ANNUAL REPORT

2012

ISRAEL DISCOUNT BANK

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

MANAGEMENT REVIEW

FINANCIAL STATEMENTS

BOARD OF DIRECTORS

DR. YOSSI BACHAR
Chairman of the Board

ILAN BIRAN
(Outside Director)

ELI ELIEZER GONEN

ILAN COHEN

DAVID LEVINSON

EDITH LUSKY
(Outside Director)

JORGE ZAFRAN

ILAN (EILON) AISH

JOSEPH CIECHANOVER - ITZHAR

RICHARD MORRIS ROBERTS

ALIZA ROTHBARD

YALI SHEFFI

* Details regarding members of the Board of Directors and Managment are brought in the Report of tne Board of Directors.

MANAGEMENT

REUVEN SPIEGEL
President & Chief Executive Officer

JOSEPH BERESSI
Senior Executive Vice President
Chief Accountant and Head of Accounting Group

YUVAL GAVISH
Senior Executive Vice President
Head of Banking Division

ESTHER DEUTSCH
Senior Executive Vice President
Chief Legal Adviser and Head of Legal Advisory Group

YAIR AVIDAN
Executive Vice President
Chief Risk Officer and Head of Risk Managment Group

SHLOMO AVIDAN
Executive Vice President
Head of Operation and Logistic Division

ORIT ALSTER
Executive Vice President
Head of Corporate Banking Division

SHAI VARDI
Executive Vice President
Head of IT & Planning Division

AVRAHAM (AVI) LEVI
Executive Vice President
Head of Customer Assets Division

GILAD SOKOLOV
Executive Vice President
Head of Strategy, marketing and service division

JOSEPH PERETS
Executive Vice President
Head of Human Resources Group

YIGAL RONAY
Executive Vice President
Head of Finance Division

NIR ABEL
Executive Vice President
Internal Auditor

RUTH MOSHKOVITZ
Corporate Secretary

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

THE DISCOUNT GROUP - GENERAL OVERVIEW AND PRINCIPAL DATA

The Board of Directors, on March 20, 2013, approved and authorized for publication the Bank's consolidated financial statements and its subsidiaries as of December 31, 2012.

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 eight 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 147 branches in Israel, direct banking services, on-line banking and Internet services.
The Bank has one banking subsidiary in Israel - Mercantile Discount Bank Ltd. ("MDB") - a commercial bank serving customers in all fields of financial activity through 79 branches.
The activities in Israel also include:

- Credit cards - The Bank controls Israel Credit Cards Ltd. ("ICC") and Diners Club Israel Ltd. ("Diners"), which issue and market "VISA", "Diners" and "MasterCard" credit cards, both for domestic and overseas use;
- Securities portfolio management - the subsidiary, Tachlit Discount Portfolio Management Ltd., ("Tachlit") which manages securities investment portfolios for private customers, corporations, not-for-profit organizations and institutional bodies;
- Non-financial investments and underwriting - the subsidiary "Israel Discount Capital Markets and Investments Ltd." ("DCMI") engages in investment banking, investments in private equity funds, in venture capital funds and in other non-financial investments. DCMI also engages in underwriting and managing the issue of securities, by means of a subsidiary company.

In addition, the Bank has an affiliated company, The First International Bank of Israel Ltd. ("FIBI"), also being one of the five major banking groups in Israel (for details regarding an agreement according to which the Bank will gradually reduce its holdings in FIBI, see Note 6 E to the financial statements).

INTERNATIONAL ACTIVITY

The international activity of the Discount Group is mostly conducted by subsidiary companies in the United States, Uruguay (including representative offices in Latin America), and in Europe by the subsidiary in Switzerland and the Bank's London Branch. The international activity is characterized as a business, commercial and private banking activity.
In the United States, IDB New York is the largest of the Israeli banks operating abroad, and at the present time operates branches in New York, Florida, California and in the Cayman Islands. This bank has a banking subsidiary in Uruguay – Discount Bank (Latin America) and representative offices in Latin America and in Israel.
In Switzerland, IDB (Swiss) Bank operates branches in Geneva and in Zurich, as well as a representative office in Israel.

PRINCIPAL OPERATIONS DURING THE REPORTED PERIOD

Efficiency and savings measures have continued during 2012 in several central fields, including: the retirement of 356 employees under the plan launched towards the end of 2011; the completion of the merger of Discount Mortgage Bank with and into the Bank, within the framework of which, some 140 employees have retired until the end of 2012 and increasing efficiency of the Bank's IT layout.
At the same time, progress has been made in the reported period in the Bank's move towards the development of private banking operations.
Also in 2012, the maintenance of capital adequacy and increasing the ratio of the core capital in accordance with targets set by the Board of Directors formed a central factor in the considerations and decisions of the Bank's Management.
In February 2013, the Bank launched a program, first of its kind in Israel, which is designed for existing and new customers who are related to one another. The "family program turns the existing family cell into a financial group, enjoying the variety of services and exclusive benefits. (For details see "Retail Segment – General" under "Activity of the Group according to principal segments of operation" below).

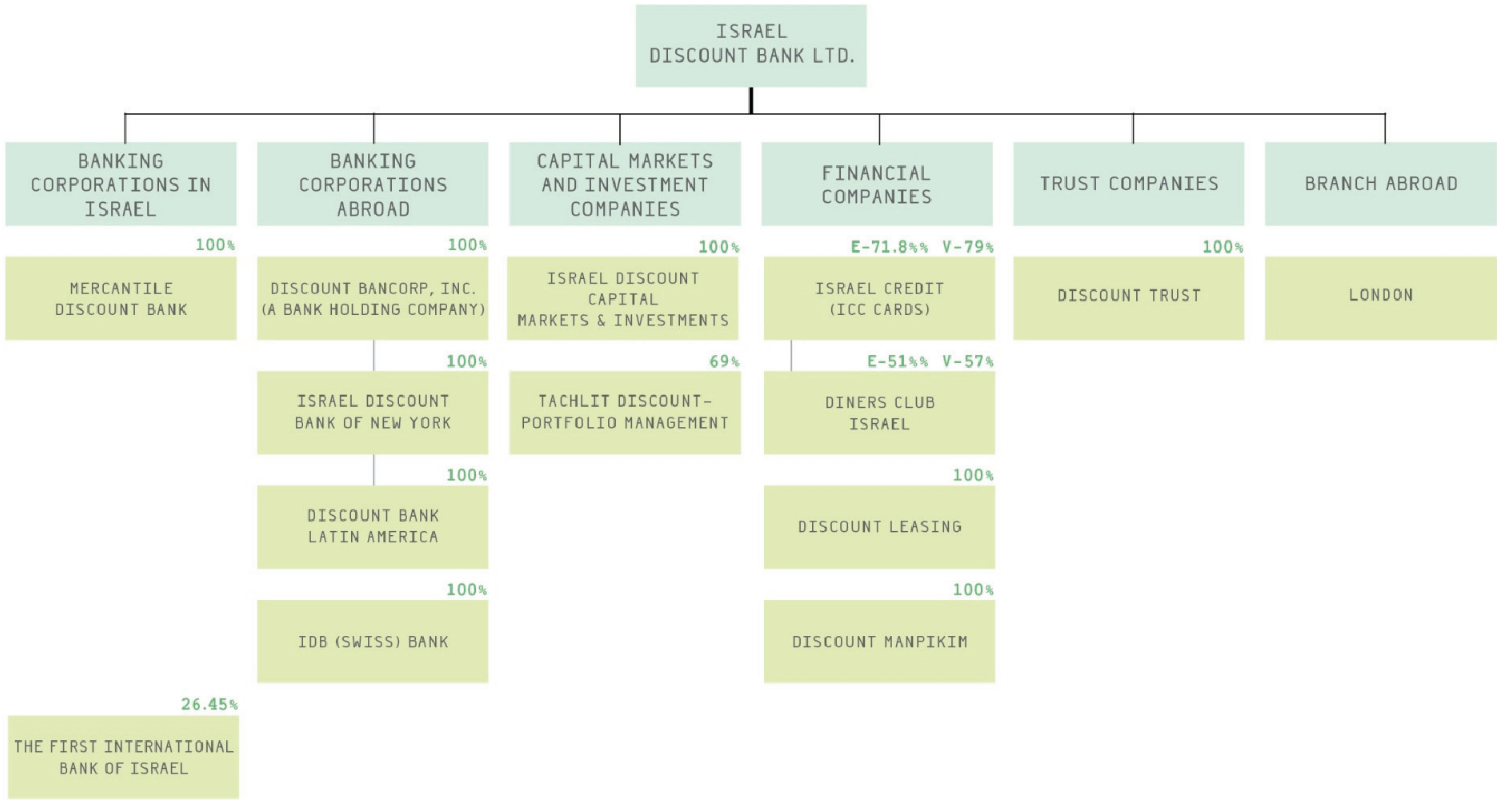
MARKET SHARE AND ADITIONAL DETAILS

Based on data relating to the banking industry as of September 30, 2012, 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, 2012	December 31, 2011	December 31, 2010
		In %	
Total assets	17.0	17.2	17.4
Credit to the public, Net	14.8	14.8	16.1
Deposits of the public	17.0	17.2	17.1
Interest income, net	17.4	(1)18.4	(1)19.2
Total non-interest income	20.5	(2)19.2	(2)18.1

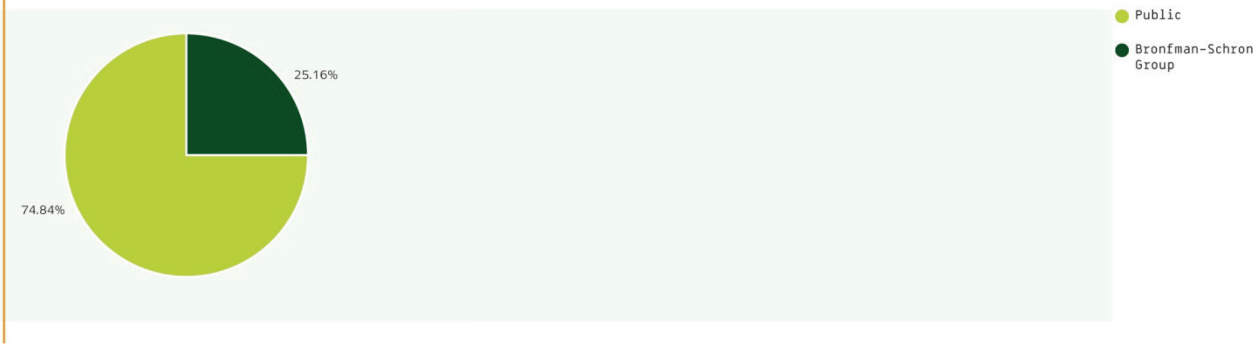
Footnotes:
(1) Income from financing activities.
(2) Non-financing income.

Discount Group Structure



V=VOTING
E=EQUITY

The Bank's Shareholders



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 the Bank’s Banking Division (formerly: the Retail Banking 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 MDB in that bank’s household segment - private customers of MDB, 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 Banking Division and customers of MDB 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 MDB. 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 MDB. 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 Banking Division (individuals and corporations) who receive banking services at the private banking centers. These customers are generally Israeli customers with financial wealth held with the Bank of NIS 4 million and over, as well as foreign resident customers with financial wealth held at the Bank of US$1 million and above. The segment also includes customers of MDB 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, MDB 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 FIBI 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 Bank's activity 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 the Bank's and to MDB's customers, as part of the services and products basket offered by the Bank and by MDB.

  The Bank's income 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 and MDB derive income from payments transferred to them in respect of credit cards issued to their customers by ICC, at the Bank's and DMB's initiative.
- **Operations in the Capital Market:** The operations in the capital market includes securities activity (excluding nostro), 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 Discount Portfolio Management and the operations in the capital market of MDB.
- **Construction and Real Estate Activity:** This activity includes customers of the Bank’s various divisions whose sectorial classification is construction and real estate. This activity also includes customers of the construction and real estate sector of MDB, IDB New York and the London Branch.
- **Mortgage Activity:** This activity includes the mortgage operations of the Discount Group in Israel. 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 unit or other property.

For further details, see "Activities of the Group according to principal segments of operations", "Further details regarding activities in certain products" and "International activity" below.

MAIN FIGURES FROM THE CONSOLIDATED FINANCIAL STATEMENTS

PROFITABILITY

	For the year ended December 31			Rate of change in %	
	2012	2011[1]	2010[1]	2012 compared with 2011	2011 compared with 2010
	In NIS millions				
Interest income, net	4,459	[2]4,617	4,551	(3.4)	1.5
Credit loss expenses	726	778	821	(6.7)	(5.2)
Income before taxes	1,164	931	1,067	25.0	(12.7)
Provision for taxes on income	407	114	479	257.0	(76.2)
Income after taxes	757	817	588	(7.3)	38.9
Net income attributed to the Bank's shareholders	802	[2][3]847	[2][3]690	(5.3)	22.8
Net income attributed to Bank's shareholders - disregarding the provision for impairment in value of the investment in FIBI	[4]875	847	690	3.3	22.8
Net earnings per one share of NIS 0.1 par value attributed to the Bank's shareholders - in NIS	0.76	[2][3]0.80	[2][3]0.69		
The ratio of income before taxes to total equity in %	11.7	10.2	12.3		
The ratio of income after taxes to total equity in %	7.6	8.9	6.8		
Return on equity attributed to the Bank's shareholders, in %	7.1	8.2	6.9		
Return on equity attributed to the Bank's shareholders, in % - disregarding the provision for impairment in value of the investment in FIBI	[4]7.8	8.2	7.0		

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling interest holders, see Note 1 D 2.2 to the financial statements.

(3) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

(4) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

BALANCE SHEET

	As at December 31		
	2012	2011	Rate of change
	In NIS millions		in %
Total assets	200,880	202,472	(0.8)
Credit to the public, net	117,611	116,383	1.1
Securities	46,001	42,898	7.2
Deposits from the public	151,935	153,368	(0.9)
Equity attributed to the Bank's shareholders	11,838	[3][2][1]10,702	10.6
Total equity	12,134	[3][2][1]11,021	10.1

Footnotes:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(3) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

FINANCIAL RATIOS

	As at December 31	
	2012	2011
	in %	
Ratio of total equity to total assets	6.0	5.4
Ratio of capital to risk assets	14.3	(2)14.1
The core capital ratio	8.6	(2)8.1
Ratio of credit loss expenses to the average balance of credit to the public	0.61	0.65
Ratio of credit to the public, net to total assets	58.5	57.5
Ratio of credit to the public, net to deposits from the public	77.4	75.9
Ratio of deposits from the public to total assets	75.6	75.7
Ratio of non-interest income to operating expenses	55.9	50.2
Ratio of operating expenses to total income	75.5	77.4
Risk assets adjusted return(1)	7.8	8.1

Footnote:

(1) Return on core capital (7.5%) computed on the average balance of risk assets.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

DEVELOPMENTS IN THE MARKET PRICE OF THE DISCOUNT SHARES

	Closing price at end of the trading day			Rate of change in 2012 in %
	1.1.2012	31.12.2012	14.3.2013	
Discount share	518	614	658	18.5
The Banks index	947.03	1,137.62	1,164.10	20.1
The TA 25 index	1,099.19	1,185.60	1,240.51	7.9
Discount market value (in NIS billions)	5.46	6.47	6.93	18.5

THE DISCOUNT GROUP STRATEGIC PLAN

On July 24, 2011, the Board of Directors of Discount Bank approved the Discount Group strategic plan for the years 2011-2013 ("the strategic plan"). The period of the plan is intended for the managerial focusing upon structural and financial change processes within the Discount Group and in efficiency measures. Since the date of approval of the plan, changes have taken place in the environment in which the Bank operates and in particular regulatory changes, the most significant of which is the change in capital requirements. During 2012, a process of corporate strategic planning for the next five years was started, and is expected to be completed in 2013, and in its framework the Bank's Management and the Board of Directors are examining the program and the preparations required for compliance with the capital adequacy targets in accordance with the Basel III requirements.

Strategic emphases for 2013. Within the framework of the work plan for 2013, the Board of Directors determined principal focus subjects: increasing the Bank's market share in the income from the retail banking segment, improving the credit portfolio and continuation of efficiency and savings measures.

The above stated, includes assessments and plans that are considered forward-looking information. Such assessments and plans are based on up-to-date information and data in the hands of the Bank's Management at date of publication of this Report. The said assessments and plans may change as a result of changes in the economic environment or material changes in regulation, which might affect the pace of implementation of the existing plans, or even require a change in the significant items and scope of such plans.

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.

The Bank's actual results 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 Bank's control, and which may result in the non-realization of the estimates and/or in changes in the Bank's business plans.

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 the 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 Bank's activity 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.

MERGER BETWEEN THE BANK AND DISCOUNT MORTGAGE BANK LTD. ("DMB")

Discount Mortgage Bank ("DMB") was a wholly owned and controlled subsidiary of the Bank. On June 28, 2012, DMB was merged with and into the Bank. Upon the completion of the merger, DMB ceased to exist without being liquidated, and for all intents and purposes, the Bank is deemed to be DMB.

The principal terms of the merger agreement were detailed in the merger report issued by the Bank on November 24, 2011 (Ref. No. 2011-01-33729). The information detailed in the said report is presented here by way of reference.

Following the said merger, Discount Mortgage Issues Ltd. was merged on November 11, 2012 with and into Discount Manpikim Ltd.

