 2008).

Also served as General Manager, Director and Liquidator in the voluntary liquidation of Amnar Underwriting and Issuance Ltd. (April 1998 – April 2004).

Mr. Aish serves as Chairman of the Audit Committee since February 24, 2009 (as member of the committee since November 1, 2008) and of the Financial Statements Committee.

Itshak Forer - Certified Public Accountant, Bachelor of Economics.

From 1959 to March 2007, served in various positions with the accounting firm of Ernst & Young Israel (Kost Forer Gabbay & Kasierer): auditor (1959-1962); partner (1962-1979); managing partner (1979-1999); chairman (2000-2007). Serves as Outside Director of AlonyHetz Properties and Investments Ltd., as Director of Otzar Hityashvut Hayehudim B.M. and of Sensible Medical Innovations Ltd. Served as director and chairman of the Finance Committee of Tadiran Ltd.

Mr. Forer acts as chairman of the financial statements committee.

Dr. Joseph Ciechanover-Itzhar - has a Ph.D. in Philosophy and Jewish Studies from Boston University, in continuation of studies at the Jewish Theological Seminary at Boston University. Has an L.L.M. from the Berkley University Law School, California, and a Magister Juris from the Hebrew University Law School, studies towards a Masters Degree at the Business Administration Department at the Hebrew University (no degree).

Serves as President of I.Y.Z Investments Ltd. and as President of Atidim-Etgar Nihul Kranot Ltd. Serves as Deputy Chairman of Hillel - The Foundation for Jewish Campus Life in Israel (NPO) and Director of Harel Insurance Investments and Financial Services and Director of the Israel Museum. Concurrently, a member and treasurer of the Elie Wiesel Foundation for Humanity and Chairman of the Dr. Jacob Isler Fund for Assisting the Handicapped and Bereaved Families.

Served as Chairman of El-Al Israel Airlines Ltd. (1995-2002). Between the years 1985 and 1995 served as President and member of the Board of PEC – Israel Economic Corporation Ltd. and member of the Board and of the Executive Committee of IDB Holding Company Ltd. Served as Chairman of Israel Discount Bank Ltd. and was a member of the Advisory Committee of the Bank of Israel (1986-1991).

Acted as Director General of the Foreign Ministry (1978-1980), as Head of the Defense Ministry Delegation to the United States (1974-1978), as Legal Advisor to the Defense Ministry (1968-1974) and has served in various positions in public service (1957-1978).

Mr. Ciechanover-Itzhar serves as member of the Financial Statements Committee.

Prof. Dafna Schwartz - Bachelor of Economics (Statistics), Master of Agricultural Economics and Management, and PhD in Economics from the Hebrew University, Jerusalem. Appointed Professor (as from April 2009), member of Faculty of the Business

Administration Department at the, Gilford Glazer School of Business Management at Ben Gurion University in the Negev. 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 (manager associate) Bengis Center for Entrepreneurship and High-Tech Management and as economic and business consultant in Israel and abroad.

Serves as an Outside Director of the following companies: Oil Refineries Ltd., Giron - Development and Buildings Ltd. and Strauss Group Ltd.

Also served in the past as director of Rotem Industries Ltd. (February 2002 – November 2008), The Phoenix Holdings Ltd. (August 2003 – February 2007), The Phoenix Insurance Company Ltd. (May 2006 – December 2007), Israel Discount Bank Ltd. (1995-2002) and Bezeq the Israel Telecommunication Corp. Ltd. (1997-2000).

CHANGES IN THE BOARD OF DIRECTORS AND MANAGEMENT

CHANGES IN THE BOARD OF DIRECTORS

On February 24, 2009, Ms. Zippi Samet retired from office as Outside Director. A special meeting of shareholders held on March 25, 2009, resolved to appoint Ms. Edith Luski as Outside Director.

The annual meeting of shareholders held on June 3, 2009 resolved to appoint Mr. Joseph Chechanover-Itzhar as Director of the Bank. Prof. Eitan Shishinsky retired from office as Director on that date.

A special meeting of shareholders held on August 27, 2009, resolved to appoint Ms. Gittit Guberman as Director of the Bank.

On January 1, 2010, Mr. Shlomo Zohar retired from office as Chairman of the Bank's Board of Directors, this following announcements made by him on October 30, 2009 and on November 11, 2009 (for details, see under "Remuneration of interested parties and senior officers and transactions with controlling shareholders", following the Table regarding "Remuneration of the Chairman of the Board and of senior officers").

The Chairman of the Board and the Directors, the President and CEO and members of management thank Mr. Zohar for his work and contribution to the Bank during his tenure of office.

In accordance with a resolution of the special meeting of shareholders held on December 29, 2009, Dr. Joseph Bachar took office on January 1, 2010 as Director of the Bank. On January 3, 2010, the Board of Directors elected Dr. Bachar as Chairman of the Board.

CHANGES IN MANAGEMENT

Mr. Israel David, deputy CEO, was appointed on March 21, 2010, to the office of President and CEO of ICC, subject to approval of the Supervisor of Banks. The appointment is to take effect on April 1, 2010, or from date of obtaining the approval of the Supervisor of Banks to the appointment, the later of the two, and on this date he is expected to terminate his office at the Bank.

On March 24, 2010, the Bank's Board of Directors decided on the following appointments: Mr. Noam Hanegbi, Senior Executive Vice President, would be appointed Head of the Retail Banking Division. Mr. Hanegbi will replace Mr. Israel David, Deputy President, who is expected to be appointed, as mentioned, CEO of ICC.

Mr. Shai Vardi, who currently serves as Deputy to the Head of the Operations and Information Systems Division, IT Manager would be appointed Executive Vice President and member of Management, Head of IT and Planning Division.

Mr. Shlomo Avidan, who currently serves as Deputy to the Head of Operations and Information Systems Division, in charge of operations and business continuity, was appointed Executive Vice President and member of Management, Head of division in charge of operations and logistics.

The decisions on the aforementioned appointments are subject to approval of the Supervisor of Banks.

The Board of Directors, the President & CEO and management wish to thank Mr. Israel David for his term of office, and wish the newly appointed members of management success in their new positions.

MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

In 2009, the Board of Directors held 40 meetings. In addition, 89 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 25, 2010	Dr. Joseph Bachar 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**

REPORTED AMOUNTS					
As at December 31					
	2009	2008	2007	2006	2005
In NIS millions					
Assets					
Cash and deposits with banks	24,583	21,554	19,850	25,100	20,586
Securities	36,338	31,535	37,278	38,977	42,226
Securities borrowed or purchased under resale agreements	336	25	346	-	-
Credit granted to the public	114,426	*116,456	*101,731	*89,901	*87,564
Credit granted to the Government	1,820	1,491	374	324	92
Investments in affiliated companies	1,795	1,827	1,935	1,367	1,478
Buildings and equipment	3,178	3,039	2,780	2,614	2,268
Other assets	5,341	5,904	4,184	4,044	4,292
Total assets	187,817	181,831	168,478	162,327	158,506
Liabilities and Shareholders' Equity					
Deposits from the public	141,825	139,232	130,518	130,517	130,285
Deposits from banks	3,724	4,555	5,072	8,099	6,518
Deposits from the Government	284	206	125	119	136
Securities loaned or sold under buy-back arrangements	7,651	7,194	5,895	-	-
Subordinated capital notes	11,529	9,373	7,437	6,302	5,342
Other liabilities	12,512	*12,248	*10,080	*8,923	*9,040
Total liabilities	177,525	172,808	159,127	153,960	151,321
Minority interest	298	226	147	402	467
Shareholders' equity	9,994	8,797	9,204	7,965	6,718
Total liabilities and shareholders' equity	187,817	181,831	168,478	162,327	158,506

* Reclassified.

SCHEDULE "B" - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

REPORTED AMOUNTS

	For the year ended December 31				
	2009	2008	2007	2006	2005
	in NIS millions				
Financing Income					
Income from financing activities before provision for doubtful debts	4,757	4,127	4,225	3,790	3,697
Provision for doubtful debts	998	780	447	570	691
Income from financing activities after provision for doubtful debts	3,759	3,347	3,778	3,220	3,006
Operating and other Income					
Operating commissions	2,625	2,495	2,474	2,297	2,296
Net income on investment in shares	197	51	58	65	3
Other income	269	27	119	68	177
Total operating and other income	3,091	2,573	2,651	2,430	2,476
Operating and other Expenses					
Salaries and related expenses	3,175	3,106	3,030	3,202	2,967
Maintenance and depreciation of buildings and equipment	981	910	819	679	670
Other expenses	1,330	1,332	1,296	1,210	1,162
Total operating and other expenses	5,486	5,348	5,145	5,091	4,799
Operating income before taxes	1,364	572	1,284	559	683
Provision for taxes on operating income	507	169	566	350	324
Operating income after taxes	857	403	718	209	359
Bank's share in operating income (loss) net of tax effect of affiliated companies	158	(70)	45	188	174
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(72)	(78)	(56)	(82)	(75)
Net operating income	943	255	707	315	458
Net cumulative effect as of the beginning of the year of change in accounting	-	-	-	-	(4)
Net income, before extraordinary income (loss) after taxes	943	255	707	315	454
Cancellation of provision for impairment in value of investment in affiliated companies	-	-	-	173	-
Net income (loss) from extraordinary items, net of taxes	(20)	(10)	558	348	4
Net income	923	245	1,265	836	458
Earnings per share of NIS 0.1 (in NIS)⁽¹⁾:					
Net operating income	0.96	0.26	0.72	0.32	0.47
Net income (loss) from extraordinary items, net of taxes ⁽¹⁾	(0.02)	(0.01)	0.57	0.53	-
Net income	0.94	0.25	1.29	0.85	0.47
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639	980,639

Footnote:

(1) December 31, 2006: Including a cancellation of provision for impairment in value of investment in an affiliated company.
December 31, 2005: Including net cumulative effect as of the beginning of the year of change in accounting.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾

REPORTED AMOUNTS

	2009				2008			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Unlinked Israeli Currency:								
Assets ⁽⁴⁾⁽⁵⁾	79,428	2,929	3.69		67,372	3,990	5.92	
Effect of derivatives ⁽³⁾								
Hedging derivatives	57	16			46	1		
Embedded and ALM derivatives	54,884	1,585			*50,272	*3,032		
Total assets	134,369	4,530		3.37	117,690	7,023		5.97
Liabilities ⁽⁵⁾	(75,374)	(638)	(0.85)		(64,985)	(1,785)	(2.75)	
Effect of derivatives ⁽³⁾								
Hedging derivatives	(60)	(15)			(46)	(8)		
Embedded and ALM derivatives	(52,798)	(1,502)			(48,243)	(2,842)		
Total liabilities	(128,232)	(2,155)		(1.68)	(113,274)	(4,635)		(4.09)
Interest margin			2.84	1.69			3.17	1.88
Israeli Currency Linked to the CPI:								
Assets ⁽⁴⁾⁽⁵⁾	27,978	2,211	7.90		25,558	2,312	9.05	
Effect of derivatives ⁽³⁾								
Embedded and ALM derivatives	322	22			*467	*25		
Total assets	28,300	2,233		7.89	26,025	2,337		8.98
Liabilities ⁽⁵⁾	(21,309)	(1,635)	(7.67)		(19,117)	(1,568)	(8.20)	
Effect of derivatives ⁽³⁾								
Embedded and ALM derivatives	(6,016)	(645)			(4,715)	(471)		
Total liabilities	(27,325)	(2,280)		(8.34)	(23,832)	(2,039)		(8.56)
Interest margin			0.23	(0.45)			0.85	0.42

* Reclassified.
For footnotes see page 366.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾ (CONTINUED)

REPORTED AMOUNTS

	2009				2008			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Foreign Currency:⁽⁶⁾								
Assets ⁽⁴⁾⁽⁵⁾	69,492	2,912	4.19		64,806	1,611	2.49	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	1,655	264			959	(50)		
Embedded and ALM derivatives	39,414	1,160			39,555	531		
Total assets	110,561	4,336		3.92	105,320	2,092		1.99
Liabilities ⁽⁵⁾	(73,413)	(1,403)	(1.91)		(68,483)	242	0.35	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(1,740)	(284)			(982)	(47)		
Embedded and ALM derivatives	(36,590)	(1,005)			(37,337)	(910)		
Total liabilities	(111,743)	(2,692)		(2.41)	(106,802)	(715)		(0.67)
Interest margin			2.28	1.51			2.84	1.32

For footnotes see page 366.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾ (CONTINUED)

REPORTED AMOUNTS

	2009				2008			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated financing income ⁽⁴⁾⁽⁵⁾	176,898	8,052	4.55		157,736	7,913	5.02	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	1,712	280			1,005	(49)		
Embedded and ALM derivatives	94,620	2,767			90,294	3,588		
Total assets	273,230	11,099		4.06	249,035	11,452		4.60
Monetary liabilities which generated financing expenses ⁽⁵⁾	(170,096)	(3,676)	(2.16)		(152,585)	(3,111)	(2.04)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(1,800)	(299)			(1,028)	(55)		
Embedded and ALM derivatives	(95,404)	(3,152)			(90,295)	(4,223)		
Total liabilities	(267,300)	(7,127)		(2.67)	(243,908)	(7,389)		(3.03)
Interest margin			2.39	1.39			2.98	1.57
In respect of options		83				(109)		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives) ⁽³⁾		32				27		
Commissions on financing operations and other financing income ⁽⁷⁾		691				208		
Other financing expenses		(21)				(62)		
Income from financing activities before provision for doubtful debts		4,757				4,127		
Provision for doubtful debts (including general and supplemental provisions)		(998)				(780)		
Income from financing activities after provision for doubtful debts		3,759				3,347		

For footnotes see next page.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾ (CONTINUED)

REPORTED AMOUNTS

	2009	2008
	Average balance ⁽²⁾	Average balance ⁽²⁾
in NIS millions		
Total:		
Monetary assets which generated financing income ⁽⁴⁾⁽⁵⁾	176,898	157,736
Assets related to derivative instruments ⁽⁸⁾	2,677	2,301
Other monetary assets ⁽⁵⁾⁽⁹⁾	2,641	2,954
General and supplemental provisions for doubtful debts	(605)	(594)
Total monetary assets	181,611	162,397
Total:		
Monetary liabilities which generated financing expenses ⁽⁵⁾	(170,096)	(152,585)
Liabilities related to derivative instruments ⁽⁸⁾	(3,407)	(2,819)
Other monetary liabilities ⁽⁵⁾	(4,477)	(4,046)
Total monetary liabilities	(177,980)	(159,450)
Surplus of monetary assets over monetary liabilities	3,631	2,947
Non-monetary assets	6,422	6,639
Non-monetary liabilities	(409)	(324)
Total capital resources	9,644	9,262

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 unlinked 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": 2009 – NIS (178) million in the unlinked segment, NIS (30) million in the CPI linked segment and NIS 543 million in the foreign currency segment; 2008 – NIS (71) million in the unlinked segment, NIS (6) million in the CPI linked segment and NIS 411 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).
- (9) The average balance of non-realized profits/losses on adjustment to fair value of bonds that was deducted/added as detailed in item (4) above, was added to/deducted from other financial assets.

SCHEDULE "C" - RATES OF FINANCING INCOME AND EXPENSE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES⁽¹⁾ (CONTINUED)

REPORTED AMOUNTS

	2009				2008			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in US\$ millions*		%		in US\$ millions*		%	
Foreign Currency -								
Nominal in US\$^{(6)*}								
Assets ⁽⁴⁾⁽⁵⁾	17,469	609	3.49		17,886	904	5.05	
Effect of derivatives ⁽³⁾								
Hedging derivatives	443	72			277	(18)		
Embedded and ALM derivatives	10,140	199			11,204	504		
Total Assets	28,052	880		3.14	29,367	1,390		4.73
Liabilities ⁽⁵⁾	(18,662)	(243)	(1.30)		(18,961)	(518)	(2.73)	
Effect of derivatives ⁽³⁾								
Hedging derivatives	(464)	(78)			(286)	(7)		
Embedded and ALM derivatives	(9,345)	(167)			(10,622)	(515)		
Total liabilities	(28,471)	(488)		(1.71)	(29,869)	(1,040)		(3.48)
Interest margin		392	2.19	1.43		350	2.32	1.25

* Nominal Israeli Shekel amounts translated to U.S. 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 unlinked 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: 2009 - in amount of US\$128 million, 2008 - in the amount of US\$121 million.
- (5) Excluding derivative instruments.
- (6) Including Israeli currency linked to foreign currency.

SCHEDULE "D" - EXPOSURE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES TO CHANGES IN INTEREST RATES AS OF DECEMBER 31, 2009

REPORTED AMOUNTS (IN NIS MILLIONS)

	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year
Non linked Israeli currency			
Financial assets and amounts receivable in respect of derivative instruments			
Financial assets*	68,366	6,413	3,865
Derivative financial instruments (except for options)	7,463	16,891	10,570
Options (in terms of base assets)	435	473	616
Total fair value	76,264	23,777	15,051
Financial liabilities and amounts payable in respect of derivative instruments			
Financial liabilities*	60,863	5,726	7,952
Derivative financial instruments (except for options)	11,017	16,882	7,967
Options (in terms of base assets)	433	524	755
Off-balance sheet financial instruments	-	-	14
Total fair value	72,313	23,132	16,688
Financial instruments, net			
Exposure to changes in interest rates in the segment	3,951	645	(1,637)
Cumulative exposure in the segment	3,951	4,596	2,959
CPI linked Israeli currency			
Financial assets and amounts receivable in respect of derivative instruments			
Financial assets*	806	699	5,211
Derivative financial instruments (except for options)	-	44	187
Options (in terms of base assets)	0	0	17
Total fair value	806	743	5,415
Financial liabilities and amounts payable in respect of derivative instruments			
Financial liabilities*	652	1,478	4,135
Derivative financial instruments (except for options)	171	135	723
Options (in terms of base assets)	2	23	142
Off-balance sheet financial instruments	-	-	8
Total fair value	825	1,636	5,008
Financial instruments, net			
Exposure to changes in interest rates in the segment	(19)	(893)	407
Cumulative exposure in the segment	(19)	(912)	(505)

For footnotes see page 370.

	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return	Effective average duration in years
								%	
	1,991	1,000	2,292	400	(1)	1,184	85,510	3.95%	0.73
	5,018	2,782	4,108	28	-	-	46,860		1.50
	264	66	122	157	-	-	2,133		0.16
	7,273	3,848	6,522	585	(1)	1,184	134,503		**0.99
	2,025	1,026	1,336	13	-	-	78,941	0.91%	0.38
	4,329	2,785	3,844	-	-	-	46,824		1.37
	235	11	4	-	20	-	1,982		0.02
	-	-	-	-	-	-	14		0.50
	6,589	3,822	5,184	13	20	-	127,761		**0.74
	684	26	1,338	572	(21)	1,184	6,742		
	3,643	3,669	5,007	5,579	5,558	6,742			
	9,085	4,983	6,787	1,912	29	99	29,611	2.51%	3.73
	21	3	5	32	-	-	292		2.27
	184	13	11	4	-	-	229		0.02
	9,290	4,999	6,803	1,948	29	99	30,132		**3.69
	6,509	4,062	4,857	2,430	-	-	24,123	1.92%	3.87
	1,166	1,497	1,612	345	-	-	5,649		3.78
	69	27	-	-	-	-	263		0.50
	-	-	-	-	-	-	8		0.50
	7,744	5,586	6,469	2,775	-	-	30,043		**3.83
	1,546	(587)	334	(827)	29	99	89		
	1,041	454	788	(39)	(10)	89			

SCHEDULE "D" - EXPOSURE OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES TO CHANGES IN INTEREST RATES AS OF DECEMBER 31, 2009 (CONTINUED)

REPORTED AMOUNTS (IN NIS MILLIONS)

	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year
Foreign currency****			
Financial assets and amounts receivable in respect of derivative instruments			
Financial assets*	28,832	14,849	8,220
Derivative financial instruments (except for options)	14,837	11,405	7,999
Options (in terms of base assets)	2,786	4,984	3,300
Off-balance sheet financial instruments	-	-	1
Total fair value	46,455	31,238	19,520
Financial liabilities and amounts payable in respect of derivative instruments			
Financial liabilities*	38,505	13,705	10,454
Derivative financial instruments (except for options)	10,383	9,450	7,896
Options (in terms of base assets)	2,746	4,903	3,026
Total fair value	51,634	28,058	21,376
Financial instruments, net			
Exposure to changes in interest rates in the segment	(5,179)	3,180	(1,856)
Cumulative exposure in the segment	(5,179)	(1,999)	(3,855)
Total exposure to changes in interest rates			
Financial assets and amounts receivable in respect of derivative instruments			
Financial assets* ****	98,004	21,961	17,296
Derivative financial instruments (except for options)	22,300	28,340	18,756
Options (in terms of base assets)	3,221	5,457	3,933
Off-balance sheet financial instruments	-	-	1
Total fair value	123,525	55,758	39,986
Financial liabilities and amounts payable in respect of derivative instruments			
Financial liabilities*	100,020	20,909	22,541
Derivative financial instruments (except for options)	21,571	26,467	16,586
Options (in terms of base assets)	3,181	5,450	3,923
Off-balance sheet financial instruments	-	-	56
Total fair value	124,772	52,826	43,106
Financial instruments, net			
Exposure to changes in interest rates in the segment	(1,247)	2,932	(3,120)
Cumulative exposure in the segment	(1,247)	1,685	(1,435)

General notes:

- (1) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument, in a manner consistent with assumptions used in calculation of the fair value of said financial instrument. (For details see "Interest rate exposure" under "Exposure to risks and risk management").
- (2) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return	Effective average duration in years
							%	in years
6,298	2,648	2,231	1,381	-	456	64,915	3.48%	1.07
1,714	983	1,727	247	-	-	38,912		0.75
214	-	4	-	20	-	11,308		0.00
-	-	-	-	-	-	1		0.50
8,226	3,631	3,962	1,628	20	456	115,136		**0.86
4,579	3,271	1,741	17	-	-	72,272	0.98%	0.66
1,863	1,771	2,529	292	-	-	34,184		1.11
330	35	112	156	-	-	11,308		0.02
6,772	5,077	4,382	465	-	-	117,764		**0.73
1,454	(1,446)	(420)	1,163	20	456	(2,628)		
(2,401)	(3,847)	(4,267)	(3,104)	(3,084)	(2,628)			
17,374	8,631	11,310	3,693	28	2,452	180,749	3.54%	1.35
6,753	3,768	5,840	307	-	-	86,064		1.16
662	79	137	161	20	-	13,670		0.03
-	-	-	-	-	-	1		0.50
24,789	12,478	17,287	4,161	48	2,452	280,484		**1.23
13,113	8,359	7,934	2,460	-	-	175,336	1.08%	0.97
7,358	6,053	7,985	637	-	-	86,657		1.43
634	73	116	156	20	-	13,553		0.03
-	-	-	-	-	-	56		0.20
21,105	14,485	16,035	3,253	20	-	275,602		**1.07
3,684	(2,007)	1,252	908	28	2,452	4,882		
2,249	242	1,494	2,402	2,430	4,882			

(3) The average effective duration of a group of financial instruments is an approximation of the change, in percentiles, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

* Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective duration.

*** Including shares listed under "No fixed maturity".

**** Including Israeli currency linked to foreign currency.

SCHEDULE "D" - BANKS EXPOSURE TO FLUCTUATIONS IN INTEREST RATES AS OF DECEMBER 31, 2008 (CONTINUED)

REPORTED AMOUNTS (IN NIS MILLIONS)

	On demand to 1 month	Over 1 month to 3 months
Non-linked Israeli Currency		
Total assets	***** 56,226	4,997
Total liabilities	***** 54,564	5,561
Difference	1,662	(564)
Effect of forward transactions and special commitments	926	(425)
Options	(133)	25
Exposure to changes in interest rates in the segment	2,455	(964)
Cumulative exposure in the segment	2,455	1,491
Israeli Currency Linked to the CPI		
Total assets	500	788
Total liabilities	431	905
Difference	69	(117)
Effect of forward transactions and special commitments	-	(21)
Options	-	-
Exposure to changes in interest rates in the segment	69	(138)
Cumulative exposure in the segment	69	(69)
Foreign Currency**		
Total assets	29,894	20,798
Total liabilities	35,581	19,203
Difference	(5,687)	1,595
Effect of forward transactions and special commitments	127	74
Options	133	(25)
Exposure to changes in interest rates in the segment	(5,427)	1,644
Cumulative exposure in the segment	(5,427)	(3,783)
Overall Exposure to Changes in Interest Rates		
Total assets***	86,620	26,583
Outstanding debt deriving from credit card transactions****		
Total balance sheet assets	86,620	26,583
Total liabilities***	90,576	25,669
Creditors in respect of credit card activity****		
Total balance sheet liabilities	90,576	25,669
Difference	(3,956)	914
Effect of forward transactions and special commitments	1,053	(372)
Exposure to changes in interest rates in the segment	(2,903)	542
Cumulative exposure in the segment	(2,903)	(2,361)

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.

	Over 3 months to 1 year	Over 1 to 3 years	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
	2,603	2,295	1,078	3,023	640	(16)	1,170	72,016	4.31	0.64
	7,083	2,133	815	2,159	309	18	120	72,762	2.85	0.50
	(4,480)	162	263	864	331	(34)	1,050	(746)	1.46	0.14
	1,298	863	403	668	126	-	-	3,859	-	-
	86	15	(79)	92	188	-	-	194	-	-
	(3,096)	1,040	587	1,624	645	(34)	1,050	3,307	-	-
	(1,605)	(565)	22	1,646	2,291	2,257	3,307	-	-	-
	3,574	7,586	4,842	6,877	2,627	153	114	27,061	4.59	4.63
	2,502	6,852	3,477	5,159	1,462	-	83	20,871	3.98	4.09
	1,072	734	1,365	1,718	1,165	153	31	6,190	0.61	0.54
	(807)	(804)	(1,303)	(1,990)	(498)	-	-	(5,423)	-	-
	-	262	-	2	-	-	-	264	-	-
	265	192	62	(270)	667	153	31	1,031	-	-
	196	388	450	180	847	1,000	1,031	-	-	-
	13,493	4,053	1,282	1,069	421	-	1,171	72,181	6.11	0.57
	9,593	3,253	3,629	3,630	89	-	98	75,076	3.34	0.85
	3,900	800	(2,347)	(2,561)	332	-	1,073	(2,895)	2.77	(0.28)
	(84)	757	648	678	(636)	-	-	1,564	-	-
	(86)	(277)	79	(94)	(188)	-	-	(458)	-	-
	3,730	1,280	(1,620)	(1,977)	(492)	-	1,073	(1,789)	-	-
	(53)	1,227	(393)	(2,370)	(2,862)	(2,862)	(1,789)	-	-	-
	19,670	13,934	7,202	10,969	3,688	137	*****9,037	177,840	-	1.25
								3,991		
	19,670	13,934	7,202	10,969	3,688	137	9,037	181,831		
	19,178	12,238	7,921	10,948	1,860	18	*****409	168,817	-	1.10
								3,991		
	19,178	12,238	7,921	10,948	1,860	18	409	172,808		
	492	1,696	(719)	21	1,828	119	8,628	9,023	-	0.15
	407	816	(252)	(644)	(1,008)	-	-	-	-	-
	899	2,512	(971)	(623)	820	119	8,628	9,023	-	-
	(1,462)	1,050	79	(544)	276	395	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.
***** Reclassified.

SCHEDULE "E" - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS

REPORTED AMOUNTS

December 31, 2009					
	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⁾
in NIS millions					
1. Lending Activity in Israel					
Agriculture	853	267	1,120	12	54
Industry	11,422	7,931	19,353	116	906
Construction and real estate	14,007	9,749	23,756	162	2,011
Electricity and water	1,151	332	1,483	-	9
Commerce	7,805	2,907	10,712	59	324
Hotels, hotel services and food	1,740	227	1,967	16	770
Transportation and storage	3,010	617	3,627	4	77
Communications and computer services	2,595	500	3,095	40	464
Financial services	7,848	3,861	11,709	90	326
Other business services	6,517	2,354	8,871	57	317
Public and community services	1,459	629	2,088	3	275
Private individuals - housing loans	16,045	1,113	17,158	1	397
Private individuals - other loans	16,724	16,368	33,092	192	785
Total	91,176	46,855	138,031	752	6,715
Less a deposit abroad linked to the credit risk of the borrower	(59)	-	(59)	-	-
Total	91,117	46,855	137,972	752	6,715
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements ⁽⁴⁾	243	17	260	-	103
Local authorities ⁽⁵⁾	193	52	245	-	7

Footnotes:

(1) Credit to the public of NIS 115,015 million, investments in bonds, assets relating to derivative instruments of NIS 2,329 million, created with the public of NIS 431 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

December 31, 2009					
	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⁾
in NIS millions					
2. Lending Activity Outside of Israel					
Agriculture	46	1	47	1	2
Industry	3,549	4,351	7,900	22	284
Construction and real estate	8,520	1,237	9,757	123	1,609
Electricity and water	421	388	809	-	-
Commerce	3,242	3,447	6,689	40	173
Hotels, hotel services and food	1,177	71	1,248	22	165
Transportation and storage	536	585	1,121	-	44
Communications and computer services	252	28	280	9	10
Financial services	4,976	2,596	7,572	8	69
Other business services	2,952	1,054	4,006	46	220
Public and community services	37	50	87	-	-
Private individuals - housing loans	20	-	20	-	-
Private individuals - other loans	930	839	1,769	8	9
Total	26,658	14,647	41,305	279	2,585

Footnotes:

- (1) Credit to the public of NIS 115,015 million, investments in bonds, assets relating to derivative instruments of NIS 2,329 million, created with the public of NIS 431 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

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⁾
in NIS millions					
1. Lending Activity in Israel					
Agriculture	891	259	1,150	1	64
Industry	14,111	8,568	22,679	121	1,137
Construction and real estate	14,817	10,171	24,988	165	2,388
Electricity and water	1,010	509	1,519	-	3
Commerce	*9,601	3,634	13,235	54	422
Hotels, hotel services and food	*1,988	321	2,309	40	786
Transportation and storage	3,407	667	4,074	12	80
Communications and computer services	2,661	620	3,281	7	436
Financial services	8,749	*2,945	11,694	28	726
Other business services	6,735	3,423	10,158	105	436
Public and community services	1,523	868	2,391	4	195
Private individuals - housing loans	14,095	728	14,823	3	419
Private individuals - other loans	*15,149	17,991	33,140	*136	684
Total	94,737	50,704	145,441	676	7,776
Less a deposit abroad linked to the credit risk of the borrower	(59)	-	(59)	-	-
Total	94,678	50,704	145,382	676	7,776
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements ⁽⁴⁾	239	34	273	4	107
Local authorities ⁽⁵⁾	218	119	337	-	11

* Reclassified.

Footnotes:

(1) Credit to the public of NIS 117,079 million, investments in bonds, assets relating to derivative instruments of 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

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⁾
in NIS millions					
2. Lending Activity Outside of Israel					
Agriculture	70	1	71	-	-
Industry	3,727	3,210	6,937	15	374
Construction and real estate	7,828	1,878	9,706	28	1,146
Electricity and water	356	472	828	-	-
Commerce	4,640	2,451	7,091	43	258
Hotels, hotel services and food	1,231	127	1,358	3	40
Transportation and storage	683	476	1,159	-	52
Communications and computer services	91	8	99	-	4
Financial services	3,982	1,051	5,033	(9)	81
Other business services	2,600	1,372	3,972	11	89
Public and community services	59	10	69	-	-
Private individuals - housing loans	18	-	18	-	-
Private individuals - other loans	1,108	1,271	2,379	4	15
Total	26,393	12,327	38,720	95	2,059

* Reclassified.

Footnotes:

- (1) Credit to the public of NIS 117,079 million, investments in bonds, assets relating to derivative instruments of 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 “F” - EXPOSURE TO FOREIGN COUNTRIES - ON A CONSOLIDATED BASIS⁽¹⁾**REPORTED AMOUNTS (IN 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, 2009			
The Country	To governments ⁽³⁾	Balance sheet exposure	
		Across the border	to Others
		balance sheet exposure	
United States	1,145	2,683	1,904
United Kingdom	-	565	173
Netherlands	11	50	2,200
Germany	23	688	706
Other	75	2,677	3,064
Total exposure to foreign countries	1,254	6,663	8,047
Includes - Total exposure to LDC countries	53	321	1,313
December 31, 2008*			
United States	252	2,336	1,892
United Kingdom	-	1,344	378
Netherlands	-	209	1,902
Germany	8	1,266	836
Other	7	5,475	3,232
Total exposure to foreign countries	267	10,630	8,240
Includes - Total exposure to LDC countries	4	651	1,366

* Reclassified.

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. 315 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 country in which the 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 liabilities of such extensions (deduction of liabilities should not exceed the amount of exposure).

B. Information regarding countries the amount of exposure in respect of each amounts to between 0.75% and 1% of total consolidated assets or between 15% and 20% of shareholders' equity, whichever is lower.

As of December 31, 2009 the Bank had no such exposure.

C. Information concerning balance-sheet exposure to foreign countries experiencing liquidity issues

As of December 31, 2009 the Bank had no such exposure.