For details regarding the agreement concerning the former staff of DMB, see "Human resources" below. For details regarding future tax implications of the merger and for details regarding the Tax Authority's decision with regard to the merger, see Note 29 L to the financial statements. For details regarding the implications of the merger on the mortgage activity, see under "Mortgage Activity" hereunder. For details regarding the effect of the merger on the layout of internal control over financial reporting, see "Controls and procedures" hereunder.

The comparative figures for the Bank's data (not consolidated) presented below in this Annual Report, have been restated unanimously in order to reflect the merger retroactively as ever existing.

EXPLANATIONS REGARDING THE BUSINESS CONDITION OF THE GROUP

INCOME AND PROFITABILITY

The Discount Group's net income in 2012 amounted to NIS 802 million, compared with NIS 847 million in 2011, a decrease of 5.3%. With the elimination of the provision for impairment of the Bank's investment in shares of FIBI (see Note 6 E (3) to the financial statements), the income for 2012 would have amounted to NIS 875 million, an increase of 3.3% compared with 2011.

Return on equity attributed to the Bank's shareholders for 2012 was 7.1%, compared with 8.2% in 2011. With the elimination of the provision for impairment of the Bank's investment in shares of FIBI (see hereunder), the return on equity in 2012 would have reached a rate of 7.8%.

Net earnings per one share of NIS 0.1 par value amounted in 2012 to NIS 0.76, compared with NIS 0.80 in 2011.

Earnings before tax amounted to NIS 1,164 million in 2012, compared with NIS 931 million in 2011, an increase of 25.0%.

The main factors that had an effect on the business results of the Group in 2012, compared with 2011:

(a) A decrease in interest income, net of NIS 158 million (3.4%).

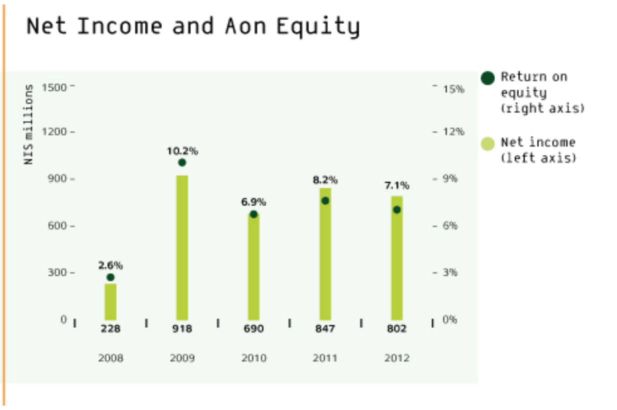
(b) A decrease in credit loss expenses, an amount of NIS 52 million (6.7%).

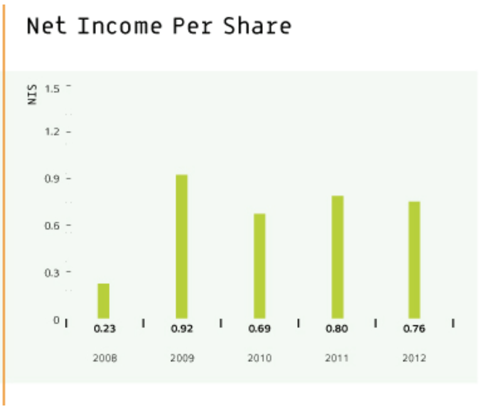
(c) An increase in the total non-interest income of NIS 320 million (10.9%), affected mostly by an increase of NIS 254 million in non-interest financing income (259.2%), from an increase of NIS 15 million in commissions (0.6%) and by an increase in other income, affected by an increase in gains of the severance pay fund of NIS 137 million. It should be noted that in 2011, non-interest financing income included an amount of NIS 48 million from the sale of the basket certificates operations and other income included a total payment of NIS 67 million from an insurance company.

(d) A decrease of NIS 19 million in operating and other expenses (0.3%), affected, mainly, by an increase in payroll and related expenses of NIS 22 million (0.6%), from an increase in buildings and equipment depreciation and maintenance expenses of NIS 44 million (3.8%) and from a decrease in other expenses in the amount of NIS 40 million (3.3%).

(e) Tax provision of NIS 407 million on earnings in 2012, compared with NIS 114 million in 2011. The increase in provision was affected, among other things, from an increase in the balance of deferred tax assets in 2011, of NIS 164 million (compared to the tax situation without the legislation changes), which had been recomputed following the legislation amendments passed in accordance with the recommendations of the Trachtenberg Committee (see Note 29 K to the financial statements; the abovementioned does not include an additional amount of NIS 13 million, the effect on the Bank's share in the profits of FIBI) and from a decrease in the provision for taxes in 2011, in the amount of NIS 95 million, due to hedge operations (see hereunder), and on the other hand by the increase in the balance of deferred tax assets in the amount of NIS 25 million in 2012, as a result of changes in tax rates (see Note 29 K to the financial statements).

(f) An increase of NIS 3 million in the Bank's share in the profits of affiliated companies after tax effect. The income in 2012 is after the provision for impairment in value of the Bank's investment in shares of FIBI, in a net amount of NIS 73 million. For details regarding this provision and changes in the provision for tax in respect of the Bank's share in earnings of FIBI, see Note 6 D and E to the financial statements.





Net income attributed to the Bank's shareholders in the fourth quarter of 2012 amounted to NIS 169 million, compared with NIS 221 million in the third quarter of the year, a decrease of 23.5%, and compared with NIS 219 million in the fourth quarter of 2011, a decrease of 22.8%.

The major factors affecting the business results of the Group in the fourth quarter of 2012, compared with the previous quarter, were:

A. A decrease in interest income, net, in an amount of NIS 76 million (6.7%).
B. An increase in credit loss expenses, in an amount of NIS 19 million (8.2%).
C. A decrease in the non-interest income, in an amount of NIS 76 million (8.8%).
D. A decrease in operating and other expenses, in an amount of NIS 115 million (7.7%).
E. Provision for taxes on income in an amount of NIS 107 million in the fourth quarter of 2012, compared with NIS 78 million in the previous quarter.
F. An increase in the Bank's share in earnings of affiliated companies, net of taxes, of NIS 32 million (82.1%).

DEVELOPMENTS IN INCOME AND EXPENSES

Following are the developments in certain income statement items in 2012, compared with 2011:

	For the year ended December 31		
	2012	[1]2011	Rate of Change
	In NIS millions		in %
Interest income	7,843	8,413	(6.8)
Interest expenses	3,384	[2]3,796	(10.9)
Interest income, net	4,459	4,617	(3.4)
Credit loss expenses	726	778	(6.7)
Net interest income after credit loss expenses	**3,733**	**3,839**	**(2.8)**
Non-interest Income			
Non-interest financing income	352	98	259.2
Commissions	2,685	2,670	0.6
Other income	220	[4]169	30.2
Total non-interest income	**3,257**	**2,937**	**10.9**
Operating and other Expenses			
Salaries and related expenses	3,444	[4]3,466	(0.6)
Maintenance and depreciation of buildings and equipment	1,203	1,159	3.8
Amortization and impairment of intangible assets	10	[5]11	(9.1)
Other expenses	1,169	[5]1,209	(3.3)
Total operating and other expenses	**5,826**	**5,845**	**(0.3)**
Income before taxes	1,164	931	25.0
Provision for taxes on income	407	114	257.0
Income after taxes	757	817	(7.3)
Bank's share in income of affiliated companies, net of tax effect	[3]104	[2][6]101	3.0
Net income attributed to the non-controlling rights holders in consolidated companies	(59)	[2](71)	(16.9)
Net income attributed to Bank's shareholders	**802**	**847**	**(5.3)**
Return on equity attributed to the Bank's shareholders, in %	7.1	8.2	
Net income attributed to Bank's shareholders - disregarding the provision for impairment in value of the investment in FIBI	**[3]875**	**847**	**3.3**
Return on equity attributed to the Bank's shareholders, in % - disregarding the provision for impairment in value of the investment in FIBI	[3]7.8	8.2	

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(4) Reclassified, see Note 1 C 5.3 to the financial statements.

(5) Reclassified, see Note 1 C 7 to the financial statements.

(6) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

Following are the developments in certain income statement items in the fourth quarter of 2012, compared with the third quarter of 2012 and the fourth quarter of 2011:

				Rate of Change Q4 2012 compared to	
	Q4 2012	Q3 2012	(1)Q4 2011	Q3 2012	Q4 2011
	In NIS millions			in %	
Interest income	1,630	2,076	1,954	(21.5)	(16.6)
Interest expenses	564	934	846	(39.6)	(33.3)
Interest income, net	1,066	1,142	1,108	(6.7)	(3.8)
Credit loss expenses	252	233	252	8.2	-
Net interest income after credit loss expenses	**814**	**909**	**856**	**(10.5)**	**(4.9)**
Non-interest Income					
Non-interest financing income	59	94	(7)	(37.2)	-
Commissions	660	693	658	(4.8)	0.3
Other income	65	(3)73	(3)37	(11.0)	75.7
Total non-interest income	**784**	**860**	**688**	**(8.8)**	**14.0**
Operating and other Expenses					
Salaries and related expenses	785	(3)882	(3)831	(11.0)	(5.5)
Maintenance and depreciation of buildings and equipment	309	297	310	4.0	(0.3)
Amortization and impairment of intangible assets	2	3	2	(33.3)	-
Other expenses	283	312	321	(9.3)	(11.8)
Total operating and other expenses	**1,379**	**1,494**	**1,464**	**(7.7)**	**(5.8)**
Income before taxes	219	275	80	(20.4)	173.8
Provision for taxes (tax savings) on income	107	78	(132)	37.2	-
Income after taxes	112	197	212	(43.1)	(47.2)
Bank's share in income of affiliated companies, net of tax effect	71	39	(2)(4)20	82.1	255.0
Net income attributed to the non-controlling rights holders in consolidated companies	(14)	(15)	(13)	(6.7)	7.7
Net income attributed to Bank's shareholders	**169**	**221**	**219**	**(23.5)**	**(22.8)**
Return on equity attributed to the Bank's shareholders, in %	5.9	7.9	8.6		

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) Reclassified, see Note 1 C 5.3 to the financial statements.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

Following are details regarding material changes in statement of income items:

Interest income, net. In 2012, interest income, net, amounted to NIS 4,459 million compared with NIS 4,617 million in the corresponding period last year, a decrease of 3.4%. The decline in net interest income is mostly explained by the decrease in the interest spread, which in part was offset by an increase in monetary assets generating financing income.

The interest spread, excluding derivatives, and with no exchange differences, reached a rate of 2.21% in 2012, compared with 2.39% in 2011.

The average balance of monetary assets generating financing income increased by 5.6% from NIS 183,437 million to NIS 193,754 million.

Non-interest financing income. In 2012, non-interest financing income amounted to NIS 352 million, compared to NIS 98 million in 2011, an increase of 259.2%.

Following are details regarding non-interest financing income:

	For the year ended December 31		
	2012	2011	Change
	in NIS millions		
From operation in derivative instruments	(333)	(156)	(177)
From investments in bonds	341	143	198
Net exchange rate differences	265	(76)	341
From investments in shares	80	141	(61)
From sale of loans	(1)	46	(47)
Total non-interest financing income	**352**	**98**	**254**

The decrease in income from activity in derivative instruments stems mostly from negative exchange rate differences amounting to NIS 320 million.

The net increase in exchange rate differences stems mainly from positive exchange rate differences on balance-sheet assets and liabilities, against which transactions in derivative instruments were conducted, the exchange rate differences of which increased the expenses from activity in derivative instruments, as stated above, and from expenses recorded last year in respect of hedge operations made by the Bank until the end of 2011, with a view of eliminating the volatility in the tax provisions stemming from changes in the value of investments in foreign consolidated subsidiaries, as a result of exchange rates devaluation or appreciation. The effect of this hedge operation was offset in full against the taxes on income item. In 2012, the Bank no longer performs hedge operations in respect of the investment in IDB New York.

The decline in gains on investment in shares stems mostly from income recorded last year on the sale of the basket certificate operation.

Adjustment to schedule C. Net interest income together with non-interest financing income and excluding gains from investment in shares, comprise the profit from financing operations before expenses in respect of credit losses that are presented in Schedule C to Management Review, below, as detailed in the following table.

Profit from financial operation before credit loss expenses:

	For the year ended December 31		
	2012	2011	Change
	in NIS millions		
Interest income, net	4,459	4,617	(158)
Non-interest financing income	352	98	254
From investments in shares	(80)	(141)	61
Profit from financing operation before credit loss expenses	**4,731**	**4,574**	**157**

Profit from financing operations before credit loss expenses, amounted in 2012 to NIS 4,731 million, compared to NIS 4,574 million in 2011, an increase of 3.4%.

After eliminating adjustments to fair value of derivative financial instruments, the effect of tax hedge, gains on investment in bonds and gain on the sale of loans, profit from financing operations before credit loss expenses amounted to NIS 4,316 million, compared to NIS 4,530 million in 2011, a decrease of 4.7%.

Income from financing operations before credit loss expenses amounted in the fourth quarter of 2012 to NIS 1,113 million, compared with NIS 1,086 million in the corresponding period last year, an increase of 2.5%

After elimination of adjustments to fair value of derivative financial instruments, the effect of tax hedge, gains on investment in bonds and gains on sale of loans, income from financing operations before credit loss expenses amounted to NIS 1,014 million, compared with NIS 1,114 million in the corresponding period last year, a decline of 9.0%.

Following are details of the effect of certain components on the financing profit presented in Schedule C to the Management Review:

	2012				
	Annual	Fourth quarter	Third quarter	Second quarter	First quarter
	in NIS millions				
Income from financing activities before credit loss expenses	4,731	1,113	1,222	1,178	1,218
Effect of adjustments to fair value of derivative financial instruments ALM	(75)	18	6	9	(108)
Effect of tax hedging in respect of IDB New York	-	-	-	-	-
Profit from investments in bonds	(341)	(117)	(102)	(74)	(48)
Loss on sale of loans	1	-	-	-	1
Financing income after adjustments	**4,316**	**1,014**	**1,126**	**1,113**	**1,063**
	*2011				
Income from financing activities before credit loss expenses	4,574	1,086	1,014	1,240	1,234
Effect of adjustments to fair value of derivative financial instruments ALM	51	2	96	(31)	(16)
Effect of tax hedging in respect of IDB New York	95	38	104	(23)	(24)
Profit from investments in bonds	(144)	(14)	(56)	(19)	(55)
Loss (profit) on sale of loans	(46)	2	3	(52)	1
Financing income after adjustments	**4,530**	**1,114**	**1,161**	**1,115**	**1,140**

*Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statement.

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) presented in Schedule C to the Management Review:

	For the year ended December 31						
	2012			2011			
		Contribution to profit			Contribution to profit		
	Volume of activity* in %	in NIS millions	In %	Volume of activity* in %	in NIS millions	In %	Changes in contribution in NIS millions
Unlinked shekels	54.5	2,764	58.4	55.9	3,031	66.3	(267)
CPI-linked shekels	8.2	244	5.2	9.2	(182)	(4.0)	426
Foreign Currency	37.3	1,268	26.8	34.9	1,380	30.2	(112)
	100.0	**4,276**	**90.4**	**100.0**	**4,229**	**92.5**	**47**
Options		15	0.3		-	-	15
Other derivative financial instruments (not including hedged derivatives and ALM)		26	0.5		(5)	(0.1)	31
Other financing income		415	8.8		351	7.6	64
Other financing expenses		(1)	-		(1)	-	-
Total		**4,731**	**100.0**		**4,574**	**100.0**	**157**

* 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 FINANCING INCOME ACCORDING TO LINKAGE SEGMENTS (INCLUDING ALM)

In the non-linked shekel segment, net financing income amounted to NIS 2,764 million in 2012, compared with NIS 3,031 million in 2011, a decrease of 8.8%. Income from this segment constituted 58.4% of total net financing income in 2012, compared with 66.3% in 2011.

The average balance of assets in this segment increased in 2012 by 9.4% compared with the preceding year.

The interest margin of the segment decreased from a rate of 1.60% in 2011 to a rate of 1.44% in 2012.

The decrease in profit of this segment, stemmed from a decline in the interest margin and a decline in the contribution of the active capital, which were offset by the effect of growth in volume of operations, inter-alia in respect of an expense of NIS 138 million in respect of fair value adjustments of derivative financial instruments in 2012 compared to an income of NIS 25 million in 2011.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 1.51% in 2012, compared to 1.59% in 2011.

The CPI-linked Shekel segment recorded in 2012 net financing income of NIS 244 million, compared with expenses of NIS 182 million in 2011. Its proportion of total net financing income in 2012 was a rate of 5.2%, compared with a negative rate of 4.0% in 2011.

The average asset balance in this segment in 2012 declined by a negligible rate of 0.6% compared with 2011.

Adjustments to fair value of derivative financial instruments created a positive gap of NIS 424 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 a negative rate of 0.31% in 2012, compared to a negative rate of 0.42% in 2011. This, compared to an actual positive spread of 0.35% in 2012 and compared to an actual negative spread of 1.40% in 2011.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net financing income amounted to NIS 1,268 million in 2012, compared with NIS 1,380 million in 2011, a decrease of 8.0%. Its proportion of all net financing income was 26.8% in 2012, compared with 30.2% in 2011.

The average balance of assets in this segment, mostly of derivative financial instruments, increased in 2012 by 19.8% compared to the preceding year.

The interest margin of the segment decreased from a rate of 1.41% in 2011 to a rate of 0.97% in 2012.