December 31, 2009

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
30,620	11,925	18,695	24,427	1,086	9,023	9	3,705	2,027
1,659	264	1,395	2,133	49	860	-	462	276
-	-	-	2,261	57	5	-	674	1,587
-	-	-	1,417	-	68	31	1,106	311
1,464	1,314	150	5,966	58	650	1	4,183	1,633
33,743	13,503	20,240	36,204	1,250	10,606	41	10,130	5,834
982	982	-	1,687	2	473	-	856	831

December 31, 2008*

31,477	16,957	14,520	19,000	797	8,479	-	2,850	1,630
1,823	239	1,584	3,306	23	1,014	-	1,339	383
-	-	-	2,111	-	472	-	721	1,390
-	-	-	2,110	-	82	23	1,290	820
1,097	1,097	-	8,714	59	1,221	11	5,559	3,155
34,397	18,293	16,104	35,241	879	11,268	34	11,759	7,378
989	989	-	2,021	24	351	0	851	1,170

SCHEDULE "G" - CONDENSED CONSOLIDATED BALANCE SHEET FOR THE END OF EACH QUARTER - MULTI QUARTER DATA

REPORTED AMOUNTS

Quarter	2009				2008			
	4	3	2	1	4	3	2	1
In NIS millions								
Assets								
Cash and deposits with banks	24,583	23,083	21,466	22,584	21,554	16,094	14,440	17,323
Securities	36,338	35,866	37,751	35,948	31,535	29,860	34,679	36,711
Securities borrowed or purchased under resale agreements	336	513	308	24	25	119	2	5
Credit granted to the public	114,426	*115,533	*116,831	*120,397	*116,456	*113,250	*107,032	*103,498
Credit granted to the Government	1,820	1,833	1,809	1,802	1,491	1,496	1,448	1,414
Investments in affiliated companies	1,795	1,783	1,735	1,748	1,827	1,887	1,952	1,927
Buildings and equipment	3,178	3,062	3,057	3,040	3,039	2,909	2,908	2,855
Other assets	5,341	5,555	6,665	7,611	5,904	5,129	4,849	5,809
Total assets	187,817	187,228	189,622	193,154	181,831	170,744	167,310	169,542
Liabilities and Shareholders' Equity								
Deposits from the public	141,825	140,390	143,064	146,629	139,232	127,686	126,945	127,969
Deposits from banks	3,724	5,200	5,155	5,344	4,555	4,733	4,395	5,145
Deposits from the Government	284	255	235	220	206	193	169	140
Securities loaned or sold under buy-back arrangements	7,651	7,639	8,866	9,929	7,194	8,175	6,668	6,994
Subordinated capital notes	11,529	10,837	9,834	9,318	9,373	9,538	8,473	8,245
Other liabilities	12,512	*12,638	*12,668	*12,506	*12,248	*11,453	*11,228	*11,694
Total liabilities	177,525	176,959	179,822	183,946	172,808	161,778	157,878	160,187
Minority' interest	298	283	263	243	226	194	177	161
Shareholders' equity	9,994	9,986	9,537	8,965	8,797	8,772	9,255	9,194
Total liabilities and shareholders' equity	187,817	187,228	189,622	193,154	181,831	170,744	167,310	169,542

* Reclassified.

SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER

REPORTED AMOUNTS

Quarter	2009			
	4	3	2	1
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	1,222	1,329	1,266	940
Provision for doubtful debts	269	246	231	252
Income from financing activities after provision for doubtful debts	953	1,083	1,035	688
Operating and other Income				
Operating commissions	664	664	647	650
Net income from investment in shares	99	65	31	2
Other income	39	82	75	73
Total operating and other income	802	811	753	725
Operating and other Expenses				
Salaries and related expenses	861	812	722	780
Maintenance and depreciation of buildings and equipment	251	248	237	245
Other expenses	364	315	322	329
Total operating and other expenses	1,476	1,375	1,281	1,354
Operating income before taxes	279	519	507	59
Provision for taxes (tax savings) on operating income	30	252	311	(86)
Operating income after taxes	249	267	196	145
Bank's share in operating income (losses) net of tax effect of affiliated companies	(78)	46	162	28
Minority interest in the operating income after taxes of consolidated companies	(15)	(21)	(20)	(16)
Net operating income	156	292	338	157
Net loss from extraordinary items, net of taxes	(2)	-	(1)	(17)
Net income	154	292	337	140
Earnings (losses) per share of NIS 0.1 (in NIS):				
Net operating income	0.16	0.30	0.34	0.16
Net loss from extraordinary items, net of taxes	-	-	-	(0.02)
Net income	0.16	0.30	0.34	0.14
Total number of shares used for the above computation (in thousands)	980,639	980,639	980,639	980,639

SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA (CONTINUED)

REPORTED AMOUNTS

Quarter	2008			
	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
Income from financing activities after provision for doubtful debts	507	875	993	972
Operating and other Income				
Operating commissions	648	663	575	609
Net income (loss) on investment in shares	94	(36)	23	(30)
Other income	3	12	11	1
Total operating and other income	745	639	609	580
Operating and other Expenses				
Salaries and related expenses	864	733	649	860
Maintenance and depreciation of buildings and equipment	239	240	215	216
Other expenses	365	341	326	300
Total operating and other expenses	1,468	1,314	1,190	1,376
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, after taxes, in the operating income of consolidated subsidiaries	(31)	(17)	(15)	(15)
Net operating income (loss)	(115)	110	222	38
Net loss from extraordinary items, net of taxes	(6)	-	(1)	(3)
Net income (loss)	(121)	110	221	35
Earnings (losses) per share of NIS 0.1 (in NIS):				
Net operating income (loss)	(0.12)	0.11	0.23	0.04
Net loss from extraordinary items, net of taxes	(0.01)	-	-	-
Net income (loss)	(0.13)	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

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, 2009 (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.
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 25, 2010

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, 2009 (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.
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 25, 2010

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, 2009, 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, 2009, 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, 2009 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 389, which includes an unqualified opinion regarding the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2009.

	Dr. Joseph Bachar	Giora Offer	Joseph Beressi
	Chairman of the	President and	Senior Executive Vice President,
March 25, 2010	Board of Directors	Chief Executive Officer	Chief Accountant

FINANCIAL STATMENTS

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Somekh Chaikin



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, 2009, 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, 2009, 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, 2009 and 2008 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, 2009, and our report dated March 25, 2010, expressed an unqualified opinion on these financial statements.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 25, 2010

Ziv Haft
Certified Public Accountants (Isr.)



Somekh Chaikin



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, 2009 and December 31, 2008, 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, 2009. 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 67 million and NIS 280 million at December 31, 2009 and 2008, respectively, and the share of the Bank in their results is a loss of NIS 10 million, a loss of NIS 37 million and an income of NIS 25 million, for the years ended December 31, 2009, 2008 and 2007, 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, 2009 and 2008, 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, 2009, 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 call attention to the Note 19 C items 11.5 and 12.4 concerning motion to approve certain lawsuits as class action suits and item 14 as regards to the Antitrust Commissioner's decision and to that stated in Note 33 A regarding developments in the field of interational electronic trading transactions and in other matters.

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, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report of March 25, 2010, included an unqualified opinion on the effectiveness of internal control over financial reporting as of December 31, 2009.

Somekh Chaikin
Certified Public Accountants (Isr.)

March 25, 2010

Ziv Haft
Certified Public Accountants (Isr.)

BALANCE SHEET AS AT DECEMBER 31**REPORTED AMOUNTS**

Reported Amounts	Consolidated		The Bank		
	Notes	2009	2008	2009	2008
in NIS millions					
Assets					
Cash and deposits with banks	2,15	24,583	21,554	31,534	26,130
Securities	3,15	36,338	31,535	13,451	13,248
Securities borrowed or purchased under resale agreements		336	25	336	25
Credit granted to the public	4	114,426	*116,456	67,541	69,283
Credit granted to Governments	5	1,820	1,491	1,818	1,461
Investment in investee companies (consolidated – affiliated companies)	6	1,795	1,827	10,051	8,978
Buildings and equipment	7	3,178	3,039	2,382	2,364
Other assets	8	5,341	5,904	3,563	4,079
Total assets		187,817	181,831	130,676	125,568
Liabilities and Shareholders' Equity					
Deposits from the public	9	141,825	139,232	105,922	102,341
Deposits from banks	10	3,724	4,555	3,964	2,923
Deposits from the Government		284	206	159	128
Securities loaned or sold under buy-back arrangements		7,651	7,194	-	-
Subordinated capital notes	11	11,529	9,373	3,638	3,588
Other liabilities	12	12,512	*12,248	6,999	7,791
Total liabilities		177,525	172,808	120,682	116,771
Minority interest		298	226	-	-
Shareholders' equity	13	9,994	8,797	9,994	8,797
Total liabilities and shareholders' equity		187,817	181,831	130,676	125,568

* Reclassified.

The notes to the financial statements are an integral part thereof.

Dr. Joseph Bachar
Chairman of the Board
of DirectorsGiora Offer
President &
Chief Executive OfficerJoseph Beressi
Executive Vice President
Chief Accountant

March 25, 2010

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

		Consolidated		
	Notes	2009	2008	2007
In NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	23	4,757	4,127	4,225
Provision for doubtful debts	1l, 4c	998	780	447
Income from financing activities after provision for doubtful debts		3,759	3,347	3,778
Operating and other Income				
Operating commissions	24	2,625	2,495	2,474
Net income on investment in shares	25	197	51	58
Other income	26	269	27	119
Total operating and other income		3,091	2,573	2,651
Operating and other Expenses				
Salaries and related expenses	27	3,175	3,106	3,030
Maintenance and depreciation of buildings and equipment		981	910	819
Other expenses	28	1,330	1,332	1,296
Total operating and other expenses		5,486	5,348	5,145
Operating income before taxes		1,364	572	1,284
Provision for taxes on operating income	29	507	169	566
Operating income after taxes		857	403	718
Bank's share in operating income (loss) net of tax effect of affiliated companies	6b	158	(70)	45
Minority interest, after taxes, in the operating income of consolidated subsidiaries		(72)	(78)	(56)
Net operating income		943	255	707
Net income (loss) from extraordinary items, net of taxes	30	(20)	(10)	558
Net income		923	245	1,265
Earnings (losses) per share of NIS 0.1 (in NIS)	1y, 13, 35			
Net operating income		0.96	0.26	0.72
Net income (loss) from extraordinary items, net of taxes		(0.02)	(0.01)	0.57
Net income		0.94	0.25	1.29
Total number of shares used for the above computation (in thousands)		980,639	980,639	980,639

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	2009	2008	2007
in NIS millions				
Financing Income				
Income from financing activities before provision for doubtful debts	23	2,746	2,564	2,692
Provision for doubtful debts	1l, 4c	654	547	245
Income from financing activities after provision for doubtful debts		2,092	2,017	2,447
Operating and other Income				
Operating commissions	24	1,174	1,136	1,162
Net income (loss) on investment in shares	25	143	(2)	13
Other income	26	293	70	152
Total operating and other income		1,610	1,204	1,327
Operating and other Expenses				
Salaries and related expenses	27	2,055	2,043	1,975
Maintenance and depreciation of buildings and equipment		676	628	557
Other expenses	28	520	614	586
Total operating and other expenses		3,251	3,285	3,118
Operating income (loss) before taxes		451	(64)	656
Provision for taxes (tax savings) on operating income	29	155	(50)	241
Operating income (loss) after taxes		296	(14)	415
Bank's share in operating income net of tax effect of investee companies	6b	647	269	292
Net operating income		943	255	707
Net income (loss) from extraordinary items, net of taxes	30	(20)	(10)	558
Net income		923	245	1,265

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
	in NIS millions			
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
Changes in 2009:				
Net Income for the year	-	-	-	-
Benefit in respect of equity based compensation transactions	-	-	2	-
Option expiration ⁽³⁾	-	4	(4)	-
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, 2009	658	2,943	48	212

Footnotes:

- (1) Translation adjustments of foreign operations, 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 a unit having a functional currency that differs from the reporting currency. 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.
- (3) In respect of 784,511 un-exercised option warrants.

The notes to the financial statements are an integral part thereof.

Other cumulative comprehensive income (loss)					
Total share capital and reserves	Adjustment for presentation of available for sale securities at fair value	Translation adjustments ⁽¹⁾	Net gains (losses) on cash flow hedging	Retained earnings ⁽²⁾	Total shareholders' equity
in NIS millions					
3,817	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
-	-	-	-	923	923
2	-	-	-	-	2
-	-	-	-	-	-
-	1,014	-	-	-	1,014
-	(556)	-	-	-	(556)
-	(205)	-	-	-	(205)
-	-	19	-	-	19
3,861	57	(236)	(1)	6,313	9,994

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31

REPORTED AMOUNTS

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
in NIS millions						
Cash Flows from Operating Activities						
Net income for the period	923	245	1,265	923	245	1,265
Adjustments necessary to present cash flows from current operations: Bank's share in undistributed income of investee companies	(131)	73	(79)	(645)	(272)	(415)
Minority interest in income of consolidated subsidiaries	73	78	56	-	-	-
Depreciation of buildings and equipment	484	417	350	355	308	254
Amortization of goodwill	33	34	32	-	-	-
Financial Statements translation adjustments	-	(21)	-	-	-	-
Provision for impairment of securities held for investment	120	380	46	10	76	44
Provision for doubtful debts	1,049	838	553	703	602	348
Gain (loss) on sale of available-for-sale securities	(524)	(161)	(67)	(363)	(91)	(33)
Realized and non realized gain (loss) from adjustment to fair value of trading securities	(18)	65	47	(33)	41	40
Loss on realization of investment in an investee company	17	-	-	-	-	-
Benefit with respect to the allotment of options	2	15	27	2	15	27
Provision for impairment in value of buildings	6	11	10	6	11	8
Loss on sale of buildings and equipment	2	22	9	0	16	4
Dividend from Visa Europe	-	(33)	-	-	(7)	-
Net deferred taxes	195	(415)	281	31	(209)	240
Severance pay – decrease (increase) in excess of deposits over the provision	(149)	267	(18)	(157)	240	(5)
Inflation adjustment component of investing and financing activities	589	*988	2,581	164	303	263
Changes in Balance Sheet Items:						
Other assets, net	515	(1,569)	(473)	628	(1,728)	(792)
Other liabilities, net	63	*2,423	*1,228	(833)	2,084	1,006
Net Cash Flows from Operating Activities	3,249	3,657	5,848	791	1,634	2,254

* Reclassified.

The notes to the condensed financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

REPORTED AMOUNTS

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
in NIS millions						
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(986)	(640)	(834)	-	-	-
Proceeds from redemption of held-to-maturity bonds	952	1,820	1,823	-	-	-
Acquisition of available-for-sale securities	(23,528)	(15,676)	(19,120)	(6,048)	(2,733)	(5,659)
Proceeds from sale of available-for-sale securities	13,678	17,093	13,482	6,302	5,225	1,530
Proceeds from redemption of available-for-sale securities	5,837	1,120	3,989	229	870	3,207
Net deposits with banks	1,354	51	756	(432)	(4,081)	(1,188)
Trading securities, net	(104)	941	(20)	(187)	663	43
Net credit granted to the public	1,468	*(15,786)	*(12,003)	1,524	(10,527)	(8,038)
Net credit granted to the Government	(329)	(1,117)	(50)	(357)	(1,099)	(51)
Net on securities borrowed or purchased under resale agreements	(311)	321	(346)	(311)	321	(346)
Reduction of (additional) investment in investee companies	172	(29)	(738)	(186)	(956)	(756)
Acquisition of buildings and equipment	(626)	(690)	(565)	(385)	(537)	(403)
Proceeds from sale of buildings and equipment	8	6	18	7	4	18
Acquisition of an initially consolidated companies (annex A)	-	(50)	-	-	-	-
Net Cash Flows from Asset Transactions	(2,415)	(12,636)	(13,608)	156	(12,850)	(11,643)
Cash Flows From Liability and Capital Transactions:						
Net deposits from the public	2,189	8,790	(317)	3,177	9,862	7,603
Net deposits from banks	(831)	*(517)	(3,028)	1,041	(118)	(2,485)
Net deposits from the Government	78	81	6	31	91	32
Net securities loaned or sold under buy-back arrangements	457	1,299	5,895	-	-	-
Issuance of subordinated capital notes	2,419	2,131	1,446	350	151	297
Redemption of subordinated capital notes	(762)	(800)	(737)	(575)	(705)	(637)
Dividend paid to shareholders	-	(250)	-	-	(250)	-
Net cash flows from liability and capital transactions	3,550	10,734	3,265	4,024	9,031	4,810
Increase in cash	4,384	1,755	(4,495)	4,971	(2,185)	(4,579)
Cash balance at beginning of year	19,068	17,313	21,808	12,251	14,436	19,015
Cash balance at end of year	23,452	19,068	17,313	17,222	12,251	14,436

* Reclassified.

The notes to the condensed financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

ANNEX A - DECREASE IN CASH DUE TO INITIALLY CONSOLIDATED SUBSIDIARIES

Reported Amounts

	2008
	In NIS millions
Assets and liabilities at acquisition date of consolidated subsidiaries:	
Assets (including excess attributed cost amounting to NIS 78 million, and excluding cash amounting to NIS 83 million)	130
Liabilities	(80)
Goodwill	-
Total decrease in cash due to initially consolidated companies	50

ANNEX B - NON-CASH ASSET AND LIABILITY ACTIVITY DURING THE REPORTED YEAR

	2009	2008	2007
	In NIS millions		
The Bank:			
Purchase of fixed assets	-	28	3
Lending of securities	(498)	216	(416)
Additional purchase of shares in a consolidated subsidiary	-	-	-
Sale of securities to a subsidiary	-	-	53
Consolidated:			
Purchase of fixed assets	13	28	4
Lending of securities	(498)	252	(381)

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 directives and guidelines of the Supervisor of Banks regarding the preparation of a bank's annual financial statements.
- 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. DEFINITIONS

In these financial statements –

"Interested party" – as defined in Section 1 of the Securities Law, 1968.

"Related party" – as defined in Opinion 29 of the Institute of Certified Public Accountants in Israel, and who is not an interested party.

"Consolidated subsidiaries" - companies in which the Bank holds voting rights, either directly or indirectly, exceeding fifty percent, and/or is entitled to appoint over one half of the members of their boards of directors, and whose financial statements are consolidated with those of the Bank.

"Affiliated companies" - companies, other than consolidated subsidiaries, the investment in which is included in the financial statements of the Bank on the equity basis.

"Investee companies" - consolidated subsidiaries or affiliated companies.

"CPI" – the Consumer Price Index in Israel published by the Central Bureau of Statistics.

"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 Opinions Nos. 23 and 36 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.

"Extensions abroad" - consolidated subsidiaries and branches abroad.

C. 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) 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.
- 3) Functional currency and presentation currency – the functional currency of the Bank is the New Israeli Shekel (NIS). The consolidated financial statements are presented in NIS and the amounts are rounded off to the nearest million.
- 4) 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Monetary items are presented in the balance sheet in nominal historical values as of balance sheet date.
- The stated value of investee companies is determined on the basis of financial statements of these companies presented in reported amounts or translated into NIS.
- Other non-monetary items (mostly – property and equipment and investments presented at cost) are stated in reported amounts.

(b) Statement of income

- Income and expenses relating to non-monetary items (such as: depreciation and amortization, prepaid expenses and deferred income) 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 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 in reported amounts of these companies.
- The remaining components of the income statement are stated in nominal historical values.

(c) Statement of Changes in Shareholders' equity

Dividend declared or actually paid in the reported period is stated in nominal values.

D. 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.
- Those optionally linked, are stated in accordance with their related terms ruling on the balance sheet date.

2) Transactions in foreign currency

Transactions in foreign currency are translated into the functional currency according to the exchange rate in effect on dates of transactions, as published by Bank of Israel. Monetary assets and liabilities at the reporting date, denominated in foreign currency, are translated into the functional currency according to the exchange rate in effect on that date. Exchange rate differences in respect of monetary items comprise the difference between the written down cost in the functional currency at the beginning of the period, adjusted by the effective rate of interest and payments made during the period, and the written down value in foreign currency translated according to the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currency and measured according to fair value are translated into the functional currency according to the exchange rate in effect on the date on which fair value had been determined. Exchange rate differences arising from new translations are recognized in the statement of income, except for differences arising from the new translations of non-monetary capital instruments classified as available for sale, which are directly recognized in shareholders' equity.

3) Foreign operations

Assets and liabilities of foreign operations, including goodwill and adjustment to fair value created upon acquisition, have been translated into NIS according to exchange rates in effect at balance sheet date. Income and expenses of foreign operations have been translated into NIS according to exchange rates in effect at date of the transactions.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4) The following are the representative rates of exchange and the CPI and their annual rates of change:

	Annual rate of change					
	2009	2008	2007	2009	2008	2007
				%	%	%
CPI (in points):						
Balance sheet month (December index)	114.8	110.4	106.4	3.9	3.8	3.4
Known at balance sheet month (November index)	114.8	110.5	105.8	3.8	4.5	2.8
Representative exchange rate (in NIS)						
at the balance sheet date of the:						
U.S. Dollar	3.775	3.802	3.846	(0.7)	(1.1)	(9.0)
Euro	5.442	5.297	5.659	2.7	(6.4)	1.7

E. CONVERSION OF FINANCIAL STATEMENTS OF EXTENSIONS ABROAD

Up to the year 1994, foreign subsidiaries were considered autonomous units, and the conversion differences with respect to the investment herein were included as a separate item in Shareholders' Equity. The capital reserve from the translation of foreign autonomous units accumulated to this date is to be recognized in the statement of income in the period in which the gain or loss on realization of the investment in the relevant foreign extension is recognized. Following guidelines of the Supervisor of Banks, foreign subsidiaries are considered, as from 1995, "extensions" of the Bank.

Since the year 2008, following the implementation of Standard 13 (amended) regarding "Effect of changes in foreign currency exchange rates", and the guidelines of the Supervisor of Banks, a foreign extension of a banking corporation, which according to earlier rules had been classified by the banking corporation as a "long arm", is classified as a foreign operation the functional currency of which is identical with the functional currency of the banking corporation.

The Supervisor of Banks has clarified that 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 his prior approval.

F. USE OF ESTIMATES

The preparation of financial statements according to accounting principles accepted in Israel and the directives and guidelines of the Supervisor of Banks, requires the Bank's Management to make use of evaluations and assessments, which affect the implementation of policy and the amounts of assets and liabilities, income and expense and the disclosure given in their respect. It should be clarified that actual results may differ from these assessments.

When forming the accounting assessments used in the preparation of the Bank's financial statements, Management is required to make assumptions as to circumstances and events involving significant uncertainties. When using its judgment in determining the assessments, the Bank's Management takes into consideration past experience, various facts, independent opinions and information and reasonable assumptions according to the circumstances applying to each assessment.

The assessments and assumptions on which they are based are reviewed on an ongoing basis. Changes in accounting assessments are recognized in the period in which the assessments have been changed and in each future period that is affected by the change in assessment.

G. STATEMENT OF CASH FLOWS

The statement of cash flows is presented classified into cash flows produced by current activities, by activities in assets and by activities in liabilities and capital. Cash flows produced by activities in assets and liabilities and capital are presented on a net basis, except for movements in securities for investment and non-monetary assets. The cash and cash equivalent item includes cash, bank deposits, marketable deposit certificates and deposits with central banks for an initial period of up to three months.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. PRINCIPLES OF CONSOLIDATION AND THE IMPLEMENTATION OF THE EQUITY METHOD

- 1) **Principles of consolidation.** Subsidiaries are entities controlled by the Bank. Control exists when the Bank is able to set monetary and operating policy of the entity so as to benefit from its resources and operations. Control exists when the Bank holds, directly or indirectly, shares conferring over 50% of voting rights in the subsidiary and the right to appoint a majority of its Board members, unless circumstances exist which evidently prevent the parent company from exercising actual control.
- 2) The consolidated financial statements include the audited financial statements of the Bank and of subsidiaries controlled by the Bank. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases. Intercompany balances and transactions between the consolidated companies are annulled in the consolidated financial statements. Financial statements of provident funds managed by the Bank or by a consolidated subsidiary have not been consolidated.

The Bank's financial statements only, include the financial statements of the property company "Nidbach Real Estate and Investments Ltd." and "Badal Computer and Management Services Ltd.", which are wholly owned by the Bank.
- 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. Investees are accounted for at equity value method, starting from the date on which material influence commences until the date on which material influence ceases.

The Bank's share in the financial results of such investees is stated net, after amortization of goodwill.
- 4) **Determination of goodwill and its amortization** the excess cost of acquisition of investment in an investee company over the Bank'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 According to directives of the Supervisor of Banks, positive and negative goodwill is to be amortized over a period of ten years, unless the Supervisor has ordered otherwise.

I. SECURITIES

- 1) In accordance with directives of the Supervisor of Banks, the Bank's investments in securities are classified into three portfolios, as follows:
 - (a) "Held to maturity bonds" - bonds which the Bank intends and has the ability to hold until maturity, except for debentures which may be called early or otherwise disposed, such that the Bank may not cover substantially all of its recognized investment. 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 with the intention of selling them in the short term except for shares with no available fair value. 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 3) Dividend income, accrued interest, exchange and linkage differentials, amortization of premium or discount (according to the effective interest method) as well as losses on impairment of an other than temporary nature are recognized in the income statement.
- 4) Interest income in respect of acquired beneficiary rights (such as: asset backed financial instruments of the MBS, CDO, CMO types), excluding beneficiary rights of a high credit quality, is recognized according to the prospective interest method, the rate of interest used for recognition of interest income being adjusted to changes in assessment of future cash flows. In this respect, beneficiary rights of a high credit quality comprise beneficiary rights issued with U.S. government guarantee or by U.S. government agencies, as well as asset backed securities the international rating of which is at least "AA".
- 5) The Bank's investment in venture capital funds is treated at cost less losses on impairment of an other than temporary nature. Gains on investments in venture capital are recognized in the income statement upon realization of the investment.
- 6) For the treatment of transactions involving the transfer of financial assets (such as: repurchase agreements, lending of securities, etc.), see O below. In the matter of computing fair value, see K below.
- 7) 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 and its relevant subsidiary to continue holding the securities until such time that the expected recovery of the fair value of the securities occurs.

For details regarding the guideline of the Supervisor of Banks in the matter, see Section Y (2) below.

Where impairment of an other than temporary nature occurs, the cost of the security is written down to its fair value, which serves as a new cost basis. The cumulative loss in respect of a security classified as available-for-sale, which in the past had been reflected as a separate item in shareholders' equity within the framework of other comprehensive profit, is reflected in the statement of income when the impairment in respect of which is of an other than temporary nature. Increase in value during consecutive reporting periods, are recognized as a separate item in shareholders' equity within the framework of other comprehensive profit, and are not reflected in the income statement (the new cost base).

J. 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The accounting treatment of changes in the fair value of derivatives that hedge exposure to changes in the cash flow generated by an asset, a liability or an anticipated transaction, depends on the effectiveness of the hedging relationships.

- The effective part of the change in the fair value of a derivative designated to hedge a cash flow risk, is initially reported in shareholders equity (outside the statement of income) as a component of "other comprehensive income", following which, when the anticipated transaction affects the income statement, it is reclassified to the statement of income.
- The non-effective part of the change in the fair value of a derivative designated as above is recognized immediately in the statement of income. 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.

K. FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

A. Fair value is the amount at which an asset may be bought or sold (a liability may be assumed or repaid) in a regular transaction between willing parties, i.e. in a transaction other than forced sale or sale in the course of liquidation. The Bank determines fair value as follows:

(1) Securities - the fair value of trading securities and available-for-sale securities is determined based on quoted market prices in active markets. If a quoted market price is unavailable, the estimated fair value relies on the best available information. The estimated fair value considers prices of similar assets or liabilities and the outcome of various valuation methods, as set forth in section (4) below.

(2) Financial derivatives instruments - financial derivatives instruments which have an active market have been valued at market value, and when multiple active markets exist on which the instrument is traded, the valuation was based on the most active market. Financial derivatives instruments not traded on an active market were valued using models which serve the Bank in its regular operations, which account for the risk inherent in the financial derivative instruments (market risk, credit risk etc.), as set forth in section (4) below.

(3) Other, non-derivative financial instruments - most financial instruments in this category (such as: deposits from the public and deposits with banks, credit to the public and to the Government, bonds, subordinated capital and non-negotiable loans) have no quoted "market price", since they are not traded on any active market. Therefore, fair value is estimated using generally acceptable pricing models, such as present value of future cash flows, discounted using a discount rate which reflects the risk level associated with the financial instrument.

As for financial instruments with an original term to maturity of up to 3 months, as well as for financial instruments bearing variable interest up to 3 months, the carrying amount approximates their fair value.

(4) Determination of fair value in inactive markets - the Bank applies clarification FSP FAS 157-3 with regard to "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active". Accordingly, when determining the fair value of securities and other financial instruments traded on an inactive market, significant use of judgment is sometimes made, including review as to whether transactions were conducted under stress and duress. In cases where no price quote is available on an active market, fair value is determined using generally accepted pricing models, based on an independent, validated system at the Bank, or based on valuations obtained from experts in valuating financial instruments. Valuation methods involve the use of various parameters, such as interest rate curves, currency exchange rates and standard deviations, and account for assumptions with regard to various factors.

(5) For further information about major methods and assumptions used in estimating fair value of financial instruments, see Note 21.

B. Effective January 1, 2008, the subsidiary IDB New York (Hereinafter: "IDBNY") adopted the U.S. financial accounting standard FAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities". (Hereinafter: "FAS 159").

C. 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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:

- 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, 2009 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
in US\$ millions				
Assets:				
Trading account securities, at fair value	-	6	-	6
Available for sale securities at fair value	5	4,216	24	4,245
Unrealized gain on derivatives	7	15	-	22
Liabilities:				
Unrealized loss on derivatives	7	15	-	22

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 IDBNI 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.

L. 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) Interest income in respect of debt classified as doubtful, is not recognized as from the beginning of the quarter in which such debt have been declared as doubtful. Upon collection of the interest, such income is stated as "Other financing income".
- 4) 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.
- 5) 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.
- 6) 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			
	2009	2008	2009	2008
General provision	0.20%	0.17%	0.16%	0.18%
Supplemental provision	0.19%	0.17%	0.13%	0.14%

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.

- 7) 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.
- 8) 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.
- 9) 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 AA (3) below.

M. 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.

In respect of hybrid capital instruments, which include a structured step-up redemption, the interest rates used to compute the interest cost are the interest rates in effect prior to the step-up, based on Management's evaluation that the instruments would be redeemed at date of increase in the interest rate.

With respect to securities - see I above; with respect to the provision for doubtful debts - see L above; with respect to derivative financial instruments - see J above.

Sale and leaseback transactions are presented in the financial statements in accordance with International Accounting Standard (IAS) 17.

N. SET-OFF OF FINANCIAL INSTRUMENTS

Assets and liabilities are set-off against one another where an enforceable legal right of set-off and the intention to set-off the transactions at maturity date exist. In addition, designated deposits, the repayment of which to the depositor is conditional upon the extent of collection of the loans granted out of such deposits, and where the Bank has no risk of loss from such loans, are stated in the balance sheet net of the loans granted therefrom. The margin earned on this activity is included in the item "Operating commissions".

O. TRANSFERS AND SERVICES RELATING TO FINANCIAL ASSETS AND SETTLEMENT OF LIABILITIES.

The Bank applies measurement and disclosure principles specified in the U.S. financial accounting standard FAS 140, regarding "Accounting for transfers and servicing of financial assets and extinguishments of liabilities", as adopted by the Supervisor of Banks, for the purpose of differentiating between transfers of financial assets to be recorded as a sale and other transfers. Accordingly, the principle was adopted according to which a transferred financial asset will be included in the balance sheet of the controlling party, whether the transferor or the recipient of the asset. In this regard, the provisions detail determinations for control relating to reacquisition transactions, securities' lending, issuance of debentures against proceeds from future cash flow, sale and participation in loans.

The Bank implements the amendments to the public reporting requirements regarding securities' lending transactions, reacquisition of securities, issuance of debentures in respect of financial assets, other transfers of financial assets, provision of services for financial assets and settlement of liabilities, implemented after December 31, 2006.

The lending of securities by the Bank for the purpose of covering short sale of securities by the borrower is stated as credit to the public so long as the securities have not been returned, subject to assumptions and clarifications of the Supervisor of Banks in the matter of the application of FAS 140.

A foreign subsidiary of the Bank engages in the sale of securities under repurchase agreements and in the purchase of securities under resale agreements. Securities sold under repurchase agreements, where control is retained over the transferred asset, are treated as an acceptance of a secured debt. Thus, the securities sold are not taken off the balance sheet and continue to be reflected in the securities item, while the deposit received, the repayment of which is secured by the said securities is stated in the item "Securities loaned or sold under repurchase agreements". Securities purchased under resale agreements, are treated as the granting of a secured debt, so that the securities purchased serve as collateral for the debt and are not included in the balance sheet. The credit granted is stated in the item "Securities borrowed or purchased under resale agreements".

P. BUILDINGS AND EQUIPMENT

1) Buildings and equipment are presented at cost, with the addition of direct acquisition costs after the deduction of accumulated

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

- 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.

Costs in respect of the development of software or its modification for own use are capitalized if, and only if: it is possible to reliably measure the development costs; the software is feasible from the technical and commercial aspects; future economic benefits are expected; and the Bank has sufficient resources and intent to complete the development and make use of the software. Costs recognized as an intangible asset include the direct cost of materials, services and direct payroll to employees. Such costs are measured at cost less accumulated depreciation and loss on impairment. Overhead costs that cannot be directly attributed to the development of the software are recognized as expenses as incurred. 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.

Q. 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 "Buildings 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.

R. IMPAIRMENT IN THE VALUE OF ASSETS

The Bank implements Accounting Standard No. 15 (Amended), 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 amount, 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

S. EMPLOYEE BENEFITS

Liabilities in respect of employee rights are covered by appropriate provisions. For further details see Note 16 hereunder.

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 FAS 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.

T. SHARE BASED COMPENSATION

Share based compensation transactions include transactions with employees or other parties involving payment in capital instruments, cash or other assets.

In share based payment transactions settled by capital instruments, the benefit created upon the granting of option warrants to officers, is recognized as a payroll expense alongside an increase in equity, based on the fair value of the options at grant date, using the Black & Scholes model. The benefit created is spread over the vesting period based on the evaluation of the Bank as to the number of options that would become vested.

The fair value of the amount due to officers in respect of rights regarding the increase in value of fully paid in cash shares (phantom options), is recorded as an expense against a parallel increase in liabilities over the period in which the right to the payment is attained. The liability is re-measured at each reporting date, as well as at the settlement date. Any change in the fair value of the liability is recognized as a payroll expense in the income statement.