The decrease in profits of the segment stems from a decrease in the interest spread, among other things, due to an income of NIS 44 million in respect of adjustments to fair value of derivative financial instruments in 2012, compared with an income of NIS 180 million in 2011, which was offset due to an increase in the contribution of the active capital and an increase in the volume of operations.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 0.94% in 2012, compared to 1.25% in 2011. A hedging operation performed by the Bank until the end of 2011, resulted in a decrease of NIS 95 million in earnings from financing operations in 2011.

The interest margin, including the effect of derivatives (in hedge transactions and ALM), reached a rate of 1.18% in 2012, compared with a rate of 1.20% in 2011.

The interest margin, disregarding the effect of adjustments to fair value of ALM derivative financial instruments (2011 - the effect of tax hedging in respect of IDB New York) reached a rate of 1.16% in 2012, compared with 1.24% in 2011.

Following are details of the development of interest income, net, by segments of operations:

	For the year ended December 31		
	2012	2011[(1)(2)]	Rate of change in %
	In NIS Millions		
Retail - household segment	1,442	1,527	(5.6)
Retail- small business segment	777	787	(1.3)
Corporate banking segment	1,032	933	10.6
Middle market banking segment	604	672	(10.1)
Private banking segment	385	337	14.2
Financial management segment	219	361	(39.3)
Total	**4,459**	**4,617**	**(3.4)**

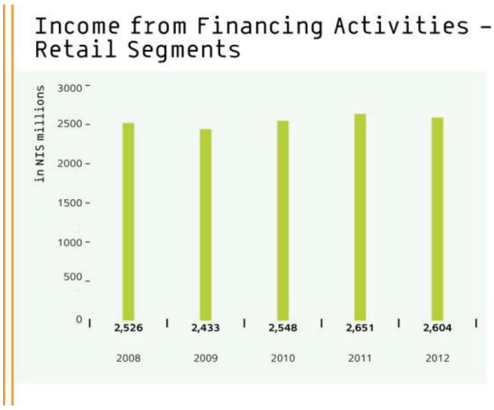
Notes:

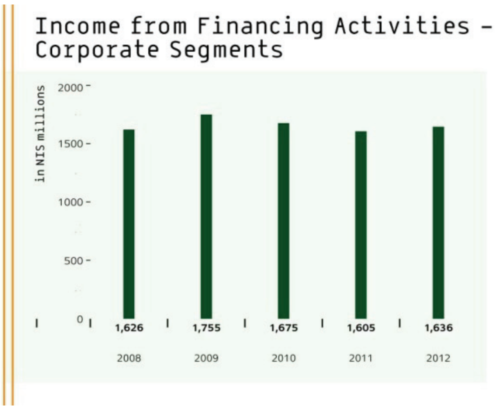
(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, See "General" at the beginning of "Activity of the Group according to principal segments of operations".

Interest income of the business segments, excluding the financial segment, declined despite the increase in the average balance of deposits (6.6%) and in the average balance of credit (1.2%). The said decline is the result of a decline in the spread in respect of credit (a decrease of 0.03%) and in respect of deposits (a decrease of 0.07%), stemming from a decline of 0.5% in the Bank of Israel interest rate.

Income in the financial segment increased, mostly in non-interest income both in Israel and abroad, including an increase of NIS 116 million in gains from the sale of securities and adjustments to fair value in Israel, and additional NIS 51 million in operations abroad. The remainder of the increase stems mostly from income arising from exchange rate differences. This income was offset by the decline in interest income, mostly as a result of the decline in the return on bond portfolios.





Credit loss expenses amounted to NIS 726 million in 2012, compared with an amount of NIS 778 million in the preceding year, a decrease of 6.7%. In 2012, the credit loss expenses constituted 16.3% of the interest income, net, compared with 16.9% in 2011.

The balance of the allowance for credit loss, including the allowance on a specific basis and the allowance on a group basis, but not including allowance for off-balance sheet credit risk, totalled NIS 2,085 million in 2012. The balance of this allowance constitutes 1.74% of the credit to the public, compared with a balance of the allowance in the amount of NIS 1,975 million, constituting 1.67% of the credit to the public as of December 31, 2011.

Following are details of the quarterly development in the credit loss expenses:

	2012				2011			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
	In NIS millions							
Total	252	233	118	123	252	226	188	112
Rate of credit loss expenses to credit to the public *								
The rate in the quarter	0.84%	0.78%	0.40%	0.42%	0.85%	0.76%	0.63%	0.38%
Cumulative rate since the beginning of the year	0.61%	0.53%	0.41%	0.42%	0.65%	0.59%	0.50%	0.38%

* On an annual basis.

Commissions amounted to NIS 2,685 million in 2012, compared with NIS 2,670 million in the preceding year, an increase of 0.6%. The commissions were affected, primarily, by an increase in credit handling commissions which was partially setoff by a decline in ledger fees and commissions on distribution of financial products.
Income from credit card operating activities amounted to NIS 924 million in 2012, compared with NIS 922 million in 2011, an increase of 0.2%.

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

	2012	2011(1)	2010(1)
	In NIS millions		
Account management	602	617	633
Credit cards	924	922	913
Revenue from the capital market	401	414	456
The handling of credit	311	258	254
Conversion differences	108	113	119
Foreign trade operations	55	57	59
Commissions from financing activities	174	181	178
Other	330	277	212
Total	**2,905**	**2,839**	**2,824**

Footnote:
(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

Income from capital market activity in 2012 amounted to NIS 401 million, compared with NIS 414 million in 2011, a decrease of 3.1%, as detailed in the following table.

Presented below are details regarding earnings from commissions of capital market operations in the years 2010-2012:

	2012	2011	2010
	In NIS millions		
Income from operations in securities and in certain derivative instruments	288	300	338
Distribution of financial products	89	82	81
Management, operational and trusteeship services to institutional bodies	24	32	35
Other	-	-	2
Total	**401**	**414**	**456**

It is noted that income presented in the said Table does not include the profit, before tax, from the sale of the basket certificates activity in 2011 (see Note 19 C 21 to the financial statements).
For details regarding "Capital market move", see "Developments in the operations" in the section "Operations in the capital

market" below.

Salaries and related expenses amounted to NIS 3,444 million in 2012, compared with NIS 3,466 million in the preceding year, an increase of 0.6% (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:

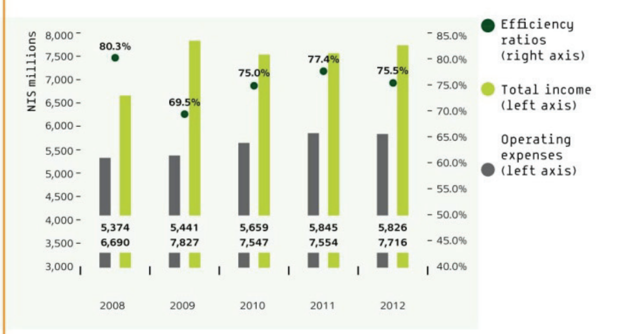
	For the year ended December 31			Change in %	
	2012	2011	2010	2012 compared to 2011	2011 compared to 2010
	In NIS millions				
Salaries and Related Expenses - as reported	3,444	3,466	3,218	(0.6)	7.7
Awards	(71)	(189)	(91)		
Expense resulting from share based payment transactions	(1)	4	(7)		
Waiver of wages in 2009	-	-	(7)		
Voluntary retirement program expenses	-	(22)	-		
The influence of the severance pay fund	-	-	96		
Salaries and Related Expenses - Disregarding certain components	**3,372**	**3,259**	**3,193**	**3.5**	**2.1**

The rise in payroll expenses in 2012, compared with the preceding year, was mainly affected by the rise in payroll expenses of the Bank and of the subsidiary companies and from the change in provisions for awards.

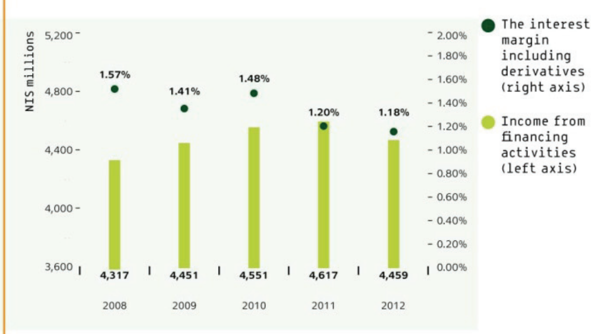
As from 2011, following changes stemming from the implementation of the guideline of the Supervisor of Banks regarding employee rights, the Bank no longer offsets a part of the gains earned on the severance pay fund against growth in the liability for severance pay. For further details see "Human Resources" below.

Salaries expenses, excluding related expenses, amounted in 2012 to NIS 2,222 million, compared with NIS 2,317 million in 2011, a decrease of 4.1%.

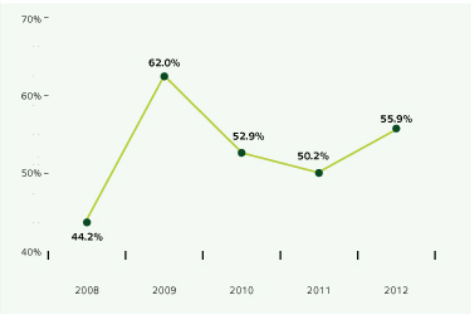
Operating Expenses to Total Income



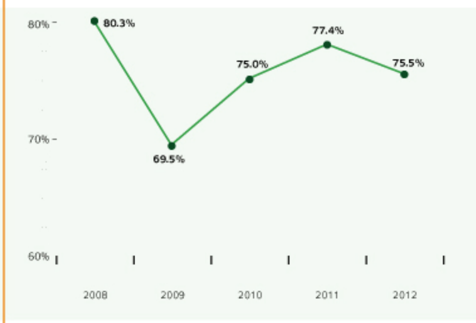
Interest Income, net- Consolidated



Coverage Ratio



Efficiency Ratio



DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2012 amounted to NIS 200,880 million, compared with NIS 202,472 million at the end of the preceding year, an increase of 0.8%.

Following are the developments in the principal balance sheet items:

	As at December 31		
	2012	2011	
	in NIS millions		Rate of changes in %
Assets			
Cash and deposits with banks	24,100	30,329	(20.5)
Securities	46,001	42,898	7.2
Credit granted to the public, net(2)	117,611	116,383	1.1
Liabilities			
Deposits from the public	151,935	153,368	(0.9)
Deposits from banks	3,720	4,249	(12.4)
Subordinated capital notes	12,284	12,239	0.4
Equity attributed to the Bank's shareholders	11,838	(1)(2)(3)10,702	10.6
Total equity	12,134	(1)(2)(3)11,021	10.1

Footnotes:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(3) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

CREDIT TO THE PUBLIC

General. Credit to the public, net, as at December 31, 2012, amounted to NIS 117,611 million, compared with NIS 116,383 million on December 31, 2011, an increase of 1.1%. The ratio of credit to the public to total assets reached 58.5% at the end of 2012, compared with 57.5% at the end of 2011.

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. For details regarding the quality of credit, see Note 4 to the financial statements.

COMPOSITION OF CREDIT TO THE PUBLIC BY LINKAGE SEGMENTS

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

	December 31, 2012		December 31, 2011		
	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of change in %
Non-linked shekels	68,444	58.2	64,043	55.0	6.9
CPI-linked shekels	17,542	14.9	18,407	15.8	(4.7)
Foreign currency and foreign currency-linked shekels	31,625	26.9	33,933	29.2	(6.8)
Total	**117,611**	**100.0**	**116,383**	**100.0**	**1.1**

Credit to the public denominated in foreign currency and in Israeli currency linked thereto decreased by 6.8% compared with December 31, 2011. In U.S. Dollar terms, credit to the public in foreign currency and foreign currency linked Shekels decreased by US$409 million as compared to December 31, 2011, a decrease of 4.6%. The total credit to the public, which includes credit in foreign currency and Israeli currency linked to foreign currency, computed in dollar terms, increased by 1.7% as compared to December 31, 2011.

Non performing assets, accruing interest income impaired debts, commercial criticized exposure and unimpaired debts in arrears of 90 days or more:

	December 31,2012			December 31,2011		
	Credit Risk					
	Balance Sheet	Off-Balance Sheet	Total	Balance Sheet	Off-Balance Sheet	Total
	In NIS millions					
1. Problematic Credit Risk(1)						
Total Impaired credit risk	(3)(4)5,527	140	5,667	(3)(4)(7)5,680	137	5,817
Substandard credit risk	866	31	897	757	17	774
Special mention credit risk(2)	(5)(6)2,409	546	2,955	(5)(6)(7)(8)2,479	(8)471	2,950
Total Problematic Credit Risk*	**8,802**	**717**	**9,519**	**8,916**	**625**	**9,541**
* Of which: Non impaired debts, in arrears for 90 days or more(2)	667	-	-	557	-	-
2. Non-Performing Assets						
Non-performing impaired debts	4,694	-	-	3,182	-	-
Assets received in respect of credit settlement	-	-	-	4	-	-
Total Non-Performing Assets	**4,694**	**-**	**-**	**3,186**	**-**	**-**

Footnotes:

(1) Impaired credit, substandard credit and credit under special mention risks

(2) Including in respect of housing loans for which a allowance based on the extent of arrears exists and in respect of housing loans that are in arrears for 90 days or over for which a allowance based on the extent of arrears does not exist.

(3) Includes corporate problematic non performing bonds in an amount of NIS 22 million (December 31, 2011- NIS 7 million).

(4) Including problematic credit risk with respect to certain debentures of bank holding companies (TRUPS), which are held by a subsidiary, in an amount of NIS 12, 10 million as of December 31, 2012, December 31, 2011, respectively.

(5) Includes corporate problematic performing bonds in an amount of NIS 72 million (December 31, 2011- NIS 85 million).

(6) Including problematic credit risk with respect to certain debentures of bank holding companies (TRUPS), which are held by a subsidiary, in an amount of NIS 259, 598 million as of December 31, 2012, December 31, 2011, respectively.

(7) Reclassified in order to include the disclosure referred to in footnotes 4,6 above.

(8) Reclassified in order to include problematic credit risk in respect of transactions in derivatives.

Impaired credit to the public. The balance sheet impaired credit to the public (interest accruing an non-accruing) amounted at December 31, 2012 to NIS 5.4 billion, compared to NIS 5.6 billion at December 31, 2011, a 3% decrease.

As of December 31, 2012, the impaired credit to the public comprised (both balance sheet and off-balance sheet) 2.9% of total credit to the public risk (both balance sheet and off-balance sheet) whereas in the economic sectors, hotel and food services, construction and real estate, different industrial sectors, it comprised, respectively, a high rate of 15.0%, 8.1% and 3.7%.

Non-performing impaired credit to the public. The non-performing impaired credit to the public amounted at December 31, 2012 to NIS 4.6 billion, compared to NIS 3.1 billion at December 31, 2011, an increase at a rate of 50.1%.

The outstanding balance of the allowance for credit losses in respect of impaired credit to the public, examined on a specific basis amounted to NIS 550 million on December 31, 2012, compared to NIS 435 million as of December 31, 2011.

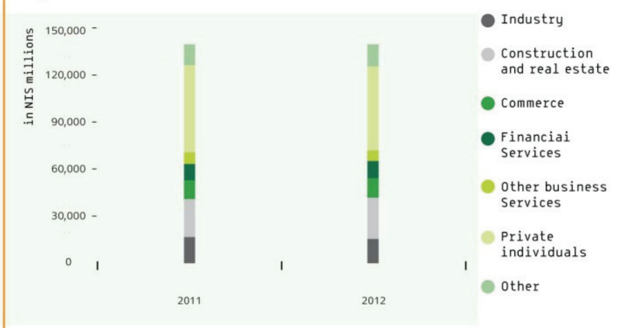
Group allowance for credit losses. The outstanding balance of the group allowance for credit losses in respect of customers examined on a group basis excluding housing loans for which the allowance for credit loss was calculated according to the extent of arrears, amounted at December 31, 2012 to NIS 493 million, compared to NIS 560 million as of December 31, 2011, comprising a decline in the current allowance in the amount of NIS 67 million, a rate of 12%. This decline stems mainly from the change in the credit balances in respect of which the allowance had been calculated.

The balance of the group allowance for credit losses in respect of customers examined on a specific basis, and which are not impaired, amounted at December 31, 2012 to NIS 816 million, compared with NIS 750 million as of December 31, 2011, an increase of NIS 66 million in the current allowance, a rate of 8.8%.

Following are data to several credit risk indices used to evaluate the quality of the Bank's credit portfolio, derived from data relating to problematic debts:

	2012	2011
Ratio of balance of impaired credit to the public to balance of credit to the public	4.5%	4.7%
Ratio of balance of non-impaired credit to the public balance in arrears for 90 days or more to balance of credit to the public	0.6%	0.5%
Ratio of balance of allowance for credit losses in respect of credit to the public, to balance of credit to the public	1.7%	1.7%
Ratio of balance of allowance for credit losses in respect of credit to the public to balance of impaired credit to the public	38.3%	35.2%
Ratio of criticized exposure in respect of the public to the total credit risk in respect of the public[(1)]	4.9%	4.8%
Ratio of credit loss expenses to the average balance of credit to the public	0.61%	0.65%
Ratio of net accounting write-offs in respect of credit to the public to the average balance of credit to the public	0.5%	0.7%
Ratio of net accounting write-offs in respect of credit to the public to the balance of allowance for credit losses in respect of credit to the public	29.3%	43.0%
Footnote:		
Disregarding certain debentures of bank holding companies (TRUPS), which are held by a subsidiary	4.8%	4.5%

Total Credit Risk in Respect of the Public Classified by Economic Sector Consolidated- Borrowers in Israel



Credit Loss Expenses

THE RISK CHARACTERIZATION OF THE CREDIT TO THE PUBLIC PORTFOLIO

Following are the rates of the credit loss expenses in certain sectors, in relation to the balance of debts, regarding credit to the public in these sectors:

Sectors	2012	2011
Construction and real estate - construction	0.2%	2.2%
Construction and real estate - real estate activity	0.1%	1.0%
Hotels, hotel services and food	0.4%	*(0.1%)
Commerce	0.8%	0.2%
Industry	1.6%	0.7%
Communications and computer services	*(0.1%)	0.4%
Financial services	2.5%	0.7%
Other business services	0.3%	1.6%
Total overall credit to the public risk	**0.6%**	**0.7%**

*Decrease in allowance

The data presented above shows that the ratio of the expenses in relation to credit to the public in the financial services sector, the industrial sector and the commerce sector was higher than the expense ratio for 2012 in relation to the credit portfolio as a whole. In comparison with 2011, the construction and real estate and the other business services sectors reflected a decline in the ratios of credit loss expenses in relation to credit to the public. On the other hand, the commercial, industrial and financial services sectors recorded a rise in expense ratios in respect of credit losses in relation to credit to the public.

Following are the proportionate share of certain economic sectors in the total credit loss expenses:

	Year ended December 31			
	2012		2011	
sectors	Credit loss expenses	Rate from total expenses	Credit loss expenses	Rate from total expenses
	In NIS millions	%	In NIS millions	%
Industry	240	33.1%	102	13.1%
Construction and real estate - construction	13	1.8%	157	20.2%
Construction and real estate - real estate activity	20	2.8%	140	18.0%
Commerce	123	16.9%	25	3.2%
Financial services	256	35.3%	68	8.7%
Other business services	20	2.8%	117	15.0%

The data presented above shows that in comparison with 2011, the weight of the industrial, public and community services and housing loans sectors in the total credit to the public portfolio decreased. In the construction and real estate sector, the weight of construction operations increased while real estate operations decreased.

Following are the developments of credit exposure, by major economic sectors:

Economic Sectors	December 31, 2012 Total credit risk	December 31, 2012 Rate from total credit risk	December 31, 2011 Total credit risk	December 31, 2011 Rate from total credit risk	Rate of change
	in NIS millions	%	in NIS millions	%	%
Agriculture	1,485	0.8%	1,401	0.7%	6.0%
Industry	23,753	12.5%	25,061	13.0%	(5.2%)
Construction and real estate - construction	15,854	8.3%	15,681	8.2%	1.1%
Construction and real estate - real estate activity	17,156	9.0%	17,965	9.3%	(4.5%)
Electricity and water	3,450	1.8%	2,424	1.3%	42.3%
Commerce	19,691	10.3%	19,240	10.0%	2.3%
Hotels, hotel services and food	2,926	1.5%	2,985	1.6%	(2.0%)
Transportation and storage	4,952	2.6%	4,125	2.1%	20.1%
Communications and computer services	2,617	1.4%	2,751	1.4%	(4.9%)
Financial services	16,512	8.6%	15,057	7.8%	9.7%
Other business services	9,563	5.0%	10,193	5.3%	(6.2%)
Public and community services	15,075	7.9%	17,546	9.1%	(14.1%)
Private individuals - housing loans	20,725	10.8%	21,188	11.0%	(2.2%)
Private individuals - other loans	37,313	19.5%	36,853	19.2%	1.2%
Total overall credit to the public risk	**191,072**	**100.0%**	**192,470**	**100.0%**	**(0.7%)**
Banks	13,286		8,929		
Governments	30,346		25,584		
Total	**234,704**		**226,983**		

The data presented above shows that the weight of the financial services, industrial and commercial sectors in the total credit loss expenses increased in comparison to 2011. On the other hand, the weight of the construction and real estate and of the other business services sectors in the total expense decreased in comparison with 2011.

For additional details, including the reclassification of the comparative figures for 2011, see Note 4 C to the financial statements.

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

	2012 In NIS Millions	2012 % of total credit to public	2011(1) In NIS Millions	2011(1) % of total credit to public	Rate of change in-%
Retail - household segment	38,199	32.5	37,129	31.9	2.9
Retail- small business segment	12,032	10.2	11,866	10.2	1.4
Corporate market segment	45,467	38.7	41,441	35.6	9.7
Middle market segment	18,291	15.6	22,431	19.3	(18.5)
Private banking segment	3,622	3.0	3,516	3.0	3.0
Total	**117,611**	**100**	**116,383**	**100**	**1.1**

Note:
(1) Reclassified, see "General" at the beginning of "Activity of the Group according to principal segments of operations".

Developments in credit to the public, including off-balance sheet credit risk by borrower size. Approx. 99.5% of borrowers were granted credit of no more than NIS 1.2 million. Credit to this group constituted 32.4% of total credit to the public as at December 31, 2012, compared with 31.4% as at December 31, 2011. The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 48.9% of all credit as at December 31, 2012, compared with 47.3% as at December 31, 2011.

The 65 largest borrowers, in the credit brackets between NIS 200 million and NIS 5,544 million, were granted credit constituting 18.7% of total credit to the public as at December 31, 2012, compared with 71 borrowers that were granted credit constituting 21.3% of the total credit as at December 31, 2011.

For details regarding credit levels in excess of NIS 800 million, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part C, item 3).

SECURITIES

General. Securities in the nostro portfolio amounted to NIS 46,001 million as at December 31, 2012, compared with NIS 42,898 million at the end of 2011, an increase of 7.2%. It is clarified that the "nostro" portfolio to the Discount Group as of December 31, 2012, did not include any security the investment in which comprised 5% or more of the value of the total portfolio, except for one class of security, of the "government variable 520" type, which amounted to 7.2% of the total portfolio.

As of December 31, 2012, some 60% of the portfolio is invested in Government bonds, and 15% of the portfolio is invested in bonds of U.S. Government Supported Enterprises (GSE).

For details regarding the breakup of the investment in government bonds according to principal governments, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "C", Item 5).

Nostro portfolios management policy. The Bank's "nostro" investment portfolios 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.

Within the framework of the strategic plan, an allocation of risk assets has been approved for a controlled variety of investments within the "Nostro" investment portfolio. A new unit was established at the Bank in 2012, which is responsible for expanding the variety of tools used for obtaining a return on capital, by means of structuring an investment portfolio within which credit and interest risks will be managed. The unit has been allocated an investment facility and a budget of risk assets, as well as a defined income target. The unit started to operate in the second quarter of 2012. An amount of NIS 1.7 billion had been invested in the period until December 31, 2012.

The investment activities of the subsidiary companies, mainly in IDB New York and Mercantile Discount Bank are being performed independently, subject to risk limitations specified by the Bank.

COMPOSITION OF THE SECURITIES PORTFOLIO BY LINKAGE SEGMENTS

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

	As at December 31		
	2012	2011	Rate of change in %
	In NIS millions		
Non-linked shekels	22,122	17,580	25.8
CPI-linked shekels	5,211	5,690	(8.4)
Foreign currency and foreign currency-linked shekels	17,962	18,965	(5.3)
Shares - non-monetary items	706	663	6.5
Total	**46,001**	**42,898**	**7.2**

Securities in foreign currency and in Israeli currency linked foreign currency decreased by 5.3% compared with December 31, 2011. In U.S. Dollar terms, the securities in Israeli currency and in foreign currency linked Israeli currency decreased by US$152 million, a decrease of 3.1% as compared with December 31, 2011. Total securities, including securities in foreign currency and in Israeli currency linked to foreign currency expressed in U.S. Dollar terms, increased by 8.2% as compared with December 31, 2011.

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 to the above categories:

	December 31,2012			December 31,2011		
	Net adjusted cost	Fair value	Book value	Net adjusted (in shares-cost)	Fair value	Book value
	in NIS millions					
Bonds						
Held to maturity	6,988	7,436	6,988	5,895	6,115	5,895
Available for sale	34,800	35,356	35,356	33,006	32,976	32,976
Trading	2,963	2,951	2,951	3,378	3,364	3,364
Shares						
Available for sale	703	704	704	653	658	658
Trading	5	2	2	8	5	5
Total Securities	**45,459**	**46,449**	**46,001**	**42,940**	**43,118**	**42,898**

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 404 million as of December 31, 2012, is included in equity under "adjustments to fair value of available-for-sale securities" as a positive capital reserve (December 31, 2011: NIS 21 million as a positive capital reserve). In addition, included in equity is the difference, as stated, relating to the Bank's share in equity of FIBI amounting to NIS 11 million as a positive capital reserve (December 31, 2011: NIS 19 million as a negative capital reserve).

Corporate bonds. Discount Group's available for sale securities portfolio as of December 31, 2012, includes investments in corporate bonds in the amount of NIS 4,075 million (an amount of NIS 1,939 million is held by IDB New York and an amount of NIS 1,048 million, directly by the Bank), compared with NIS 3,306 million as of December 31, 2011 (an amount of NIS 1,716 million is held at IDB New York and an amount of NIS 438 million is held directly by the Bank). For details as to the balance of unrealized losses included in the balance of the said bonds, see Note 3 to the financial statements.

Data by market segments. For details of the data relating to available-for-sale bonds, bonds held to maturity and trading bonds according to economic sectors, see Annex "A" to the Report of the board of Directors, forming an integral part thereof, Sections 1, 2 and 3, respectively.

INVESTMENTS IN MORTGAGE AND ASSET BACKED SECURITIES

General. Discount Group's securities portfolio as of December 31, 2012 includes investment in mortgage backed securities in the amount of US$3,034 million, which are held by IDB New York, compared to an amount of US$3,382 million as at December 31, 2011, a decrease of 10.3%. About 93% of the mortgage backed securities portfolio is comprised of debentures of various federal agencies (Ginnie Mae, Fannie Mae, Freddie Mac) with an AA+ rating in the U.S. (the lowering of the rating of the said bonds from "AAA", stems from the lowering of the credit rating of the United States). The investment in the said bonds does not include exposure to the subprime market.

As of December 31, 2012, the portfolio of mortgage backed securities (MBS) included unrealized net gains of US$28 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.

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.

These measures 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, 2012 their market value increased by US$24 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, 2012, 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$76 million, compared to US$171 million on December 31, 2011.

CMBS. For details regarding exposure to commercial mortgage backed securities (CMBS) in immaterial amounts, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "A", item 4).

CLO. During 2012, IDB New York purchased secured bonds of the CLO type, in the total amount of NIS 696 million. The said securities are rated AA-AAA by at least one rating agency. For details, see Note 3 to the financial statements.

DETAILS REGARDING IMPAIRMENT IN VALUE OF AVAILABLE FOR SALE SECURITIES

General. 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.

At December 31, 2012, and December 31, 2011, there were no unrealized accumulated losses in respect of available-for sale shares. As of December 31, 2012 and December 31, 2011, unrealized accumulated losses on available-for-sale mortgage backed securities amounted to NIS 64 million and NIS 28 million, respectively. (See Annex to the Report of the Board of Directors, comprising an integral part thereof, Part "A", items 5 and 6, respectively).

Unrealized losses – bonds available for sale. **Following are details regarding the distribution of unrealized 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 occurred:**

	Period of decline in fair value below amortized cost				
Ratio of unrealized loss to amortized cost	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	Total
	In NIS millions				
	December 31, 2012				
Up to 20%	5	-	-	107	112
From 20% to 40%	-	-	-	79	79
Total	**5**	**-**	**-**	**186**	**191**
Of which: Government bonds	-	-	-	8	8
	December 31, 2011				
Up to 20%	54	20	9	87	170
From 20% to 40%	-	5	-	217	222
Over 40%	-	-	-	23	23
Total	**54**	**25**	**9**	**327**	**415**
Of which: Government bonds	25	1	-	45	71

For details regarding certain available-for-sale bonds held by IDB New York, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "A", item 7).

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 details regarding the considerations involved in the decision as to the type of losses accumulated in respect of securities as stated see below in the item "Critical accounting policy" and Note 1 D 5 to the financial statements. 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.

In 2012, a provision for impairment of a non-temporary nature with regard to a number of securities amounting to NIS 28 million (in 2011: NIS 42 million).

For further details see Note 3 to the financial statements.

DEPOSITS FROM THE PUBLIC

Deposits from the public as at December 31, 2012, amounted to NIS 151,935 million, compared with NIS 153,368 million at the end of the preceding year, an increase of 0.9%.

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

	December 31, 2012		December 31, 2011		
	In NIS millions	% of deposits from the public	In NIS millions	% of deposits from the public	Rate of change in %
Non-linked shekels	83,620	55.0	84,116	54.9	(0.6)
CPI-linked shekels	10,363	6.8	10,913	7.1	(5.0)
Foreign currency and foreign currency-linked shekels	57,952	38.1	58,339	38.0	(0.7)
Total	**151,935**	**100.0**	**153,368**	**100.0**	**(0.9)**

Deposits from the public in foreign currency and in Israeli currency linked to foreign currency decreased at the rate of 0.7%, compared with December 31, 2011. In dollar terms the deposits from the public in foreign currency and in Israeli currency linked to foreign currency increased by US$256 million, an increase of 1.7% compared with December 31, 2011. Total deposits from the public, including deposits in foreign currency and in Israeli currency linked to foreign currency, expressed in U.S. Dollar terms, remained unchanged as compared with December 31, 2011.

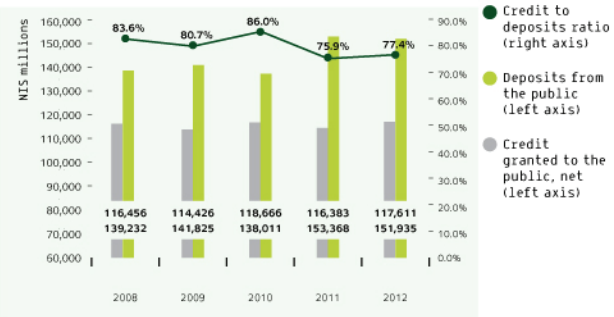
The following is a review of developments in the balance of deposits from the public, by segments of operations:

	2012		2011[1]		
	In NIS Millions	% of total Deposits from the public	In NIS Millions	% of total Deposits from the public	Rate of change in-%
Retail - household segment	67,089	44.2	65,865	42.9	1.9
Retail - small business segment	15,807	10.4	13,909	9.1	13.6
Corporate marker segment	21,531	14.2	27,843	18.2	(22.7)
Middle market segment	7,234	4.8	6,773	4.4	6.8
Private banking segment	40,274	26.4	38,978	25.4	3.3
Total	**151,935**	**100.0**	**153,368**	**100.0**	**(0.9)**

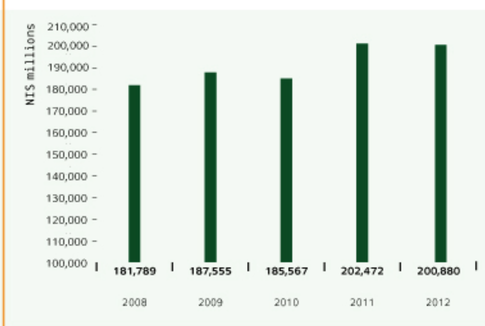
Note:
(1) Reclassified, see "General" at the beginning of "Activity of the Group according to principal segments of operations".

The ratio of total credit to the public, net, to deposits from the public was 77.4% at the end of 2012, compared with 75.9% at the end of the previous year.

Development of Credit to the Public and Deposits from the Public- Consolidated



development of Total Assets- Consolidated



CAPITAL RESOURCES

PREPARATIONS FOR THE ADOPTION OF BASEL III IN ISRAEL

Policy regarding capital for the interim period. The meeting of the Board of Directors held in March 2011, determined, among other things, a core capital target that shall not fall below 7.5%, as well as a total capital adequacy ratio of not less than 13%, until December 31, 2011. This, according to guidelines of the Supervisor of Banks regarding the capital policy for interim period. The resolution of the Board of Directors regarding the "Strategic plan for the Discount Group for the years 2011-2013", has determined targets for the core capital at the rate of 8% by the end of 2012 and 8.5% by the end of 2013. The Bank attained the determined goals, as stated.

Guideline regarding the core capital ratio. On March 28, 2012, the Supervisor of Banks issued a circular, according to which, banking corporations and credit card companies will be required as from January 1, 2015, to maintain a minimum core capital ratio of 9%.

Draft of new instructions. On December 30 2012, the Supervisor of Banks issued a draft amendment of Proper Banking Management Directives Nos. 201-205, 208 and 211, which includes amendments to the existing measurement rules in the matter of capital adequacy ("Basel II" guidelines), and new guidelines intended to integrate the principles included in the Basel Committee document published in December 2010 ("Basel III guidelines").

To date, a binding version of these instructions has not yet been published, and no date for their initial adoption has yet been fixed.

Future issues of capital instruments. As detailed in the description of the draft amendment of Proper Banking Management Directive in the matter of "Basel III" (see "Regulatory framework for risk management" under "Exposure to risks and risk management"), the capital instruments will include "loss-absorbing" mechanisms.

The Bank estimates that it would not be possible to issue such capital instruments to the public, at least in the immediate time range, in view of the required agreement between the supervisory bodies regarding the characteristics of the securities that may be offered to the public, and which, to the best of the Bank's knowledge, has not yet been formed at this stage.