(For details regarding an option plan to officers of the Bank, see Note 13 D below. For details as to phantom options to officers of the Bank, see Note 13 D (3) below).

U. 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

The Bank is exposed to unasserted claims/suits due, inter alia, to doubts with regard to interpretation of agreements and/or statutory provisions and/or their application. The Bank is made aware of such exposure in several ways, including: appeals or complaints by third parties to Bank entities. In assessing the risk associated with unasserted claims/lawsuits, the Bank relies on internal assessment by the handling entities and by Management, which weigh the estimated probability of a claim being made, the chances of such claim, if made, to prevail and any settlement payments. Such assessment is based on past experience with regard to the claims filed, and on an analysis of the actual allegations. By nature, in view of the preliminary stage of inquiring of the legal allegation, the actual outcome may differ from assessment conducted prior to filing of the claim.

V. 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) A deferred tax asset in respect of brought forwards tax losses and in respect of a brought forward right to a tax setoff is recognized in the books in cases where the said tax utilization in the foreseeable future is not uncertain. A deferred tax asset in respect of temporary differences is recognized where it is probable that a tax savings will arise upon their reversal. The creation of net deferred taxes shall not exceed the current tax in the period, unless in special cases where the tax realization in the foreseeable future is not uncertain.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

W. SEGMENT REPORTING

Segment reporting is a component of a banking corporation engaged in operations from which it may generate income and incur expenses. Division into segments and the related reporting outline have been set in provisions and directives of the Supervisor of Banks. For further information, see Note 31 below.

X. 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.

Y. EARNINGS PER SHARE

The Bank implements Accounting Standard No. 21 "Earnings per share", subject to the instructions of the Supervisor of Banks. The Standard determines the principles for computation and presentation of the basic earnings per share and the diluted earnings per share.

Z. INITIAL APPLICATION OF ACCOUNTING PRINCIPLES

(1) Accounting Standard No. 15 (updated 2009). In January 2009, the Israel Accounting Standards Board issued Accounting Standard No. 15 (updated 2009), "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 (updated 2009) 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 was allocated firstly to goodwill in the investment account and the remaining balance of the loss was 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 (updated 2009) and clarification No. 10.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

On April 23, 2009, the Supervisor of Banks announced that banks and credit card companies are obliged to prepare their financial statements for periods beginning on January 1, 2009 and thereafter, in accordance with Standard 15 (Updated 2009), including the related clarifications. The Bank has implemented the rules of Standard 15 (Updated 2009). The said implementation did not have an impact on the financial statements.

(2) Impairment of securities of an other than temporary nature. On March 1, 2009, the Supervisor of Banks issued a guideline concerning the conditions under which an impairment of an other than temporary nature will be recognized.

According to this guideline, banking corporations and credit card companies must recognize impairments of an other than temporary nature in the reporting period, at least in respect of each security where one or more of the following conditions exist:

- A security that had been sold prior to the date of publication of the financial report for that period;
- A security, which near the date of publication of the financial report for that period, is intended to be sold within a short period;
- A bond, the rating of which at date of publication of the financial report for that period has been significantly reduced compared to its rating on date of purchase by the banking corporation;
- A bond which following its purchase has been classified by the banking corporation as problematic;
- A bond in respect of which there has been a payment default subsequent to its purchase;
- A security, the fair value of which at the end of the reporting period and also proximate to the date of publication of the financial report for that period, was significantly lower than its cost (or written-down cost in case of bonds). This, unless the banking corporation has objective and solid evidence as well as a careful analysis of all relevant factors, which proves at a high level of assurance that the impairment is of a temporary nature.

The guideline also includes, among other things, a summary list of examples for possible deficiencies in documentation, which, if exist, raise a significant doubt whether the required level of assurance exists in order to reach the conclusion that under those circumstances, the impairment of the security is in fact not of an other than temporary nature.

The guideline came into effect on January 1, 2009.

AA. DISCLOSURE OF THE EFFECT OF NEW ACCOUNTING STANDARDS ON THE PERIOD PRIOR TO THEIR APPLICATION.

Details regarding the effect of new accounting standards and of new directives of the Supervisor of Banks are stated 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").

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.

In June 2009, the Supervisor of Banks issued a circular in the matter of "Reporting by banking corporations and credit card companies in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner according to which the IFRS will be adopted by banking corporations and credit card companies in Israel.

According to the circular, the targeted date for the reporting by banks and credit card companies in accordance with the IFRS rules, are:

- As regards issues which are not part of the core banking business - as from January 1, 2011. As from this date onwards, banking corporations would be required to update the accounting treatment of these issues on a current basis, in accordance with the

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

transitional provisions prescribed by new international standards to be issued regarding these issues, and in accordance with clarifications to be given by the Supervisor of Banks;

- As regards issues which form part of the core banking business - as from January 1, 2013. It is the intention of the Supervisor of Banks to make a final decision on this matter during of 2011. The final decision will take into consideration the time table that will be provided in the United States and the progress to be made in the convergence process of the international and the US accounting standards boards.

The circular clarifies that following the modification of the rules to international standards, the Supervisor of Banks will maintain his authority to issue binding clarifications as to the manner of implementation of the requirements specified by international standards, as well as prescribe further directives in cases where these are required in view of the requirements of regulatory authorities of developed countries, or regarding issues for which no reference exists in the international standards. In addition, the Supervisor of Banks will maintain his authority to issue disclosure and reporting requirements, instructions regarding internal control over financial reporting and instructions relating to the work of the independent auditors.

Accordingly, until the target dates for the implementation of the IFRS rules, financial statements of banking corporations or of credit card companies shall continue to be prepared according to the directives and guidelines of the Supervisor of Banks.

Adoption of certain international financial reporting standards (IFRS). On December 31, 2009, the Supervisor of Banks issued a circular according to which certain international financial reporting standards (IFRS) dealing with the treatment of subjects that are not part of the core banking business, are to be adopted. The circular adopts international financial reporting standards dealing with the following matters:

1. IAS 8, regarding "accounting policies, changes in accounting estimates and errors";
2. IAS 16, regarding "property, plant and equipment";
3. IAS17, regarding "leases";
4. IAS 21, regarding "the effects of changes in foreign exchange rates";
5. IAS 27 (2008), regarding "consolidated and separate financial statements";
6. IAS 28, regarding "investment in associates";
7. IAS 29, regarding "financial reporting in hyperinflationary economies";
8. IAS 33, regarding "earnings per share";
9. IAS 34, regarding "interim financial reporting";
10. IAS 36, regarding "impairment of assets";
11. IAS 40, regarding "investment property";
12. IFRS 2, regarding "share based payment";
13. IFRS 3R, regarding "business combinations".

The international financial reporting standards stated above and interpretations of the International Financial Reporting Interpretations Committee (IFRIC) relating thereto, shall be adopted according to the following principles:

- In cases where no specific reference exists in the Standards or in interpretations of material issues or where several alternatives exist for treating a material issue, a banking corporation shall act according to specific implementation guidelines determined by the Supervisor of Banks. This approach is intended to provide a higher certainty level in the financial reporting of banking corporations and of credit card companies, while maintaining a high level of consistency in the reports of banking corporations;
- In cases where a material issue is not addressed in the international standards or in the implementation directives of the Supervisor, a banking corporation shall treat the matter in accordance with generally accepted accounting principles in U.S. banks that specifically apply to such issues;
- In cases where reference exists in an international standard to another international standard that has been adopted by the public

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

reporting instructions, the banking corporation shall act in accordance with the provisions of that other standard and the related guidelines of the Supervisor of Banks;

- In cases where reference exists in an international standard to another international standard that has not been adopted by the public reporting instructions, the banking corporation shall act in accordance with the public reporting instructions and in accordance with generally accepted accounting principles in Israel;
- In cases where an international standard includes reference to a definition of a term that is defined in the public reporting instructions, then the reference to the definition in the instructions shall replace the original reference.

The principles for the adoption of the international financial reporting standards, as stated in the circular, clarify that any material issue related to financial reporting, and in particular in any place where clarification is required regarding references and standpoints included in the public reporting instructions with respect to the international standards, the matter should be referred to the Supervisor of Banks. Furthermore, in places where the international standard is not materially different from accounting principles previously applied, it is to be considered whether a decision, according to which it is proper to change the accounting treatment due only to the implementation of the international standard, would be justified.

Banking corporations shall implement the international financial reporting standards stated above, as well as the interpretations of IFRIC related to the implementation of these standards, as from January 1, 2011 onwards. Upon the initial implementation of an international financial reporting standard according to the circular, a banking corporation shall act in accordance with the transitional instructions determined in the international financial reporting standard. The above stated includes a retroactive restatement of prior period figures, if this is required by the international financial reporting standard. As from January 1, 2011 onwards, a banking corporation shall currently update the accounting treatment of issues mentioned in the circular in accordance with the effective date and the transitional instructions determined in new international financial reporting standards to be issued with respect to these matters, in accordance with the adoption principles detailed in the circular and in accordance with clarifications of the Supervisor of Banks.

The transitional instructions for adoption of the international financial reporting standards included in the circular, state that upon the implementation of an international financial reporting standard relating to a certain subject, to the extent that according to the transitional instructions of the standard it is required to apply it also with respect to existing transactions, a banking corporation shall consider what is the suitable accounting treatment according to the standard to be applied to all existing transactions that are treated according to this standard. In cases where the banking corporation has reached a conclusion according to which it is appropriate to materially change the accounting treatment applied by it in the past with respect to a certain issue, it should consider thoroughly whether the conditions justifying such a change in accounting treatment do exist, or whether it should treat the change as a correction of an error. In case of doubt or in any event where the treatment decided in the matter is a correction of error, a bank should apply to the Supervisor of Banks for preliminary guidance.

The Bank is preparing to adopt the international financial reporting standards as stated in the circular. The Bank is examining the implications of the said adoption on the financial statements, though at this stage it is unable to assess the expected effect of their initial implementation.

- (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 assets and liabilities being the subject of a transaction between the entity and its controlling shareholders shall be measured at date of the transaction according to their fair value, and the difference between the fair value amount and the consideration determined for the transaction shall be recorded as part of shareholders' equity. Where the difference is a negative amount, it forms a dividend in substance, and therefore reduces the balance of retained earnings. A credit difference forms in substance an investment by the owners and is to be presented as a separate

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

item in shareholders' equity to be designated as "Capital reserve on a transaction between the entity and its controlling shareholders". The Standard discusses three issues relating to transactions between an entity and its controlling shareholders, as follows: (1) the transfer of an asset from the controlling shareholder to the entity or vice versa, transfer of an asset from the entity to the controlling shareholder; (2) assumption of debt of the entity to a third party, in part or in full, by the controlling shareholder, indemnification of the entity by the controlling shareholder in respect of an expense, a waiver of a debt, in part or in full, due by the entity to the controlling shareholder; and (3) loans granted by the entity to the controlling shareholder or granted by the controlling shareholder to the entity. Furthermore, the Standard determines the disclosure that should be included in the financial statements with respect to transactions between the entity and its controlling shareholders during the period.

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.

In May 2008, the Supervisor of Banks issued a letter stating that rules applying to banking corporations and credit card companies with respect to the treatment of transactions between an entity and its controlling shareholders are being re-examined. According to this letter, the Supervisor intends to determine that the following rules will apply to transactions between a banking corporation and a credit card company and the controlling shareholders thereof and to transactions between a banking corporation and a corporation under its control: (1) the international financial reporting standards; (2) in the absence of specific reference in the international financial reporting standards, U.S. generally accepted accounting principles applying to banking corporations in the U.S. shall apply, provided that they do not contradict the international financial reporting standards; (3) in the absence of reference in the U.S. generally accepted accounting principles, then the relating part of Standard 23 shall apply, provided that it does not contradict the international financial reporting standards and the U.S. generally accepted accounting principles, as stated above.

As of date of issue of the financial statements, the final directive of the Supervisor of Banks with respect to the adoption of specific principles on this matter and to the manner of their initial implementation has not yet been published.

- (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 Original 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 "group provision", as detailed below:
- "The specific provision for credit losses" - shall be applied in respect of a debt the contractual balance thereof 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 "group 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, according to the fair value of the security pledged with respect to that loan;
- "Group 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, including -
 - a. "Substandard credit risk" - Credit that is not protected sufficiently by collateral and/or the borrower's repayment ability, so that the Bank may be required to absorb a certain loss in respect of this credit in the event that the deficiency is not amended.
 - b. "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.

- c. "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 directive determines as follows:
 - 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;
 - 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);
 - 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:
 - 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.
 - In the case of debts secured by a mortgage on a residential unit, an updated valuation shall be obtained, the amount of the debt exceeding the value of the collateral is to be written off if in default for over 180 days.
 - 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.
 - Disclosure requirements in financial statements have been expanded in respect of problematic debts and rules have been set for the preparation of procedures, documentation and internal control in respect of the processes for identifying, measuring and reporting of problematic debts and provisions for loan losses in their respect.
- The guidelines included in the original instruction of December 31, 2007, were supposed to come into effect as from January 1, 2010 and thereafter (see hereunder). In addition, the instruction includes transitional provisions to apply upon the initial implementation of the instruction:
- Balances of problematic debts that meet the terms of the criteria for accounting write-off are to be written off;
 - All interest income accrued in respect of delinquent debts meeting the terms of the criteria determined in the instruction and not actually collected as of date of implementation of the instruction shall be cancelled;
 - Differences created upon the initial implementation of the new guidelines, between the balance of provisions for credit losses and the provisions as computed according to the new guidelines, are to be charged to the retained earnings item in shareholders' equity.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In continuation of the original Directive, the Supervisor of Bank issued on February 18, 2010, an update of the original Directive, which includes, among other things, an extension of the disclosure requirements in the financial statements for December 31, 2010.

Following are the principal changes and additions included in the amended Directive:

- Implementation of the Directive is postponed to January 1, 2011 (instead of January 1, 2010 in the original Directive);
- The reporting requirements with respect to the financial statements as of December 31, 2010, have been expanded, including:
 - A requirement to include in the financial statements a pro-forma note relating to the effect of the Directive on the main balance sheet items, had the Directive been applied on December 31, 2010;
 - A requirement to include in the Directors' Report a discussion of the effect of the Directive on the main balance sheet items in the financial statements, and on the quality of credit granted, had the Directive been applied on that date;
 - It is clarified that wherever there is reference in the Directors' Report to balances as of December 31, 2010, which shall be affected by the implementation of the Directive, the relevant pro-forma data should also be addressed;
- The required disclosure in the financial statements as of March 31, 2011, regarding the effect of the initial adoption of the new Directive, has been clarified;
- A provisional instruction, to be applied in the years 2011 and 2012 (hereinafter: "the transition period"), has been added, which determines the manner of computing the specific provisions for credit losses on a group basis, with respect to the credit to the public item. According to the provisional instruction, the rates of the provisions for credit losses on a group basis, shall be determined in the transition period based on the range of the historical rates of provisions for doubtful debts (including provisions for interest in respect of non-performing debts) for the years 2008, 2009 and 2010, divided into economic sectors (as defined in reporting instruction no. 831 to the Supervisor of Banks regarding "Quarterly report on the division of the overall risk of credit to the public according to economic sectors"), while differentiating between the rate of provisions relating to the average balance of problematic debts and the rate of provisions relating to the average balance of total debts.

A banking corporation that adopted the rules for measuring credit losses on a group basis, as defined in the provisional instruction, is not required to maintain on its records general, supplemental and special provisions for doubtful debts, as required by Proper Banking Management Directive No. 315, on condition that the amount of the provision for credit losses on a group basis, at any date during the transition period, shall not fall below the amounts of the general, supplemental and special provisions on such date, computed according to the rules specified in Proper Banking Management Directive No. 315, gross before taxes.

- Amendments have been made to the Directive in line with the amendments made to Proper Banking Management Directive No. 325 regarding "Management of credit facilities in current accounts" (see hereunder), which refers mostly to the cancellation from the definition of "delinquent debts" of current loan accounts or checking accounts chargeable to exceptional interest rates and to special handling commissions.

On February 21, 2010, the Supervisor of Banks issued a letter regarding the "reporting of the effect of the Directive for the measurement and disclosure of delinquent debts, credit risk and provision for credit losses". The letter requires that banking corporations and credit card companies report to the Supervisor of Banks certain balance sheet data, on the assumption that the Directive would have been applied at the reporting dates, this within the framework of quarterly reporting as of December 31, 2009, March 31, 2010, June 30, 2010 and September 30, 2010.

On February 18, 2010, amendments to Proper Banking Management Directives were published, following the change in public reporting directives regarding delinquent debts. The principal amendments are:

- The sections in Proper Banking Management Directive No. 325 regarding "Management of credit facilities in current accounts", which relate to the accounting aspects of classifying certain accounts as problematic, and to the recognition of interest income will

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

be cancelled. These matters are to be treated within the framework of the general directive as to the measurement of provisions for credit losses and disclosure regarding problematic debts.

- Reference to risk characteristics of "problematic debts" included in Proper Banking Management Directive No. 315 regarding "Supplemental provision for doubtful debts" has been amended, in line with the definitions and terms included in the instruction for "Measurement and disclosure of delinquent debts, credit risk and provision for credit losses". The risk characteristic has been changed to "credit risk with negative classification and credit risk under special supervision", and under it three types of credit risk have been defined (compared to four prior to the amendment): "credit risk under special supervision", "inferior credit risk" and "delinquent credit risk". Furthermore, the rates of the supplemental provision applying to the various classes of problematic debts have been updated as follows:

Credit risk under special supervision	- 1%
"Inferior" credit risk	- 2%
"Delinquent" credit risk	- 4%

Proper Banking Management Directive No. 311 regarding "Minimal capital ratio", clarified the mode of computing balance sheet and off-balance sheet risk assets so that they would be stated after deducting accounting write-offs, specific and group provisions and with the addition of a general provision for doubtful debts, included in the tier II capital.

The application of the directives requires preparation and significant changes to the existing information systems, which, at this stage, are not compatible with reporting according to the new regulations. Furthermore, the new rules require each bank to formulate methodologies regarding various matters, including for example, the evaluation of the effect on the outstanding credit 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 Directives on the Bank's results of operations, including the effect of the initial implementation of the Directive on the Bank's equity. Notwithstanding, it is expected that the implementation of the Directive will have an adverse effect on the Bank's results of operations and its financial position.

(4) Measurement of fair value and fair value alternative

On December 31, 2009, the Supervisor of Banks published a circular regarding "Measurement of fair value, fair value alternative, and adoption of certain international financial reporting standards (IFRS)" (hereinafter: "the circular"). Among other things, the circular adopts as follows:

- (a) U.S. financial accounting standard 157, regarding "Measurement of fair value" (hereinafter: "FAS 157");
- (b) U.S. financial accounting standard 159, regarding "Fair value alternative for financial assets and liabilities" (hereinafter: "FAS 159");

(a) FAS 157 - measurement of fair value

FAS 157 defines fair value and determines a consistent framework for the measurement of fair value by defining techniques for the evaluation of fair value in respect of assets and liabilities, and the determination of a fair value scale and detailed implementation guidelines. Furthermore, FAS 157 extends the disclosure requirements regarding fair value measurement. Implementation of the provisions of FAS 157 will require termination of the use of a blockage factor in computing fair value as well as replacement of the guidelines of EITF 02-3 "Issues of accounting treatment of derivative contracts held for trading and energy trading contracts and risk management activities", which prohibit the recognition of day one profits and require to determine the fair value of derivative instruments that are not traded on an active market on the basis of the transaction cost. Furthermore, FAS 157 requires the banking corporation to reflect the nonperformance risk in measuring fair value of the debt, including derivatives, which had been issued by it and measured according to fair value. The nonperformance risk shall include the credit risk of the banking corporation, but shall not be limited to that risk only.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FAS 157 shall apply as from January 1, 2011 onwards, and shall be initially adopted in a limited format of retroactive application. In view of this, FAS 157 shall be applied from now onwards, excluding financial instruments that had been measured before the initial application of FAS 157, in the following manner:

- Positions in financial instruments traded on an active market, measurement of the fair value of which has been made using the blockage factor:
- Financial instruments, the fair value of which was measured at date of the initial recognition according to Part 1A to the public reporting directives, using the transaction price, in accordance with the guidelines mentioned in footnote 3 of EITF 02-3;
- Hybrid financial instruments the fair value of which is measured at date of initial recognition in accordance with Part 1A to the public reporting directives.

At date of initial application, the difference between the stated balances of the said financial instruments and the fair value amounts of the said instruments shall be recognized as cumulative effect on the opening balance of retained earnings as of January 1, 2011, which shall be separately presented.

The new disclosure requirements, including the disclosure required only in annual financial reports, shall be applied as from the first quarter of 2011, with no obligation to apply these disclosure requirements to financial statements for periods presented prior to the initial application of FAS 157.

In order to determine the adjusting amount to be recorded as cumulative effect on the opening balance of retained earnings as of January 1, 2011, and in order to secure compatibility of the evaluation methods of the banking corporation with principles determined in FAS 157, the banking corporation will be required to re-examine the evaluation methods applied by it for the measurement of fair value taking into consideration the relevant circumstances of the different transactions, including prices of the most recent transactions in the market, indicative prices of evaluation agencies and the results of back-testing of similar types of transactions. The Bank is studying the implications of adoption of the Standard on the financial statements, though at this stage it is unable to assess the expected effect of the initial application of FAS 157.

(b) U.S. financial accounting standard 159 – fair value alternative for financial assets and liabilities

The purpose of FAS 159 is to allow a reduction in volatility of reported earning resulting from the measurement of hedged assets and liabilities and of hedging derivative instruments, according to different measurement bases.

FAS 159 will allow a banking corporation to choose, at defined selection dates, to measure at fair value financial instruments and other specific items (the eligible items), which in accordance with the public reporting directives, are not required to be measured at fair value. Unrealized gains and losses in respect of changes in fair value of items, in respect of which the fair value alternative has been elected, shall be reported in the income statement at every consecutive reporting date. Furthermore, costs and commission paid in advance, related to items in respect of which the fair value alternative has been chosen, shall be recognized in the income statement as incurred and shall not be deferred. Selection of the application of the fair value alternative, as stated, shall be made instrument-by-instrument and may not be revoked. Furthermore, FAS 159 determines presentation and disclosure requirements intended to facilitate comparison between banking corporations choosing different measurement bases for similar types of assets and liabilities.

Notwithstanding the above, the circular clarifies that a banking corporation shall not select the fair value alternative unless the banking corporation has developed in advance knowledge, systems, procedures and controls at a high level, which would allow it to measure the item at a high level of reliability. Accordingly, a banking corporation shall not select the fair value alternative in respect of any asset that meets the classification of level 2 or level 3 of the fair value scale, or in respect of any liability whatever, unless it had received the prior approval of the Supervisor of Banks.

FAS 159 shall apply as from January 1, 2011 onwards. Retroactive or early adoption of the Standard is not permitted.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The transitional instructions of the Supervisor of Banks relate to the application in respect of eligible items existing at the effective date, as well as to available-for-sale securities and securities held to maturity, as follows:

- Application in respect of eligible items existing at the effective date – a banking corporation is permitted to choose the fair value alternative for eligible items existing at the effective date. In such cases, the stated balances of such eligible items shall be adjusted to fair value, and the effect of the first renewed measurement of fair value shall be recorded as an adjustment in respect of the cumulative effect on the opening balance of retained earnings. Furthermore, a banking corporation choosing the fair value alternative in respect of items existing at the effective date shall include extensive disclosure in the annual financial report and in its first interim financial report for 2011, as required in the circular.
- Available-for-sale securities and securities held to maturity - available-for-sale securities and securities held to maturity, existing at the effective date, are eligible for the fair value alternative at that date. Where the fair value alternative is selected in respect of any security of the said securities held at the effective date, unrealized accumulated gains or losses at that date, shall be included in the adjustment in respect of the cumulative effect, and the said security will be reported as from that date as a trading security. Furthermore, a separate disclosure shall be given regarding the unrealized gains or losses that had been reclassified from other cumulative comprehensive earnings, and regarding the amount of unrealized gains or losses not recognized earlier. Upon the initial application, the selection of the fair value alternative for an existing security held to maturity shall not indicate doubt as to the intention of the banking corporation to hold to maturity other bonds in the future.

The Bank is studying the implications of adoption of the Standard on the financial statements, though at this stage it is unable to assess the expected effect of the initial application of FAS 159.

The circular allows the use of three different approaches for determining fair value, as follows:

- "Market approach", according to which the fair value of assets and liabilities shall be evaluated on the basis of prices and relevant information obtained from market transactions involving identical or comparable assets and liabilities;
- "Revenue approach", whereby fair value is assessed based on the discounted amount required to convert future amounts, with the value of said future amounts derived from current market expectations with regard thereof (fair value assessment techniques under this approach include: Present value, models for option pricing and multi-period retained earnings method with regard to determination of fair value of certain intangible assets).
- "Income cost", according to which fair value shall be evaluated on the cost of replacement of the relevant asset or liability.

The circular distinguishes between two classes of data used in the determination of fair value:

- "Foreseen data", reflecting the assumptions on which other participants in the market price assets or liabilities and which are based on market data obtained from independent sources;
- "Unforeseen data", reflecting the assessments of the banking corporation regarding assumptions of other participants in the market and based on the best available data of the banking corporation.

The circular guides banking corporations to make as much use as possible of foreseen data, and to make as little use as possible of the unforeseen data, in the process of determining the fair value of assets and liabilities being measured using this method. In addition, the draft directive determines a qualitative grading for assets and liabilities measured by the fair value method, as follows:

- (a) High quality group (Level 1) - pertaining to assets or liabilities the fair value of which is determined on the basis of quoted market prices on an active market for identical assets and liabilities;
- (b) Intermediate quality group (Level 2) - pertaining to assets and liabilities the fair value of which is based on direct or indirect foreseen data (not comprising prices quoted on an active market), including prices quoted on an active market for similar assets or liabilities;
- (c) Low quality group (Level 3) - pertaining to assets and liabilities the fair value of which is determined on the basis of unforeseen data

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(where relevant foreseen data is not available).

The financial statements shall include disclosure regarding the various approaches used for the determination of fair value of assets and liabilities measured by this method, as well as regarding the quality groups to which assets and liabilities measured by the fair value method belong, giving extensive disclosure as to the effect that assets and liabilities belonging to the lowest quality group have on the business results.

Furthermore, the circular allows banking corporations to select a measurement on the basis of fair value method for certain financial instruments, to which, under the Bank of Israel public reporting instructions it is not required to apply this measurement method.

Notwithstanding, the circular permits the use of the "fair value" method of measurement only with respect to items the fair value measurement thereof shall belong to the highest quality group (Level 1) and in respect of which the banking corporation has developed in advance knowledge, systems, procedures and high level controls, enabling it to measure the item at a high level of reliability. Implementation of the aforementioned measurement with regard to items not meeting the aforementioned criteria would require approval by the Supervisor of Banks.

The circular also determined rules regarding classes of assets and liabilities that do not qualify for measurement according to fair value and also with regards to the dates on which it is possible to select the alternative of measurement on the basis of "fair value".

For further details, see item K above.

- (5) In May 2009, the FASB published U.S. financial accounting standard 166 (hereinafter: "FAS 166"), regarding "Transfers and servicing of financial assets" (Amendment of FAS 140). FAS 166 cancels the principle of qualified special purpose entity (QSPE), determines stricter terms for the accounting treatment as a sale of the transfer of a part of financial assets, including clarification regarding the terms for removal of financial assets amends measurement principles in the initial recognition of retained interests, and also cancels the principles for the reclassification of guaranteed mortgage securitization.

Concurrently, the FASB published the U.S. financial accounting standard 167 (hereinafter: "FAS 167"), regarding "Amendments to interpretation 46 as amended (FIN 46(R) - consolidation of entities having variable interests)", which amends principles determined in FIN 46(R) regarding the consolidation of entities having variable interests. FAS 167 requires the examination of the obligation to consolidate all entities previously defined as qualified special purpose entities (QSPE), updates the criteria for the identification of variable interests entities (VIEs), changes the approach to determining the identity of the primary beneficiary (from the approach based on quantitative tests to a qualitative test for the identification of control of financial interests). It also requires the reporting corporations to perform a re-examination of the consolidation obligation of VIEs at more frequent intervals.

In addition, FAS 166 and FAS 167 determine new disclosure requirements to be included in annual as well as interim financial reports. According to a circular of the Supervisor of Banks dated September 6, 2009, a banking corporation and a credit card company (hereinafter: "a banking corporation") are required to apply the rules determined by FAS 166 and FAS 167, including the disclosure requirements stated therein as from January 1, 2010 onwards, in accordance with the transitional instructions determined in such standards. As a general rule, the transitional instructions require the following:

- The application of the recognition and measuring requirements specified in the standard with respect to the transfer of financial assets made on January 1, 2010 and thereafter;
- The examination on January 1, 2010 and thereafter of whether it is required to consolidate in accordance with FAS 167 entities defined according to the old rules as qualified special purpose entities (QSPE).

Furthermore, a banking corporation may not provide disclosure of comparative data for 2009, with respect to disclosure requirements initially added by the Supervisor of Banks' circular.

The Bank believes that the effect of the initial application of FAS 166 and FAS 167 is not material.

2. CASH AND DEPOSITS WITH BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
	in NIS millions			
Cash and deposits with central banks	18,964	12,281	15,123	7,847
Deposits with commercial banks	4,822	8,304	3,191	6,601
Deposits with specialized banking institutions	797	969	13,220	11,682
Cash and deposits with banks	24,583	21,554	31,534	26,130
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	23,452	19,068	17,222	12,251

3. SECURITIES⁽¹⁾

A. CONSOLIDATED

	December 31, 2009				
	Book value	Amortized cost	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value	Fair value ⁽²⁾
	In NIS millions				
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	1,561	1,561	49	1	1,609
Government Sponsored Enterprises (GSE) Agencies	20	20	1	-	21
Others	408	408	2	26	384
Total held-to-maturity bonds and bills	1,989	1,989	52	27	2,014

	Book value	Amortized cost (for shares - cost)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
(2) Available for sale securities:					
Bonds and bills:					
Government	18,937	18,768	213	44	18,937
Government Sponsored Enterprises (GSE) Agencies	9,204	8,985	238	19	9,204
Others	3,350	3,698	33	381	3,350
Total bonds and bills	31,491	(3)31,451	484	444	31,491
Shares:					
Fund of Hedge Funds	44	(7)44	-	-	44
Others	659	656	3	-	659
Total shares	703	700	3	-	703
Total available-for-sale securities	32,194	32,151	(4)487	(4)444	(5)32,194

For footnotes see next page.

3. SECURITIES⁽¹⁾ (CONTINUED)**A. CONSOLIDATED (CONTINUED)**

December 31, 2009					
	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	2,033	1,994	41	2	2,033
Government Sponsored Enterprises (GSE) Agencies	5	5	-	-	5
Others	107	111	2	6	107
Total bonds and bills	2,145	2,110	43	8	2,145
Shares:					
Others	10	16	1	7	10
Total trading securities	2,155	2,126	⁽⁶⁾ 44	⁽⁶⁾ 15	2,155
Total securities	36,338	36,266	583	486	36,363

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 7,651 million (US \$2,027 million).
- (4) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".
- (5) Including shares, the fair value of which is not readily available, stated at cost of NIS 650 million.
- (6) Recorded in the statement of income.
- (7) The balance of the investment at December 31, 2009 is net of impairment considered not to be temporary in nature in the amount of NIS 47 million, and net of redemption of part of the fund's units. Subsequent to balance sheet date, the fund redeemed further units in the total amount of NIS 3 million.

3. SECURITIES⁽¹⁾ (CONTINUED)**A. CONSOLIDATED (CONTINUED)**

December 31, 2008					
	Book value	Amortized cost	Unrecognized gains from adjustment to fair value	Unrecognized 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	Amortized 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 bonds and bills	26,260	(3)26,682	470	892	26,260
Shares:					
Fund of Hedge 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

For footnotes see next page.

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 bonds and bills	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 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) 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 731 million.
- (6) Recorded in the statement of income.
- (7) The balance of the investment at December 31, 2008 is net of impairment considered not to be temporary in the amount of NIS 63 million, and net of redemption of part of the fund's units. Subsequent to balance sheet date, the fund redeemed further units in the total amount of NIS 48 million.

3. SECURITIES⁽¹⁾ (CONTINUED)**B. THE BANK**

December 31, 2009					
	Book value	Amortized cost (for shares - cost)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
In NIS millions					
(1) Available for sale securities:					
Bonds and bills:					
Government	9,841	9,693	156	8	9,841
Others	1,573	1,609	13	49	1,573
Total bonds and bills	11,414	11,302	169	57	11,414
Shares:					
Fund of Hedge Funds	44	⁽⁶⁾ 44	-	-	44
Others	12	12	-	-	12
Total shares	56	56	-	-	56
Total available-for-sale securities	11,470	11,358	⁽³⁾169	⁽³⁾57	⁽⁴⁾11,470
	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⁾
(2) Trading Securities:					
Bonds and bills:					
Government	1,974	1,935	41	2	1,974
Others	5	8	-	3	5
Total bonds and bills	1,979	1,943	41	5	1,979
Shares:					
Others	2	4	-	2	2
Total trading securities	1,981	1,947	⁽⁵⁾ 41	⁽⁵⁾ 7	1,981
Total securities	13,451	13,305	210	64	13,451

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, the fair value of which is not readily available, stated at cost of NIS 52 million.

(5) Recorded in the statement of income.

(6) The balance of the investment at December 31, 2009 is net of impairment considered to be other than temporary in nature in the amount of NIS 47 million, 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 3 million.

3. SECURITIES⁽¹⁾ (CONTINUED)**B. THE BANK (CONTINUED)**

December 31, 2008					
	Book value	Amortized cost (for shares - cost)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
In NIS millions					
(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 bonds and bills	10,920	10,940	336	356	10,920
Shares:					
Fund of Hedge Funds	120	⁽⁶⁾ 120	-	-	120
Others ⁽⁷⁾	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
	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⁾
(2) Trading Securities:					
Bonds and bills:					
Government	1,501	1,476	26	1	1,501
Others	258	334	-	76	258
Total bonds and bills	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 million, 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 48 million.