The effect of adoption of the Directive on the core capital. As aforesaid, on December 30, 2012, the Supervisor of Banks published a draft Proper Banking Management Directive No. 202 in the matter of Capital Measurement and Adequacy (hereinafter: "the Draft"). The Draft, among other things, states more stringent requirements with respect to the components qualified for inclusion in equity, minimum capital targets, regulatory adjustments, deductions from capital and transitional instructions for implementation.

Immediate effect. The Bank estimates that had the guidelines of the Draft been implemented as of December 31, 2012, on the basis of the data for that date and the transitional instructions that would apply at the date of the initial implementation of the guidelines, the ratio of the core capital would have been reduced by 0.2% from 8.6% to 8.4%.

Short-term effect. The transitional instructions stated in the Draft, determine a gradual adoption of the more stringent requirements included therein. The Bank estimates that had the guidelines of the Draft been implemented as of December 31, 2012, on the basis of the data for that date and the transitional instructions as would apply two years after the date of the initial implementation of the guidelines, the ratio of the core capital, without the consideration of income accumulated during the period, would have been reduced by 0.4% from 8.6% to 8.2%.

Long-term effect. The Bank estimates that had the guidelines included in the draft been implemented in full as of December 31, 2012, on the basis of the data for this date, and without taking into account the provisional instructions (a situation equal to the situation that will prevail at the end of nine years since the date of initial implementation of the directive, though without taking into consideration earnings that will accumulate during the period), the core capital ratio would have declined by 1.2%, from 8.6% to 7.4%.

It should be emphasized that the data presented above forms a preliminary estimate only. As stated, the final version of the directive has not yet been published, and theoretically, it is possible that the final version will include changes in comparison with the draft. Furthermore, in view of its complexity, the draft requires various interpretations. The Bank is in the study stage of the draft and is examining its implications; accordingly, it is possible that at a later date, when experience in the implementation of the directive is gained, changes will take place in interpretation of the directive or in the policy adopted for its implementation in practice. Moreover, the said estimates assume a situation of static existence of the data as of December 31, 2012, throughout the period of implementation, while in practice changes will occur during the period of implementation in the capital adequacy of the Bank, both as a result of the accumulation of current earnings and of preparation measures adopted by Management of the Bank, if at all. In view of the above, the actual result will inevitably be different than from the estimates stated above.

Preparations made by the Bank. The Bank operates for the preparation of a detailed plan for attaining the capital targets, being at least the level of capital prescribed by the policy of the Supervisor of Banks and according to the time schedules published by him. In this respect, the Bank studies various possibilities of enlarging the capital base, which do not include an additional issue of shares by the Bank. Among other things, the Bank studies various alternatives for the sale of holdings or a part thereof. At this stage, it is not possible to determine which of the alternatives will be chosen, if at all, and the possibility exists that the Bank would not be required at all to choose any of the alternatives, as stated. However, whereas on the reporting date, there is no certainty that the assumptions of a continuous holding of the Bank's investments will in fact exist in full, the Bank recorded a provision for taxes in the amount of NIS 14 million, in respect of a part of its investments. It is emphasized that the recording of the said provision should not be construed as an indication of an expected materialization of any of the alternatives.

For further details, see "Basel III" under "Exposure to risks and risk management".

CAPITAL MANAGEMENT

The capital management process is composed of the following stages:

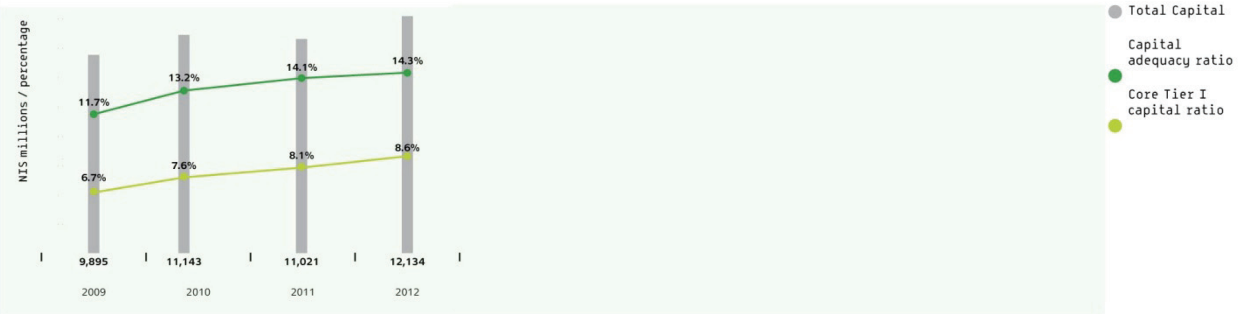
- **Determination of the capital goals in the work plan.** The capital goals in the work plan are determined by the Bank's Board of Directors, taking into consideration the competitive environment in which the Bank operates, the capital adequacy review performed by the Chief Risk Manager, an evaluation of the implications on the computed capital ratios of the implementation of the Basel III instructions and regulatory requirements.
- **Formation of the risk appetite and determining a capital cushion.** The risk appetite is reflected in determining the size of the capital cushion held by the Bank, in order to assure the attainment of the capital goals under changing market and profitability conditions. The Bank determined a capital cushion based on a varied analysis of profitability tests, volatility of the capital reserve and the exchange rate.
- **Deriving the maximum growth in the volume of risk assets.** Following the determination of the capital goals and the required capital cushion, and in view of the risk appetite and the assumptions made in the preliminary work plan, the overall growth limitation of risk assets was computed.
- **Risk assets budget.** The Bank has determined a restraining risk asset budget for the years 2013 and 2014, with a view of attaining the capital targets determined by the Supervisor of Banks.
- **Allocation of risk assets among the business units and the subsidiary companies.** The process of allocating risk assets among the business units and the subsidiaries in the Group is an outcome of the determination of the capital goal and formation of the strategic planning. At the end of 2012, a mix was determined regarding the application of risk assets, at the Bank and at its subsidiaries, which would maximize the return on capital of the Group. Within the framework of this process, a mapping had been performed of the capital needs of each company in the Group, and decisions had been taken regarding the allocation of risk asset facilities on the basis of business considerations of maximization of profits and additional strategic considerations.
- **Capital management and monitoring.** In order to assure attainment of the determined capital adequacy goal, the Bank performs ongoing monitoring operations as part of the capital management process. Monitoring includes monthly reporting

to the Board of Directors, within the framework of which the principal changes in the capital components and in risk assets are being analyzed.

Capital management at the subsidiary companies. The capital goals determined in the process of the Group capital management serve as guiding principles and have been adopted by the subsidiary companies. These goals serve as a basis for planning the individual capital of each company, with required adjustments. The capital planning by the subsidiary companies is performed using similar methodology to that used in the planning of the group capital.

Capital maneuverability. During 2012, the Bank withdrew excess capital from the subsidiary companies by way of dividend distribution. Mercantile Discount Bank distributed NIS 150 million, ICC distributed NIS 291 million (the Bank's share approx. NIS 209 million) and IDB New York distributed US$100 million to its direct parent company, Bancorp. The aim of the transfer of capital to the parent company was to avoid the creation of excess capital and to maintain in each of the subsidiaries of the Group a level of capital that matches the risk level managed by it.

Capital Adequacy



COMPONENTS OF CAPITAL

Total capital as at December 31, 2012, amounted to NIS 12,134 million, compared with NIS 11,021 million at December 31, 2011, an increase of 10.1%.

Equity attributed to the Bank's shareholders as at December 31, 2012, amounted to NIS 11,838 million, compared with NIS 10,702 million at December 31, 2011, an increase of 10.6%.

The change in equity attributed to the Bank's shareholders in 2012 was affected, among other things, by earnings in 2012, by an increase of NIS 413 million in the "net adjustments for the presentation of available for sale securities at fair value, net of tax" item and from a decrease of NIS 77 million in financial statements transactions adjustments.

The ratio of total capital, to total assets as at December 31, 2012, stood at 6.0%, compared with 5.4% as of December 31, 2011.

Ratio of tier I capital to risk assets as of December 31, 2012, reached a rate of 9.3%, compared with 8.8% at the end of 2011.

The core capital ratio as of December 31, 2012, reached a ratio of 8.6%. It should be noted that in view of the agreement signed between FIBI and the Bank and in view of the approvals granted in respect thereof (see Note 6 E to the financial statements), in which a layout has been determined for the sale of the Bank's holdings in FIBI, the Supervisor of Banks has permitted the Bank to exclude from the core capital the deduction in respect of the Bank's investment in FIBI.

Ratio of original tier I capital to risk assets ("original tier I capital to risk assets ratio" in Basel I terms), reached a rate of 8.6% as of December 31, 2012, compared with 8.1% at the end of 2011. It should be noted that the Bank's Board of Directors resolved with respect to the issuance of subordinated capital notes, to adopt a capital adequacy policy according to which the Bank will maintain, at all times, an original tier I adequacy ratio of at least 6.5%.

The ratio of total capital to risk assets, as at December 31, 2012, reached a rate of 14.3%, compared to a rate of 14.1% on December 31, 2011.

Additional issues of hybrid capital instruments. 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 6 A to the financial statements. For details regarding the clarification of the Supervisor of Banks, according to which banking corporations must take into consideration the high probability that new issues of such instruments will not be recognized in the future for capital adequacy purposes, see Note 14 6 b to the financial statements. In view of the above, the Bank has not issued hybrid capital instruments since the beginning of 2010.

Raising of Lower Tier II Capital. For details regarding raising Lower Tier II capital in 2012, see "Liquidity and the Raising of Resources at the Bank" below.

Possible future effect of the agreement with FIBI Holdings. In accordance with the agreement between the Bank and FIBI Holdings (see Note 6 E (1)), the right of the Bank requiring FIBI Holdings to continue to cause the appointment of one quarter of the Directors of the First International bank from among candidates recommended by Discount Bank, will expire on March 13, 2014. Upon expiry of the said right, the Bank will lose the material influence it has over the First International Bank (within the meaning of this term according to generally accepted accounting principles), and as from that date onwards, in accordance with reporting directives of the Supervisor of Banks, the shares in that bank will be presented as available-for-sale, according to their fair value. The difference between the fair value of the shares and their stated value on date of change in presentation as above, to the extent that such a difference will exist on that day, shall be deducted from equity. Had the said change taken effect on December 31, 2012, the difference would have reduced the Bank's core capital ratio by 0.13%.

CAPITAL STRUCTURE

CAPITAL ADEQUACY DATA

	December 31	
	2012	2011
	in NIS millions	
1. Capital for Calculating ratio of capital		
Tier 1 capital less deductions	12,562	(2)(3)11,887
Tier 2 capital less deductions	6,862	7,173
Total capital for calculating capital ratio	**19,424**	**19,060**
2. Weighted risk assets balance		
Credit risk	120,686	120,256
Market risk	2,238	1,875
Operational risk(4)	12,788	13,418
Total weighted risk assets balance	**135,712**	**135,549**
3. Ratio of capital to risk assets(1)		
Ratio of original tier 1 capital to risk assets	8.6	8.1
Ratio of tier 1 capital to risk assets	9.3	8.8
Ratio of total capital to risk assets	14.3	14.1
Ratio of total minimum capital required by the Supervisor of Banks	**9.0**	**9.0**

Footnotes:

(1) For details regarding the capital ratio of significant banking subsidiaries and additional details, see Note 14 the condensed financial statements.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(3) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(4) For details regarding the change in the method of computation of risk assets in respect of the operational risk and its effect, see Note 14 subsection 2 to the financial statements.

CAPITAL STRUCTURE

	December 31	
	2012	2011
	in NIS millions	
A. Capital components		
Tier 1 capital		
Paid up regular share capital	4,099	4,093
Retained earnings	7,203	(2)(3)(4)6,401
Other capital reserves	131	214
Non-controlling rights	296	(3)319
Adjustments regarding put options granted to the non-controlling interest's holders of a subsidiary	81	(3)75
Total core capital	**11,810**	**11,102**
Innovative hybrid capital instruments	1,747	1,723
Amounts deducted from tier 1 capital:		
Goodwill	(142)	(142)
Other intangible assets	-	(10)
Net losses on fair value adjustments of available for sale securities	(10)	(3)(4)(8)
Tier 1 capital less deductions from this tier's capital only	13,405	12,665
50% deductions from tier 1 capital (see B below)	(843)	(2)(3)(778)
Total tier 1 capital	**12,562**	**11,887**
Tier 2 capital		
45% of net gains before tax effect relating to adjustment to fair value of available for sale securities	297	-
General provision for doubtful debts	254	254
Preferred shares	2	2
Innovative hybrid capital instruments	1,383	1,362
Subordinated capital notes	5,769	(2)(3)6,333
50% deductions from tier 2 capital (see B below)	(843)	(2)(3)(778)
Total tier 2 capital	**6,862**	**7,173**
Total qualified capital	**19,424**	**19,060**
B.50% deductions from tier 1 capital and from tier 2 capital		
Investments in non-financial companies with significant influence[1]	1,687	(2)(3)1,556
Total deductions	**1,687**	**1,556**

Footnotes:

(1) Including amount in respect of the First International Bank of Israel Ltd of NIS 1,624 millions (December 31,2011: NIS 1,538 millions)

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statement.

(3) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

RISK ASSETS

	December 31			
	2012		2011	
	Risk assets	(1)Capital requirements	Risk assets	(1)Capital requirements
	in NIS millions			
Risk assets and capital requirements in respect of credit risk caused by exposures of:				
Sovereigns	697	63	858	77
Public sector entities	1,078	97	1,189	107
Banking corporations	3,697	333	3,546	319
Corporations	78,656	7,079	79,985	7,199
Secured by commercial real estate	2,370	213	1,991	179
Single retailer exposures	13,550	1,220	11,815	1,064
Small business loans	7,311	658	6,301	567
Housing mortgage	7,530	678	8,479	763
Securitization	155	14	15	1
Other assets	5,642	508	6,077	547
Total risk assets and capital requirements in respect of credit risk	**120,686**	**10,862**	**120,256**	**10,823**
Risk assets and capital requirements in respect of market risk according to the standard approach	**2,238**	**201**	**1,875**	**169**
Risk assets and capital requirements in respect of operational risk according to the standard approach(2)	**12,788**	**1,151**	**13,418**	**1,208**
Total risk assets and capital requirements	**135,712**	**12,214**	**135,549**	**12,200**

Footnote:

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

(2) For details regarding the change in the method of computation of risk assets in respect of the operational risk and its effect, see Note 14 subsection 2 to the financial statements.

LIQUIDITY AND THE RAISING OF RESOURCES IN THE BANK

GENERAL

A 8.7% increase was recorded during 2012 in the M1 money supply (cash held by the public and NIS current account bank deposits), with an 8.2% increase in the M2 money supply (M1 together with non-linked deposits of up to one year). The increase in the money supply in 2012 occurred concurrently with the process for the reduction in the market interest rate. It should be noted that in 2011 the M1 and M2 money supply rose by 2% and 4%, respectively.

- The increase in the M1 money supply reflected an increase of 14% in cash held by the public (most of which during the months of January to September 2012) and an increase of 6% in current account deposits (all the increase was recorded in the second and third quarters of 2012). An increase of 11% was recorded in 2011 in cash held by the public, which was partly setoff by a decrease of 3% in current account deposits;
- The rise in the M2 money supply reflected mostly an increase of 8% in deposits of up to one year (most of which in the period from January to September). This occurred on the background of the increase in uncertainty, which led to preferring bank deposits over riskier investment channels. It should be noted that in 2012, a steeper increase (16%) in deposits of up to one year was recorded on the background of the increase in interest rates and the dropping prices on the capital markets.

On the other hand, a moderate growth of NIS 0.7 billion was recorded in 2012 in the monetary base (compared with NIS 6.1 billion in 2011). In fact, the growth in the monetary base was recorded only in the second quarter of the year, reflecting liquidity supplied by the Bank of Israel, which was partly offset by Government absorption.

	2012	2011	Change
	in NIS billions		in %
Operations on the Capital Market	8.15	16.65	(51.0)
The Shekel deposits tender	(1.00)	(27.60)	
Government activity	(9.10)	(2.14)	

THE BANK

Liquidity risk management policy at the Discount Group. See "Management of the Liquidity Risk" hereunder.

The Bank's liquidity risk management policy defines the Bank's risk appetite in terms of survival range in various liquidity scenarios, the concentration of resources – the ratio of the fifteen largest depositors shall not exceed 15% of total resources, and a limitation of 35% on the variable resources (deposits by corporations and banks) out of total resources.

Transferability of liquidity within the Group. The transfer of liquidity between the Group companies and the Bank is based on the money price mechanism established at the Bank. As stated, the subsidiary companies may not rely upon the transfer of liquidity where no liquidity framework had been defined which is taken into account in the liquidity model at the counterparty. During the course of 2012, U.S. dollar term liquidity in immaterial amounts was transferred to the Bank by IDB (Swiss) Bank and from IDB New York.

For additional details, see "Management and measurement of the liquidity risk" under "Exposure to risks and risk management".

During the entire year, the Bank maintained liquid assets in a volume higher than its liquid liabilities.