(7) See item C below.

3. SECURITIES (CONTINUED)

- C. As at December 31, 2008 the item included a balance of: consolidated - NIS 399 million; the Bank - NIS 285 million, which represented 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 were 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.

For details regarding the realization of the balance of the Bezeq shares during 2009, and for details regarding the dividends received by the Bank and Mercantile Discount bank in the years 2007-2009 in respect of the Bezeq shares, see Note 25 hereunder.

For details regarding legal proceedings filed against the Bank, Mercantile Discount Bank and five additional banks in the matter of charging the accounts of the borrower with transgression interest, see Note 19 C below, item 11.8.

- D. As at December 31, 2008 the item included 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 were taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value. For details regarding the realization of the balance of the HOT shares in the years 2008-2009, see Note 25 below.

E. Further details regarding mortgage and asset backed securities, on a consolidated basis

The Bank's securities portfolio as of December 31, 2009, 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, 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. The agencies were founded by the U.S. Government and are supervised by it. There is, however, no explicit guarantee on the part of the U.S. Government to the agencies.

In securitized mortgage loans, of the type abovementioned, it is customary to grant the private borrower the right of early repayment at any given time.

As a result, the investor's exposure to changes in the rate of early repayments, linked to the interest rate, to the real estate market and the economy and others.

3. SECURITIES (CONTINUED)

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, 2009			
	Other cumulative income ⁽¹⁾			
	Amortized cost	Unrecognized gain from adjustment to fair value	Unrecognized losses from adjustment to fair value	Fair value
	In NIS millions			
1. Mortgage-backed securities (MBS):				
Available-for-sale trading securities:				
A. Mortgage pass-through securities				
Securities guaranteed by GNMA	282	6	1	287
Securities issued by FHLMC and FNMA	4,684	158	2	4,840
Total mortgage-backed pass-through securities	4,966	164	3	5,127
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	8,217	95	35	8,277
Other mortgage-backed securities	84	-	10	74
Total mortgage-backed other MBS securities	8,301	95	45	8,351
Total available-for-sale MBS securities	13,267	259	48	13,478
Held-to-maturity securities				
A. Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	10	1	-	11
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Other mortgage-backed securities	251	-	26	225
Total held-to-maturity MBS securities	261	1	26	236
Securities for sale:				
Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	5	-	-	5
Total securities for sale MBS securities	5	-	-	5
Total mortgage-backed securities (MBS)	13,533	260	74	13,719
2. Asset-backed available-for-sale securities (ABS):				
Credit financing the purchase of motor vehicles	4	-	-	4
Credit to other than private individuals	1	-	-	1
Total asset-backed available-for-sale securities (ABS)	5	-	-	5
Total mortgage and asset-backed securities	13,538	260	74	13,724

Footnote:

(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, 2008				
	Amortized cost	Unrecognized gain from adjustment to fair value	Unrecognized losses from adjustment to fair value	Fair value
In NIS millions				
1. Mortgage-backed securities (MBS):				
Available-for-sale trading securities				
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 CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FNMA and FHLMC or GNMA	4,541	53	8	4,586
Other mortgage-backed securities	104	-	26	78
Total available-for-sale other MBS securities	4,645	53	34	4,664
Total available-for-sale MBS securities	11,164	112	58	11,218
Held-to-maturity securities				
A. Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	10	-	-	10
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Other mortgage backed securities	320	-	44	276
Total held-to-maturity MBS securities	330	-	44	286
Securities for sale				
Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	6	-	-	6
Total securities 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

Footnote:

(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 mortgage and asset-backed securities in unrealized loss position:

December 31, 2009				
	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 securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	64	1	-	-
Securities issued by FHLMC and FNMA	417	2	-	-
Total mortgage-backed pass-through securities	481	3	-	-
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	2,270	34	67	1
Other MBS securities	-	-	74	10
Total other mortgage-backed securities	2,270	34	141	11
Total available-for-sale MBS securities	2,751	37	141	11
Held-to-maturity securities:				
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Other MBS securities	26	3	199	23
Total held-to-maturity MBS securities	26	3	199	23
Total mortgage-backed securities (MBS)	2,777	40	340	34

3. SECURITIES (CONTINUED)**F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET-BACKED SECURITIES (CONTINUED)**

Additional details regarding mortgage and asset-backed securities in unrealized loss position (continued):

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 securities:				
A. 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
B. 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 securities:				
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
Asset-backed available-for-sale Securities (ABS):				
Credit financing the purchase of motor vehicles	1	1	-	-
Total asset-backed available-for-sale securities (ABS)	1	1	-	-
Total mortgage and asset-backed securities	2,649	77	1,020	26

3. SECURITIES (CONTINUED)

G. As of December 31, 2009 the mortgage backed securities (MBS) portfolio, included unrealized losses of US\$20 million (NIS 74 million). (As of December 31, 2008: unrealized losses of US\$27 million (NIS 103 million)).

H. Discount Group's available-for-sale securities portfolio includes corporate bonds, including bonds of banks, in a total amount of NIS 3,350 million (December 31, 2008: NIS 4,460 million). The balance of the said bonds included as of December 31, 2009, unrealized losses in the amount of NIS 381 million (December 31, 2008: NIS 836 million).

I. Most of the unrealized losses as at December 31, 2009 relate to securities rated as "investment grade" 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 its 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.

In 2009, IDB New York recorded other than temporary in nature write downs on several securities, in the amount of US\$27 million (NIS 108 million).

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, 2009 except for certain securities, in respect of which a provision for impairment in value has been included.

J. Investment in bonds of foreign financial institutions. The Bank and IDB New York recorded a provision for impairment in value in 2008, in respect of the foreign financial institution bonds, which include the Lehman Group, WAMU and Landsbanki in the amount of NIS 283 million.

K. The securities portfolio of the Discount Group as at December 31, 2009, 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\$161 million, (NIS 608 million), compared to US\$203 million on December 31, 2008 (NIS 772 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	
	2009	2008	2009	2008
	in NIS millions			
Credit	114,672	*116,819	67,590	69,443
Customers' liabilities for acceptances	343	260	276	158
Total credit	115,015	117,079	67,866	69,601
General provision and supplemental provision for doubtful debts	(589)	*(623)	(325)	(318)
Total credit to the public	114,426	116,456	67,541	69,283

* Reclassified.

Footnote:

The specific provision for doubtful debts has been deducted from the relevant items (see Note 4 C).

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES

1. Credit to problem borrowers (continued):

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
in NIS millions				
a) Non-Income Bearing Loans to Problem Borrowers Balance at balance sheet date:				
In Israeli currency, non-linked	1,574	1,804	1,182	1,344
In Israeli currency, linked to CPI	151	154	62	98
In foreign currency (including linked to foreign currency)	466	389	253	250
b) Restructured Credit to Borrowers				
1) Credit restructured in prior years, with waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	1	1	-	-
In Israeli currency linked to CPI	78	*79	70	*70
In foreign currency (including linked to foreign currency)	-	-	-	-
2) Credit restructured during the current year:				
without waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	636	174	585	104
In Israeli currency, linked to CPI	101	31	95	21
In foreign currency (including linked to foreign currency)	727	81	672	76
c) Restructured Credit Not Yet Executed				
Balance at balance sheet date	266	231	266	216
d) Credit in Temporary Arrears				
Balance at balance sheet date ⁽¹⁾	563	695	415	476
Interest in respect of such credit included in the statement of income	25	27	22	25
e) Credit Under Special Supervision				
Balance at balance sheet date ⁽¹⁾	3,565	4,249	2,218	3,056

* Reclassified.

Note:

(1) Including local authorities.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED):**C. PROVISION FOR DOUBTFUL DEBTS**

	2009			
	Specific provision ⁽¹⁾		Supplemental provision ⁽²⁾	Total
	According to period of arrears	Other		
	In NIS millions			
Consolidated				
Balance of provision at beginning of year	*167	*5,451	*685	6,303
Provision for current year	50	1,214	66	1,330
Reduction of provision	(47)	(173)	(99)	(319)
Collection of debts written-off in previous years	-	(13)	-	(13)
Provision charged to statement of Income	3	1,028	(33)	998
Net write-offs**	(1)	(657)	-	(658)
Exchange rate differentials	-	(2)	-	(2)
Balance of provision at end of year	169	5,820	652	6,641
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	184	63	247
The Bank				
Balance of provision at beginning of year	-	4,212	362	4,574
Provision for current year	-	725	42	767
Reduction of provision	-	(78)	(35)	(113)
written-off in previous years	-	-	-	-
Provision charged to statement of Income	-	647	7	654
Net write-offs*	-	(426)	-	(426)
Exchange rate differentials	-	-	-	-
Balance of provision at end of year	-	4,433	369	4,802
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	173	44	217

* Net of debts collected during the year.

** Less 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 348 million; 2008 - NIS 404 million; 2007 - NIS 427 million. The Bank: - NIS 197 million; 2008 - NIS 197 million; 2007 - NIS 197 million (see Note 1 I).

2008				2007			
Specific provision ⁽¹⁾			Total	Specific provision ⁽¹⁾			Total
According to period of arrears	Other	Supplemental provision ⁽²⁾		According to period of arrears	Other	Supplemental provision ⁽²⁾	
In NIS millions							
*166	*5,133	*676	5,975	*164	*5,267	*683	6,114
55	*939	*95	1,089	61	*644	*34	739
(50)	(156)	(86)	(292)	(56)	(185)	(41)	(282)
-	(17)	-	(17)	-	(10)	-	(10)
5	766	9	780	5	449	(7)	447
(4)	(447)	-	(451)	(3)	(575)	-	(578)
-	(1)	-	(1)	-	(8)	-	(8)
167	5,451	685	6,303	166	5,133	676	5,975
-	186	62	248	-	119	75	194
-	4,031	349	4,380	-	4,271	360	4,631
-	629	53	682	-	400	16	416
-	(94)	(40)	(134)	-	(143)	(27)	(170)
-	(1)	-	(1)	-	(1)	-	(1)
-	534	13	547	-	256	(11)	245
-	(351)	-	(351)	-	(496)	-	(496)
-	(2)	-	(2)	-	-	-	-
-	4,212	362	4,574	-	4,031	349	4,380
-	179	44	223	-	118	44	162

D. COMPOSITION OF CREDIT TO THE PUBLIC⁽¹⁾ AND OFF-BALANCE-SHEET CREDIT RISK⁽²⁾, BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS

Footnotes:

(2) Number of borrowers based on total credit and credit risk.

(4) Consolidated - by combining specific balances.

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⁽³⁾, BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS (CONTINUED)

The Bank

			December 31					
			2009			2008		
			Number of borrowers ⁽²⁾	Credit ⁽¹⁾	Credit risk	Number of borrowers ⁽²⁾	Credit ^{*(1)}	Credit risk ⁽³⁾
in NIS millions								
Credit limit (in NIS thousand):								
	Up to	10	181,626	367	515	193,398	332	414
Over	10	Up to	20	108,943	678	989	76,739	531
Over	20	Up to	40	119,180	1,594	1,871	106,012	1,315
Over	40	Up to	80	86,019	2,686	2,308	98,399	2,314
Over	80	Up to	150	43,764	2,802	1,892	69,542	2,768
Over	150	Up to	300	15,922	2,210	1,004	19,679	2,163
Over	300	Up to	600	5,493	1,508	814	6,150	1,594
Over	600	Up to	1,200	3,185	1,702	995	3,424	1,824
Over	1,200	Up to	2,000	1,367	1,465	660	1,447	1,533
Over	2,000	Up to	4,000	1,211	2,383	1,103	1,274	2,534
Over	4,000	Up to	8,000	819	3,057	1,508	838	3,198
Over	8,000	Up to	20,000	640	5,464	2,710	707	5,999
Over	20,000	Up to	40,000	318	5,994	3,088	324	5,914
Over	40,000	Up to	200,000	332	18,823	8,239	359	20,609
Over	200,000	Up to	400,000	39	7,291	3,448	45	9,015
Over	400,000	Up to	800,000	16	5,482	3,224	15	6,266
Over	800,000	Up to	1,200,000	9	4,967	3,665	6	2,134
Over	1,200,000	Up to	1,600,000	1	74	1,143	1	1,251
Total			568,884	68,547	39,176	578,359	71,294	41,584

* Reclassified (See Note 1 Z).

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	Specific provision		Total
				According to extent of delinquency ⁽⁵⁾	Other	
in NIS millions						
December 31, 2009						
Housing loans ⁽¹⁾⁽⁶⁾	11,146	245	108	152	-	152
"Large loans" ⁽²⁾	4,058	109	39	5	26	31
Other loans ⁽³⁾	861	43	17	12	14	26
Total	16,065	397	164	169	40	209
December 31, 2008*						
Housing loans ⁽¹⁾⁽⁶⁾	9,964	288	97	146	-	146
"Large loans" ⁽²⁾	3,351	76	35	5	29	34
Other loans ⁽³⁾	798	55	19	16	14	30
Total	14,113	419	151	167	43	210

* 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 873 thousand (2008: NIS 841 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 22.9 million (2008: NIS 19.0 million)
- (6) Including balance of credit at the Bank in the amount of NIS 121 million (2008: NIS 90 million).

4. CREDIT GRANTED TO THE PUBLIC (CONTINUED):

F. HOUSING LOANS AND THE PROVISION FOR DOUBTFUL DEBTS IN RESPECT THEREOF BASED ON THE PERIOD OF ARREARS

Consolidated						
December 31, 2009						
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	18	91	-	127
Of which: Interest on the amount in arrears	1		1	26	-	28
Balance of provision for doubtful debts based on period of arrears ⁽¹⁾	1	17	40	111	-	169
Balance of loans net of provision for doubtful debts	107	94	35	27	-	263
December 31, 2008						
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	*39	*111	-	167
Balance of loans net of provision for doubtful debts	137	107	43	28	-	315

* Reclassified.

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	
	2009	2008	2009	2008
	in NIS millions			
Deposit of the Accountant General - tender for teaching employees	1,517	1,460	1,517	1,460
Other credit ⁽¹⁾	303	31	301	1
Total credit granted to Governments	1,820	1,491	1,818	1,461

Footnote:

(1) Including credit to foreign governments: Consolidated - NIS 2 million (2008: NIS 20 million), the Bank - no balance.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES**A. CONSOLIDATED**

	December 31, 2009			December 31, 2008		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
In NIS millions						
Investments						
Shares stated on equity basis (including goodwill) ⁽¹⁾	1,674	-	1,674	1,711	-	1,711
Other investments:						
Capital notes	52	-	52	52	-	52
Shareholders' loans	69	-	69	64	-	64
Total other investments	121	-	121	116	-	116
Total investments	1,795	-	1,795	1,827	-	1,827
Includes:						
Earnings accumulated since January 1, 1992	1,053	-	1,053	817	-	817
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	19	-	19	(9)	-	(9)
Adjustment for translation of foreign currency financial statements	(2)	-	(2)	(16)	-	(16)
Details Regarding Goodwill:						
Period of amortization	10 years			10 years		
Original amount	7	293	300	204	292	496
Unamortized balance	3	174	177	98	206	304
Book and Market Values of Marketable Investments:						
Book value	1,632	-	1,632	1,453	-	1,453
Market value	1,683	-	1,683	705	-	705

Footnote:

(1) Includes earnings and translation adjustments in units having a functional currency that differs from the reporting currency (defined in the past as "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, 2009			December 31, 2008		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
In NIS millions						
Investments:						
Shares stated on equity basis (including goodwill) ⁽¹⁾	1,667	6,833	8,500	1,509	5,981	7,490
Other investments:						
Subordinated debt notes and Capital notes	3	1,546	1,549	3	1,419	1,422
Shareholders' loans	2	-	2	2	64	66
Total other investments	5	1,546	1,551	5	1,483	1,488
Total investments	1,672	8,379	10,051	1,514	7,464	8,978
Includes:						
Retained earnings since January 1, 1992	1,087	3,405	4,492	943	2,908	3,851
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	17	(31)	(14)	(11)	(214)	(225)
Adjustment for translation of foreign currency financial statements	-	30	30	(1)	13	12
The State's bonus to the employees (privatization)	-	32	32	-	32	32
Details Regarding Goodwill:						
Period of amortization	10 years			10 years		
Original amount	7	292	299	8	292	300
Unamortized balance	3	173	176	5	206	211
Book and Market Values of Marketable Investments:						
Book value	1,632	-	1,632	1,453	-	1,453
Market value	1,683	-	1,683	705	-	705

Footnote:

(1) Includes earnings and translation adjustments in units having a functional currency that differs from the reporting currency (defined in the past as "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		
	2009	2008	2007	2009	2008	2007
In NIS millions						
The Bank's share of operating income of investee companies (consolidated - affiliated companies)	149	18	175	664	272	457
Provision for impairment in value of investee companies	(1)	(88)	-	(1)	-	-
Total	148	(70)	175	663	272	457
Provision for taxes:						
Current taxes	-	-	-	26	26	22
Deferred taxes	⁽³⁾ (10)	-	⁽¹⁾ 130	⁽³⁾ (10)	⁽²⁾ (23)	⁽¹⁾ 143
Total provision for taxes (tax saving)	(10)	-	130	16	3	165
Bank's share in operating income (loss) net of tax effect of investee companies (consolidated - affiliated companies)	158	(70)	45	647	269	292

Footnotes:

- (1) Including a provision for taxes in the amount of NIS 130 million in respect of the Bank's share in earnings of the First International Bank (see Section F below).
- (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).
- (3) For details regarding changes in the provision for taxes in respect of the Bank's share in the earnings of the First International Bank, see item (d) below.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

C. INFORMATION ON PRINCIPAL INVESTEE COMPANIES

						Value of investment in shares on equity			
Name of Company	Details of company	Share in capital conferring rights to profits		Share in voting rights		Equity basis ⁽¹⁾		Market value	
		2009	2008	2009	2008	2009	2008	2009	2008
		As a percentage				In NIS millions			
1. Consolidated Subsidiaries:									
Discount Bancorp, Inc. ⁽²⁾	Holding company, U.S.A.	100.00	100.00	100.00	100.00	23	20	-	-
Israel Discount Bank of New York ⁽³⁾	Commercial bank, U.S.A.	100.00	100.00	100.00	100.00	2,672	2,390	-	-
Mercantile Discount Bank Ltd.	Commercial bank	100.00	100.00	100.00	100.00	1,695	1,480	-	-
Discount Mortgage Bank Ltd.	Mortgage bank	100.00	100.00	100.00	100.00	1,097	907	-	-
Israel Credit Cards Ltd. ⁽⁴⁾	Credit card service	71.83	71.83	79.00	79.00	924	774	-	-
Discount Leasing Ltd.	Equipment leasing	100.00	100.00	100.00	100.00	106	104	-	-
Discount Israel Capital Markets and Investments Ltd.	Underwriting and investments	100.00	100.00	100.00	100.00	(23)	(219)	-	-
Discount Manpikim Ltd.	Securities issue	100.00	100.00	100.00	100.00	58	56	-	-
IDB (Swiss) Bank Ltd. ⁽⁶⁾	Commercial bank, Switzerland	100.00	100.00	100.00	100.00	183	173	-	-
Companies held by Israel Discount Bank of New York:									
Discount Bank (Latin America) ⁽⁷⁾	Commercial bank, Uruguay	100.00	100.00	100.00	100.00	209	190	-	-
IDBNY Realty (Delaware), Inc. ⁽⁷⁾	Holding company, U.S.A.	100.00	100.00	100.00	100.00	2,347	1,694	-	-
IDB Realty LLC. ⁽⁸⁾	REIT, U.S.A.	100.00	100.00	100.00	100.00	6,419	6,401	-	-
Company held by Discount Israel Capital Markets and Investments Ltd.:									
Freetnet A.K. Communications Ltd.	Holding company	100.00	100.00	100.00	100.00	(29)	(41)	-	-
2. Affiliated Companies:									
First International Bank of Israel Ltd. ⁽⁹⁾	Commercial bank	26.45	26.45	11.09	11.09	1,632	1,453	1,683	705
Company held by Discount Israel Capital Markets and Investments Ltd.:									
Kardan Financial Services N.V. ⁽¹⁰⁾	Financial Investments, the Netherlands	-	11.00	-	20.00	-	189	-	-

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.

(3) The company is owned by Discount Bancorp, Inc.

(4) For details regarding a guarantee unlimited in amount in favor of VISA Europe, securing all of ICC's liabilities, see Note 19 C 9 below.

(5) 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) For details regarding the acquisition of Arzi Bank and its merger with the company, see Section F hereunder.

(7) Included in the financial statements of Israel Discount Bank of New York.

(8) Included in the financial statements of IDBNY Realty (Delaware), Inc.

(9) For additional details regarding the investment, see Section D below.

(10) For details regarding the sale of the investment in KFS and the option agreement for the purchase of shares in KFS, see Section E hereunder.

(11) Including adjustments from translation of financial statements of units having a functional currency that differs from the reporting currency (defined in the past as "autonomous units") and adjustments concerning the presentation of certain securities of investee companies at fair value.

(12) Goodwill.

(13) Including changes in provision for taxes in respect of the Bank's share in earnings of the First International Bank (see Section D below).

Of which excess of cost balance		Other investments		Contribution to net operating income		Of which, loss on impairment		Other items recorded in shareholders' equity ⁽¹¹⁾		Guarantees issued for consolidated subsidiaries in favor of entities outside the group	
										2009	2008
2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
In NIS millions											
-	-	193	-	(3)	(3)	-	-	3	3	-	-
-	-	94	285	120	58	-	-	(286)	(428)	-	-
-	-	-	-	181	149	-	-	47	12	-	-
⁽¹²⁾ 7	⁽¹²⁾ 8	497	371	30	27	-	-	-	-	7	7
⁽¹²⁾ 166	⁽¹²⁾ 198	35	40	153	⁽⁵⁾ 191	-	-	-	3	100	61
-	-	-	-	3	4	-	-	-	-	-	-
-	-	233	327	(19)	(63)	-	-	(1)	(2)	-	-
-	-	-	-	1	2	-	-	-	-	-	-
44	66	-	-	(9)	(1)	(7)	(10)	-	-	-	-
-	-	-	-	13	27	-	-	-	(6)	-	-
-	-	-	-	42	25	-	-	611	5	-	-
-	-	-	-	18	56	-	-	(91)	(87)	-	-
-	-	488	454	12	(21)	-	-	(5)	(4)	-	-
-	-	-	-	⁽¹³⁾ 161	43	-	-	18	(21)	-	-
-	⁽¹²⁾ 92	-	-	-	(107)	-	(85)	-	(20)	-	-

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

D. 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. The period in which publishing of a shelf offering pursuant to the aforementioned prospectus was possible has expired. On November 30, 2009, the First International Bank published a shelf Prospectus, according to which, among other things, it may issue shares of a par value of NIS 0.01 each as well as option warrants, whether by way of a rights issue or by way of an offer to the public.

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 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.

In a letter dated November 23, 2009, received by the Bank on November 29, 2009, the Antitrust Authority approached the Bank again for data, documentation and details with respect to an examination performed by the Authority regarding various aspects relating to the holdings of the Bank in the First International Bank.

In its letter, the Authority noted that the examination had been delayed in order to allow for a solution to the problem with the assistance of the Supervisor of Banks, and whereas a long period of time has passed without the issue being solved, the Authority reiterates its request for the said data. The Bank delivered to the Authority part of the requested information and data. In a discussion held with the representative of the Authority, the Bank was informed that, at this stage, it is not required to submit further material to the Authority.

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, the Bank has suspended the filing of proceedings.

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

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

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 the above, there was no certainty at that date that the assumption of the continued holding of this investment would be materialized in full, and accordingly 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 introduced 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. Under these circumstances, the Bank estimated no change in its holding stake in FIBI in the foreseeable future and therefore, the Bank has reversed the provision for taxes in the financial statements as of June 30, 2009, amounting to NIS 130 million made, as abovesaid, in its financial statements as of December 31, 2007.

Formation of understandings with FIBI Holdings. In the middle of February 2010, the Bank, FIBI and the controlling shareholder of FIBI renewed their discussions with a view of reaching an agreement with respect to the holdings of the Bank in FIBI and the rights attached thereto.

In the second half of March 2010, the Bank reached an understanding with FIBI Holdings Ltd. (hereinafter: "FIBI Holdings") regarding the Bank's holdings in FIBI. The said understanding is subject to the signing of an agreement between the parties (hereinafter: "the Agreement") and to obtaining the approvals of the Boards of Directors of the Bank and of FIBI Holdings.

Following are the main points of the understanding:

- The Agreement will contain conditions precedent to the validity of the Agreement (hereinafter: "the conditions precedent"), which are: approvals by the Supervisor of Banks and the Antitrust Commissioner and completion of the distribution of a dividend in the amount of NIS 800 million by FIBI its shareholders.
- FIBI Holdings will act to the best of its ability towards the unification of the share capital in FIBI ("unification of the capital"), and Israel Discount Bank shall support such an action, subject to the completion of the dividend distribution or obtaining all the approvals for its distribution.
- Soon after the said unification of the share capital is completed, if and when completed, Israel Discount Bank shall deposit with a trustee all its shares in FIBI, the voting rights attached to them exceeding the rate of voting rights existing at present in Israel Discount Bank's hands. Israel Discount Bank shall not use the voting rights attached to the deposited shares.
- Until the end of six months from the date of completion of the said unification of the share capital, and subject to the fulfillment of the conditions precedent and subject to the completion of the unification of the share capital, Israel Discount Bank shall take action to sell 6% of its shares in the capital and voting rights in FIBI to third parties, on condition that market conditions will allow a sale at a price that is not lower than the stated value of the shares being sold in the financial statements of Israel Discount bank.
- Starting with the date on which all conditions precedent are fulfilled, the arrangement existing between FIBI holdings and Israel Discount

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

Bank regarding the right of first refusal for the purchase of shares in FIBI will be cancelled, and any transfer or sale of shares of FIBI by FIBI Holdings or by Israel Discount Bank, shall not be subject to such a right.

- Until December 31, 2013 (hereinafter: "the determining date"), Israel Discount Bank shall be entitled to have FIBI Holdings continue to cause the appointment of one quarter of the Directors of FIBI from among candidates recommended by Israel Discount Bank (subject to Directives regarding the prevention of conflict of interests), this with no consideration to the number of shares held by Israel Discount Bank. Subsequent to the determining date, the existing arrangements between FIBI Holdings and Israel Discount Bank shall be void, including the said arrangement regarding the appointment of Directors. The determining date may be postponed in the event that all conditions precedent are not fulfilled, or if the unification of the capital is not completed within periods to be specified in the Agreement.
- The said understandings are subject to approval of the Boards of Directors of Israel Discount Bank and of FIBI Holdings and to the signing of an Agreement. The validity of the agreement shall be subject to the conditions precedent stated above.

In view of the above, the Bank has included in the financial statements as of December 31, 2009, a provision for taxes in the amount of NIS 120 million, in respect of its holdings in FIBI.

E. INVESTMENT IN "KFS".

On December 30, 2007, Israel Discount Capital Markets and Investments Ltd., (hereinafter: "DCMI") Kardan Financial Services BV (hereinafter: "KFS") and Kardan N.V. (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. The investment transaction was consummated on December 31, 2007.

Sale of investment in KFS. On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of its holdings in the shares of KFS in consideration for Euro 38.5 million. This amount is paid as follows: An amount of Euro 30 million was paid upon signing the agreement and an amount of Euro 8.5 million is payable at the end of seven years from date of the agreement, without interest. In view of the above, DCMI adjusted the value of this investment on its books to the value of the sale consideration.

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

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 Euro 386 million together with interest of 5% per annum (subject to adjustments specified in the agreement). For the purpose of interest accumulation, exercise of the option in the course of the first two years, will be considered as though the option was exercised at the end of two whole years. 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.

Being cautious, the Bank did not take into account, in computing the provision for impairment, the economic value attributed to the option. A further loss of NIS 18 million was recognized in the financial statements as of March 31, 2009, in respect of the realization of the investment in KFS (most of which was in respect of exchange rate differentials recorded in relation to this investment up to realization date). This was on top of provisions for impairment in the amount of NIS 85 million, recorded in 2008.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES
(CONTINUED)

F. Investment in Arzi Bank

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 (date of initial consolidation) in NIS millions:

	Unaudited
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	*2,276	3,954	6,230	*1,655	2,681	4,336
Additions	164	475	639	27	358	385
Disposals	(66)	(293)	(359)	(14)	(66)	(80)
Balance as at December 31, 2009	2,374	4,136	6,510	1,668	2,973	4,641
Depreciation						
Balance at beginning of the year	*949	2,242	3,191	*663	1,309	1,972
Depreciation for the year	51	433	484	30	325	355
Recognized impairment losses	6	-	6	6	-	6
Accumulated depreciation on disposals	(58)	(291)	(349)	(8)	(66)	(74)
Balance as at December 31, 2009	948	2,384	3,332	691	1,568	2,259
Depreciated balance as at December 31, 2009	1,426	1,752	3,178	977	1,405	2,382
Depreciated balance as at December 31, 2008	1,327	1,712	3,039	992	1,372	2,364
The average depreciation rate in 2009	3.3%	14.9%	10.8%	2.6%	16.0%	11.1%
The average depreciation rate in 2008	2.9%	13.9%	9.7%	2.5%	16.3%	10.8%

* Reclassified.

** Includes:

- Installations and leasehold improvements, the depreciated balance of which amounted to NIS 133 million - consolidated and to NIS 67 million in the Bank. (2008: NIS 134 million - consolidated; and NIS 66 million - in the Bank).
- Interest capitalized in prior years net of amortization, in the amount of NIS 2 millions (2008: NIS 2 millions).
- Including a provision for decline in value in the amount of NIS 46 million - consolidated and NIS 44 million - in the Bank (2008: NIS 42 million - consolidated and NIS 40 million - in the Bank).

- B. The Bank and a consolidated subsidiary own leasehold rights for various periods ending in the years 2009 to 2056. The Bank and a consolidated subsidiary are the owners of non-capitalized leasehold rights: Consolidated – NIS 34 million (2008: NIS 33 million). The Bank, stand alone: NIS 30 million (2008: NIS 31 million). The Bank and a consolidated subsidiary are the owners of capitalized leasehold rights: Consolidated – NIS 79 million (2008: NIS 80 million). The Bank, stand alone – NIS 52 million (2008: NIS 53 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 590 million (2008: NIS 479 million) on a consolidated basis, and NIS 429 million (2008: NIS 431 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 14 million (2008: NIS 47 million) on a consolidated basis, and NIS 10 million (2008: NIS 43 million) for the Bank. No losses were recognized in 2009 in respect of impairment.
- E. The outstanding balance of building and equipment designated for sale amounted on December 31, 2009 to NIS 6 million. Losses on impairment of buildings and equipment in the amount of NIS 0.4 million were recognized in 2009.

7. BUILDINGS AND EQUIPMENT (CONTINUED)**F. THE COST OF IN-HOUSE DEVELOPMENT OF COMPUTER SOFTWARE:**

	Consolidated		The Bank	
	2009	2008	2009	2008
in NIS millions				
The cost of software put into operation	1,531	1,211	1,438	1,133
Accumulated depreciation	(662)	(568)	(602)	(516)
Undepreciated balance	869	643	836	617
Accumulated costs in respect of software under development	73	173	65	162
Total cost of in-house development of computer software	942	816	901	779

8. OTHER ASSETS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
Net deferred tax assets (see Note 29 M)	402	599	116	149
Excess advance tax payments over current provisions	317	134	65	54
Excess deposits for severance pay and pensions, over provision (see Note 16 D, H)	410	237	392	235
Goodwill	174	206	-	-
Issue costs and discount expenses of subordinated capital notes	28	25	36	24
Income receivable	176	151	84	64
Debit balances of derivative financial instruments (except for derivative instruments)	1,836	3,407	1,724	3,302
Surrender value of life assurance policies owned by the Bank and corporate owned life insurance	611	591	-	-
Other debtors and debit balances	1,387	554	1,146	251
Total other assets	5,341	5,904	3,563	4,079

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
Demand deposits	32,470	22,009	17,648	13,068
Time and other deposits	103,770	111,542	83,320	84,273
Savings plan deposits	5,585	5,681	4,954	5,000
Total deposits from the public	141,825	139,232	105,922	102,341

10. DEPOSITS FROM BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
Commercial banks:				
Demand deposits	950	1,157	513	312
Time deposits	1,344	1,071	2,659	1,979
Acceptances	330	260	264	158
Central banks:				
Schedule deposits	982	1,969	-	-
Specialized banking institutions:				
Deposits on demand	60	16	279	62
Time deposits	58	82	249	412
Total deposits from banks	3,724	4,555	3,964	2,923

11. SUBORDINATED CAPITAL NOTES

	Average maturity ⁽¹⁾	Internal rate of return ⁽¹⁾	Consolidated		The Bank	
	years	%	December 31		December 31	
			2009	2008	2009	2008
in NIS millions						
Subordinated capital notes not convertible into shares:						
In non-linked Israeli currency	7.16	6.43	2,422	1,979	69	73
In Israeli currency, linked to CPI	7.87	5.49	7,447	6,155	1,909	2,276
Subordinated capital notes convertible into shares:						
In Israeli currency, linked to CPI ⁽²⁾	11.64	6.03	1,660	1,239	1,660	1,239
Total subordinated capital notes			11,529	9,373	3,638	3,588

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, 2009.

(2) Subordinated capital notes regarded as "hybrid tier I capital" (see Note 14 5 below).