Deposits from the public:

			Change compared to	
	December 31, 2012	December 31, 2011	December 31, 2011	
	In NIS millions		In NIS millions	in %
Non-linked shekels	70,199	71,949	(1,750)	(2.4)
CPI-linked shekels	12,074	12,810	(736)	(5.7)
Foreign currency and foreign currency linked shekels	29,537	31,306	(1,769)	(5.7)
Total	**111,810**	**116,065**	**(4,255)**	**(3.7)**
Foreign currency and foreign currency- In US$ millions	**7,912**	**8,193**	**(281)**	**(3.4)**

Deposits from Banks:

			Change compared to	
	December 31, 2012	December 31, 2011	December 31, 2011	
	In NIS millions		In NIS millions	in %
Non-linked shekels	1,038	1,430	(392)	(27.4)
CPI-linked shekels	275	479	(204)	(42.6)
Foreign currency and foreign currency linked shekels	1,805	2,482	(677)	(27.3)
Total	**3,118**	**4,391**	**(1,273)**	**(29.0)**

RAISING OF RESOURCES

Issuances of lower tier II capital in 2012. During 2012 the Bank and its subsidiaries raised funds in a total amount of NIS 448 million.

Deduction of Capital Notes in 2013. An amount of NIS 1,101 million of capital notes issued in the past will be deducted in the course of 2013 from the Tier II capital of the Group, used in calculating the ratio of capital to risk assets. It should be noted that the said data had been computed on the basis of instructions in effect at the present time (Basel II).

ACTIVITY OF THE GROUP ACCORDING TO PRINCIPAL SEGMENTS OF OPERATION

GENERAL

A summary description of segments of operation, including the criteria for assigning customers to segments of operation, in general was included above in the Section "Discount Group Segment of operations - condensed description" under "The Discount Group - general overview and structure of the Group".

Details regarding the distribution of human resources in the Group according to segments of operation are included under "Human resources" below. For details regarding the assumptions, assessments and reporting principles used in the preparations of the data, see Note 31 to the financial statements. For details regarding the main differences between the managerial reporting and the public reporting format, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part C, item 4).

Reclassification of comparative data for segments of operations. The comparative data for prior periods have been reclassified following the reclassification made by Mercantile Discount Bank, intended to reflect updated definition of segments of operations resulting from a change in the organizational structure at Mercantile Discount Bank, and in order to reflect the results of a comprehensive expenditure survey, conducted for the purpose of updating the distribution of expense data by segments of operation of the Mercantile Discount Bank.

ADMINISTRATIVE STRUCTURE

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

The Bank's business operations in 2012 were conducted by four divisions: Banking Division, Corporate Division, Finance Division and the Customer Assets Division.

The Banking Division conducts business with households, VIP customers, small companies and businesses, medium corporations (middle market) and customers of direct banking. The Division is responsible for the operation of the investment consultants and the pension consultants operating in branches and investment centers.

The Corporate Division is responsible for operations with the large corporations through business managers, the Tel Aviv main branch and its extensions, 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: construction (real estate project financing) and infrastructure companies and large capital market operators.

The Finance Division coordinates the management of market and liquidity risks, management of Nostro as well as the operations of the dealing rooms at the Bank and at the Group. The activity of the Division is divided between several units: assets and liabilities management, dealing room, investment unit, the central control layout, back office, Chief Economist and Investors Relations. In addition, the Division is responsible for the subsidiaries BLD, Ltd. and Discount Manpikim Ltd..

The Customer Asset Division is responsible for the Bank service to private banking customers, both Israelis and foreign residents. The Division is also responsible for the advisory services at the Bank – pension and securities advisory services – and for the initiating, developing and managing of the financial products offered to all customer segments. In addition, the Division is responsible for investment portfolio management (through "Tachlit Discount Portfolio Management"), for trusteeship services (through "Discount Trust") and for the subsidiary IDB (Swiss) Bank.

RETAIL SEGMENT - GENERAL

The Bank presents two retail segments: the "household segment" and the "small business segment". This general section includes several subjects that relate jointly to the two said segments.

DISCOUNT, THE BANK FOR THE FAMILY

In February 2013, the Bank launched a program, first of its kind in Israel, which is designed for existing and new customers who are related to one another. A "family program" turns the existing family cell into a financial group, enjoying the variety of services and exclusive benefits.

The program will be enjoyed by the Bank's customers who will join as a group to the "family program" at Discount Bank. Joining the program is simple and easy and is possible by registering at the branch, at the TeleBank center and through the Bank's Internet site.

Despite the marking of the family relations in the Bank's systems, banking confidentiality is strictly maintained and none of the family group joining the program would be involved in or become a party to the accounts of the other family members.

The connection to the family group grants the family members participating in the program, benefits of a personal value in accordance with the status of the accounts and in accordance with the type of benefits elected by the participants, including:

- **Exemption from commission on money transfers** in Israeli currency between accounts of the family members participating in the program.
- **"Family plus"** – offsetting interest on overdrawn accounts against the accounts of the other family members. An exclusive benefit for new customers and for existing customers adding another family member as a new customer. "Family plus" allows the customer to enjoy the setting off of interest charged on their overdraft so long as one or more family members participating in this benefit has at that time a credit balance on their current account. The interest amount being offset relates to a maximum debit balance of NIS 5,000 in each account participating in the program. It is emphasized, that the family member having a credit balance on their account, who assists another family member with a debit balance on their account, does so without forfeiting the interest due to them on their credit balance.
- **Participation award of up to NIS 2,000** – a monetary award of between NIS 750 and up to NIS 2,000, deposited in cash into the accounts of new participants. Customers who deposit a monthly salary of NIS 10 thousand and over, or who have deposit accounts of NIS 100 thousand and over, who are not entitled to other improved terms, shall receive an award of NIS 2,000.
- "**2go key" card** – a rechargeable card, which family members may order for a customer who is not the account owner, including also children from the age of 14. The card may be recharged through the customer's account at the branch, by TeleBank or by the Internet. The 2go key card allows a daily cash withdrawal of up to NIS 400, and daily purchase transactions of up to NIS 400. The card provides security and control over expenditure.
- **Higher education savings** – a fifteen year savings account, with an additional full year of savings provided by the Bank. Family members may make saving deposits of NIS 150 to NIS 1,000 per month, and at the end of the period enjoy the accumulated principal amount and interest as well as an additional award by the Bank in the value of the annual principal amount linked to the CPI. Namely, a total amount of up to NIS 12,000 together with CPI linkage increments.
- **"Two months interest free" loan** – family members are entitled to a loan of up to NIS 50 thousand, for any purpose, for a period of up to 60 months, which is interest free in the first two months of repayment.

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 2012, the Bank operated a country wide layout of 147 branches and extensions, being organized within the framework of 6 areas. Mercantile Discount Bank ("MDB") operated 79 additional branches.

Changes in the Bank Branches. In February 2012, the Immanuel Boulevard Branch was united with the Rabin Square Branch, on Ibn Gabirol Street in Tel Aviv. The Palyam Branch in Haifa was merged in March 2012 with the Haifa Main Branch. The Sonol Tower Branch in Tel Aviv was closed in July 2012. In July 2012, the Em Hamoshavot Branch was opened in Petach Tiqva. A new branch was opened in January 2013, at the Drorim shopping mall at the Bnei Dror junction.

For details regarding the modification of the branch network, complementary services and the consultation layout, see "The household segment" hereunder.

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.

In the course of 2012, the Bank continued to improve the segmentation of customers of this sector in order to provide appropriate service to each segment. In addition to the distribution to service teams at the branches, based mainly on financial parameters, customers were classified into sub-segments enabling improvement of the level of service provided to the customer, including the range of products, services and channels required by him.

CUSTOMER SEGMENTATION

In the household segment, which has been in focus in recent years, various strategic emphases were determined for operation with each segment, in accordance with its characteristics and needs. In recent years the Bank has focused on the private sector including all its segments. Based on a segmental study of this sector, strategic emphases have been put on the activity with each segment, according to its characteristics, needs and order of priorities of the Bank. Based on the segmentation of the private sector, account channels have been established allowing, among other things, the granting of structured credit facilities in which the interest rate decreases as the facility is utilized, loans etc., while offering unique channels to customers having financial wealth and/or salaried customers.

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 needs of the customer, their repayment ability, and the acquaintance with them over the years as regards to 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

In 2012, the Bank focused on differentiating service according to customer segments, focused on the needs of the customer, including the modification of a variety of segment adjusted products.

Conduct of the service is based on the following principles:

- Focus on the customer - specialization according to segments (customer arenas) instead of products - providing appropriate services and products in accordance with the characteristics and unique requirements of each segment;
- 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;
- Expert banking - provision of various professional services in the credit and investment sectors, including customizing the product to customers' needs and requirements;
- Familiarity and warm 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.

"DISCOUNT KEY"

In 2012, the Bank continued the unique marketing effort in the area of financial consumption – "Discount key". This campaign reflects a new approach which combines consumption culture with savings culture, with the aim of bolstering customer loyalty to the Bank. In this framework, Bank customers holding Discount's credit cards (VISA CAL, Diners and MasterCard) enjoy discounts at over 120 marketing chains as well as discounts at hundreds of local shops.

Customers have the possibility of joining a unique savings plan, accumulating amount through credit card transactions. Bank customers may save in one of the following channels: the rounding off of credit card transaction amounts to NIS 5 or NIS 10; accumulation to the savings scheme of discounts granted by trading houses participating in the plan; and complementing the monthly fixed amount deposit.

In August 2012, the Bank in cooperation with "Sonol" Oil Company granted customers holding Discount Key a discount on the cost of refueling.

In addition, the Bank launched in the third quarter a GPS based Discount Key application, which presents all the benefits and discounts granted to holders of the card.

OPERATIONAL EFFICIENCY IN THE BRANCHES

Removal from the branches of the operational activity concurrently with measures for improving efficiency and changes in performance concepts.

The activity was designed to achieve the following targets:

a. The customer may choose between teller assisted banking services and self service banking;
b. Removal of all operations not essential for customer service from the branch;
c. Simplifying and shortening the remaining processes at the branch;
d. Focusing on the customer and his needs in order to improve the service experience;
e. Reducing the amount of paperwork and filing at the branch;
f. Savings in manpower and costs.

All the Bank's branches have a self service banking area, where the customer is able to conduct most of their daily banking transactions, including check deposits, cash deposits and drawing services, foreign currency drawing services and effecting payments. At the date of publication of this Report, approx. 100 automatic machines provide foreign currency drawing services, and ATM machines provide deposit of cash services in all of the Bank's branches.

A back office was established in Tel Aviv, Jerusalem and Haifa, to which over 27 operating activities were transferred until now, including: incoming clearing examination, foreclosures, establishment of authorizations for charging accounts and managing them, deposits through teller machines, etc.

A similar project is being carried out since 2011 at Mercantile Discount Bank. One back-office operating unit was established in 2011, and a second back-office operating unit was established in the beginning of 2012. The aforesaid units perform operations pertaining to the technical examination of incoming clearings, foreclosures, the “Business +” center, computer input of benefits and miscellaneous charges. The units have also made preparations for the integration of the handling of business information.

The back office pension consulting changed to a digital forms system. The consulting products are transmitted electronically to the back office and the conveying to the sellers of the product is conducted within one hour from the time the consulting service had been provided. This move has contributed to improving efficiency of the work procedures – by improving the customer service, reducing reaction time, by paperless office work and savings in manpower.

In addition, the activity continued for taking over from the branches the filing and maintenance of basic documents as well as the daily paperwork and their integration in a manner that enables the business factor to view the documents of origin. The removal of basic documents has been carried out at about 84 branches. In 2012 this process was completed at 9 additional branches. Removal of the daily paperwork has been carried out in all of the branches. These activities saved office space at branches, reduced the use of paper, shortened the time required for locating documents and reduces risks. In addition, in 2012, the Bank discontinued the printing of reports by all branches of the Bank and of Mercantile Discount Bank by changing work procedures to viewing reports and handling them by commenting on them via the computer as well as signing them electronically.

RETAIL BANKING SECTOR - HOUSEHOLD SEGMENT

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. The service enables to improve the quality of telephonic response and to afford the staff of the branch more time to create for the customer added value from the aspects of initiative and sales.

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

Internet loans. Starting in June 2012, private customers who comply with determined criteria, may apply for loans via the Internet.

Discount by cellular. A service based on cellular application enabling Internet access to the account, obtaining information and executing bank transactions by means of SMS/application at any place and at any time. Various services are provided to the customer, including obtaining support while surfing on the web.

ATM stations adapted to the needs of the visually impaired. Audio devices have been installed at some 340 ATM stations of the Bank and MDB 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.

Providing services to State employees and to teaching staff. In 2012, the Bank continued providing unique services to State employees and to teaching staff, in accordance with agreements signed with the Accountant General (for additional details, including the continued provision of services to teaching staff, see Note 19 C 17 and 18).

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.

A change in format of rapid banking services. Within the framework of the preparations for the year 2013, it has been decided that rapid banking services at the front of the branch, which include advanced machines able to respond rapidly to routine banking services, will be provided by self-service, with no permanent assistance by bank employees. Accordingly, a part of the employees providing this service were moved to other duties at the telephonic information and sales center and at the teller layout at the branches.

Conversion of branches to business branches. In 2012, a move began to convert certain branches into business branches. Accordingly, the Bay Branch in Haifa and the Poleg Branch in Nataniyah were converted in 2012. This move is to continue in 2013.

"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. Ten "Discount Your Way" branches operated at the end of 2012.

"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 at business hours adapted to the needs of customers living in the vicinity. Ten "Household Discount" branches operated at the end of 2012.

Vacating Yahav Bank branches from Government premises. The 2010 annual report (p. 136) stated that in June 2010 the Jerusalem District Attorney's Office (civil cases) submitted to the Jerusalem Magistrate's Court a claim brief submitted in summary procedure for the eviction of the Yahav Bank branches located at Government office premises in the Capital (Ministry of Interior and Sheikh Jarrah). The mediation process conducted between the parties has failed. The legal proceedings between the parties continue in their course.

CONSULTING LAYOUT

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

4 investment centers extensions were in operation at the end of 2012.

Consulting services in Bank branches. Customers with deposits in the range of NIS 120-750 thousand are entitled to advisory services provided at the branches by authorized investment consultants that specialize in the capital market.

Pension advisory services. The Bank provides pension advisory services at the Bank's branches and investment centers. The Bank has elected a unique model of providing pension advisory services by differentiated consultants specializing in pension advisory services to all types of customer. The Bank provides pension consulting services to self employed and salaried employees all over the country. (For further details see hereunder "Capital market activities" in the Chapter "Further details regarding the activity in certain products"). In the end of 2012, the deployment of consultants was aligned to the needs and their number was slightly reduced.

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;
- Through the Discount automatic teller machine, by which marketing messages and marketing suggestions are being communicated;
- In the interactive voice response (IVR) system in the "Telebank", by means of marketing messages and marketing suggestions while the customer is waiting for service;
- Direct mailing to customers (to which is attached a statement of account) and through the automatic service machines (ATM and Information Desk).
- Direct channels – in the course of 2012, the Bank launched a service that allows the possibility of receiving a loan through the Internet.

TARGETS AND BUSINESS STRATEGY

Three goals were set for the segment, in focusing the activity in the upcoming year: focusing on profitability, growing the customer base and their activity at the bank and enhancing quality.

To achieve the aforesaid goals, the following are to be emphasized:

- **Positioning "Telebank"** as a nationwide service and sales center – initiating general banking calls and integrating "value" offers and sales into incoming calls, along with providing a voice response service to subscribers and customers, the referral of personal and general calls and the activation of retention centers for VIP customers and students;
- **Fulfilling customer potential** – by means of secondary segmentation, including adapting "value" offers surrounding "Family with Discount", products and prices, offering loans through a variety of channels, improving the activation of the promotional personnel - "Telebank" and tellers encouraging family savings;
- **Customer retention** using mortgages as a retentive product – improving customer service, primarily by shortening schedules; expanding the service spread, including greater activity with purchasing groups, providing "value" offers in association with mortgages;
- **Improving quality:**
  - Developing private and business credit models;
  - Continuing to deploy compliance officers in the branches;
  - Focused management of control-monitoring-collection, including significantly improving response time.

POINTS OF EMPHASIS FOR THE COMING YEAR

- Continued leadership in personal service;
- Strengthening the focus on the customer;

- 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;
- The continued positioning of the Bank as a leader in the pension consulting field;
- Emphasis on the preservation and fostering of customer loyalty and intensifying operations with new and existing customers;
- Intensifying operations on the liabilities side;
- Shortening banking processes;
- The integration of processes for the removal of operational activities from the branches, such as the renewal of insurance policies for assets serving as collateral;
- Continued installation of the line management system at fifteen additional branches;
- Multi-channel banking that would allow the customer to perform banking operations through any channel of his choice;
- Increased customer satisfaction by upgrading the service experience at the branch and raising the bar for service quality;
- The continued development and use of analytical models as a tool supporting decision making in the granting of credit.

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 ("FIBI") 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;
- 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 2012 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).

CRITICAL SUCCESS FACTORS IN THE SEGMENT

- Matching the disposition of service points and hours of operation to the area and type of 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.
- Inputs and efforts are required for the preserving of existing customers and attracting 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.

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.

The segment's net income in 2012 amounted to NIS 224 million, compared to NIS 219 million in 2011, an increase of 2.3%. The improvement in net income was due, among other things, to the increase in activity with the customers, efficiency (merger of branches and employee retirement) and improvement in the credit portfolio management quality.

The credit loss expenses in this segment amounted to NIS 19 million in 2012, compared to NIS 148 million in 2011, a decrease of 87.2%.

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 31,2012						
	in NIS millions						
Interest income, net							
- From external sources	(278)	265	-	250	237	[1]-	237
- Intersegmental	1,336	(35)	-	(96)	1,205	[1]-	1,205
Total Interest income, net	1,058	230	-	154	1,442	[1]-	1,442
Non-interest financing income	1	10	7	9	27	[1]-	27
Commissions and Other income	482	753	224	38	1,497	[1]	1,497
Total Income	**1,541**	**993**	**231**	**201**	**2,966**	**[1]-**	**2,966**
Credit loss expenses	(4)	23	-	-	19	[1]-	19
Operating and other expenses	1,540	752	174	134	2,600	[1]-	2,600
Profit before taxes	5	218	57	67	347	[1]-	347
Provision for taxes (tax savings) on profit	(18)	67	14	25	88	[1]	88
Net Income Attributed to the shareholders of the banking corporation	**23**	**116**	**43**	**42**	**224**	**[1]-**	**224**
Return on equity (percentage)	3.0	19.4	139.3	5.9	10.7	[1]-	10.7
Average Assets	9,502	8,267	10	19,641	37,420	13	37,433
Average Liabilities	66,046	2,137	-	492	68,675	17	68,692
Average Risk-assets	9,952	8,026	410	9,619	28,007	13	28,020
Average customers' securities	-	-	34,064	-	34,064	[1]-	34,064
Average other assets under management	1,609	-	1,576	1,074	4,259	[1]-	4,259
Components of Interest income, net:							
Margin from credit activity	430	230	-	154	814	[1]-	814
Margin from deposits activity	628	-	-	-	628	[1]-	628
Total Interest income, net	**1,058**	**230**	**-**	**154**	**1,442**	**[1]-**	**1,442**

(1) Amounts lower than NIS 1 million.

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

	Domestic operations					International operations	
	Banking and finance	Credit cards	Capital market	Mortgage	Total domestic operations	Banking and finance	Total
	For the year ended December 31,2011[2]						
	in NIS millions						
Interest income, net[1]							
- From external sources	(1,219)	253	-	209	(757)	[3]-	(757)
- Intersegmental	2,379	(38)	-	(57)	2,284	[3]-	2,284
Total Interest income, net[1]	1,160	215	-	152	1,527	[3]-	1,527
Non-interest financing income[1]	-	20	31	(4)	47	[3]-	47
Commissions and Other income[1]	457	767	230	43	1,497	[3]-	1,497
Total Income	**1,617**	**1,002**	**261**	**191**	**3,071**	**[3]-**	**3,071**
Credit loss expenses	130	20	-	(2)	148	[3]-	148
Operating and other expenses	1,519	691	181	149	2,540	1	2,541
Profit (loss) before taxes	(32)	291	80	44	383	(1)	382
Provision for taxes (tax savings) on profit	(12)	86	23	16	113	[3]	113
Net Income (loss) Attributed to the shareholders of the banking corporation	**(20)**	**155**	**57**	**28**	**220**	**(1)**	**219**
Return on equity (percentage)	(2.8)	17.0	163.4	4.1	9.1	(62.0)	9.0
Average Assets	9,750	8,161	11	19,124	37,046	8	37,054
Average Liabilities	62,042	759	-	1,357	64,158	19	64,177
Average Risk-assets	10,195	12,140	467	9,448	32,250	11	32,261
Average assets of provident and mutual funds	-	-	-	-	-	[3]-	-
Average customers' securities	-	-	34,324	-	34,324	[3]-	34,324
Average other assets under management	1,036	-	1,328	1,326	3,690	[3]-	3,690
Components of Interest income, net[1]:							
Margin from credit activity	481	215	-	152	848	[3]-	848
Margin from deposits activity	679	-	-	-	679	[3]-	679
Total Interest income, net[1]	**1,160**	**215**	**-**	**152**	**1,527**	**[3]-**	**1,527**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

(3) Amounts lower than NIS 1 million.

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. For details regarding measures for the implementation of the recommendations of the team for the examination of the competitiveness in the banking system with regard to commissions, see Note 34 to the financial statements.

THE RETAIL SEGMENT AT THE MERCANTILE DISCOUNT BANK ("MDB")

Most of the customers of MDB belonging to the household segment of this bank, receive banking services by means of the MDB branches organizationally belonging to the Acco and Nazareth regions (32 branches). Such branches are located in areas where the population has an absolute "non-Jewish" majority. MDB 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. MDB 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.

RETAIL BANKING SECTOR - SMALL BUSINESSES SEGMENT

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in 2012 amounted to NIS 263 million, compared with NIS 174 million in 2011, an increase of 51.1%. The improvement in net income was due, among other things, to the intensification of management focusing in this segment, an increase in activity with the customers, and improvement in the credit portfolio management quality.

The credit loss expenses in this segment amounted to NIS 98 million in 2012, compared to NIS 109 million in 2011, a decrease of 10.1%.

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 31,2012					
	in NIS millions					
Interest income, net						
- From external sources	624	32	-	48	47	751
- Intersegmental	60	(10)	-	(5)	(19)	26
Total Interest income, net	684	22	-	43	28	777
Non-interest financing income	-	-	3	-	3	6
Commissions and Other income	363	72	36	19	2	492
Total Income	**1,047**	**94**	**39**	**62**	**33**	**1,275**
Credit loss expenses	104	-	1	(1)	(6)	98
Operating and other expenses	675	50	34	10	8	777
Profit before taxes	268	44	4	53	31	400
Provision for taxes on profit	88	9	1	19	11	128
Net Income Attributed to the shareholders of the banking corporation	**180**	**26**	**3**	**34**	**20**	**263**
Return on equity (percentage)	26.1	39.3	65.2	57.5	27.1	29.5
Average Assets	10,244	415	4	802	1,127	12,592
Average Liabilities	14,518	882	-	671	14	16,085
Average Risk-assets	9,133	899	71	792	963	11,858
Average customers' securities	-	-	7,088	-	-	7,088
Average other assets under management	-	-	344	-	-	344
Components of Interest income, net:						
Margin from credit activity	556	22	-	37	28	643
Margin from deposits activity	128	-	-	6	-	134
Total Interest income, net	**684**	**22**	**-**	**43**	**28**	**777**

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 31,2011[2]					
	in NIS millions					
Interest income, net[1]						
- From external sources	513	30	-	62	39	644
- Intersegmental	178	(10)	-	(10)	(15)	143
Total Interest income, net[1]	691	20	-	52	24	787
Non-interest financing income[1]	(4)	-	15	4	(2)	13
Commissions and Other income[1]	343	53	35	17	3	451
Total Income	**1,030**	**73**	**50**	**73**	**25**	**1,251**
Credit loss expenses	125	-	-	(10)	(6)	109
Operating and other expenses	764	46	33	22	10	875
Profit before taxes	141	27	17	61	21	267
Provision for taxes on profit	45	8	6	21	7	87
Net Income Attributed to the shareholders of the banking corporation	**96**	**13**	**11**	**40**	**14**	**174**
Return on equity (percentage)	12.1	22.5	157.0	39.6	15.7	16.5
Average Assets	10,993	312	5	1,018	1,099	13,427
Average Liabilities	12,639	901	-	694	50	14,284
Average Risk-assets	10,626	769	92	1,328	1,192	14,007
Average customers' securities	-	-	8,574	-	-	8,574
Average other assets under management	-	-	364	-	-	364
Components of Interest income, net[1]:						
Margin from credit activity	557	20	-	44	24	645
Margin from deposits activity	134	-	-	8	-	142
Total Interest income, net[1]	**691**	**20**	**-**	**52**	**24**	**787**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

DEVELOPMENTS IN 2012

Financing of small businesses. In July 2012, the Bank launched four funds for the financing of small businesses. As part of the Bank's policy of focusing on operations in this segment, existing customers of the Bank are being offered two financing channels, while two additional channels are being offered to new customers. The total financing per customer offered by the fund, may reach NIS 1 million, including reduced collateral requirements.

Business dealing room. In February 2012, a commercial dealing room was opened, providing dealing room services (purchase and conversion of foreign currency services and conducting hedge transactions) to customers of the Small Business segment and the Middle Market Banking segment at the Bank. Since its opening, a focused activity is being conducted, to connect certain customers to this dealing room.

Classifying branches as business branches. With the aim of focusing operations and improving service, two branches were classified at the end of 2012 as business branches offering service only to customers of the small and medium business segment and to VIP customers. Four additional branches will be classified in 2013 as business branches.

POINTS OF EMPHASIS FOR THE COMING YEAR

- Continuing the move of positioning branches as business branches, with the focus being on high-activity branches, which is primarily based on the completion of the conversion of four additional branches to business branches;
- Customizing the sale of unique products to the segment’s customers and addressing selected customer categories within the segment;
- Continuous focusing on improvement of the customer service level by improvement of staff proficiency, measurement and control;
- Continuing the development of analytical models and the use thereof as a decision supporting tool for granting credit;
- Expansion of the use made of the direct channels, including a designated website for segment’s customers, the "Business +";
- Completion of the reorganization of the service layouts according to segments;
- Increasing the use of models analyzing the activity of the segment's customers (the "red lights" system);

COMPETITION

The existing competition in this segment is mainly in the banking sector. Nevertheless, financing services for small business customers are also provided by credit card companies as well as by designated private companies financing specific operations, such as: the purchase of vehicles, equipment or import activity. 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.

SERVICE TO SEGMENT CUSTOMERS

The small business segment provides the full variety of services to the segments' customers. Service is provided at the Bank branches, except for foreign trade services. Customers also have the option of receiving service through a designated Internet site as well as by telephone.

Customers transacting international trade business are being serviced by the foreign trade department in accordance with their particular economic sector (see below under "Corporate Banking Segment").

Service to small and medium businesses. The Bank's small and middle market customers obtain services commensurate to their volume of operations, this in order to provide professional service appropriate to the customer's characteristics. Customers having a volume of operations of up to NIS 15 million and indebtedness of up to NIS 4-5 million, obtain services from the business banking teams at the Bank branches. Customers having higher volumes of operations and indebtedness than those stated above, obtain services from the Bank's business centers.

"Business +" website. A designated website for business customers. The website presents comprehensive data regarding the accounts of the business and allows customers to transact business independently from their place of business.

SMS business packages. A package that allows extension of current account services. Receiving massages regarding the following matters are available: notice in advance as to the termination of a guarantee, outstanding balance of guaranties relating to the account, collection of post-dated checks (balance and payments), checks serving as collateral (balance, payments and shortage vis-à-vis the defined amount), order of check books, dishonored checks, etc.

THE SMALL BUSINESS SEGMENT AT THE MERCANTILE DISCOUNT BANK ("MDB")

The small business segment at the MDB 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 MDB who belong to this segment live in areas where the population has an absolute "non-

Jewish" majority and receive banking services by means of 32 branches of this bank belonging organizationally to the Acre and Nazareth regions. MDB 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.

CORPORATE BANKING SEGMENT

REVIEW OF DEVELOPMENTS IN THE BUSINESS SECTOR IN 2012

The Israeli economy expanded in 2012 by 3.1%, compared to a growth of 4.6% in 2011. Concurrently, the rate of growth of the business product slowed down from 5.1% in 2011 to 3.1% in the reported year.
Following are the factors which affected the business product development in 2012:
A standstill (0.1%) in exports, reflecting a regression of 2.4% in the export of goods and on the other hand an increase of 6% in the export of services.

- Slowdown in private consumption, 2.6%, in particular a standstill was recorded in the fourth quarter;
- Slowdown (3.2%) in investments in fixed assets (excluding ships and airplanes), with a significant slowdown in investments in economic sectors, alongside a slowdown in investments in housing construction. Regression was particularly recorded in investments in fixed assets during the second half of the year;
- Public consumption (excluding defense imports) recorded an acceleration (3.3%) in 2012, which related to both non-defense consumption and purchases from the domestic defense industry.

Concurrently with the slowdown affecting most of the application components, a slowdown (3.4%) was recorded in 2012 in the import of goods and services (excluding defense imports). The said slowdown affected both the import of goods and of services.

DEVELOPMENTS IN THE DEBT OF THE BUSINESS SECTOR

The debt of the business sector (excluding banks and insurance companies) contracted by 1% in the course of the fourth quarter, as compared with the end of September 2012, and following an increase of 1% during the first nine months of the year (the rates of change are in nominal terms, and are affected by changes in exchange rates and in the CPI). The balance of the debt as of the end of 2012 amounted to NIS 782 billion, similar ro the end of 2011.
The stability in the debt in the course of the year stemmed from an increase of 38% in loans granted by institutional bodies, and approx. 2% in the debt to foreign residents. On the other hand, a decrease of approx. 6% in the debt to institutional bodies through bonds, and approx. 2% in the debt of the business sector to private individuals (households) and to companies (marketable corporate bonds). Concurrently, the debt to banks declined by approx. 1%. In accordance with the Bank of Israel estimates, in quantitative terms (eliminating the effect of inflation and the change in exchange rates), the debt of the business sector declined during 2012 by 0.3%, and the debt to banks declined by 1%.
Following the above mentioned developments, the weight of banks in the total debt of the business sector decreased from 52.2% at the end of 2011 to 51.7% at the end of December 2012.
The volume of fund raising through corporate bonds (excluding banks and insurance companies) in 2012 amounted to NIS 29 billion, compared to NIS 26 billion in 2011. The raising of funds in 2012 included, among other things, high volume fundraising by the Israel Electric Corporation.

DEVELOPMENTS IN SEGMENT MARKETS

The slow expansion in economic activity continued in 2012, on the background of the global economic situation and the uncertainty stemming there from.

Following are development directions in the principal economic sectors:

- Industrial sector – an export inclined economic sector affected by foreign demand. Regression in industrial production and in industrial exports was recorded in the last quarter of 2012; The industry is characterized by export inclined sectors that were adversely affected by the crisis in Europe (a prime export target for Israeli manufacturers), the weakness in the U.S. and the slowdown in world trade. A number of the corporations in the sector have adopted efficiency measures, which include shifting of exports from Western European and U.S. markets to the markets in Asia, Africa and Latin America;
- Diamonds – a decline in activity of this sector is noticed in the foreign trade data and in revenues for this sector received by the banking industry. A certain decline in the rate or regression was noted in the last quarter of 2012;
- The services sectors – these sectors are varied sectors and those services exposed to the world crisis have been affected to a higher degree. Furthermore, there are sectors that in recent years are characterized by changes in regulation and increased competition.

  The communication and computer services sector and the financial services sector have recently been affected by many changes in regulations and by increasing competition. The marine transportation field suffers from relatively low freight prices, excess supply, a moderate growth of demand and a significant decrease in the central trade routes;
- Commercial sector – the sector is mainly affected by local demands, which indicate a certain weakness – a decline in the per capita consumption, a decline in revenues of the marketing chains and a slowdown in the rate of growth of purchases by means of credit cards;
- Real estate sector – for details, see below under "Construction and real estate activity" under "Further details as to activity in certain products".

ANTICIPATED DEVELOPMENTS IN THE SEGMENT'S MARKETS

A slight acceleration in the growth rate is expected in 2013. According to the Bank of Israel forecasts, the Israeli economy will grow at a rate of 3.8% compared with 3.3% in 2012. The forecast is based, among other things, on the beginning of natural gas production planned for the second quarter of 2013.

Following are the main expected developments:

- The domestic market – A slight acceleration is expected in the growth rate of the business product. Corporations will operate in a challenging environment influenced by a global economic environment typified by uncertainty, changes in regulation and budgetary cuts; moderation in the level of domestic demand, despite the low interest rate environment, on the background of the moderating influence of the expected deterioration in the employment market and the increase in taxes anticipated on the background of the growing deficit;
- Maintaining stability of operations in the construction sector, in view of the decline in the number of housing projects beginning concurrently with a low interest environment, which may maintain stability in demand;
- A slowdown in investments in economic sectors. The development of investments in economic sectors will be largely affected by the completion of the investment in the new Intel plant in Kiriyat Gat, as well as by a high level of uncertainty in the business sector. On the other hand, investments will be positively affected by the construction of the central military training center in the South;
- Moderation in the growth rate of exports, on the background of the slowdown in world trade and a slow pace of economic recovery in the world.

EXPECTED DEVELOPMENTS IN CREDIT TO THE CORPORATE BANKING SEGMENT

Banking credit. In view of the economic situation, alongside an increase in risk levels and the implications of the capital restriction of the banks, a slowdown is expected in the growth rate of bank credit. The moderation in the growth rate will, among other things by the curbing of credit to business, which is expected to grow in 2013 at a rapid rate compared to 2012, though at lower rates than in the past.

Off-banking credit. A moderate growth rate is anticipated in off-banking credit. This, due to the volatility of the capital market, debt arrangements entered into recently and stricter regulatory demands.

The above said in the last two items 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. The foregoing may not materialize in case of different changes in macro-economic conditions, which are not under the Bank's control.

REACHING TARGETS AND BUSINESS STRATEGY - 2012

In 2012 the Bank operated in accordance with the work plan for the corporate banking segment, while focusing on expanding operations in the capital market and adjusting the exposure to economic sectors according to the sectorial risk evaluation. In addition, measures required to attain the desired portfolio structure and the business targets, were taken.

In view of the uncertainty prevailing in financial markets around the world and in particular in the Eurozone, as well as the concern regarding the possible implications of the Bank's borrowers, the Bank continues to maintain a consistent process of monitoring corporations that are exposed to the said markets and acts accordingly. Furthermore, the Bank strictly monitors large customers and borrower groups at a high level of risk. For further details, see under "Credit risk management".