12. OTHER LIABILITIES

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
Net provision for deferred taxes (see Note 29 M)	14	16	14	16
Excess current tax provisions over advance payments	30	51	-	1
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16 D, H)	42	18	-	-
Provisions for vacation pay, seniority bonus and retirement benefits	1,037	947	876	786
Deferred income	168	137	58	55
Credit balances of derivative financial instruments (except for derivative instruments)	2,489	4,222	2,292	4,005
Payables for credit card activity	5,257	*4,947	2,182	2,015
Provision for doubtful debts in respect of guarantees	154	185	124	160
Accrued expenses	747	546	370	328
Amounts received from realization of Other creditors and credit balances	2,574	*1,179	1,083	425
Total other liabilities	12,512	12,248	6,999	7,791

* Reclassified.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS**A. THE AUTHORIZED, ISSUED AND PAID-UP NOMINAL SHARE CAPITAL (IN NEW ISRAEL SHEKELS):**

	December 31, 2009		December 31, 2008	
	Issued and		Issued and	
	Authorized	Fully Paid-Up	Authorized	Fully Paid-Up
Ordinary "A" Shares of NIS 0.1 par value each	196,100,000	98,063,921	185,000,000	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 shareholders' equity	196,100,202	98,064,123	185,000,202	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 preference share, the par value of which is equivalent to 10 pounds sterling, is entitled to an annual dividend in an amount of NIS 3.67, and at the time of liquidation to a distribution in an amount of NIS 61.11. According to an Opinion issued by the Institute of Certified Public Accountants in Israel, non-participating preference shares are not to be included as part of shareholders' equity, and accordingly they are presented under the item "other liabilities".

C. (1) Increase of the registered share capital in the years 2006-2008 –creation of a pool of shares for the purpose of "forced conversion events" of subordinate capital notes Series "A" and "B"

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 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.

(2) Increase of the registered share capital in 2009 – increase for the purpose of raising tier I capital

The special meeting of shareholders convened on December 15, 2009 resolved to increase the registered share capital of the Bank by 111 million ordinary A shares of NIS 0.1 par value each, and to amend the Memorandum and Articles accordingly.

The shares created by the said increase were intended to promote a move for the raising of tier I capital, in the volume, format and dates to be determined.

The Bank is committed towards the State of Israel, which holds 20% of the share capital of the Bank, that the shares constituting part of the registered share capital of the Bank, which were created as a result of the said increase in capital, will be utilized for the above purpose and will not be used for any other purposes.

D. EQUITY BASED COMPENSATION TRANSACTIONS - AN OPTION PLAN FOR OFFICERS OF THE BANK**(1) An option plan for officers of the Bank (excluding the former 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

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

Bank, the President and CEO of the Bank and to he who acted at that time as the Chairman of the Board, and terminated his office on January 1, 2010 (hereinafter: "the former Chairman of the Board"). The part of the plan applying to the former 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").

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. At 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 were not allotted.

The terms of the option warrants. The exercise price of each of the option warrants offered according to the plan to seven of the other officers, is 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 price of each of the said option warrants as of December 31, 2009, were NIS 7,016 in respect of four officers (remaining in the Bank out of the seven officers mentioned above), NIS 9,684 in respect of the officer who joined the Bank on March 1, 2006, and NIS 9,554 in respect of an officer who joined the Bank on April 2, 2006.

The exercise period of two thirds (2/3) of the warrants allotted under the plan began on January 5, 2009 and will 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.

In accordance with section 102 of the Income tax ordinance, all the option warrants under the plan were 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.

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).

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

The theoretical value of the benefit in respect of the option warrants, allotted as above, in accordance with the provisions of Accounting Standard No. 24, is estimated at NIS 39 million. The value of the benefit in respect of the option warrants, allotted as above, which includes payroll tax, considering the change that has taken place in the payroll tax rates and the actual profit component (in contrast to that estimated at the time), is assessed at NIS 40 million.

The value of the benefit on behalf of the said nine 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 an officer in the course of 2007, the options issued to her (1,176,767) expired. Following the retirement of one of the officers at the end of January 2009, the option warrants allotted to him expired in 2009 (1,176,767). The balance of the unexpired option warrants on December 31, 2009, in respect of six officers amounted to 6,276,090 option warrants. In the year ended on December 31, 2009, an amount of NIS 1 million were charged in respect of six officers, as salary expenses as against a capital reserve. (2008: an amount of NIS 8.5 million in respect of seven Officers; 2007: an amount of NIS 7.6 million in respect of seven Officers).

(2) Option plan for the former 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 former Chairman of the Bank's Board of Directors, as part of the option plan for the former Chairman of the Board and the President and CEO.

A special shareholders meeting of the Bank held on August 26, 2007, approved the terms of office of the former Chairman of the Board of the Bank as well as the issue of option warrants to the former Chairman of the Board within the framework of the stock option plan for the former 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 former Chairman of the Board of Directors; each option exercisable into one ordinary share. The exercise price of the options is NIS 8.455. 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, linked to the CPI, subject to adjustments.

The option warrants allotted to the trustee may be exercised, according to the plan, on the following dates:

- grantee will be entitled to exercise into shares, parcels of option warrants vested in him until the end of 2008, as from January 5, 2009, and until January 4, 2011;
- A grantee will be entitled to exercise into shares, parcels of option warrants vested in him until the end of 2008, as from January 5, 2010, and until January 4, 2012;
- A grantee will be entitled to exercise into shares, parcels of option warrants vested in him until the end of 2010, as from January 5, 2011 and until January 4, 2013.

Each of the periods during which option warrant become exercisable under the plan, as stated above, shall be called hereunder, "the exercise period".

Option warrants allotted to the trustee on behalf of a grantee whose office was terminated, and which had not been exercised (and have not expired), and which are included in the parcels which have been vested in the grantee until the end of the last year of measurement preceding the date of termination of office, shall be exercisable until the earliest of the following dates: (1) 180 days since date of termination of office or 180 days from the beginning of the exercise period of each of the option warrants as stated above, whichever is the later; or (2) the end of the exercise period of each of the option warrants, as stated above, as the case may be.

Assuming, theoretically, exercise in full of all the options granted to the President and CEO and to the Chairman of the Board of Directors

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

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 exercise price of each of the aforesaid option warrants as of December 31, 2009, was NIS 8,975.

The option warrants were divided into five equal annual installments in each of the years 2006 through 2010.

In view of the termination of office of the former Chairman of the Board, 1,618,055 option warrants, included in the portion for 2010, have expired.

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 in 2009 in respect of the years 2008-2009, 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 former Chairman of the Board of Directors and the President and CEO according to the option plan, is calculated as of the date of approval by the general meeting, according to the closing rate of the Bank's shares on the stock exchange on the preceding day, is NIS 31.3 million.

In 2009 an expense in the amount of NIS 1.3 million was recorded in respect of the said benefit. (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).

(3) Issue of Options to additional Members of Management

General background. 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 (hereinafter: "offeree A"), 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 (hereinafter: "offeree B"), 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. 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. The committee instructed that the option plan be brought for approval of the authorized organs at the Bank, following obtaining of State's approval in accordance with the agreement of February 1, 2005, signed between the State and the Bronfman-Schron group (hereinafter: "agreement for the sale of the controlling interest in the Bank").

The Bank has approached the State and the Bronfman-Schron group requesting the approval of allotment of the option warrants. At the time, a dispute arose between the parties to the agreement for the sale of the controlling interest in the Bank as to the manner of calculating the additional consideration (as this term is defined in the agreement), which under certain circumstances, might become

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

payable to the State. Whereas the said allotment might have had an effect upon the calculation of the additional consideration, though very negligible, the parties did not approve the request. At the end of the day, the circumstances required for the payment of the additional consideration have not materialized, and such consideration has not been paid.

Proximate to the final date of settlement between the State and the controlling shareholders, the crisis broke out in world markets, which caused a sharp decline in the value of shares, including the shares of the Bank, so that the allotment did not seem realistic. Therefore the allotment was postponed and was not realized.

The phantom option plan comprises an alternative to the plan which would have been granted to the said Management members to begin with.

Due to the passing of time and in order to grant to the said members of Management the remuneration that would have resulted from the allotment of the option warrants, had they been allotted to them on the original date or proximate to it, the Audit Committee and the Board of Directors approved the granting of phantom options with the addition of the grossing up of tax differences between the marginal tax applying to the offerees and the capital gains tax that would have been paid by them had they actually received option warrants in accordance with the original plan.

Notwithstanding, on January 11, 2010, the Bank's Board of Directors approved a remuneration policy in accordance with the letter of the Bank of Israel regarding remuneration policy of a banking corporation, dated April 5, 2009, according to which future remuneration to members of Management of the Bank (whose option plan terminates at the end of 2010) will be determined. In order for the new remuneration plan to also apply to the said members of Management – the period of the plan has been shortened by one year, and concurrently a proportionate part of the option warrant in respect of this period has been deducted from the original number of option warrants.

The other terms of the plan are identical to those of the original plan approved in respect of other members of Management, mutatis mutandis, as from date of appointment of the offerees and from the fact that the subject matter is a phantom option plan and not a plan for the actual allotment of option warrants.

"Phantom option" plan. Offeree A and Offeree B will be entitled to a cash amount being the difference between the closing market price of an ordinary share of the Bank on the trading day prior to the exercise date, multiplied by the number of shares resulting from the phantom options in respect of which an exercise notice had been given, and the exercise price multiplied by the same number of phantom options (hereinafter: "the amount of cash benefit"). To the amount of cash benefit shall be added the grossed up tax difference between the marginal tax applying to the offeree member of Management and the capital gains tax that would have been paid by him had he received the option warrants according to an option plan subject to Section 102 of the Income Tax Ordinance (the capital gains option). The grossed up tax amounts and the amount of cash benefit shall be known together as the "phantom award".

The exercise price of each of the phantom options shall be determined according to the closing market price of an ordinary share of the Bank, on the last trading day prior to the date of appointment as Executive Vice President (hereinafter: "trading day") (NIS 9.3 and NIS 9.171, respectively), together with linkage increments to the CPI, as from the most recent CPI published prior to the last trading day before entry into office and until the known index in effect on date of exercise (hereinafter: "the exercise price"), subject to adjustments as detailed in the plan.

Offeree A has been offered 980,639 phantom options (instead of 1,176,767 options which were supposed to have been granted to him) and Offeree B has been offered 817,199 phantom options (instead of 980,639 options which were supposed to have been granted to her).

Offeree A and Offeree B will be entitled to phantom options in two portions, as follows:

- The first portion including 784,511 phantom options to Offeree A and 653,759 phantom options to Offeree B was granted to the offerees

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

on February 24, 2010. The phantom options included in the first portion are exercisable within two years from the above date.

- The second portion including 196,128 phantom options to Offeree A and 163,440 phantom options to Offeree B to be granted to the offerees on February 24, 2011. The phantom options included in the second portion are exercisable within three years from the above date.

As of the date of the decision the exercise price was NIS 10.060 and NIS 9.923 respectively (taking into account the dividend distributed on October 6, 2008).

The offerees shall be entitled to the phantom options only if they will serve as officers of the Bank on the determining date. The plan includes provisions for the shortening of the exercise period and the pro-rata granting of the phantom options in cases of termination of employment as well as provisions regarding the modification of the plan under certain circumstances.

The exercise of the phantom options does not have any effect on the share capital of the Bank.

The value of the benefit to the said two offerees, based on the Black & Scholes model, amounts to NIS 2.811 million. The economic value, as stated, has been computed on the basis of the assumption that all the phantom options would be exercised on the last day of the exercise period determined in their respect and it does not take into account the fact that these are not marketable options and that the date determining the right to a part of the phantom options has not yet arrived. The total economic value of the phantom award, also taking into consideration the grossing up of the said tax differences, amounts to NIS 3.710 million.

It is emphasized that the above computation serves only as an indication of the cost of the phantom award, and that the actual cost may be different because it is affected by changes in the price of the Bank shares during the period of the plan, as well as changes that might occur, if at all, in future tax rates.

The expense in respect of the first portion of the phantom options will be recognized in the income statement of the interim financial report for March 31, 2010 (taking into consideration the date of approval of the plan) while the expense in respect of the second portion will be distributed over the period to its date of entitlement. At each reporting date, until the exercise of the phantom options, a calculation of the fair value of the plan shall be made, in accordance with the market terms at that date, and the resultant difference will be recognized in the income statement.

(4) SHARE BASED PAYMENT OF THE SHARE OPTION TYPE - QUANTITATIVE DETAIL SUMMARY

a. Share based payment for senior officers of the Bank (Consolidated and Bank)

	2009		2008		2007	
	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS
Changes in option						
Outstanding at beginning of the year	7,452,857	7.42	7,452,857	7.34	8,629,624	7.06
Granted during the year	-	-	-	-	-	-
Lapsed during the year	1,176,767	6.85	⁽²⁾ -	-	1,176,767	6.59
Outstanding at end of the year ⁽³⁾	6,276,090	7.83	7,452,857	7.42	7,452,857	7.34

Footnotes:

(1) The exercise price is linked to the last published CPI. The actual exercise price is subject to adjustments, as detailed above, in addition to the linkage increments. As of December 31, 2008, the exercise price was adjusted by NIS 0.255 in respect of the dividend distributed during 2008.

(2) Subsequent to balance sheet date, 392,256 options have expired due to the retirement of an officer.

(3) Options outstanding at the end of the year divided by ranges:

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)**(4) SHARE BASED PAYMENT OF THE SHARE OPTION TYPE - QUANTITATIVE DETAIL SUMMARY (CONTINUED)****a. Share based payment for senior officers of the Bank (Consolidated and Bank) (continued)**

	31 December, 2009		31 December, 2008		31 December, 2007	
	Range 1	Range 2	Range 1	Range 2	Range 1	Range 2
Exercise price range (in NIS)	7.014	9.55-9.68	6.76	9.20-9.33	6.71	9.05-9.17
Number of options	4,314,812	1,961,278	5,491,579	1,961,278	5,491,579	1,961,278
Weighted average exercise price (in NIS)	7.014	9.617	6.76	9.26	6.71	9.11
Weighted average contractual life (years)	1.667	1.667	2.667	2.667	3.667	3.667
Of which exercisable:						
Number of options	2,876,541	1,307,519				
Weighted average exercise price (in NIS)	7.014	9.617				

b. Share based payment for the previous Chairman of the Board and the President and CEO of the Bank (Consolidated and Bank)

	2009		2008		2007	
	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS
Changes in option						
Outstanding at beginning of the year	16,180,550	8.64	16,180,550	8.51	-	-
Granted during the year ⁽²⁾	-	-	-	-	16,180,550	8.45
Lapsed during the year ⁽³⁾	-	-	-	-	-	-
Outstanding at end of the year	16,180,550	8.97	16,180,550	8.64	16,180,550	8.51
Of which exercisable:	6,472,220					

Footnotes:

- (1) The exercise price is linked to the last published CPI. The actual exercise price is subject to adjustments, as detailed above, in addition to the linkage increments. As of December 31, 2008, the exercise price was adjusted by NIS 0.255 in respect of the dividend distributed during 2008.
- (2) The weighted average fair value of each option granted during 2007 was NIS 1.93.
- (3) Subsequent to balance sheet date, 1,618,055 options have expired due to the retirement of the Chairman of the Board of Directors on January 1, 2010.

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.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

(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 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

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES AND OPTIONS (CONTINUED)

date). The amount distributed comprises approximately NIS 0.255 per share of NIS 0.1 par value (225%).

On June 3, 2009, the General Meeting of Shareholders resolved to approve as final dividend for the year 2008, the interim dividend at the rate of 6%, paid on December 30, 2008, to the holders of 40,000 cumulative preferred shares NIS 0.60504 par value each.

On November 16, 2009, the Board of Directors of the Bank resolved to pay on December 30, 2009, 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 2010 to declare such dividend as final.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

General - Capital adequacy as of December 31, 2009 is computed in accordance with the standard approach based on the provisional instruction issued by the Supervisor of Banks in the matter of "framework for the measurement of capital adequacy" dated December 31, 2008 (hereinafter: "Basel II guidelines"). Until December 31, 2009, capital adequacy has been computed in accordance with Proper Banking Management Directives Nos. 311 and 341 regarding "minimum capital ratio" and "allocation of capital in respect of exposure to market risk", respectively (hereinafter: "Basel I guidelines").

According to the second pillar of the said provisional instructions, banking corporations are required to perform an internal evaluation process of capital adequacy (ICAAP process), while the Supervisor of Banks is required to perform an internal process of review and evaluation (SREP process). In his letter of August 20, 2009, the Supervisor of Bank clarified that in the interim period, until the completion of a comprehensive SREP process, banking corporations are also required to comply with capital targets that had been defined by them in accordance with Basel I guidelines.

The following Note presents capital adequacy data as of December 31, 2009, as computed in accordance with both Basel I guidelines and Basel II guidelines. The comparative data as of December 31, 2008 are stated in accordance with the Basel I guidelines. The said format of presentation is intended to clarify the effect of the change in measurement method of the ratio of capital to risk assets and in order to allow comparison with prior periods.

The principal changes in the measurement rules of capital adequacy in the first pillar of the Basel II guidelines, as compared with the measurement rules of Basel I, which materially affected the ratio of capital to risk assets of the Bank, are as follows:

(a) Capital resources

According to the Basel II guidelines, the capital reserve in respect of adjustment of available-for-sale securities according to fair value, shall be included in the computation of the capital resources. This component comprises the difference between the balance of the fair value of available-for-sale securities (determined mostly according to market value) and their written down cost. Accordingly, material fluctuations in market price of these securities may materially affect the capital adequacy ratio of the Bank.

(b) Risk assets

- allocation of risk assets in respect of operating risk;
- allocation of risk assets in respect of the commitment to grant credit for a period not exceeding one year;
- averaging the indebtedness of the retail segment at the rate of 75% (instead of 100% according to Basel I guidelines);
- averaging the credit indebtedness in respect of housing loans at the rate of 35% (instead of 50%-100% according to Basel I guidelines);
- averaging certain past due loans at the rate of 150% (instead of 100% according to the Basel I guidelines).

As of December 31, 2009, the Bank is in compliance with both the Basel I and Basel II guidelines.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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.

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

Reported amounts

	31 December		
	2009	2008	
	Basel II ⁽¹⁾	Basel I ⁽²⁾	Basel I ⁽²⁾
	in NIS millions		
Tier 1 capital post deductions	10,699	11,653	10,130
Tier 2 capital post deductions	6,485	*5,742	*3,849
Total capital	17,184	17,395	13,979

2. WEIGHTED CREDIT RISK ASSETS BALANCE

	31 December		
	2009	2008	
	Basel II ⁽¹⁾	Basel I ⁽²⁾	Basel I ⁽²⁾
	in NIS millions		
Credit risk	126,775	129,174	***134,539
Market Risk	2,752	3,401	1,916
Operational risk	12,969	-	-
Total weighted credit risk assets balance	142,496	132,575	136,455

For notes to the table see after item 4.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

3. RATIO OF CAPITAL TO RISK ASSETS

	31 December		
	2009		2008
	Basel II ⁽¹⁾	Basel II ⁽²⁾	Basel II ⁽²⁾
	in %		
A. The bank			
Ratio of original tier 1 capital to risk assets	7.0	7.6	6.5
Ratio of tier 1 capital to risk assets	7.5	8.8	7.4
Ratio of total capital to risk assets	12.1	13.1	10.2
Ratio of total minimum capital required by the Supervisor of Banks	9.00	9.00	9.00
B. Significant subsidiaries			
1. Mercantile Discount Bank LTD. and its subsidiaries			
Ratio of tier 1 capital to risk assets	10.5	11.3	9.8
Ratio of total capital to risk assets	12.3	13.1	12.4
Ratio of total minimum capital required by the Supervisor of Banks	9.00	9.00	9.00
2. Discount Mortgage Bank LTD. and its subsidiaries			
Ratio of tier 1 capital to risk assets	12.8	8.0	7.2
Ratio of total capital to risk assets	19.3	12.1	10.8
Ratio of total minimum capital required by the Supervisor of Banks	9.00	9.00	9.00
3. Discount Bakcorp Inc.⁽³⁾			
Ratio of tier 1 capital to risk assets	-	12.5	9.9
Ratio of total capital to risk assets	-	14.9	12.1
Ratio of total minimum capital required by the Supervisor of Banks	(4)-	(4)8.0	(4)8.0
4. Israel Credit Cards LTD.			
Ratio of tier 1 capital to risk assets	13.5	22.5	***20.5
Ratio of total capital to risk assets	13.7	22.8	***21.1
Ratio of total minimum capital required by the Supervisor of Banks	9.00	9.00	9.00

For notes to the table see after item 4.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

4. CAPITAL COMPONENTS FOR CALCULATING RATIO OF CAPITAL

	31 December		
	2009		2008
	Basel II ⁽¹⁾	Basel I ⁽²⁾	Basel I ⁽²⁾
	in NIS millions		
A. Tier 1 capital			
Equity	9,994	9,994	8,797
Minority interests in the equity of consolidated subsidiaries	298	298	226
Complex capital instruments	1,636	1,636	1,223
Less goodwill	(220)	(218)	(272)
Less net gains (losses) on fair value adjustments of available for sale securities	(57)	** (57)	** 156
Less investments in non-realistic companies with significant influence	(825)	-	-
Less other deductions from tier 1 capital ⁽⁵⁾	(127)	-	-
Total tier 1 capital	10,699	11,653	10,130
B. Tier 2 capital			
1. Upper tier II capital			
45% of net gains amount, pre related tax influence, on fair value adjustments of available for sale securities	42	-	-
General provision for doubtful debts	254	254	254
Complex capital instruments	1,313	1,313	-
Other upper tier II capital components	2	2	2
2. Lower tier II capital			
Subordinated capital notes	5,826	5,827	5,065
3. Amounts deducted from tier 2 capital			
Investments in non-realistic companies with significant influence	(825)	(1,654)	(1,472)
Other deductions from tier 2 capital ⁽⁵⁾	(127)	-	-
Total tier 2 capital	6,485	5,742	3,849

Footnotes:

* After deductions from the comprehensive capital according to Basel I with respect to balance of investments in shares and in subordinate capital notes of affiliated financial corporations and of non-consolidated subsidiaries.

** For Basel I purposes, this deduction includes losses in respect of adjustments to fair value of available-for-sale shares as well as net gains on adjustments to fair value of available-for-sale securities (net losses in respect of adjustments to fair value of available-for-sale securities, have been deducted in 2008).

*** Reclassified.

(1) Computed according to the provisional directive regarding "A working framework for measuring capital adequacy", dated December 31, 2008.

(2) Computed according to Directives of the Supervisor of Banks Nos. 311 and 341 regarding "Minimum capital ratio" and "Allocation of capital with respect to exposure to market risks".

The headings for certain terms determined by these directives and subtotals presented in this Note to the financial statements published in the past, have been restated and reclassified according to the disclosure format of the current year.

The data for December 31, 2009, according to Basel I are presented in order to clarify the effect of the change in the method of measurement of the ratio of capital to risk assets and in order to allow comparison with prior periods.

(3) The data in this item was computed in accordance with the rules mandatory in the U.S.A.

(4) IDB New York, a subsidiary of Discount Bankcorp Inc., was classified by the FDIC as "well capitalized". Retaining 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%. IDB New York is not required to comply with Basel II regulations.

(5) Deduction in respect of certain securitization risks.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

5. 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).

The said shelf prospectus expired in February 2010.

6. Clarification regarding the recognition of hybrid capital instruments issued prior to the Basel II guidelines taking effect

At the Bank's request, the Supervisor of Banks clarified in a letter dated March 3, 2010, that until otherwise determined, the specific terms established for the recognition of hybrid capital instruments, as detailed in the approvals granted for each issue of the said instrument, continue to apply with respect to the particular issue even after the Basel II guidelines taking effect.

The Supervisor further clarified, to avoid doubt, that whenever the Bank is required to maintain capital adequacy ratios (overall, primary, original or other), including as a precondition for the recognition of hybrid capital instruments as a part of the Bank's capital base, such ratios shall not be changed, despite the change made from time to time in the criteria for the issue, and that they will be computed in accordance with the calculation method in practice at that date.

The above stated relates to issues made by the Bank as detailed in Sections 7 and 8 hereunder.

7. 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:

- The capital notes are to be issued under terms identical to those of the capital notes issued as part of the existing Series;
- The rate of the Hybrid Tier I Capital is not to exceed 15% of the Bank's total Tier I capital;
- 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.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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, 2009, 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" (83 million shares; 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 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

statements regarding the Bank's inability to fulfill its obligations, as stated above;

- (b) The Board of Directors of the Bank has determined that probability exists that payment of the interest would create a situation in which the Bank will be unable to settle its existing and/or expected liabilities, or the independent auditors of the Bank drew attention in their audit report or review report attached to the Bank's annual or interim financial statements, respectively, to notes to the financial statements regarding the probability of such situation;
 - (c) During six consecutive quarters, the financial statements for the last of which were published prior to the date for payment of the interest, the Bank did not report on accrued net income (i.e. if the simple addition of the quarterly amounts of the net earning or losses reported in the Bank's financial statements, for six consecutive quarters, constituted a negative amount);
 - (d) The last financial statements of the Bank published prior to the date of the interest payment indicate that the Bank has no distributable profits.
- (7) Allotment of shares in respect of interest - In the case of erasure of interest, as described in 6 above, the Bank is empowered to issue shares to holders of the capital notes against the erased interest. Such shares may be issued only in respect of interest not paid in the same year, and shares may not be issued in respect of interest erased in prior years.
- (8) Sustaining of losses - The Bank is required to convert all outstanding balances of principal and interest in respect of the subordinate capital notes into ordinary "A" shares of the Bank, of the circumstances described below occur:
- (a) If the ratio of the overall tier I capital to risk assets of the Bank, as stated in the annual financial statements or in the quarterly interim financial statements of the Bank for the reporting period, falls in a particular quarter below 6%, and does not recover within 90 days from the date of issue of the said financial statements, to a rate of at least 6%, conversion will be implemented immediately;
 - (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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

period of 15 years is enabled, after at least 15 years from the issuance date.

(10) Subordination - Except for the rights of creditors in accordance with similar capital instruments, the capital notes are subordinate to claims of all other creditors, including holders of capital notes issued as secondary capital.

(11) Collateral - The liabilities according to the capital notes are not secured by any collateral.

(12) Issuance to related entities - The Bank will not issue subordinate capital notes to provident funds and/or mutual funds controlled and/or managed by the bank (insofar as this condition is at the Bank's discretion in the primary allocation).

(13) Transparency - The terms of the issuance will be clear and disclosed, including full disclosure in the Bank's published annual financial statements of all conditions of the hybrid tier I capital, inter alia, the following details regarding the compound primary capital: amount, components, share in the total overall primary capital and principal characteristics.

Regarding recognition of the capital notes as 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.

It should be mentioned that with the coming into effect of the Basel II guidelines, a possibility arises that the Supervisor of Banks would make changes to the said basic terms regarding the recognition of additional subordinate capital notes that may be issued in the future as upper tier I capital.

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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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.

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.

It should be mentioned that with the coming into effect of the Basel II guidelines, a possibility arises that the Supervisor of Banks would make changes to the said basic terms regarding the recognition of additional subordinate capital notes that may be issued in the future as upper or tier I capital.

8. 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.

Issue of upper tier II capital in 2009. In 2009, Discount Manpikim issued NIS 1,252 million par value subordinated capital notes (Series 1), for a total consideration of NIS 1,258 million, designated as upper tier II capital.

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.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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%.
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 risks. 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. Redeemability – 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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 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 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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 its 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.

It should be mentioned that with the coming into effect of the Basel II guidelines, a possibility arises that the Supervisor of Banks would make changes to the said basic terms regarding the recognition of additional subordinate capital notes that may be issued in the future as upper tier I capital.

15. PLEDGES

A. IDB New York has pledged various loans and corporate bonds with the Federal Reserve Bank of New York (FRBNY). This pledge was made to secure credit from the FRBNY credit window as well as for credit within the framework of TAF tenders of this bank. The carrying value of the loans and securities pledged for FRBNY credit as of December 31, 2009 amounted to US\$1,739 million (NIS 6,563 million) [December 31, 2008 - US\$237 million (NIS 900 million)].

In addition, IDB New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US\$419 million (NIS 1,582 million) as of December 31, 2009 as a collateral for deposits received from it [as at December 31, 2008 US\$582 million (NIS 2,214 million)].

B. IDB New York has sold securities, under buyback terms, in the amount of US\$2,331 million (NIS 8,800 million) as of December 31, 2009 [as at December 31, 2008: US\$2,367 million (NIS 8,999 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 3 describes the risk fund established by the Ma'of clearing house. The Bank's share in the fund, deriving from the volume of the clearing activity on behalf of the Bank's customers as of December 31, 2009, amounted to NIS 35 million (December 31, 2008: NIS 44 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, 2009, was NIS 106 million (2008: NIS 47 million).

According to the Memorandum and Bye Laws of the Ma'of clearing house all member of the clearing house, including the Bank signed pledge agreements to secure their liabilities in favor of the Ma'of clearing house and deposited liquid security only (State of Israel bonds and/or cash).

The Bank provided the Ma'of Clearing House with a first degree pledge on all monies that had been deposited by the Bank in an account in the name of the Ma'of Clearing House at the Stock Exchange Clearing House and at an account in the name of the Ma'of Clearing

15. PLEDGES (CONTINUED)

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, 2009, totaled NIS 598 million (December 31, 2008: NIS 527 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, 2009, to NIS 131 million (December 31, 2008: NIS 129 million).

Balance of collateral* provided to the Ma'of Clearing House:

	Balance as of December 31, 2009	Highest balance during the year	Average balance in 2009*	Balance as of December 31, 2008
In NIS millions				
Cash	11	13	9	-
Securities	720	739	696	656

* The reporting is made on the basis of the month-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 30 million (December 31, 2008: CHF 20 million), as collateral for credit facilities in the amount of US\$0.5 million.

I. As detailed in Note 19 C 4 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, 2009, to NIS 142 million (as at December 31, 2008: NIS 106 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, 2009, amounted to NIS 8 million (December 31, 2008: NIS 8 million).

Balance of collateral* provided to the Stock Exchange Clearing House:

	Balance as of December 31, 2009	Highest balance during the year	Average balance in 2009	Balance as of December 31, 2008
In NIS millions				
Cash	12	17	13	-
Securities	139	146	131	114

* The reporting is made on the basis of the month-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.

15. PLEDGES (CONTINUED)

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, 2009, at NIS 5 billion (December 31, 2008: NIS 6 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 581 million (December 31, 2008: NIS 570 million).

Details of the pledge:

	Balance as of December 31, 2009	Highest balance during the year	Average balance in 2009	Balance as of December 31, 2008
In NIS millions				
pledge securities (market value)	5,230	5,904	5,128	6,457

* The report is based on outstanding monthly balances.

K. Furthermore, the Bank and Mercantile Discount Bank make deposits from time to time with Bank of Israel, constituting (together with the securities deposited, as stated) the collateral for the credit granted by Bank of Israel to the Bank and to Mercantile Discount Bank, within the framework of the credit tender.

The bank and Mercantile Discount Bank did not participate in 2009 in the said credit tenders.

Details of the deposits:

	Balance as of December 31, 2009	Highest balance during the year	Average balance in 2009	Balance as of December 31, 2008
In NIS millions				
Deposits with the Bank of Israel	14,642	15,485	10,507	7,714

* The report is based on outstanding monthly 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, 2009, the Bank allocated in favor of foreign banks deposits in a total amount of NIS 684 million (December 31, 2008: NIS 798 million).

M. The Bank deposits bonds with foreign brokers (in the United States) as collateral for option transactions performed by its customers by means of these brokers. The value of such collateral at December 31, 2009 amounted to NIS 41 million (December 31, 2008: NIS 85 million).

15. PLEDGES (CONTINUED)

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
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:				
Securities against cash	332	22	332	22
Total	332	22	332	22
The sources of securities that had been received as collateral and securities of the Bank, at their fair value, before setoffs effect:				
Securities against cash	332	22	332	22
Total	332	22	332	22

O. Details of securities pledged to the lenders:

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
In NIS millions				
Trading Securities	-	673	-	673
Available for sale securities	16,042	10,212	5,468	5,980
Held-to-maturity bonds	335	305	-	-
Total (as stated in the balance sheet)	16,377	11,190	5,468	6,653

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, based on actuarial computations, is covered by current deposits into a recognized foreign pension fund.

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 2008. The financial statements include provisions for long-service bonuses totaling: Consolidated - NIS

445 million (2008: NIS 380 million); the Bank - NIS 375 million (2008: NIS 313 million).

An agreement with the representatives of the employees was signed in November 2007, regarding the redemption in cash of "Jubilee vacation" days. The agreement 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 147 million (2008: NIS 146 million); and for the Bank - NIS 116 million (2008: NIS 116 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 445 million (2008: NIS 421 million); the Bank - NIS 385 million (2008: NIS 357 million).

D. THE PROVISION AND DEPOSITS FOR EMPLOYEES' SEVERANCE PAY ARE AS FOLLOWS:

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
	in NIS millions			
Deposits	2,455	2,142	2,183	1,896
Provision	2,049	1,915	1,791	1,661
Excess of deposit over provision	406	227	392	235
The excess (shortage) of amounts deposited over the provision is included in the item:				
Other assets (Note 8)	410	237	392	235
Other liabilities (Note 12)	(4)	(10)	-	-
Total, Net	406	227	392	235

The Bank and its subsidiaries are not permitted to withdraw these deposits except for the purpose of making severance payments.

- E.** In the years 2007-2009, the Bank and some of its subsidiaries carried out several concerted drives encouraging early retirement of employees, focusing on an employee population having defined characteristics, in respect of which a focused effort to encourage their early retirement was made. In this framework, the said employees were approached and were offered early retirement at beneficial terms. (As to expenses relating to early retirement, see Note 27).

- F.** Several of the subsidiaries have adopted employee remuneration plans, according to which the General Managers and/or other employees of these subsidiaries are entitled to a bonus, the amount of which is based upon their business results. The necessary provisions in respect of these bonuses are included in the financial statements.

The previous general manager of one of the subsidiaries had been 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. The said period of entitlement expired in June 2009. In 2007, the board of directors of ICC approved a monetary remuneration plan to senior executives of ICC and of one of its consolidated subsidiaries. Entitlement to remuneration under the plan is subject to the fulfillment of certain conditions precedent. Following the merger of the subsidiary into ICC, the said plan was cancelled (see Note 33 A to the financial statements).

- G. An award plan for members of the Bank's management.** In March 26, 2006, the board of directors of the Bank resolved to approve an award plan to members of the Bank's management, including the Internal Auditor. In terms of the plan the Bank is to grant to every member of management an annual award in respect of each year in which he served as member of management in the period from 2006 to 2010. The annual award would be derived in part from the rate of the annual return on equity and in part by the decision of the President and CEO (within the framework of an additional budget, the volume of which will also be derived from the annual rate of return on equity), in

16. EMPLOYEE BENEFITS (CONTINUED)

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 additional details and for details regarding a stock option plan for officers of the Bank, see Note 13 D (1) and (2). For details regarding a phantom option plan for officers of the Bank, see Note 13 D (3).

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):

	Dec-31	
	2009	2008
Deposits	27	17
Provision	17	15
Excess of deposit over provision	10	2
The excess (shortage) of amounts deposited over the provision is included in the item:		
Other liabilities (Note 12)	10	2
	%	%
The annual discount rate	5.80	6.26
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, and states that at the end of this period the parties will act with respect to the validity of the Labor Charter, namely, its extension by one year at a time beginning on March 31, 2011, unless the Bank's management informs the Employees' Representative Committee otherwise, or the Employees' Representative Committee informs the Bank's management, by advance written notice, three months prior to the said date.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS**CONSOLIDATED**

	December 31, 2009						
	Israeli currency		Foreign currency ⁽¹⁾			Non	
	Non-linked	Linked to the CPI	In US\$	In Euro	In other currencies	monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	16,247	798	5,533	1,144	861	-	24,583
Securities	8,594	6,897	18,924	919	291	713	36,338
Securities borrowed or purchased under resale agreements	336	-	-	-	-	-	336
Credit granted to the public	59,498	19,021	25,679	6,836	3,392	-	114,426
Credit granted to the Government	-	1,517	302	-	1	-	1,820
Investments in affiliated companies	59	56	-	7	-	1,673	1,795
Buildings and equipment	-	-	-	-	-	3,178	3,178
Other assets	2,091	34	1,699	108	591	818	5,341
Total assets	86,825	28,323	52,137	9,014	5,136	6,382	187,817
Liabilities							
Deposits from the public	68,048	12,982	45,559	11,233	4,003	-	141,825
Deposits from banks	1,694	411	1,390	210	19	-	3,724
Deposits from the Government	192	49	43	-	-	-	284
Securities loaned or sold under repurchase arrangements	-	-	7,651	-	-	-	7,651
Subordinated capital notes	2,422	9,107	-	-	-	-	11,529
Other liabilities	8,370	737	2,101	368	339	597	12,512
Total liabilities	80,726	23,286	56,744	11,811	4,361	597	177,525
Difference	6,099	5,037	(4,607)	(2,797)	775	5,785	10,292
Effect of non-hedging derivative instruments:							
Derivative instruments (except for options)	(89)	(4,773)	3,021	2,676	(835)	-	-
Options in the money, net (in terms of underlying asset)	106	-	(138)	32	-	-	-
Options out of the money, net (in terms of underlying asset)	(270)	146	73	49	-	2	-
Total	5,846	410	(1,651)	(40)	(60)	5,787	10,292
Options in the money, net (discounted par value)	195	-	(246)	51	-	-	-
Options out of the money, net (discounted par value)	(1,924)	490	1,234	273	(76)	3	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)**CONSOLIDATED (CONTINUED)**

	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	*56,020	21,016	29,526	6,203	3,691	-	116,456
Credit granted to the Government	10	1,461	20	-	-	-	1,491
Investments in affiliated companies	57	48	-	11	-	1,711	1,827
Buildings and equipment	-	-	-	-	-	3,039	3,039
Other assets	2,400	39	2,093	231	676	465	5,904
Total assets	76,007	27,061	55,409	9,716	7,056	6,582	181,831
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 repurchase arrangements	-	-	7,194	-	-	-	7,194
Subordinated capital notes	1,979	7,394	-	-	-	-	9,373
Other liabilities	*8,558	418	1,826	402	936	108	12,248
Total liabilities	76,753	20,871	59,128	11,043	4,905	108	172,808
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	-	-

* Reclassified.

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

BANK

	December 31, 2009						
	Israeli currency		Foreign currency ⁽¹⁾			Non	
	Non-linked	Linked to the CPI	In US\$	In EURO	In other currencies	monetary itemss	Total
	in NIS millions						
Assets							
Cash and deposits with banks	18,614	9,125	3,100	504	191	-	31,534
Securities	7,029	4,397	1,094	855	18	58	13,451
Securities borrowed or purchased under resale agreements	336	-	-	-	-	-	336
Credit granted to the public	40,071	6,577	11,364	6,422	3,107	-	67,541
Credit granted to Governments	-	1,517	301	-	-	-	1,818
Investments in affiliated companies	826	438	287	-	-	8,500	10,051
Buildings and equipment	-	-	-	-	-	2,382	2,382
Other assets	1,875	15	526	73	561	513	3,563
Total assets	68,751	22,069	16,672	7,854	3,877	11,453	130,676
Liabilities							
Deposits from the public	58,297	13,587	21,341	9,699	2,998	-	105,922
Deposits from banks	1,741	145	1,650	287	141	-	3,964
Deposits from the Government	110	49	-	-	-	-	159
Subordinated capital notes	69	3,569	-	-	-	-	3,638
Other liabilities	4,486	621	896	273	201	522	6,999
Total liabilities	64,703	17,971	23,887	10,259	3,340	522	120,682
Difference	4,048	4,098	(7,215)	(2,405)	537	10,931	9,994
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	(117)	(4,392)	3,049	2,274	(814)	-	-
Options in the money, net, (in terms of base asset)	119	-	(126)	7	-	-	-
Options out of the money, net, (in terms of base asset)	(260)	146	57	57	-	-	-
Total	3,790	(148)	(4,235)	(67)	(277)	10,931	9,994
Options in the money, net, (discounted nominal value)	102	-	(123)	21	-	-	-
Options out of the money, net, (discounted nominal value)	(1,899)	490	1,187	298	(76)	-	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)**BANK (CONTINUED)**

	December 31, 2008						
	Israeli currency		Foreign currency ⁽¹⁾			Non	
	Non-linked	Linked to the CPI	In US\$	In EURO	In other currencies	monetary itemss	Total
	in 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 base asset)	169	262	(518)	88	(1)	-	-
Options out of the money, net, (in terms of base asset)	118	2	(108)	(10)	(2)	-	-
Total	1,992	558	(3,761)	(89)	(372)	10,469	8,797
Options in the money, net, (discounted nominal value)	239	481	(844)	125	(1)	-	-
Options out of the money, net, (discounted nominal value)	505	4	(501)	(11)	3	-	-

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, 2009 Balance sheet amount**

	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	Over 2 years and up to 3 years
Israeli currency, non-linked:					
Assets	32,127	12,787	12,247	9,644	4,620
Liabilities	45,311	12,758	15,371	1,909	1,056
Difference	(13,184)	29	(3,124)	7,735	3,564
Derivative instruments (excluding options)	(2,097)	452	1,330	78	(41)
Options (in terms of underlying assets)	16	(135)	(273)	-	(53)
Israeli currency, CPI-linked:					
Assets	871	629	4,277	4,383	3,967
Liabilities	372	888	3,643	4,318	2,905
Difference	499	(259)	634	65	1,062
Derivative instruments (excluding options)	(171)	(92)	(1,211)	(518)	(647)
Options (in terms of underlying assets)	-	-	-	145	-
Foreign currency-local activity⁽³⁾:					
Assets	5,908	5,730	3,559	2,055	1,986
Liabilities	21,053	10,036	5,872	294	119
Difference	(15,145)	(4,306)	(2,313)	1,761	1,867
Derivative instruments (excluding options)	2,242	(386)	(106)	379	633
Options (in terms of underlying assets)	(16)	135	273	(145)	51
Foreign currency-foreign activity of extensions:					
Assets	8,718	6,350	6,454	2,243	1,655
Liabilities	18,429	3,088	5,612	1,711	2,045
Difference	(9,711)	3,262	842	532	(390)
Non-monetary items:					
Assets	-	-	-	-	-
Liabilities	-	-	-	-	-
Difference	-	-	-	-	-
Options (in terms of underlying assets)	-	-	-	-	2
Total:					
Assets	47,624	25,496	26,537	18,325	12,228
Liabilities	85,165	26,770	30,498	8,232	6,125
Difference	(37,541)	(1,274)	(3,961)	10,093	6,103
Derivative instruments (excluding options)	(26)	(26)	13	(61)	(55)
Options (in terms of underlying 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.

(2) Includes past-due receivables totaling NIS 1,686 million (2008: NIS 1,623 million).

						Balance sheet amount ⁽⁴⁾			
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	The contractual rate of return, in percentages ⁽⁵⁾	
3,985	2,186	8,718	3,791	405	90,510	2,842	86,825	3.82	
367	980	2,668	637	69	81,126	-	80,726	1.06	
3,618	1,206	6,050	3,154	336	9,384	2,842	6,099	2.76	
46	82	157	2	-	9	-	(89)	-	
17	17	110	157	(20)	(164)	-	(164)	-	
2,334	2,310	9,362	5,972	948	35,053	130	28,323	3.87	
2,293	2,244	6,761	4,235	-	27,659	-	23,286	3.90	
41	66	2,601	1,737	948	7,394	130	5,037	(0.03)	
(811)	(803)	(1,951)	(481)	-	(6,685)	-	(4,773)	-	
-	-	1	-	-	146	-	146	-	
2,866	1,113	2,924	315	-	26,456	375	24,870	2.66	
27	40	61	34	2	37,538	2	38,691	0.83	
2,839	1,073	2,863	281	(2)	(11,082)	373	(13,821)	1.83	
701	674	1,701	417	-	6,255	-	4,862	-	
(17)	(17)	(111)	(157)	20	16	-	16	-	
1,566	1,659	6,177	11,830	4,297	50,949	1,153	41,417	5.57	
1,857	1,300	3,615	-	-	37,657	49	34,225	2.91	
(291)	359	2,562	11,830	4,297	13,292	1,104	7,192	2.66	
-	-	-	-	-	-	6,382	6,382	-	
-	-	-	-	-	-	597	597	-	
-	-	-	-	-	-	5,785	5,785	-	
-	-	-	-	-	2	-	2	-	
10,751	7,268	27,181	21,908	5,650	202,968	10,882	187,817	4.07	
4,544	4,564	13,105	4,906	71	183,980	648	177,525	1.74	
6,207	2,704	14,076	17,002	5,579	18,988	10,234	10,292	2.33	
(64)	(47)	(93)	(62)	-	(421)	-	-	-	
-	-	-	-	-	-	-	-	-	

(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.

(5) The contractual rate of return is the rate of interest discounting the expected future contractual cash flows presented in this Note in respect of a monetary item, to its balance sheet amount.

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS⁽¹⁾ (CONTINUED)

CONSOLIDATED (IN NIS MILLIONS)

B. Balance Sheet Amount at 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	Over 2 years and up to 3 years
Total:					
Assets	*46,897	21,136	24,032	19,295	13,952
Liabilities	*73,219	27,459	33,987	9,440	5,600
Difference	(26,322)	(6,323)	(9,955)	9,855	8,352
Derivative instruments (excluding options)	(144)	(170)	(45)	(107)	(34)

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.
- (2) Includes past-due receivables totaling NIS 1,686 million (2008: NIS 1,623 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.
- (5) The contractual rate of return is the rate of interest discounting the expected future contractual cash flows presented in this Note in respect of a monetary item, to its balance sheet amount.

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	Balance sheet amount ⁽⁴⁾		The contractual rate of return, in percentages ⁽⁵⁾
						No fixed maturity date ⁽²⁾	Total	
8,436	8,509	25,142	17,994	16,194	*201,587	*12,257	*181,831	-
4,634	5,015	13,770	2,563	17	*175,704	*402	*172,808	-
3,802	3,494	11,372	15,431	16,177	25,883	11,855	9,023	-
(32)	(54)	(132)	(99)	-	(817)	-	-	-

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, 2009 Balance sheet amount

	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	Over 2 years and up to 3 years
Israeli currency, non-linked:					
Assets	27,177	8,472	8,379	7,687	3,608
Liabilities	36,801	9,974	11,885	1,453	913
Difference	(9,624)	(1,502)	(3,506)	6,234	2,695
Derivative instruments (excluding options)	(2,108)	441	1,314	78	(41)
Options (in terms of base assets)	40	(59)	(259)	56	60
Israeli currency, CPI-linked:					
Assets	812	429	2,896	3,469	2,943
Liabilities	211	584	2,528	3,040	2,316
Difference	601	(155)	368	429	627
Derivative instruments (excluding options)	(171)	(71)	(1,212)	(497)	(626)
Options (in terms of base assets)	-	-	-	145	-
Foreign currency-local activity⁽³⁾:					
Assets	5,451	5,446	3,520	1,935	1,884
Liabilities	18,871	9,731	5,820	208	104
Difference	(13,420)	(4,285)	(2,300)	1,727	1,780
Derivative instruments (excluding options)	2,251	(410)	(88)	349	607
Options (in terms of base assets)	(40)	59	259	(201)	(60)
Foreign currency-foreign activity of extensions:					
Assets	384	956	2,188	319	83
Liabilities	732	678	412	-	-
Difference	(348)	278	1,776	319	83
Non-monetary items:					
Assets	-	-	-	-	-
Liabilities	-	-	-	-	-
Difference	-	-	-	-	-
Total:					
Assets	33,824	15,303	16,983	13,410	8,518
Liabilities	56,615	20,967	20,645	4,701	3,333
Difference	(22,791)	(5,664)	(3,662)	8,709	5,185
Derivative instruments (excluding options)	(28)	(40)	14	(70)	(60)
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.

(2) Includes past-due receivables totaling NIS 1,176 million (2008: NIS 1,235 million)..

						Balance sheet amount ⁽⁴⁾			
	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	The contractual rate of return, in percentages ⁽⁵⁾
	4,186	1,864	7,677	3,779	559	73,388	2,194	68,751	3.81
	279	812	2,431	424	73	65,045	-	64,703	1.01
	3,907	1,052	5,246	3,355	486	8,343	2,194	4,048	2.80
	46	82	157	2	-	(29)	-	(117)	-
	5	4	7	5	-	(141)	-	(141)	-
	1,736	2,010	8,273	3,572	923	27,063	81	22,069	3.85
	1,843	1,596	5,855	3,770	-	21,743	-	17,971	4.00
	(107)	414	2,418	(198)	923	5,320	81	4,098	(0.15)
	(791)	(784)	(1,720)	(175)	-	(6,047)	-	(4,392)	-
	-	-	1	-	-	146	-	146	-
	2,794	1,046	2,942	236	1	25,255	368	24,289	2.81
	22	36	49	1	-	34,842	2	35,702	0.34
	2,772	1,010	2,893	235	1	(9,587)	366	(11,413)	2.47
	678	654	1,493	148	-	5,682	-	4,509	-
	(5)	(4)	(8)	(5)	-	(5)	-	(5)	-
	66	17	-	-	-	4,013	124	4,114	3.62
	-	-	-	-	-	1,822	-	1,784	0.88
	66	17	-	-	-	2,191	124	2,330	2.74
	-	-	-	-	-	-	11,453	11,453	-
	-	-	-	-	-	-	522	522	-
	-	-	-	-	-	-	10,931	10,931	-
	8,782	4,937	18,892	7,587	1,483	129,719	14,220	130,676	3.61
	2,144	2,444	8,335	4,195	73	123,452	524	120,682	1.26
	6,638	2,493	10,557	3,392	1,410	6,267	13,696	9,994	2.35
	(67)	(48)	(70)	(25)	-	(394)	-	-	-
	-	-	-	-	-	-	-	-	-

(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.

(5) The contractual rate of return is the rate of interest discounting the expected future contractual cash flows presented in this Note in respect of a monetary item, to its balance sheet amount.

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, 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	Over 2 years and up to 3 years
Total:					
Assets	28,918	13,828	15,677	14,010	10,447
Liabilities	51,469	17,006	24,589	6,335	3,000
Difference	(22,551)	(3,178)	(8,912)	7,675	7,447
Derivative instruments (excluding options)	(139)	(149)	(41)	(97)	(25)

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.
- (2) Includes past-due receivables totaling NIS 1,176 million (2008: NIS 1,235 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.
- (5) The contractual rate of return is the rate of interest discounting the expected future contractual cash flows presented in this Note in respect of a monetary item, to its balance sheet amount.

	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	Balance sheet amount ⁽⁴⁾		The contractual rate of return, in percentages ⁽⁵⁾
							No fixed maturity date ⁽²⁾	Total	
	6,229	7,362	18,187	5,730	1,033	121,421	14,377	125,568	-
	2,328	1,850	8,031	2,517	16	117,141	306	116,771	-
	3,901	5,512	10,156	3,213	1,017	4,280	14,071	8,797	-
	(27)	(47)	(116)	(7)	-	(648)	-	-	-

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
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	1,318	1,417	656	714
Credit guarantees	2,951	2,928	2,506	1,833
Guarantees for home purchasers	4,249	3,644	2,430	2,219
Other guarantees and obligations ⁽¹⁾	⁽²⁾ 8,105	4,946	⁽²⁾ 7,449	4,249
Unutilized credit line for credit cards	13,476	16,508	4,749	9,410
Unutilized current loan account and other credit facilities in on-call accounts	9,482	9,943	8,568	8,943
Irrevocable commitments to extend credit approved but not yet granted	18,370	18,101	10,553	13,638
Commitment to issue guarantees	4,538	4,568	2,984	2,854
B. Off-Balance Sheet Commitment at Year-End regarding activity based on loan repayments⁽³⁾				
Balance of loans granted out of deposits repayable according to the repayment of the loans⁽⁴⁾				
Israeli currency - non linked	1,044	855	1,005	818
Israeli currency - linked to the CPI	1,696	1,924	17	21
Foreign currency	595	476	595	476
Total	3,335	3,255	1,617	1,315

Footnotes:

(1) See item C3 below.

(2) Including, for the first time, a commitment in respect of OTC, Ma'of and securities trading operations.

(3) 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).

(4) Standing loans and government deposits made in respect thereof, totaling NIS 97 million (2008: NIS 131 million), have not been included in the table.

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, 2009						2008	
	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	13	24	21	45	28	1	132	150
Expected future flows based on Management's estimates of early repayments	13	23	18	33	19	-	106	120
Discounted expected future flows based on Management's estimates of early repayments ⁽²⁾	12	22	16	27	12	-	89	101

3. Information as to the granting of loans during the year by the mortgage banks:

	31.12.2009	31.12.2008
Loans out of deposits repayable according to the repayment of loans	15	41

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 a total amounts repayable according to collection of loans granted therefrom.
(2) Discounted at the rate of 2.65% (2008: 3.16%).

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
in NIS millions				
1. Long-term lease contracts - rent payable in future years ⁽¹⁾ :				
First year	103	81	46	46
Second year	91	72	41	39
Third year	66	62	29	30
Fourth year	46	53	19	24
Fifth year	37	35	12	15
Sixth year and thereafter	155	148	22	27
Total	498	451	169	181
2. Commitment to acquire buildings and equipment	61	32	31	25

Footnote:

- (1) For details as to long-term lease agreement, see section 19 hereunder.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

3. 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, 2009, amounts to NIS 35 million, comprising 4.92% 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.
4. 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).
5. 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.
c) Mercantile Discount Bank committed to indemnify Mercantile Capital Markets Ltd. and Mercantile Mutual Funds Ltd. (wholly owned subsidiaries of Mercantile Discount Bank), with respect to claims that might be submitted against them in respect of professional liability in excess of amounts stated in the insurance policies purchased in their name. The letters of indemnity are in effect until March 31, 2011, and are limited in amounts as follows: Mercantile Capital Markets Ltd – US\$6 million; Mercantile Mutual Funds Ltd. - US\$1.3 million.
6. 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.
7. 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

issued letters of indemnity, unlimited as to amount, to Directors who serve or served at the Bank's request in other companies held, directly or indirectly, by the Bank.

- b) According to the Articles of Association of the Bank, any employee or clerk of the Bank who is not an executive officer, will be indemnified out of the funds of the Bank for any liability incurred by him in his capacity as an employee or clerk of the Bank in defending himself in any legal proceedings, whether civil or criminal, in which a judgment is given in his favor or in which he is acquitted, and the Bank is entitled to indemnify him for any financial liability imposed on him in favor of another person for an act done in his capacity as an employee or clerk of the Bank.
- c) The Articles of Incorporation of certain consolidated subsidiaries of the Bank allow for indemnification of officers under certain conditions, subject to the provisions of the Law. Certain companies in certain cases granted such indemnification.
- d) Discount Manpikim Ltd., a wholly owned and controlled subsidiary of the Bank, has granted indemnification to its Directors, with respect to a financial liability that might be imposed on any of them and with respect to reasonable legal expenses in connection with a prospectus for the public issue and the listing for trade of subordinated capital notes, published in March 2004, of subordinated capital notes in a total amount of NIS 500 million, under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification payable to all Directors as a group will not exceed the gross proceeds of the said issue. Discount Manpikim Ltd. has granted its Directors identical indemnification in connection with a prospectus regarding the offer to the public and the listing for trade of subordinated capital notes issued in November 2004, of subordinated capital notes in a total amount of NIS 600 million.
- 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 indemnify 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 item 20 below, 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,

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 item 20 below.
- 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, 2006) 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.

On June 3, 2009, the Annual General Meeting of shareholders approved the engagement of the Bank in a policy with respect to the responsibility of officers of the Bank and of companies in which the Bank holds, directly or indirectly, an interest of 50% or more in the equity or voting therein. The policy is for a period of one year as from April 1, 2009 and until March 31, 2010. The details of the policy are as described above (except for the change according to which the insurance premium will amount to US\$900 thousand, and the Bank's share excluding the subsidiaries will not exceed US\$540 thousand).

- l) **Advance exemption and and a commitment to indemnify 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 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.

Following approval by the Audit Committee dated June 28, 2009, the Bank's Board of Directors approved on July 12, 2009, the granting of exemption and indemnification to Directors and other Officers appointed subsequently to June 2007 (the date on which the General Meeting of shareholders approved the granting of exemption and indemnification to acting Officers and to Officers that had acted in the past) as well as to Directors and other Officers that may be appointed in the future, excluding controlling shareholders in respect of whom a specific resolution is required. In this framework, certain amendments to the indemnification letter have been approved, which will apply also to Directors and Officers who had been issued indemnification letters in June 2007. The General Meeting of Shareholders approved the said resolution on August 27, 2009.

- m) **Exemption and a commitment to indemnify of Directors and Officers of Mercantile Discount Bank.** On November 29, 2009, Mercantile Discount Bank's General meeting of Shareholders approved the granting of a commitment to indemnify and exemption to Directors and other Officers of Mercantile Discount Bank and providing a commitment for the indemnification of other Directors and officers and of certain of its subsidiaries, who held office at Mercantile Discount Bank and at those subsidiaries since the year 2002 onwards. The said the commitment to indemnify and exemption were granted in accordance with principles and group limitations approved by the Bank's board in July 2009.

8. 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

9. a) 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. ICC has signed an indemnification letter in favor of the Bank with respect to the said guarantee.
- b) The Bank issued a guarantee in the amount of US\$26 million, in favor of the MasterCard Worldwide organization, to secure the activity of ICC within the framework of the Organization.
- c) As security for the liabilities of E.R.N. (Israel) Ltd., an affiliated company of ICC, towards a certain commercial bank, the Bank has issued a guarantee in the amount of NIS 8 million.
- d) As security for the liabilities of ICC concerning payments to Government offices by means of credit cards, the Bank has issued a guarantee in favor of the State in the amount of NIS 3 million.
10. 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.
11. 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 1,053 million.
- 11.1 In November 1999 a former customer of the Bank submitted to the Tel-Aviv District Court a claim against the Bank in the amount of NIS 456 million.
- In the action, the plaintiff alleges wrongful doings made in his accounts until 1989. According to the plaintiff, who maintained a business account with the Bank, the Bank exploited his mental and physical condition, and made use of his account and the accounts of his family members as if they belonged to the Bank, while opening dozens of additional accounts without permission, concealing information, forging signatures, taking out loans in the name of the plaintiff, buying and selling securities fictitiously and embezzling funds.
- Hearing of evidence in respect of this claim commenced in January 2004. The Bank, inter alia, raised an argument of obsolescence and the Court determined that this argument will be considered in the framework of the verdict.
- Based on the opinion of legal counsel, management of the Bank believes that the amount of the claim is excessive and the arguments of the plaintiff are baseless.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

11.2 On June 19, 2006, an action was filed together with a motion for its approval as a class action against the State of Israel and 31 other defendants, including the Bank, Mercantile Discount Bank, Discount Gemel and the Provident funds of Mercantile Discount Bank.

The claimants allege that the defendants have unlawfully received payments in respect of foreclosures imposed by those who were granted execution through the magnetic media. The principal claim is that the defendants do not provide the service required by law, in that they do not provide full and detailed information in their reply to the Bailiff Office, and accordingly are not entitled to the payment determined in the regulations.

The amount of the claim against all defendants totals NIS 233 million. The claim does not specify the amount claimed from each of the defendants. The Bank estimates that the maximum exposure of the companies of the Discount Group involved in this case for the restitution claim would not exceed NIS 10 million.

On October 18, 2006, the Bank motioned the Court for the dismissal of the claim in limine concurrently with a plea for extension of the date for submission of a response brief to the motion for approval of the claim as a class action. As claimed by the Bank, the claim is to be dismissed 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 July 19, 2010. A preliminary hearing at the District Court was fixed for October 9, 2010.

11.3 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 in everything relating to credit.

The Plaintiff alleges that the similarity in prices of the five parameters at the defendant banks indicates the existence of coordination between them that resulted in huge profits to these banks and caused enormous damage to the public and to the economy.

The Plaintiff's claim is 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 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.

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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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.

In this respect, it should be noted that the Commissioner issued on April 26, 2009, a ruling as detailed in Section 14 below.

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, 2010.

The hearing of the class action was suspended by the District Court until a ruling is given by the Supreme Court in the request for permission to appeal.

- 11.4** 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 Bank responded to the motion to approve the claim as a class action suit.

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 action described in item 11.3 above.

The Plaintiffs requested permission to appeal against the Courts decision to stay the proceedings. On July 7, 2008 the Supreme Court rejected the request.

- 11.5** 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 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 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.

Documents which, according to the Claimants, had been seized by the Antitrust Commissioner were attached, among other things, to this motion. In this respect, it should be noted that the Commissioner issued on April 26, 2009, a ruling as detailed in Section 14 below. According to the decision of the District Court of October 7, 2009, the claim will be heard together with the claim described in Section 12.4 hereunder. The Court ordered a stay in the hearing of the motion for approval until a decision is given in the appeal against the decision of the Commissioner, to be submitted by the banks to the Antitrust Tribunal.

- 11.6** 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. The Claimants argue that the provident funds management companies and the selling banks have violated various laws and fiduciary duties.

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.

On July 1, 2009, the Tel Aviv District Court dismissed the motion for approval of the lawsuit against KAHAL as a class action suit.

On January 10, 2010, the Court requested that the Attorney General inform whether he wishes to participate in the proceedings and state his position on the matter. On March 11, 2010, the Attorney General informed that, at this stage, he sees no reason to take part in the proceedings in the matter. An additional meeting was fixed for May 9, 2010.

- 11.7** 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.

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."

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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 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 and that the respondent banks did not receive approval of Bank of Israel for charging such a commission. 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 Bank filed its response on February 9, 2009. The case was fixed for the submission of testimonies on October 27, 2010.

- 11.8** On October 29, 2009, two companies submitted a lawsuit against the Bank, Mercantile Discount Bank and five additional banks, requesting a declarative ruling according to which the defendant banks are not entitled to charge the Claimants with violation interest in the amount of NIS 840 million, but only with an amount of NIS 37 million. Alternatively, the banks are entitled to charge the Claimants only with interest and linkage increments, and accordingly, the accounts of the Claimants should be credited with the difference in the amount of NIS 521 million.

The Claimants argue that the violation interest constitutes an agreed compensation, and therefore the Court is entitled to reduce it under Section 15 of the Contract Law ("Relief"), 1970, as no reasonable relation exists between the agreed compensation and the amount of damage caused to the banks as a result of the violation. The reduction in the violation interest is called for also by the interpretation of the agreements according to the opinion of the parties. Charging the Claimants with violation interest comprises an unjust enforcement of the agreement. The banks' insistence on charging the Claimants with violation interest comprises lack of good faith and its collection by the banks constitutes illegal creation of wealth.

According to the Claimants, the principal rationale for the circumstances that justify the reduction in interest is the length of time between the date of the receivership and the date of sale of the shares.

The Bank's share in the alleged damage, based on its share in the credit consortium, is 10% and that of Mercantile Discount Bank is 4%.

In accordance with the decision of the District Court, The Claimants filed a monetary claim of NIS 830 million. A defense brief has not yet been submitted.

- 11.9** 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.

- 11.10** 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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's response was submitted on May 11, 2009. On June 25, 2009, the claimant filed his response to that of Discount Mortgage Bank, together with an economic expert opinion.

Discount Mortgage Bank has submitted a motion for the dismissal of the request to approve the lawsuit as a class action suit, and alternatively to reject the response of the Claimant, in view of the attempt to amend the original request while adding new causes of action and arguments. The Claimant responded to the motion and Discount Mortgage Bank responded to the response. At a hearing held on January 5, 2010, the Court permitted Discount Mortgage Bank to submit a complementary opinion, and instructed that a copy of the Court's documents be delivered to the Supervisor of Banks, who is to inform the Court, within 60 days, whether he is interested in joining the proceedings. Interrogation of the experts has been fixed for July 1, 2010. Following the appearance of the experts, the Court will rule on the motion for rejection and dismissal submitted by Discount Mortgage Bank.

- 11.11** On June 2, 2009, a lawsuit was filed with the Tel Aviv District Court against Discount Mortgage Bank together with a motion to approve the suit as a class action suit.

The claimant and her deceased husband were borrowers of Discount Mortgage Bank and provided that bank with a life assurance policy as collateral for the repayment of the loan in case of death of one of the borrowers. Following the death of the husband the remaining borrower wished to act on the policy and accordingly Discount Mortgage Bank informed the assurance company of the balance of the loan with the addition of an early repayment charge.

According to the claimant, adding the early repayment charge was illegal, and the claim should be admitted on the following grounds: contractual grounds, the illegal creation of wealth, lack of proper disclosure and misleading the customer.

In the motion for approval of a class action, the claimant requests the Court to instruct Discount Mortgage Bank to refund early repayment charges collected over the past seven years on loans where one of the borrowers had passed away. The total amount of this claim, as assessed by the claimant, totals not less than NIS 75 million.

Discount Mortgage Bank has responded to the motion to approve the lawsuit as a class action suit. On November 23, 2009, the Claimant submitted its response to the reaction of Discount Mortgage Bank. A preliminary hearing was held on March 3, 2010, in which the Court advised the parties to negotiate. An additional preliminary hearing was fixed for April 6, 2010.

- 11.12** A motion to approve an action as a class action suit against Leumi Card, IsraCard, American Express International Inc., Diners Club Israel Ltd. and Israel Credit Cards Ltd., was filed on July 12, 2009, in respect of which it was argued that the credit card companies had accumulated wealth in an illegal manner and that they had been operating in violation of the Consumer Protection Law, 1981.

Perusal of the motion and of the claim reveals that it relates to the charging of a credit card of a deceased customer of Leumi Card, where it is claimed that the charge does not relate to the customer. The credit card company had indeed reimbursed the customer's heirs with the amount charged, but it is alleged that the said reimbursement did not include the reimbursement of interest. Hence, the said heirs refer their claim to all credit card companies on the assumption that they all act in the same manner.

In January 2010, the claims and pleas against Diners Club Israel Ltd. and against Israel Credit Cards Ltd. were dismissed.

- 11.13** A motion was filed on October 29, 2009, at the Jerusalem District Court for approval of a lawsuit against the Bank, the Accountant General at the Ministry of Finance, the Supervisor of Banks and the Head of the Consumer Protection Authority, as a class action suit.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

According to the Claimant, the Bank unlawfully discriminates against customers who do not enjoy the reduced interest rate of the Accountant General on loans, as do State employees who are entitled to receive loans at this reduced interest rate.

The Claimant claims a general damage assessed by him at NIS 1 billion.

The Claimant requested the Court to order the Bank to compensate all customers who do not enjoy the Accountant General rate of Interest and to order the Bank to discontinue the discrimination of customers who are not State employees and to order the Bank to grant loans at the Accountant General rate of interest to all its customers.

On January 7, 2010, the Bank submitted a motion for the striking-off in limine of the motion for approval of the suit as a class action suit.

On February 11, 2010, the District Court decided to dismiss in limine the motion for approval of the lawsuit as a class action suit.

- 11.14** On December 25, 2008, a client of the Bank filed a motion to approve a lawsuit as a class action against the Bank, in which he argues that the bank gives a benefit to clients setting up deposits through the internet. The client claims that the Bank doesn't provide its clients with the information regarding the rate of the said benefit and the fact that the benefit is cancelled on the first renewal date. The client estimates the damage to all members of the group at NIS 115 million. The Bank responded to the motion.

- 12.** 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.

- 12.1** 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 US\$4 million in respect of a transaction undertaken between the company in liquidation and a third party involving the sale of an asset mortgaged to the Bank, which, according to the liquidators' assertions, was sold for less than its true value, the release of the shareholders of one of the companies in the group from their guarantees in relation to the debts of the company to the Bank totaling NIS 3 million; and the return of deferred payment orders to the company in liquidation without the items passing through the company's bank account, thus causing injury valued at NIS 9 million. It should be noted that the liquidators claim that the behavior of the Bank as described above led to the final liquidation of the company without any specific claims having been made by the liquidators as to the injury attributable to the Bank in relation to this cause of action. The Bank filed a request for amendment of the claim brief that had been filed against the Bank so that the amount claimed thereby would be correctly specified. The legal action is pending.

In addition, the Bank motioned for the in limine dismissal of the claim on the grounds of limitation. The motion has been dismissed and on November 16, 2008, the Bank petitioned for a motion to appeal the said decision at the District Court.

On November 29, 2009, the Bank resubmitted the request for determination of the claim amount. The appeal of the Bank with regards to the limitation of the claim is pending until the mediation process between the parties is completed.

- 12.2** On June 19, 2000, two borrowers of DMB filed with the District Court a petition for approval of an action as a class action suit against DMB and against the Israel Phoenix Insurance Co. Ltd. ("Phoenix"), where the properties of the borrowers are insured. The action is for an amount of NIS 105 million.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, since the insured amounts included the land component, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

On September 10, 2000, DMB filed its response to the petition for approval of a class action suit, in which the Court is requested to dismiss the petition in limine and as regards its substance. It should be noted that Phoenix Insurance also responded to the petition requesting the Court dismiss the petition in limine and as regards its substance. On October 29, 2000, the claimants submitted their reply to the above response, in which they repeat the request for approval of a class action suit.

On December 25, 2000, the Court decided that the arguments raised in this petition were similar to the arguments raised in the pleas for approval of class actions discussed in 14.6 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.

- 12.3** 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 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.

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 took place on February 28, 2010. The case has been fixed for written summations, following which a decision will be given.

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.

As long as exemption is not granted or the Court fee is not paid, the lawsuit is not considered as filed.

- 12.4** On May 12, 2009, an action was filed against the Bank, Bank Leumi, Bank Hapoalim, Mizrahi-Tefahot Bank and the First International Bank together with a motion to approve the action as a class action suit.

The action is based on the statement of the Antitrust Commissioner (see item 14 below) according to which binding arrangements regarding the communication of information with respect to commissions had existed between the defendant banks.

The Claimants argue that a binding arrangement had existed between the said banks with respect to commission rates charged by these banks and that the banks established a coordinated policy, which, as alleged by the claimants, was typified by prohibited cooperation and exchange of information.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

The Claimants argue that the banks created between them a binding arrangement in contravention of Sections 2 and 4 of the Antitrust Law and that according to Section 50 of that Law an act of commission or omission in contravention of the provisions of the Law constitute a damaging injustice.

The class defined in the action constitutes all customers of the defendant banks, both private and business customers, in the period from 1990 to 2004. The total damage for all the defendant banks is assessed for the purpose of the action at approximately NIS 1 billion, with no allocation between them. The Claimants reserve the right to amend the amount of the damage claimed following receipt of the full data from the banks. On October 7, 2009, the District Court rejected the motions submitted for the in limine dismissal of the claim and instructed that the hearing of this claim should be incorporated with the claim discussed in Section 11.5 above. The Court ordered a stay in the hearing of the motion for approval until a decision is given in the appeal against the Commissioner's ruling, to be submitted by the banks to the Antitrust Tribunal. (see item 14 hereunder)

13. 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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. According to the recommendation of the Supreme Court, all parties agreed to refer the case to mediation procedures.

If the said motions were granted, the earnings of FIBI Group would be reduced in this field.

14. 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.

In January 2009, the Authority suggested to the banks the possibility of forming an "agreed order" as an alternative to the publication of the decision being considered. In this respect it is suggested that the "agreed order" shall include a cash payment of NIS 290 million, to be allocated between the banks, so that the share of the Bank in this amount will be NIS 80 million. The Authority also suggested that the "agreed order" will include agreed limitations on the communication of information between banks, as well as the mapping and regulation of all collaborative activities between them.

In February, 2009, the Bank informed the Authority that it rejects the said suggestion for an "agreed upon order".

On April 26, 2009, the Bank received the decision of the Antitrust Commissioner, given under Section 43(a)(1) of the Antitrust Law, 1988, according to which the Commissioner states that binding arrangements had existed between the banks regarding the communication of information with respect to commissions, and that according to the findings in her possession, such binding arrangements had been in effect since the beginning of the 1990's and until the beginning of the investigation initiated in the matter by the Antitrust Authority in November 2004.

According to the Commissioner's decision, communication of information in the said statement constitutes a binding arrangement within the meaning of the Antitrust Law.

The Commissioner further stated that in accordance with Section 43(e) of the said Law, the said statement serves as prima facie evidence for everything determined therein in any legal proceedings.

The Bank disputes the ruling, its findings and conclusions. The date for submission of the appeal is March 24, 2010.

15. Israel Discount Capital Markets and Investments Ltd. ("DCMI") is a partner in several venture capital funds, private investment funds and in this respect is obligated to invest in these funds.

As of December 31, 2009, DCMI has a commitment to additional investments in 16 such entities amounts totaling US\$185.9 million (as of December 31, 2008, US\$205.5 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, 2009, guaranties have been provided in the amount of NIS 47 million (December 31, 2008 - NIS 46 million).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

In July 2007, DCMI signed an agreement for the acquisition of control in Menif, in consideration for an immaterial amount. Consummation of the transaction was subject, inter alia, to the approval of the Bank of Israel.

An amendment to the share purchase agreement was signed in August 2008, which, among other things, has been conditioned upon the approval of the Bank of Israel and the Antitrust Commissioner until December 15, 2008. As a result of the non-fulfillment of the conditions precedent specified in the agreement, DCMI informed on August 20, 2009, of the annulment of the agreement.

In addition, as of December 31, 2009, 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 US\$0.6 million, as of December 31, 2009.

16. 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 dunams, 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).

17. 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, 2009, the nominal amount deposited by members of the Fund, in respect of which the commitment had been given, totaled NIS 154 million. Mercantile Discount Bank's exposure as at December 31, 2009 (with respect to the negative difference between the value of members' rights and the nominal amount deposited by them, as stated) amounted to NIS 153 thousand. 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, 2008, according to which enrollment of new members by central provident funds 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.

18. **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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

19. 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.

20. The sale of operations of the provident funds. The transaction where by the Bank and its subsidiary Discount Management of Provident Fund Ltd. (hereinafter: "Discount Provident") sold Clal Insurance Company Ltd. (hereinafter: "Clal Insurance") their provident fund management activity was completed in June 2007.

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 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.

21. Investment in activities abroad. In September 2007 an agreement for investment in two companies owned by Mayer Cars and Trucks

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

Co. Ltd. (hereinafter: "the Mayer Group") was signed. The Bank, through DCMI, has committed itself to investing an amount of up to Euro 40 million in Mayer (Keshet) Real Estate Ltd. (hereinafter: "Mayer Real Estate") and an amount of up to Euro 30 million in Mayer Europe Ltd. (hereinafter: "Mayer Europe"). The Bank's said commitment is subject to 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.

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, 2009, DCMI invested an amount of Euro 11.1 million in the two companies of the Mayer Group (December 31, 2008: Euro 11.1 million).

22. a. Chairman of the Board during the period of November 1997 to January 2006 (hereinafter: "Past Chairman of the Board") 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 past 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 past 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 past 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 past 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 past 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 past 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

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

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:
 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 Bank and the Past Chairman 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.
- q. After discussions of this issue, representatives of the State announced, in a letter dated May 27, 2009, that they insist on their objection to making the payments to the former Chairman and to continuation of the arbitration proceedings. The State representatives added that this position is also endorsed by Bronfman-Schron Group. The State's position was, inter alia, that making the payments is subject to approval by the General Meeting of Shareholders.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES

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.

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, and changes in fair value being taken currently to the income statement. Some 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 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 the income statement. 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, sold, cancelled or realized;

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

GENERAL (CONTINUED)

- 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 in the income statement 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 DATES (CONTINUED)**A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS**

December 31, 2009					
	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					
A. Hedging derivatives⁽¹⁾					
Swaps	-	1,378	-	-	-
Total	-	1,378	-	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	1,312	-	-	-
B. ALM derivatives⁽¹⁾⁽²⁾					
Futures contracts	-	2,009	-	-	-
Forward contracts	1,039	9,950	15,618	-	-
Other option contracts					
Options written	-	-	15	755	-
Options purchased	-	-	134	3	-
Swaps	-	39,846	15,294	-	-
Total	1,039	51,805	31,061	758	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	20,718	-	-	-
C. Other derivatives⁽¹⁾					
Forward contracts	68	113	630	1,489	1,744
Marketable option contracts					
Options written	-	-	278	4,202	33
Options purchased	-	-	410	4,202	33
Other option contracts					
Options written	-	55	12,926	153	13,565
Options purchased	-	55	12,626	160	12,711
Swaps	-	1,064	-	-	-
Total	68	1,287	26,870	10,216	28,086
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	493	-	-	-
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	4,630	-	-

Footnotes:

(1) Excluding credit derivatives and SPOT foreign currency swap contracts.

(2) Derivatives comprising a part of the asset and liability management system which were not designated for hedging relations.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)**A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)**

December 31, 2008					
	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	-	-	*	-	-
Swaps	-	1,460	-	-	-
Total	-	1,460	-	-	-
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	*412	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	32,259	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	-	-

* Reclassified.

Footnotes:

(1) Excluding credit derivatives and SPOT foreign currency swap contracts.

(2) Derivatives comprising a part of the asset and liability management system which were not designated for hedging relations.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTINUED)

December 31, 2009					
	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	-	9	-	-	-
Negative gross fair value	-	66	-	-	-
B. ALM derivatives					
Positive gross fair value	1	831	437	1	-
Negative gross fair value	59	1,004	817	5	-
C. Other derivatives					
Positive gross fair value	1	41	332	138	218
Negative gross fair value	1	35	314	127	217
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					
Positive gross fair value	-	1	*-	-	-
Negative gross fair value	-	109	*-	-	-
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	*1,055	184	94
Negative gross fair value	1	44	*1,012	173	93

* Reclassified.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

B. DERIVATIVE INSTRUMENT CREDIT RISK BASED ON THE COUNTERPART TO THE CONTRACT, ON A CONSOLIDATED BASIS

December 31, 2009					
	Stock markets	Banks	Dealers/ brokers	Others	Total
In NIS millions					
Gross positive fair value of derivative instruments ⁽¹⁾	52	1,309	78	570	2,009
Net of set-off agreements	5	22	-	72	99
Balance of assets deriving from derivative instruments ⁽²⁾	47	1,287	78	498	1,910
Off-balance sheet credit risk in respect of derivative instruments ⁽³⁾	112	8,187	26	2,969	11,294
Total credit risk in respect of derivative instruments	159	9,474	104	3,467	13,204

Footnotes:

- (1) Of which, NIS 74 million of positive gross fair value of derivative instruments.
- (2) Of which, a balance of non-related derivative instruments of NIS 1,836 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, 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.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

C. DUE DATES – PAR VALUE: CONSOLIDATED YEAR END BALANCES

December 31, 2009					
	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	170	433	354	150	1,107
Other	7,575	14,939	15,714	16,242	54,470
Foreign currency contracts	39,818	17,232	1,769	3,742	62,561
Contracts on shares	10,464	234	266	-	10,964
Commodities and other contracts	24,168	3,714	204	-	28,086
Total	82,195	36,552	18,307	20,134	157,188
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	67,305	37,137	18,299	19,860	142,601

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 present value is measured in respect of the future cash inflows (principal sum and interest) separately for each loan, at a rate of interest reflecting the risk level inherent in the credit.

Determination of the risk level has, to the extent possible, been made, 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, 2009, the Bank has classified some 96% of the indebtedness which has to be classified according to the directives of the Supervisor of Banks (31.12.2008: 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.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

The discount rates used were generally determined according to interest rates applying to similar transactions effected at the reporting date.

The fair value of problematic debts, net of the provision for loan losses, was calculated using discount rates reflecting the high credit risk involved.

Increasing the discount interest rate by 1 percentage point would have reduced the fair value of the problematic debts by NIS 54 million.

Increasing the discount interest rate by 0.1 percentage point would have reduced the fair value of the problematic debts by NIS 6 million.

Cash flows in respect of mortgages have been evaluated on the basis of an early repayment forecast based on a statistical model.

Discounting the said cash flows in accordance with expected repayment dates instead of the contractual repayment dates, reduced the fair value of the mortgages, particularly in the CPI linked segment, by NIS 218 million.

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.

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, Based on parameters, such as: the size of the deposit, the period of the deposit, type of linkage. Marketable subordinate capital notes are stated at market value.

Cash flows in respect of deposits were evaluated on the basis of an early withdrawal forecast based on a statistical model. Discounting the said cash flows in accordance with expected withdrawal dates instead of the contractual withdrawal dates, increased the fair value of the deposits, particularly savings deposits in the CPI linked segment, by NIS 46 million.

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 - Some of the subsidiaries assume that the balance stated in the balance sheet reflects fair value (until December 31, 2008 - all of the Group's companies assumed so).

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.

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.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

D. COMPOSITION - CONSOLIDATED

December 31, 2009				
Balance sheet amounts				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets:				
Cash and deposits with banks	4,383	20,200	24,583	24,603
Securities	34,459	1,879	36,338	36,360
Securities borrowed or purchased under resale agreements	-	336	336	336
Credit to the public	23,571	90,855	114,426	115,736
Credit to the Government	2	1,818	1,820	1,820
Investment in affiliated companies	117	5	122	103
Other financial assets	3,627	-	3,627	3,627
Total financial assets	66,159	115,093	181,252	182,585
Financial liabilities:				
Deposits from the public	14,130	127,695	141,825	142,100
Deposits from banks	1,786	1,938	3,724	4,501
Deposits from the Government	10	274	284	295
Securities loaned or sold under buy-back arrangements	7,643	8	7,651	8,202
Subordinated capital notes	288	11,241	11,529	12,320
Other financial liabilities	10,408	-	10,408	10,408
Total financial liabilities	34,265	141,156	175,421	177,826

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)

D. COMPOSITION - CONSOLIDATED (CONTINUED)

December 31, 2008				
Balance sheet amounts				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets:				
Cash and deposits with banks	*1,676	*19,878	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	*15,408	*101,048	*116,456	*116,485
Credit to the Government	*20	*1,471	1,491	1,235
Other financial assets	3,745	-	3,745	3,745
Total financial assets	50,467	124,339	174,806	174,660
Financial liabilities:				
Deposits from the public	*8,560	*130,672	139,232	140,045
Deposits from banks	*2,161	*2,394	4,555	4,545
Deposits from the Government	*4	*202	206	212
Securities loaned or sold under buy-back arrangements	2,761	4,433	7,194	7,450
Subordinated capital notes	*-	*9,373	9,373	8,651
Other financial liabilities	*10,070	-	10,070	*10,070
Total financial liabilities	23,556	147,074	170,630	170,937

* Reclassified.

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
- (2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. COMPOSITION - THE BANK

December 31, 2009				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets:				
Cash and deposits with banks	251	31,283	31,534	31,880
Securities	13,451	-	13,451	13,451
On securities borrowed or purchased under buy-back agreements	-	336	336	336
Credit to the public	3,478	64,063	67,541	67,518
Credit to the Government	-	1,818	1,818	1,818
Investment in investee companies	-	1,551	1,551	1,624
Other financial assets	2,427	-	2,427	2,427
Total financial assets	19,607	99,051	118,658	119,054
Financial liabilities:				
Deposits from the public	772	105,150	105,922	106,787
Deposits from banks	2,657	1,307	3,964	3,967
Deposits from the Government	-	159	159	158
Subordinated capital notes	-	3,638	3,638	3,881
Other financial liabilities	5,299	-	5,299	5,299
Total financial liabilities	8,728	110,254	118,982	120,092

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 (CONTINUED)**

December 31, 2008				
Balance sheet amounts				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets:				
Cash and deposits with banks	*430	*25,700	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	*3,203	*66,080	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	20,350	93,266	113,616	113,604
Financial liabilities:				
Deposits from the public	*1,096	*101,245	102,341	102,405
Deposits from banks	*1,184	*1,739	2,923	2,927
Deposits from the Government	*-	*128	128	118
Subordinated capital notes	*-	*3,588	3,588	3,244
Other financial liabilities	6,353	-	6,353	6,353
Total financial liabilities	8,633	106,700	115,333	115,047

* Reclassified.

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
- (2) Other financial instruments.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

A. BALANCES:

December 31, 2009										
Interested parties ⁽¹⁾						Related parties held by the Bank ⁽¹⁾				
Controlling Shareholders ⁽²⁾		Others Shareholders ⁽³⁾		Directors and President ⁽⁴⁾		Affiliated companies		Others ⁽⁵⁾		
(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)	
in NIS millions										
Assets:										
Deposits with banks	-	-	-	-	-	118	367	-	-	
Securities ⁽⁸⁾	-	-	3	3	-	-	-	379	417	
Credit granted to the public	(A)	(A)	50	62	42	42	292	1,457	280	320
Investments in affiliated companies ⁽⁸⁾	-	-	-	-	-	-	1,795	1,795	-	-
Other assets	-	-	-	-	-	-	53	77	-	1
Liabilities:										
Deposits from the public	4	26	16	16	1	5	747	2,835	250	696
Deposits from banks	-	-	-	-	-	-	422	780	-	-
Subordinated capital notes	-	-	-	-	-	-	18	19	-	-
Other liabilities	-	-	-	-	8	8	9	30	-	-
Shares (included in shareholders' equity)	2,598	2,598	-	-	-	-	-	-	-	-
Credit risk in off-balance-sheet financial instruments ⁽⁹⁾	3	3	18	18	11	11	2,004	2,011	44	53

(A) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 16 million for credit received by a third party (2008 - NIS 23 million).

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, 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⁾	
	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)
in NIS millions										
Assets:										
Deposits with banks	-	-	-	-	-	-	118	201	-	-
Securities ⁽⁸⁾	-	-	*2	*2	-	-	-	-	*380	*380
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	-	-	-	-	-	-	*15	*20	-	-
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	*1,038	106	106

* Reclassified.

(A) In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 16 million for credit received by a third party (2008 - NIS 23 million).

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, 2009					
	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**	-	4	1	120	10
Non-financing income	-	-	-	5	5
Non-financing expenses***	-	-	(27)	(3)	-
Net loss from extraordinary items	-	-	-	(17)	-
Total	-	4	(26)	105	15

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**	-	*(2)	1	*18	6
Non-financing income	-	-	-	15	*(27)
Non-financing expenses***	-	-	(24)	(31)	-
Total	-	(2)	(23)	2	(21)

* Reclassified.

** See Note D.

*** See Note C.

C. BENEFITS FROM THE BANK AND CONSOLIDATED SUBSIDIARIES TO INTERESTED PARTIES:

	For the year ended December 31, 2009		For the year ended December 31, 2008	
	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	17	2	18	2
Directors who are not employed by the Bank or on its behalf	5	*16	4	*16
Total	22	18	22	18

* Including two and three Directors who retired during 2009 and 2008 respectively.
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		
	2009	2008	2007	2009	2008	2007
	in NIS millions					
A. On assets						
Credit granted to the public	116	80	11	105	69	7
Deposits with Banks	1	-	-	1	-	-
Total	117	80	11	106	69	7
B. On liabilities						
Deposits from the public	(14)	(42)	(28)	(16)	(38)	(8)
Deposits from the banks	(6)	(20)	(22)	(6)	(20)	(22)
Subordinated capital notes	(2)	(2)	(9)	(2)	(2)	(3)
Total	(22)	(64)	(59)	(24)	(60)	(33)
C. On Derivative Financial Instrument						
Financing income from other transactions	32	6	6	32	4	6
Total	32	6	6	32	4	6
D. Other						
Other financing income	9	*2	-	6	*5	-
Other financing expenses	(1)	(1)	(1)	-	-	(1)
Total	8	1	(1)	6	5	(1)
Total expenses from financing activities before provision for doubtful debts	135	23	(43)	120	18	(21)

* 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 3.
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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

- E.** 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, 2007, 2008 and 2009, the state owned 25% of the shares. (at a date proximate to date of approval of the financial statements, the State owned 20% 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.
- F.** 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 ordinarily to others, or that the consideration for it is not reasonable, such service shall not be given.

The provisions of this Section shall not apply to Directors' remuneration payable to all Directors of the Bank in equal amounts.

G. Remuneration for the acting Chairman of the Board

The Chairman of the Board of the Bank took office on January 3, 2010, however at this stage no remuneration has been paid to him in respect of his said services. On January 11, 2010, the Board formed an ad-hoc committee in the matter of the remuneration to the chairman of the Board. The committee was entrusted with forming a remuneration plan for the chairman and bringing its recommendation before the authorized organs of the Bank.

H. Remuneration plan for the President and CEO and the Former Chairman of the Board

On January 30, 2007, the Bank's audit committee approved a comprehensive remuneration plan for the President and CEO and to the Chairman of the Board of Directors who retired from office on January 1, 2010 (hereinafter: "the former Chairman").

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 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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

to a proposal for the increase of the registered share capital of the Bank.

New employment agreement with the President and CEO of the Bank. On July 18, 2007 the Bank's Board of Directors of the Bank decided, after receiving the Bank's Audit Committee's, approval, to approve a new personal employment agreement between the President and CEO of the Bank (replacing the previous employment agreement with him). The agreement is for a period of five years, as from February 1, 2006 and thereafter renewed automatically for periods of one year at a time

The agreement stipulates indemnification to which the President and CEO 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 President and CEO will be entitled to a proportionate share of the annual bonus for the year in which the employment agreement was terminated.

The President and CEO will be entitled, subject to fulfillment of certain conditions as determined in the agreement, to a 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).

The extent of the President and CEO's employment shall be a full time position and he shall not be permitted to accept another paid position, without the prior consent of the Board of Directors.

The monthly salary of the President and CEO 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 President and CEO, annually from 2006 until 2010, a special bonus as detailed hereunder.

The agreement further stipulates that the President and CEO will be entitled to vacation days, sick leave, recreation pay, appropriate vehicle, entertainment expenses, social benefits (severance pay, retirement benefits, loss of ability to work and payments to continuing education fund) and additional benefits.

The agreement also includes provisions regarding responsibilities levied on the President and CEO, being among others: provisions regarding a cooling off period of three months and maintenance of confidentiality.

Employment agreement with the former 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's, approval, to approve the personal employment agreement between the Bank and the former Chairman of the Bank's Board of Directors, which is similar in principle to the personal employment agreement of the Bank's President and CEO, except as detailed hereunder:

The employment agreement was for the period as from February 6, 2006 until February 5, 2011, and was not supposed to be renewed automatically at each time for an additional period of one year. According to the engagement agreement, Mr. Zohar is entitled, under certain circumstances, to agreed compensation in an amount equal to his full salary including benefits and provisions, in respect of the remaining period until the cut off date, or, under other circumstances, to an award in an amount equal to twelve months of salary, though, in any event, he is not entitled to double compensation, as stated.

The agreement for the engagement of the former Chairman of the Board was approved by an extraordinary shareholders meeting held on August 26, 2007.

Bonus plan for the President and CEO and the former Chairman of Board of Directors of the Bank. The employment agreement of

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

the President and CEO and the former Chairman of the Board of Directors of the Bank stipulates that the Bank will grant each of them, annually as from 2006 until 2010, a special bonus that will not exceed twice their annual salary (hereinafter: "the maximum annual bonus"). The annual bonus will only be granted in respect of a year in which the Bank's financial statements record a net income.

The annual bonus will be calculated according to five indices as detailed in the agreement, wherein the maximum annual bonus for each index will constitute 25% of the maximum annual bonus. The annual bonus for each of the indices will be determined according to the operating results in the relevant period, in such a way that a minimum goal, target goal and maximum goal will be fixed regarding each index. Fulfillment of the minimum goal will entitle the officer to 20% of the maximum annual bonus for the relevant index, fulfillment of the target goal will entitle the officer to 50% of the maximum annual bonus for the relevant index and fulfillment of the maximum goal will entitle the officer to the maximum annual bonus for the relevant index.

Following are the indices for purposes of determining the annual bonus:

- (1) Increase in the Bank's market share - Measured as increase (in percentiles) of the Bank's share relative to the entire banking system, according to the weighted average of three sectors (sub indices): credit to the public, deposits of the public and operating and other income (according to the relative part of each of the sub indices as stated in the agreement). Non-decrease in the market share relative to the previous period will be deemed fulfillment of the minimum goal for purposes of this index. An increase of 0.1% will be deemed fulfillment of the target goal and an increase of 0.2% will be deemed fulfillment of the maximum goal. It should be noted that calculation of this index will be implemented with regard to a period of 12 months ending on September 30 of the year of the bonus, compared to the previous 12 months, wherein the data will be derived from the Bank of Israel's publications regarding the said period.
- (2) Increase in the Bank's scope of activity - Measured as an increase in credit to the public (as defined in the agreement), and in deposits by the public according to the Bank's consolidated balance sheet as of December 31 of the year of the bonus, compared to corresponding data in the Bank's balance sheet as of December 31 of the previous year. The minimum goal, the target goal and the maximum goal fixed for this index will be deemed an increase of 1%, 1.75% and 2.5%, respectively.
- (3) Increase relative to coverage of expenses - Measured according to increase (in percentiles) regarding coverage of expenses (as defined in the agreement), calculated according to the Bank's financial statements for the year of the bonus, compared to the rate of coverage of expenses calculated for the previous year. The minimum goal, the target goal and the maximum goal fixed for this index will be deemed an increase of 1%, 2% and 3%, respectively.
- (4) Decrease in margin in respect of return on equity of the Bank compared to average return on equity of other banks – Measured according to the difference between the return on equity of the Bank, compared to the average 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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 President and CEO and the former Chairman of the Board complied in 2009 with the determined indices, and they are entitled to a bonus of NIS 3.85 million each in respect of this year. According to the terms of the plan, the President and CEO and the Chairman of the Board received an award of NIS 2.3 million each in 2008. In 2007 the President and CEO and former Chairman of the Board received, pursuant to the terms of the agreement, a bonus in the amount of NIS 4.4 million each.

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 at the request of IDB New York by an independent lawyer, indicated 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. In view of the recommendations of the examination report, the company paid IDB New York interest in respect of the delay in the payment of rent. In addition, according to the recommendations of the report, an opinion of an independent appraiser has been received with respect to the appropriate amount of rent as of the date of the examination report. In view of the opinion of the assessor, IDB New York negotiated to change the rental fees and it has been agreed to increase such fees by US\$4 per square foot.

The amendment of the 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 2009 rental fees of US\$324 thousand (2008 - US\$317 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,

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

in which Mr. Matthew Bronfman has a 20% equity interest, for the management of assets in the amount of US\$150 million.

The management fee paid in consideration thereof is at the rate of between 0.2% and 0.35% of the volume of the managed portfolio.

IDB New York informed Ernest Partners on March 20, 2009, of the termination of the engagement between them. In 2009, an amount of US\$89 thousand was paid to Ernest Partners Corporation in management fees (2008 - US\$273 thousand).

- J.** 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 subsidiary Manpikim Discount Bank Issues Corporation 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 subordinated capital notes, the proceeds of which were deposited with the Bank. The said liability, as at December 31, 2009, amounted to NIS 6,991 million (as at December 31, 2008 - NIS 4,852 million).
- L.** The Bank and Mercantile Discount Bank have commitments towards the Tel-Aviv Stock Exchange and towards the "Ma'of" clearing house as mentioned in Note 19 C 3 and Note 19 C 4.
- M.** Investee companies of the Bank are included in the framework of the undertaking granted by the Bank to VISA Europe (as stated in Note 19 C 9).
- 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 7, items K and L.
- 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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

- 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:

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 was 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		
	2009	2008	2007	2009	2008	2007
	in NIS millions					
A. On Assets*						
Credit granted to the Public	6,105	6,558	4,162	3,474	3,488	2,645
Credit granted to the Governments	19	66	3	18	63	4
Deposits with the Bank of Israel and cash	201	(1)	(55)	57	20	(23)
Deposits with Banks	521	(160)	144	1,150	545	586
Securities borrowed or purchased under buy-back agreements	2	5	10	2	5	10
Bonds ⁽¹⁾	1,160	1,342	84	550	737	811
Other assets	24	-	-	24	-	-
Total	8,032	7,810	4,348	5,275	4,858	4,033
B. On Liabilities*						
Deposits from the public	(2,537)	(1,779)	(41)	(2,256)	(1,376)	(961)
Deposits from the Government	(4)	(5)	(2)	(1)	(1)	(1)
Deposits from the Bank of Israel and cash	-	(21)	(44)	-	(21)	(44)
Deposits from banks	(70)	(216)	73	(6)	(44)	7
Securities loaned or sold under buy-back arrangements	(179)	(328)	310	(3)	(4)	-
Subordinated capital notes	(885)	(763)	(539)	(354)	(359)	(320)
Total	(3,675)	(3,112)	(243)	(2,620)	(1,805)	(1,319)
C. In Respect of Derivative Financial Instruments and Hedging Activities						
Net expenses in respect of ALM derivative instruments**	(386)	(636)	(231)	(393)	(558)	(218)
Income (expenses) net in respect of other derivative instruments	116	(81)	16	70	(84)	(4)
Total	(270)	(717)	(215)	(323)	(642)	(222)
D. Other						
Commissions on financing activities	171	139	125	106	84	71
Other financing income	425	(18)	126	289	83	90
Interest income on problem debts	95	87	110	48	48	77
Gain from sale of loans	-	-	2	-	-	2
Other financing expenses	(21)	(62)	(28)	(29)	(62)	(40)
Total	670	146	335	414	153	200
Total income from financing activities before provision for doubtful debts						
	4,757	4,127	4,225	2,746	2,564	2,692
Of which: Net exchange differences	45	(121)	115	33	6	337

* 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\$113 million for the year ended December 31, 2009 (2008: US\$128 Million, 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 140 Million for the year ended December 31, 2009 was recorded in respect of the said securities (2008: income of NIS 599 million, 2007: expense of NIS 467 million).

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS (CONTINUED)

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
in NIS millions						
E. Results of Activity in Investments in Bonds⁽¹⁾						
Accrual basis, financing income (expenses) from bonds:						
Held-to-maturity	71	(22)	(209)	-	-	-
Available for-sale	931	1,261	83	404	656	638
Trading	158	103	210	146	81	173
Total included in income on assets from financing activities	1,160	1,342	84	550	737	811
Gains on sale of available-for-sale bonds	393	209	68	251	133	33
Losses on sale of available-for-sale bonds	(5)	(7)	(1)	(5)	(2)	-
Provision for decline in value of available-for-sale bonds	(119)	(311)	-	(10)	(57)	-
Net realized and unrealized gains (losses) from adjustment of trading bonds to fair value*	13	(58)	(43)	34	(40)	(37)
Total included in other financing income	282	(167)	24	270	34	(4)
Total from investments in bonds	1,442	1,175	108	820	771	807
F. Details of the Net Effect of Derivative Instruments Hedging Earnings From Financing Operations						
Financing income (expenses) in respect of assets (item A)	(19)	(103)	6	(19)	(103)	6
Financing expenses in respect of liabilities (item B)	-	(1)	-	-	(1)	-

* Of which: a part of the gains (losses) relating to trading bonds that are still on hand at balance sheet date:
Consolidated - NIS 79 million, the Bank - NIS 76 million (2008: consolidated - NIS (12) million, the Bank - NIS (32) million, 2007: consolidated - NIS 8 million, the Bank - NIS (22) million).

Footnote:

(1) Financing income generated by mortgage backed securities (MBS) amounted to US\$113 million for the year ended December 31, 2009 (2008: US\$128 Million, 2007: expense of 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 140 Million for the year ended December 31, 2009 was recorded in respect of the said securities (2008: income of NIS 599 million, 2007: expense of NIS 467 million).

24. OPERATING COMMISSIONS

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
in NIS millions						
Ledger fees	666	*624	*585	425	*409	*383
Credit cards	1,010	*937	*847	106	*102	*89
Operations in securities and in certain derivative instruments	339	*306	*315	249	*218	220
Commissions from the distribution of financial products	55	37	54	50	35	51
Management, operational and trusteeship services for institutional bodies	49	30	127	16	-	57
Handling credit	212	*213	*208	116	*129	*123
Conversion differences	128	*159	*143	99	*129	*121
Foreign trade services	59	*70	*74	48	56	62
Net income from credit portfolio services	20	19	*17	5	5	4
Other income	87	*100	*104	60	*53	*52
Total operating fees	2,625	2,495	2,474	1,174	1,136	1,162

* Reclassified.

25. NET GAIN (LOSSES) FROM INVESTMENTS IN SHARES

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
	in NIS millions					
Gains on sale of shares available-for-sale	171	7	-	136	7	-
Losses and provision for decline in value of available-for-sale shares	(36)	(117)	(46)	(19)	(67)	(44)
Net realized and unrealized gains (losses) from adjustment of trading securities to fair value ⁽¹⁾	5	(7)	(4)	(1)	(1)	(3)
Dividends from available-for-sale or trading shares	57	⁽²⁾ 168	108	27	⁽²⁾ 59	60
Total from investments in shares	197	51	58	143	(2)	13

Footnotes:

- (1) Of which part of the income (loss) related to trading shares that are still on hand at balance sheet date: consolidated: NIS (1) million, Bank: NIS (1) million, (2008-consolidated: NIS (5) million, Bank: NIS (1) million, 2007-consolidated: NIS (4) million, Bank: NIS (0.4) million).
- (2) Including a dividend from VISA Europe, in the amount of NIS 110 million consolidated, and NIS 24 million for the Bank.

- A. During 2009, the Bank realized the balance of the "Bezeq" shares, which served as collateral that a certain borrower received from a consortium of banks. The share of the Bank and of Mercantile Discount Bank Ltd. in the proceeds of the realization of these shares, net of fees and expenses of the Receiver, amounted to NIS 439 million (the Bank: NIS 314 million). The Bank and Mercantile Discount Bank Ltd. recorded in this respect, in these financial statements, gains before tax in the amount of NIS 121 million (the Bank: NIS 87 million). For details regarding a lawsuit filed against the Bank, Mercantile Discount Bank and additional banks, See Note 19 C hereunder, Section 11.8.
- B. During 2009, dividends in respect of "Bezeq" shares in the amount of NIS 38 million (consolidated) and NIS 27 million (the Bank) were received (2008 - NIS 38 million and NIS 26 million, respectively; 2007 - NIS 70 million and NIS 50 million, respectively).
- C. During 2009, the Bank realized the balance of the "HOT" shares, which had been received as part of a creditors' arrangement with a certain borrower, for a total consideration of NIS 55 million, and recorded gains in the amount of NIS 22 million. (In 2008 "HOT" shares in the total amount of NIS 21 million were realized, in respect of which gains before tax in the amount of NIS 13 were recorded).
- D. During 2009, the Bank sold shares in "Harel" for a total consideration of NIS 190 million. In respect of the said realization the Bank recorded gains before tax in the amount of NIS 25 million.

26. OTHER INCOME

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
	In NIS millions					
Management fees from consolidated subsidiaries	-	-	-	4	3	3
Profit from severance pay funds	260	-	89	229	-	87
Other income	9	27	30	60	67	62
Total other income	269	27	119	293	70	152

27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
In NIS millions						
Salaries	2,135	2,009	2,146	1,338	1,262	1,322
Expense resulting from share based payment transactions ⁽¹⁾⁽²⁾	2	15	27	2	15	27
Severance pay, pension, continuing education fund, seniority bonuses, vacation and medical insurance	494	464	267	304	302	193
National Insurance and payroll taxes	407	392	377	316	301	286
Other related expenses	102	112	99	62	63	58
Adjustment of reserves for salary-related expenses due to changes in salaries during the year	29	114	23	27	100	21
Voluntary retirement program expenses ⁽³⁾	6	-	91	6	-	68
Total salaries and related expenses	3,175	3,106	3,030	2,055	2,043	1,975
Includes: Overseas salaries and related expenses	445	405	426	18	19	22

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		
	2009	2008	2007	2009	2008	2007
In NIS millions						
Advertising	169	218	233	59	92	96
Communications	132	132	124	69	65	60
Computer services	200	231	228	152	190	195
Office expenses	31	38	39	15	18	13
Insurance	82	39	40	14	8	9
Professional services	154	162	196	55	67	61
Directors' fees	14	11	10	5	4	2
Instruction and training	15	16	18	10	13	15
Fees	42	43	37	24	27	27
Amortization of goodwill	33	34	32	-	-	-
Other	458	408	339	117	130	108
Total other expenses	1,330	1,332	1,296	520	614	586

29. PROVISION FOR TAXES ON OPERATING INCOME**A. COMPOSITION:**

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
In NIS millions						
Taxes for current year	420	263	365	133	56	137
Taxes for previous years	26	(7)	1	5	(20)	-
Total current taxes	446	256	366	138	36	137
Addition (deduction):						
Deferred taxes for current year	103	(18)	199	50	(41)	104
Deferred taxes for previous years	(42)	(69)	1	(33)	(45)	-
Total deferred taxes	61	(87)	200	17	(86)	104
Total provision for taxes (tax saving) on operating profit	507	169	566	155	(50)	241
Includes taxes of foreign subsidiaries	99	32	140	4	11	17

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		
	2009	2008	2007	2009	2008	2007
Statutory tax rate on banks in Israel	36.21%	36.80%	38.53%	36.21%	36.80%	38.53%
in NIS millions						
Income tax at the statutory tax rate	494	211	494	163	(24)	253
Income tax (tax savings) on:						
Increment (deduction) for inflation	-	-	(41)	-	-	(21)
Income of foreign subsidiaries ⁽¹⁾	14	2	110	-	14	11
General and supplemental provision for doubtful debts	2	2	(9)	3	5	(5)
Income exempt from tax or taxed at restricted rates	(3)	(3)	9	-	-	9
Adjustment differences on depreciation and capital gains	22	(2)	(20)	25	(1)	(19)
Other non-deductible expenses	45	43	55	16	18	39
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	(44)	23	(31)	(41)	-	(28)
Profit tax on payroll tax	-	15	27	-	12	22
Change in the balance of deferred taxes resulting from the change in tax rates	24	(15)	(19)	17	(9)	(20)
Taxes for prior years	(16)	(76)	2	(28)	(65)	-
Income of Israeli subsidiaries	(31)	(31)	(11)	-	-	-
Provision for taxes (tax saving) on income	507	169	566	155	(50)	241

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.

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

- 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 2005. Following the settlement of the income tax assessment for the year 2003, and the settlement of withholding tax assessments for the years 2003-2005, excess provisions for tax amounting to NIS 40 million were reversed in 2008. At the beginning of September 2009, the Bank received a final assessment in respect of the 2004-2005 tax years. The final assessment has no material effect on the Bank's business results, as the demanded taxes reflect timing differences.
- (2) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2003 to 2006. Following the settlement of tax assessments of a Mercantile Discount Bank for the years 2002-2006, an additional provision for taxes was required in 2008, in the amount of NIS 12 million.
- On July 27, 2009, Mercantile Discount Bank was issued "no-consent" tax assessments for 2004-2005. According to Mercantile Discount Bank's management, the additional tax liability inherent in these assessments, including interest and linkage differentials, amounts to NIS 13 million. Mercantile Discount Bank completely disagrees with the position of the Tax Authority. At the end of August 2009, Mercantile Discount Bank appealed the tax assessment. Do date, the Tax Authorities have not yet responded to the appeal.
- 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 in 2008.
- E. The consolidated balance as of December 31, 2009, of the carry forward tax losses, deductibles and timing differences amounted to NIS 184 million (December 31, 2008: NIS 188 million).
- F. On February 9, 2000, the Bank's shares in IDB New York were transferred to Discount Bancorp. Inc. (hereinafter – "Bancorp"), a wholly-owned holding subsidiary of the Bank, registered in the State of Delaware, U.S. The transfer of the shares to Bancorp was made at their value in the Bank's books, in consideration for shares issued by Bancorp.
- The transfer of the shares was made in accordance with the provisions of Section 104A of the Israeli Income Tax Ordinance. The Bank is obligated to pay taxes in Israel with respect to the said transfer of shares, if and when such shares will be sold. The Bank has provided the Israeli Income Tax Authorities with a guarantee as to the payment of such taxes.
- G. In August 2005 the Income Tax Ordinance Amendment Law (No.147) – 2005 (hereinafter – "the Amendment") was publish. The Amendment provides for a gradual reduction in the rate of company tax, down to a rate of 25% as from the 2010 tax year and thereafter.
- On July 14, 2009, the Knesset passed the Economic Efficiency Act (Legislation amendments for the implementation of the economic program for the years 2009 and 2010), 2009, which stipulated, among other things, an additional gradual reduction in the corporate tax rates down to 18% as from the 2016 tax year and thereafter. The said change reduced the deferred tax balance alongside recording of a one-off tax expense of NIS 32 million.
- H. Changes in the rate of "Payroll tax" and "Profit Tax"
- (1) A Value Added Tax Order (Tax rate applying to non-profit organizations and financial institutions) (Provisional directive), 2009, was published on July 1, 2009. Accordingly, in the period from July 1, 2009 and December 31, 2010, the rate of wage tax and profit tax applying to financial institutions will be 16.5% instead of 15.5% (hereinafter: "the Amendment"). According to the Amendment, the new rate of profit tax will apply to one half of the earnings for 2009. Therefore, the average rate of profit tax for 2009 has been 16%.
- (2) On December 31, 2009, a Value Added Tax Order (tax rate applying to non-profit organizations and financial institutions) (Provisional order) (Amendment), 2009, was officially published, according to which, in the period from January 1, 2010 to December 31, 2010, the rate of value added tax and the rate of wage tax and profit tax applying to financial institutions will be 16% instead of 16.5%.
- The effect of the said amendments on the Bank's profits is not significant.
- I. Following the said amendments to items G-H above, the statutory tax rate applying to banking corporations stood at 38.53% in 2007, 36.80% in 2008 and 36.21% in 2009. The statutory tax rates applying to banking corporations will be as follows: in the 2010 tax year -

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

35.34%, in the 2011 tax year - 34.20%, in the 2012 tax year - 33.33%, in the 2013 tax year - 32.47%, in the 2014 tax year - 31.60%, in the 2015 tax year - 30.74% and in the 2016 tax year and thereafter - 29.00%.

- J.** On March 6, 2008, the Israeli Income Tax Law (Inflationary Adjustments) (Amendment No. 20) (Restriction of Period of Application) – 2008 (hereinafter: “the Amendment”) was published. According to the Amendment, the Inflationary Adjustments Law is no longer applicable subsequent to the 2007 tax year, and commencing with the 2008 tax year the provisions of the law no longer applied, 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, no longer applied. In addition, depreciation on fixed assets and tax loss carryforwards are no longer linked to future changes in the CPI, such that these amounts were linked only to the CPI as of the end of the 2007 tax year and are no longer 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 in 2008 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			
	2009	2008	2009	2008
	in NIS millions			
Balance at beginning of year	65	74	56	64
Non-deductible amount for the current year	(6)	(9)	(5)	(8)
Balance at end of year	59	65	51	56

M. YEAR-END BALANCES OF DEFERRED TAXES RECEIVABLE AND PROVISION FOR DEFERRED TAXES:

Deferred tax receivable				Provision for deferred taxes			
balance		The average tax rate		balance		The average tax rate	
2009	2008	2009	2008	2009	2008	2009	2008
in NIS millions		in percentage		in NIS millions		in percentage	

1. Consolidated

On specific provision for doubtful debts	140	115	31.2	34.8	-	-	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	304	341	29.3	34.9	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	90	84	29.1	35.1
On income tax carry-forward deductions	29	62	34.2	25.0	-	-	-	-
On foreign operations	196	366	36.1	36.7	-	-	-	-
On securities	17	9	30.8	28.9	-	-	-	-
On adjustment of depreciable non-monetary assets	-	-	-	-	140	141	28.6	29.1
On other monetary assets	52	45	31.1	29.1	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	120	130	34.2	35.1
Total, net	738	938	31.6	34.3	350	355	30.4	32.4

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)**M. YEAR-END BALANCES OF DEFERRED TAXES RECEIVABLE AND PROVISION FOR DEFERRED TAXES (CONTINUED):****2. The Bank**

	Deferred tax receivable				Provision for deferred taxes			
	balance		The average tax rate		balance		The average tax rate	
	2009	2008	2009	2008	2009	2008	2009	2008
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	95	75	32.0	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	265	289	29.0	35.1	-	-	-	-
On excess of deposits of severance pay	-	-	-	-	85	78	29.0	35.1
On income tax carry-forward deductions	29	61	34.2	25.0	-	-	-	-
On foreign operations	7	4	30.0	30.3	-	-	-	-
On securities	16	14	34.2	35.1	-	-	-	-
On adjustment of depreciable non-monetary assets	-	-	-	-	122	123	28.7	28.9
On other monetary assets	17	21	29.0	27.8	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	120	130	34.2	35.1
Total, net	429	464	30.1	32.9	327	331	30.6	32.5

	Consolidated		The Bank	
	December 31			
	2009	2008	2009	2008
	in NIS millions			
Deferred taxes are included:				
In "Other assets" (Note 8)	402	599	116	149
In "Other liabilities" (Note 12)	(14)	(16)	(14)	(16)
Total, net	388	583	102	133

30. NET INCOME ON EXTRAORDINARY ITEMS, AFTER TAXES

	Consolidated			The Bank		
	2009	2008	2007	2009	2008	2007
	in NIS millions					
Capital income on sale of buildings and equipment	1	-	3	1	-	3
Capital loss on sale of buildings and equipment	(1)	(3)	(3)	(1)	(3)	(1)
Provision for impairment in value of buildings ⁽¹⁾	(1)	(7)	(1)	(1)	(7)	(1)
Income (loss) on sale of shares of previously consolidated subsidiary	(17)	-	2	-	-	1
Gain on sale of provident funds activities	-	-	681	-	-	557
Gain on sale of further education funds activities	-	-	107	-	-	107
Income (loss) before taxes	(18)	(10)	789	(1)	(10)	666
Provision for taxes on profit from extraordinary items:						
Current taxes	(2)	-	(159)	(1)	-	(90)
Deferred taxes	-	-	(118)	-	-	(144)
Total provision for taxes	(2)	-	(277)	(1)	-	(234)
Income (loss) after taxes	(20)	(10)	512	(2)	(10)	432
Bank's share in income (loss) on extraordinary items after taxes of investee (in consolidated-affiliated) companies	-	-	46	(18)	-	126
Income (loss) on extraordinary items, after taxes	(20)	(10)	558	(20)	(10)	558

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,

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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 and Mercantile Discount 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).
- **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 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 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 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 with financial wealth held with the Bank of US\$1 million and over, as well as foreign resident customers with financial wealth held at the Bank of US\$0.5 million and above. 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 FIBI and its share in the income of its affiliated companies which operate in a supporting capacity.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

The segment also includes the sub-segment of non-financial corporations, which includes the Group's investment in non-financial corporations, mainly investments made by DCMI, as well as direct investments by the Bank.

B. THE PRINCIPAL ASSUMPTIONS, ESTIMATES AND PRINCIPLES USED IN THE PREPARATION OF SEGMENT INFORMATION

The classification of the business results of the Group into the various segments of activity, as stated above, was prepared based on the principles, assumptions and estimates detailed hereunder:

1) Income

Income from financing operations before provision for doubtful debts. The segment is credited with the margin resulting from the difference between interest on loans granted to customers of the segment and the interest paid on deposits of customers of the segment and the transfer prices.

The transfer prices reflect the marginal alternative cost of financing sources or the application thereof.

The margins are set at the date the transaction is entered into and stay in effect for the duration of the transaction free of market risks.

According to this methodology, earning or losses from financing operations resulting from changes in market conditions, are taken to the "Financial Management" segment.

Income earned on the nostro securities of the Bank 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. 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 36.2% (2008: 36.8%).

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,

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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.

Accordingly, as from the financial statements for 2008, the capital allocated to each segment was also increased.

4) Presentation of inter-segment income and expenses

The accountability between the profit centers in the Bank is made by a mechanism that allocates the total amount of expenses to customers of the Bank, using various activity indices, and not by allocating the expenses to the profit centers (and the "sale" of inter-segment services).

The method for the allocation expenses used by the Bank is a multi-stage one. In the first stage the direct expenses of the branch are allocated to all the customers keeping their accounts at the branch, (customers attached to various segments). In the second stage, the expenses of designated units are allocated based on an estimate of the distribution of the service to the various headquarters, and the total expenses of the headquarters and administrations to the customers whom they serve. Finally, the costs of the general headquarter units (management, human resources, comptroller, operations and computer services, etc.) to all the customers of the Bank.

According to the system described above, each customer "bears" its own relevant expenses, which are accumulated in the various segments according to the affiliation of customers to these segments.

The format described above does not allow the determination as to what expenses of one segment were charged to another segment (referred to in the reporting format as "inter-segment activity"). The Supervisor of Banks permitted the Bank to report on the basis of the mechanism it developed for the purpose of allocating income and expenses, and in consequence thereof not to report inter-segment transfers.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)**C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS**

Reported Amounts

For the year ended December 31, 2009								
	Small Households	Corporate Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management Non-Financial Companies	Other	Total Consolidated
in NIS millions								
Income from financing activities before provision for doubtful debts								
- From external sources	153	835	1,904	621	254	1	989	4,757
- Intersegmental	1,057	(22)	(808)	35	99	(3)	(358)	-
Total Income (loss) from financing activities	1,210	813	1,096	656	353	(2)	631	4,757
Operating and other income								
- From external sources	1,629	524	424	229	187	33	65	3,091
Total income	2,839	1,337	1,520	885	540	31	696	7,848
Provision for doubtful debts	249	191	293	219	15	-	31	998
Operating and other expenses	2,274	808	703	596	445	4	656	5,486
Operating Income before taxes	316	338	524	70	80	27	9	1,364
Provision for taxes on operating income	87	117	192	35	54	6	16	507
Operating Income (loss) after taxes	229	221	332	35	26	21	(7)	857
Bank's share in operating income of affiliated companies	1	-	-	-	-	(7)	164	158
Minority interest in the income of subsidiaries	(54)	(6)	(9)	(3)	-	-	(-)	(72)
Loss from extraordinary items, net of taxes	-	-	-	-	-	(18)	(2)	(20)
Net income (loss)	176	215	323	32	26	(4)	155	923
Return on equity (percentage)	10.2	28.0	9.1	2.4	12.2	(9.0)	9.0	9.8
Average Assets	31,673	14,581	48,352	19,349	5,828	749	67,501	188,033
Of which - Investment in Investee companies	10	-	-	-	-	120	1,570	1,700
Average Liabilities	65,095	14,206	24,652	10,479	36,835	745	26,377	178,389
Average Risk-assets (Basel I)	26,524	11,785	54,870	20,588	3,277	749	18,082	135,875
Average assets of provident and mutual funds	55	25	426	83	308	-	2,182	3,079
Average customers' securities	29,366	6,275	64,172	8,014	18,718	-	-	126,545
Average other assets under management	3,659	302	141	1,518	1,419	-	-	7,039
Margin from credits activity	763	669	938	555	115			
Margin from deposits activity	401	78	78	60	250			
other	46	66	80	41	(12)			
Income (loss) from financing activities before provision for doubtful debts	1,210	813	1,096	656	353	(2)	631	4,757

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)**C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)**

For the year ended December 31, 2008								
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management Companies	Other	Total Consolidated
in NIS millions								
Income (loss) from financing activities before provision for doubtful debts								
- From external sources	155	1,153	1,736	798	402	(39)	(78)	4,127
- Intersegmental	1,183	(323)	(735)	(174)	(58)	(16)	123	-
Total Income (loss) from financing activities	1,338	830	1,001	624	344	(55)	45	4,127
Operating and other income (loss)								
- From external sources	1,408	512	368	259	172	(32)	(114)	2,573
Total income	2,746	1,342	1,369	883	516	(87)	(69)	6,700
Provision for doubtful debts	176	156	233	198	7	-	10	780
Operating and other expenses	2,198	856	740	644	407	4	499	5,348
Operating Income (loss) before taxes	372	330	396	41	102	(91)	(578)	572
Provision for taxes on operating income	92	111	116	(16)	26	(10)	(150)	169
Operating Income (loss) after taxes	280	219	280	57	76	(81)	(428)	403
Bank's share in operating income of affiliated companies	-	-	(1)	-	-	(115)	46	(70)
Minority interest in the income of subsidiaries	(56)	(8)	(11)	(3)	-	-	-	(78)
Loss from extraordinary items, net of taxes	-	-	-	-	-	-	(10)	(10)
Net income (loss)	224	211	268	54	76	(196)	(392)	245
Return on equity (percentage)	15.1	26.9	8.1	3.7	27.1	(249.3)	(23.4)	2.7
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	11,942	19,677	9,279	35,934	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	128	95	83	268			
other	86	58	158	52	(13)			
Income (loss) from financing activities before provision for doubtful debts	1,338	830	1,001	624	344	(55)	45	4,127

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)**C. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)**

For the year ended December 31, 2007

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management		Total Consolidated
						Non-Financial Companies	Other	
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 (loss) from financing activities	1,184	744	940	723	314	(36)	356	4,225
Operating and other income								
- From external sources	1,426	446	342	240	140	32	25	2,651
Total income	2,610	1,190	1,282	963	454	(4)	381	6,876
Provision for doubtful debts	123	128	60	124	5	-	7	447
Operating and other expenses	2,106	779	648	717	381	4	510	5,145
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 taxes	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
Return on equity (percentage)	50.3	34.0	13.9	7.1	16.9	29.9	(5.6)	14.7
Average Assets	*24,033	12,160	37,822	*21,126	*3,960	958	65,105	165,164
Of which - Investment in Investee companies	-	3	2	-	-	69	1,381	1,455
Average Risk-assets	*54,165	11,145	*18,004	13,574	*37,805	248	21,361	156,302
Average Liabilities	*19,536	10,505	*39,540	22,780	*3,960	958	*17,932	115,211
Average assets of provident and mutual funds	11,408	1,861	99	908	1,250	-	2,024	17,550
Average customers' securities	27,689	4,748	39,490	11,887	16,724	-	-	100,538
Average other assets under management	3,553	300	152	1,595	708	-	-	6,308
Margin from credits activity	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

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		
2009	2008	2007	2009	2008	2007	2009	2008	
in NIS millions								
Israel	6,649	5,809	5,708	818	266	1,110	146,097	*140,315
Europe	164	103	108	(14)	(118)	27	5,781	*5,600
North America	957	670	932	109	63	103	33,097	33,586
Sout America	138	118	128	10	34	25	2,842	2,330
Total Overseas	1,259	891	1,168	105	(21)	155	41,720	41,516
Total Consolidated	7,848	6,700	6,876	923	245	1,265	187,817	181,831

* Reclassified.

Footnote:

(1) Income-earnings from financing operations before provision for doubtful debts and other operating income.

32. EARMARKED DEPOSITS, CREDIT AND DEPOSITS FROM EARMARKED DEPOSITS

	Consolidated		The Bank	
	December 31		December 31	
	2009	2008	2009	2008
in NIS millions				
Credit and deposits from earmarked deposits				
Credit granted to the public	488	506	136	104
Total	488	506	136	104
Earmarked deposits				
Deposits from the public	1	1	1	-
Deposits from banks	239	554	-	-
Deposits from the Government	166	134	135	104
Total	406	689	136	104

33. CREDIT CARD ACTIVITY**A. Developments in the field of clearing of international electronic trading transactions**

Following the large number of returned charges in respect of the cancellation of transactions, mostly in the food additives field, that had been cleared by a subsidiary of ICC, ICC International, VISA Europe Organization imposed monetary sanctions in the amount of US\$18 million, in respect of the said returned charges that were recorded until the end of 2009. It should be noted that according to agreements with the trading houses, ICC International is entitled to charge the relevant trading houses with the cost of the monetary sanctions.

In September 2009, VISA Europe precluded ICC International from entering into engagements with new trading houses for a period of three months ended on December 15, 2009. For the time being, though the said date has passed, ICC does not enter into agreements with new trading houses. ICC is in the midst of a reorganization process designed to return it to the regular lines of operation, and its intention is to renew attracting new trading houses as from the second quarter of 2010.

33. CREDIT CARD ACTIVITY (CONTINUED)

In November 2009, Visa Europe Organization informed ICC International that it expects it to take stringent and vigorous measures for the treatment of the deviations and to adopt a plan to which it is committed for the reduction of risk, and this within a period of three months beginning December 1, 2009. In the event that ICC does not fulfill its commitments and deviates from the rules of the Organization, revocation of its international clearing license might be considered and in most extreme cases even termination of its membership in the Organization. ICC has adopted and is adopting a series of measures in order to secure compliance with the rules of VISA Europe Organization and with the risk reduction plan. Among other things, ICC's board of directors in its meeting of November 12, 2009, decided on the immediate suspension of certain executives of ICC International. No monetary sanctions in respect of cancelled charges have been imposed with respect to the months of December 2009 and January 2010.

Several trading houses and groups have recently voiced demands with respect to having been charged with monetary sanctions in recent months, as well as with respect to reduction in the activity of ICC International with certain trading houses. Such demands may result in legal proceedings.

In February 2010, the MasterCard Worldwide organization (hereinafter: "MasterCard") approached ICC indicating a series of prima facie deviations from the rules of MasterCard by trading houses (mainly in respect of gambling transactions). ICC objected to the assertions included in MasterCard's approach. On March 22, 2010, MasterCard announced that it would charge ICC, in accordance with rules of the organization, some US\$3.6 million for the aforementioned deviations. In its announcement, MasterCard expressed its appreciation of the immediate action taken by ICC upon receiving the previous notice with regard to deviations from MasterCard rules.

ICC believes that it can charge the cost of these sanctions to the relevant trading houses, in accordance with the agreements with them. Notwithstanding, the value of collateral held by ICC does not cover the full amount of the monetary sanctions as assessed above, and a certain, imaterial, exposure might arise in this respect.

ICC acted immediately towards the implementation of a reduction plan in order to comply with the requirements of the international organizations, within the framework of which the following steps were taken:

- Organizational changes, within the framework of which the business activity of ICC International was separated from risk management, the ICC's risk management department taking responsibility for risk management at ICC International;
- Discontinuing operations with trading houses having a high rate of cancelled charges, resulting in a significant decline in clearing turnover and in the rate of cancelled charges;
- Conducting a renewed underwriting process with trading houses operating in the electronic clearing field by means of an outside company, in accordance with the requirements of the international organizations;
- Consideration of engaging an external company to perform on behalf of ICC, monitoring processes, similar to those performed by MasterCard;
- Formation of work procedures with respect to clearing operations of international electronic trading transactions;
- Formation of a committee of the Board of Directors for supervising and monitoring treatment of this subject.

Furthermore, ICC has adopted measures for compliance with rules of VISA Europe and MasterCard Worldwide, in addition to terminating engagement with a number of trading houses, which caused most of the exposure. The contribution of the trading houses, with which relations have been terminated, to the net earnings of ICC is approximately US\$7 million.

With the aim of reducing the risk involved in clearing operations of international electronic trading transactions, ICC's board of directors decided to terminate the clearing of transactions made by trading houses engaged in content areas defined as "adults only".

In view of the above, ICC believes that the prospects of the risk of losing the international clearing license for VISA credit cards and the risk of losing its membership in the International VISA Organization, actually materializing, are remote.

Adequate provisions, based on the assessments of ICC's management, are included in the financial statements in respect of the various monetary exposures described above.

33. CREDIT CARD ACTIVITY (CONTINUED)

Several internal audits conducted at ICC International in recent months by the internal auditor of ICC and ICC International, produced findings that indicate deficiencies in various areas, among other things, in the authorization process with respect to ICC's engagement with trading houses regarding the clearing of international electronic trading transactions. The findings indicate deficiencies regarding risk management, improper maintenance of controls and documentation, non-compliance with the rules of the international organizations and the prima facie neglect of duties arising from regulation with respect to money laundering prohibition. These findings are being studied by ICC, and various actions with respect to a number of them have already been taken.

The Internal Auditor continues the review of various aspects related to ICC's operations, including alleged improper operations by organs.

Significant weaknesses at ICC. The evaluation performed by the management of ICC regarding the effectiveness of the controls over financial reporting as of December 31, 2009, revealed two significant weaknesses: (1) a significant weakness regarding the control system applying to operations in the field of clearing international electronic trade transactions; (2) a significant weakness regarding the recording of expenses, in particular marketing and advertising expenses.

Merger of ICC International with ICC. On December 22, 2009, ICC decided to transfer the international electronic trading clearing operations from ICC International to ICC. The transfer of these operations will be achieved by way of merger as defined in the Companies Law, 1999. The decision to transfer the said operations had been made within the framework of a comprehensive structural change, in which, among other things, the responsibility for monitoring and control was transferred to the organs responsible for risk management at ICC, with the aim of providing an appropriate response to the compliance demand of the international organizations, and in order to extend the supervision and control over the international electronic trading clearing operations. Consummation of the merger is subject to obtaining all approvals required by the Companies Law and subject to fulfillment of all conditions precedent specified in the merger agreement.

B. HOLDING MEANS OF CONTROL IN DINERS

The establishment of the YOU customer club and the sale of the means of control in Diners. Pursuant to an agreement dated November 29, 2005, ICC sold Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together - "the Purchasers") shares comprising 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter - "Diners"). Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The transaction was consummated on December 18, 2006.

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 therefore the sale was not recognized in the financial statements.

C. ARRANGEMENTS BETWEEN THE CREDIT CARD COMPANIES AND BETWEEN SUCH COMPANIES AND THE BANKS

1) 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 Tribunal (hereinafter: "the Tribunal") 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 Tribunal 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.

Over the years, the Tribunal has granted the Appellants provisional and temporary permits for the charging of issuer commissions at agreed rates. Concurrently, the validity of the general exemption has been extended from time to time. The Tribunal proceedings in

33. CREDIT CARD ACTIVITY (CONTINUED)

the case have been divided in two, firstly, determination of the proper methodology for determining the issuer commission, and only afterwards the Tribunal will be required to its implementation.

Within the framework of the Tribunal 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 Tribunal handed down a ruling regarding the methodology for the determination of the Cross Clearing Commission (hereinafter: "the methodology decision"), while adopting the principal points of the Commissioner's position on the matter. On February 1, 2007, the Appellants filed an appeal with the Supreme Court against the ruling of the Tribunal.

Concurrently with the procedures in Tribunal, 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 Tribunal on October 31, 2006, and will expire on July 1, 2013 (hereinafter: "the period of the agreement") unless the Tribunal rules otherwise at a prior date.

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 Tribunal 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.

The arrangement has been submitted for approval of the Antitrust Tribunal, and five opposing motions have been submitted to the

33. CREDIT CARD ACTIVITY (CONTINUED)

Tribunal in this respect. On October 31, 2006 the Antitrust Tribunal issued a provisional permit for the agreement.

This permit has been extended by the Tribunal from time to time, most recently until June 30, 2010.

On November 23, 2009, a letter from the Commissioner was received informing that upwards deviations from the average maximum commission permitted by the tripartite agreement had been found, which had not been offset in subsequent periods. Management of ICC believes that no material monetary exposure exists as a result of the approach of the Commissioner.

Appointment of an expert. According to the methodology ruling, the Tribunal decided that in order to examine whether the tripartite agreement brought for approval is compatible with public interest, an expert is to be appointed to examine the rate of issuer commission, issuer commission categories and the rate of its amortization. The Tribunal has decided that the expert shall perform the examination in accordance with the methodology determined in previous proceedings (see above), the expert being appointed and supervised by the Antitrust Authority. 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 Tribunal 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 Tribunal 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 Tribunal; 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.

The parties including ICC have, at this stage, waived the interrogation of the expert and the submission of the claim sum-up briefs, and the Tribunal has been asked to instruct the expert to continue his work to the second stage, until submission of his final opinion. Accordingly, the Tribunal ruled on June 4, 2009, that the date for cross examining the expert, fixed for June 7, 2009, be cancelled.

On February 24, 2009, two documents (hereinafter: "disclosure requests") were submitted to the Antitrust Tribunal, as follows: the one, a notice and request regarding the expert opinion, within the framework of which the Tribunal was motioned to instruct the three credit card companies and their controlling banks to support the factual basis as presented to the expert by legally prepared and verified depositions. The other, a motion for disclosure of documents, within the framework of which the Tribunal is motioned to instruct the expert to deliver to the Plaintiffs all the information, documents and records received from the applicants for the certificate, and which relate to matters detailed in an annex to the motion.

On May 27, 2009, the Tribunal dismissed all the said petitions for disclosure, ruling that they are not in accordance with the decision of the Tribunal for the appointment of an expert.

On December 28, 2009, the Commissioner filed a notice with the Antitrust Tribunal, according to which, in view of the fact that the expert had been appointed Chairman of Discount Bank, he would not be able to complete his final opinion. Accordingly, all the material assembled by the expert is currently being transferred, in an orderly fashion, to the Antitrust Authority. The Commissioner is considering alternatives that would allow the completion of the expert's work in an expedient and efficient manner. These alternatives will be presented to the Antitrust Tribunal for decision.

Appeal against the decision on the methodology. As stated, on February 1, 2007, the Appellants filed an appeal with the Supreme Court against the methodology decision. On December 24, 2009, the Appellants and the Commissioner filed in agreement a motion for granting the compromise agreement on the appeal the power of a Court ruling (hereinafter, respectively, "the motion" and "the compromise agreement"). According to the motion, the Appellants and the Commissioner agree to postpone the hearing of the arguments of the Appellants regarding the methodology for determining the cross commission, as this is expressed in the decision

33. CREDIT CARD ACTIVITY (CONTINUED)

on the methodology, until the hearing of an appeal, if submitted, against the first Tribunal ruling given with respect to a cross clearing arrangement, in any proceedings conducted at the Antitrust Tribunal, following the termination of the tripartite arrangement framework. It was further agreed that if, at the end of the day, an appeal is lodged against the methodology decision, the arguments of the parties regarding the methodology would be only those detailed in the appeal.

On December 27, 2009, the Supreme Court ruled that the compromise agreement is to have the power of a Court ruling.

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.

2) 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.

3) 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.

4) 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 value, 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

33. CREDIT CARD ACTIVITY (CONTINUED)

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

There are multiple ongoing legislative efforts (laws, regulations and procedural directives) at various stages of legislation, some of which may negatively impact the Bank's operations and its subsidiaries as well as their future operating results. The Bank is unable to assess the extent of such impact.

35. EARNINGS PER SHARE

	Consolidated		
	2009	2008	2007
Basic earnings (losses)⁽¹⁾ Per share⁽¹⁾ of NIS 0.1 (in NIS)			
Net operating income	0.96	0.26	0.72
Net income (loss) from extraordinary items, net of taxes	(0.02)	(0.01)	0.57
Net income	0.94	0.25	1.29
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,	
	2009	2008
	in NIS millions	
Balance Sheet		
Total assets	130,244	125,110
Total liabilities	120,670	116,761
Shareholders' equity	9,573	8,349
	For the Year Ended on December 31	
	2009	2008
	in NIS millions	
Statement of Income		
Net income	953	273

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°
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:
Tel Aviv, Israel / Paris, France /
Santiago, Chile / São Paulo,
Rio de Janiero, Brazil / Lima, Peru /
Mexico City, Mexico / montavido, Uruguay

Discount Bank Latin America, Uruguay
Montevideo Head Office: Rincon 390
Branches troughout Uruguay: Montevideo /
Punto del Este

IDB (Swiss) Bank Ltd.
Geneva, Switzerland Head Office:
100 Rue du Rhone
Zurich Branch: Talacker 41
Representative Office: Tel Aviv, Israel

SUBSIDIARIES IN ISRAEL

BANKING
Mercantile Discount Bank
Discount Mortgage Bank

CAPITAL MARKETS
Israel Discount Capital Markets & Investments
Tachlit Investment House

FINANCIAL
Israel Credit Cards
Diners Club Israel
Discount Leasing
Discount Manpikim

TRUST SERVICES
Discount Trust

Website: www.discountbank.co.il