In the course of 2012, the Bank continued the project financing operations for large corporations, taking into account the limitation concerning risk assets combined with a risk concept the aim of which is the lowering of exposure to economic sectors and activities defined as involving a risk higher than average. As a result of the above, the Bank maintained the size of the credit portfolio for the Corporate Banking Segment.

TARGETS AND BUSINESS STRATEGY

In 2013, the Bank will endeavor to operate in a wide variety of segments and economic sectors, whilst spreading out its credit portfolio and reducing exposure to segments in which the risk involved has been identified as higher than average. This, whilst allocating risk assets according to risk adjusted return. In addition, the Bank will focus on small and medium size businesses, whilst continuing project financing operations for large corporations.

Within the framework of the focusing by the Bank on value maximization with respect to the risk asset portfolio in the corporate banking segment and attainment of the capital adequacy goals, the following principal development directions have been defined with respect to the year 2013:

- Widening the array of services to customers while increasing the risk adjusted return;
- Intensifying the control and monitoring processes over current exceptional developments in the risk profile of customers;
- Forming a return on equity adjusted pricing possibility;
- Maintaining the existing risk profile by way of defining preferred economic sectors for expanding credit, economic sectors for the maintenance of an unchanged total credit, and economic sectors for the reduction in credit. Distribution of risk among the different economic sectors, while reducing exposure to foreign operations;
- Focusing on operations having an administrative infrastructure, a proper automation infrastructure, manpower, monitoring and control;
- The Bank will refrain from credit operations that involve fear of damage to the goodwill of the Group or the Bank, among other things, areas related to money laundering or the finance of terror;

- Participation in the financing of large merger and acquisition transactions structured by the two large banks in Israel;
- Leading syndication transactions with institutional bodies.

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 2012". 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 Antitrust Commissioner, the Israel Securities Authority etc. The principal restrictions applicable to this segment are briefly described hereunder.

Proper Banking Management Directive No. 313. As of December 31, 2012 no deviations existed to the limitations as set in the directive.

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 bank's equity. 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 bank's equity.

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 Bank's equity, Mr. Matthew Bronfman - 0.78% of the Bank's equity, Mr. Adam R. Bronfman - 0.39% of the Bank's equity, Ms. Holly B. Lev - 0.39% of the Bank's equity, Mr. Michael Rubinoff - 0.2% of the Bank's equity, Mr. Philip Milstein - 0.39% of the Bank's equity and Mr. Rubin Schron - 4.0% of the Bank's equity.

As of December 31, 2012, there were no deviations from the said limitations.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Sale of credit portfolio. No credit portfolios of the Bank were sold in 2012. A credit portfolio of the corporate banking segment was sold in 2011 in a total amount of NIS 910 million. A gain in the amount of NIS 53 million (before tax) was recorded in 2011 in respect of this sale. For details regarding additional sales in 2011, see Note 4 to the financial statements.

Net income of the segment in 2012 amounted to NIS 245 million, compared with NIS 353 million in 2011, an increase of 30.6%. The decline in net income stemmed from an increase in credit loss expenses on domestic operations and an increase in operating expenses.

The credit loss expenses in this segment amounted to NIS 467 million in 2012, compared to NIS 287 million in 2011, an increase of 62.7%, which stemmed from the increase in credit loss expenses of domestic banking and finance operations.

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 31,2012								
	in NIS millions								
Interest income, net									
- From external sources	655	18	1	597	1,271	172	10	182	1,453
- Intersegmental	(72)	(1)	-	(314)	(387)	(30)	(4)	(34)	(421)
Total Interest income, net	583	17	1	283	884	142	6	148	1,032
Non-interest financing income	47	-	2	1	50	-	-	-	50
Commissions and Other income	179	56	47	114	396	43	3	46	442
Total Income	**809**	**73**	**50**	**398**	**1,330**	**185**	**9**	**194**	**1,524**
Credit loss expenses	422	-	-	(35)	387	28	52	80	467
Operating and other expenses	431	32	39	69	571	86	18	104	675
Profit (loss) before taxes	(44)	41	11	364	372	71	(61)	10	382
Provision for taxes (tax savings) on profit	(24)	8	3	129	116	25	(14)	11	127
Net Income (loss) Attributed to the shareholders of the banking corporation	**(20)**	**23**	**8**	**235**	**246**	**46**	**(47)**	**(1)**	**245**
Return on equity (percentage)	(1.0)	60.9	102.5	17.0	6.8	10.2	(38.8)	(0.1)	5.9
Average Assets	26,138	440	31	13,108	39,717	4,639	1,545	6,184	45,901
Average Liabilities	22,133	923	1	2,265	25,322	1,905	144	2,049	27,371
Average Risk-assets	28,663	523	115	18,392	47,693	6,235	1,629	7,864	55,557
Average customers' securities	-	-	90,787	-	90,787	-	-	-	90,787
Average other assets under management	-	-	590	-	590	-	-	-	590
Components of Interest income, net:									
Margin from credit activity	546	17	1	274	838	109	3	112	950
Margin from deposits activity	37	-	-	9	46	33	3	36	82
Total Interest income, net	**583**	**17**	**1**	**283**	**884**	**142**	**6**	**148**	**1,032**

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 31,2011[(2)]								
	in NIS millions								
Interest income, net[(1)]									
- From external sources	1,027	18	1	850	1,896	104	9	113	2,009
- Intersegmental	(479)	-	-	(588)	(1,067)	(9)	-	(9)	(1,076)
Total Interest income, net[(1)]	548	18	1	262	829	95	9	104	933
Non-interest financing income[(1)]	20	-	-	38	58	(2)	-	(2)	56
Commissions and Other income[(1)]	228	54	49	36	367	45	2	47	414
Total Income	**796**	**72**	**50**	**336**	**1,254**	**138**	**11**	**149**	**1,403**
Credit loss expenses	49	-	-	80	129	55	103	158	287
Operating and other expenses	390	44	36	63	533	33	8	41	574
Profit (loss) before taxes	357	-	14	193	564	50	(100)	(50)	514
Provision for taxes (tax savings) on profit	124	7	2	65	198	20	(38)	(18)	180
Net Income (loss) Attributed to the shareholders of the banking corporation	**233**	**12**	**12**	**128**	**385**	**30**	**(62)**	**(32)**	**353**
Return on equity (percentage)	14.0	31.5	142.5	11.2	13.3	10.2	(97.6)	(12.1)	9.9
Average Assets	26,215	430	30	13,191	39,866	2,419	1,004	3,423	43,289
Average Liabilities	20,674	1,295	2	1,891	23,862	1,504	39	1,543	25,405
Average Risk-assets	21,527	519	116	19,121	41,283	5,022	1,307	6,329	47,612
Average customers' securities	-	-	85,985	-	85,985	-	-	-	85,985
Average other assets under management	-	-	412	-	412	-	-	-	412
Components of Interest income, net[(1)]:									
Margin from credit activity	503	18	1	252	774	77	9	86	860
Margin from deposits activity	45	-	-	10	55	18	-	18	73
Total Interest income, net[(1)]	**548**	**18**	**1**	**262**	**829**	**95**	**9**	**104**	**933**

Notes:
(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.
(2) Reclassified, see "General" above, at the beginning of this Chapter.

SERVICE TO SEGMENT CUSTOMERS

The Corporate banking segment enjoys a professional banking service, specializing in a "one stop shop", including an in depth examination of the requirements of the company and adaptation of creative financial solutions. Customers enjoy a personal, professional and quality service relating to all their financial needs by adapting various banking products in the credit, currency hedge, international trade, clearing of credit card transactions, financing, specialized investments in the capital market and additional fields.

The financing operations of the large corporations are performed by business managers in the large corporation department of the Corporate Division. The teams are divided according to the business activity fields of the corporations. The teams include a business manager, a business banker, economists and credit coordinators. Such teams serve as the banking address for all the financial needs of the corporate customer.

The services of the Tel Aviv Main Branch are at the disposal of the customers. This branch specializes in serving the Bank's large corporate customers, as well as in providing services to financial and institutional bodies, including custodian services to foreign entities.

The Capital Market Department. The aim of the department is to expand the services provided by the Bank with respect to capital market activity, to the large corporations, institutional bodies and capital market operators. The department engages in the allotment of credit to capital market operators, including the rendering of related services (brokerage, investment consultancy and administration), providing initiated consulting services to corporations, and the comprehensive handling of institutional bodies.

Customers engaged in international trade are being served by the foreign trade department (for additional details, see below).

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.

Some of the segment’s customers utilize the services of the Bank’s trading desk (see below, ‘Finance management segment’) and the Bank's overseas offices (see below, ‘International operations segment’).

The opening of extensions of the Tel Aviv Main Branch. An extension of the Jerusalem Main Branch was opened towards the end of 2012, located within the premises of the Jerusalem Main Branch. This extension will coordinate all the branch operations of customers belonging to the corporate banking segment of Jerusalem and the vicinity (with the exception of cash operations), and will be subject to the Tel Aviv main Branch. The opening of a similar extension in Haifa is planned for the coming months.

FOREIGN TRADE OPERATIONS

General. The foreign trade department operates within the framework of the Bank’s Corporate Division, and offers a range of services to customers from the various business segments engaged in international trade.

Scale of operations. According to data issued by the Central Bureau of Statistics, the import of goods in 2012, amounted to US$72.3 billion, a decrease of 0.7% compared with 2011. Export of goods amounted to US$54 billion, a decrease of 7.1% compared with 2011 (these data include aircraft, ships, diamonds and energy materials). The clear trend in 2012 is for an increase of 24.9% in the merchandise trade deficit.

According to the trend data in the last quarter of 2012, the import of goods shows a decline of 17.8% and a decline of 10.1% in the export of goods (excluding aircraft, ships, diamonds and energy materials).

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 2012 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.

Technological improvements. The year 2012 was characterized by the success of the marketing efforts in increasing the pool of customers using foreign trade services 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.

DEVELOPMENTS IN THE SECTOR'S MARKETS AND CHANGES 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.
A significant part of the credit portfolio includes holding companies, the credit that had been granted to served to finance domestic or foreign operations. The risk profile of these companies increased in the recent year, when several of the major holding companies were unable to honor their liabilities and were forced to reach a debt arrangement with the holders of bonds issued by them (the same doubt exists with respect to other companies, which is reflected in the level of return on their bonds).
Following the growth in the risk profile of holding companies active on the domestic and or overseas markets, the Bank reduced the credit granted to them by way of transferring the credit to their operational subsidiaries, backing-up the loan by reasonable local collateral, and avoiding the granting of credit to companies mostly operating abroad.

TECHNOLOGICAL CHANGES THAT MAY HAVE A MATERIAL IMPACT ON THE SEGMENT

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".

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", 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 human resource;
- Improvement of the technical ability to provide services;
- Relations with large banks in Israel and abroad.

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 deterioration in the economic condition. A large number of large corporations have adopted a leverage policy which includes the use of bank financing resources together with use of off-banking means of finance.
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.

In situations of expanding business activity and improvement in business performance of companies operating in the local and foreign markets, the availability of off-banking financing sources has increased with respect to certain of the large and financially stable customers.
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 competition from the other four large banking groups as well as from foreign banks that operate in Israel (HSBC, Citigroup).
During the past year, competition in the banking system intensified, while capital restrictions imposed on the banking system and the downturn in the capital market resulted in credit becoming more expensive for the segment's customers.

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 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.
The activity of the segment with capital market customers is performed by the capital market department, engaged in the marketing of credit and related services to existing and new customers, which include operations, investment consulting and brokerage.

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, execution and so forth.

MIDDLE MARKET BANKING SEGMENT

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2012 amounted to NIS 173 million, compared with NIS 150 million in 2011, an increase of 15.3%. The improvement in net income was due, among other things, to the increase in activity with the customers and improvement in the credit portfolio management quality.

The credit loss expenses amounted to NIS 127 million in 2012, compared to NIS 161 million in 2011, a decrease of 21.1%.

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 31,2012									
	in NIS millions									
Interest income, net										
- From external sources	315	5	-	117	5	442	208	124	332	774
- Intersegmental	(74)	-	-	(17)	(3)	(94)	(51)	(25)	(76)	(170)
Total Interest income, net	241	5	-	100	2	348	157	99	256	604
Non-interest financing income	15	-	-	-	-	15	-	-	-	15
Commissions and Other income	88	16	10	27	-	141	29	14	43	184
Total Income	**344**	**21**	**10**	**127**	**2**	**504**	**186**	**113**	**299**	**803**
Credit loss expenses	41	-	-	13	-	54	60	13	73	127
Operating and other expenses	207	10	8	33	1	259	108	48	156	415
Profit before taxes	96	11	2	81	1	191	18	52	70	261
Provision for taxes on profit	32	2	1	28	-	63	4	19	23	86
Net Income Attributed to the shareholders of the banking corporation	**64**	**7**	**1**	**53**	**1**	**126**	**14**	**33**	**47**	**173**
Return on equity (percentage)	10.9	36.9	116.8	16.7	3.4	13.3	3.2	10.4	6.2	10.2
Average Assets	7,497	116	1	3,138	321	11,073	4,509	2,966	7,475	18,548
Average Liabilities	3,803	246	-	810	-	4,859	1,376	688	2,064	6,923
Average Risk-assets	7,925	236	19	4,201	301	12,682	5,794	4,214	10,008	22,690
Average customers' securities	-	-	7,319	-	-	7,319	-	-	-	7,319
Average other assets under management	1,846	-	194	-	-	2,040	-	-	-	2,040
Components of Interest income, net:										
Margin from credit activity	221	5	-	94	2	322	122	83	205	527
Margin from deposits activity	20	-	-	6	-	26	35	16	51	77
Total Interest income, net	**241**	**5**	**-**	**100**	**2**	**348**	**157**	**99**	**256**	**604**

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 31,2011[(2)]									
	in NIS millions									
Interest income, net[(1)]										
- From external sources	308	7	-	123	4	442	343	100	443	885
- Intersegmental	(76)	(1)	-	(29)	(2)	(108)	(81)	(24)	(105)	(213)
Total Interest income, net[(1)]	232	6	-	94	2	334	262	76	338	672
Non-interest financing income[(1)]	-	-	6	5	-	11	-	-	-	11
Commissions and Other income[(1)]	92	19	12	24	-	147	66	3	69	216
Total Income	**324**	**25**	**18**	**123**	**2**	**492**	**328**	**79**	**407**	**899**
Credit loss expenses	22	-	-	(14)	-	8	92	61	153	161
Operating and other expenses	253	16	11	32	1	313	167	31	198	511
Profit (loss) before taxes	49	9	7	105	1	171	69	(13)	56	227
Provision for taxes (tax savings) on profit	15	2	3	36	-	56	24	(6)	18	74
Net Income (loss) Attributed to the shareholders of the banking corporation	**34**	**4**	**4**	**69**	**1**	**112**	**45**	**(7)**	**38**	**150**
Return on equity (percentage)	6.3	-	496.6	27.3	-	14.1	6.5	(14.5)	2.3	8.6
Average Assets	6,983	130	1	3,088	272	10,474	6,927	1,980	8,907	19,381
Average Liabilities	3,766	1,344	-	784	-	5,894	1,620	483	2,103	7,997
Average Risk-assets	7,778	255	33	4,205	221	12,492	8,549	2,192	10,741	23,233
Average customers' securities	-	-	10,593	-	-	10,593	-	-	-	10,593
Average other assets under management	961	-	287	-	-	1,248	-	-	-	1,248
Components of Interest income, net[(1)]:										
Margin from credit activity	206	6	-	87	2	301	217	67	284	585
Margin from deposits activity	26	-	-	7	-	33	45	9	54	87
Total Interest income, net[(1)]	**232**	**6**	**-**	**94**	**2**	**334**	**262**	**76**	**338**	**672**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

SERVICE TO SEGMENT CUSTOMERS

The service to the Bank's customers is provided by six business centers countrywide, covering geographically the six regions operated by the Bank: Tel Aviv, Dan, Sharon, Lowlands, Jerusalem and Southern Region and Northern Region. For additional details regarding service to small and medium businesses, see above "Small businesses segment".

The middle market banking segment enjoys professional banking services. 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.

The service provided by the business centers is integrative, provided by teams that include business bankers, economists, investment advisors and credit officers, with the assistance of the team handling loans and guarantees. 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. (For further information, see above, "Corporate Banking Segment").

DEVELOPMENTS IN THE SEGMENT'S MARKETS

Customers of this segment are in general companies with an average scale of operations, mostly in the domestic market. A part of the segment's customers conduct also import and export business.

During 2012, economic growth and private consumption recorded a certain slowdown. Concurrently, global economy and in particular the European economy recorded a slowdown (on the background of the debt crisis in the Eurozone), which led to a sharp decline in exports.

DEVELOPMENTS IN THE SEGMENT

Credit performance. The growth in the volume of credit in 2012 in the business centers exceeded the determined conservative target.

The increase in credit in the business centers in 2012 was over the conservative goal that was determined.

Business dealing room. In February 2012, a dealing room was opened, providing dealing room services (purchase and conversion of foreign currency services and conducting hedge transactions) to customers of the Small Business segment and the Middle Market Banking segment at the Bank. Since its opening, a focused activity is being conducted, to connect certain customers to this dealing room.

TARGETS AND POINTS OF EMPHASIS FOR 2013

- In view of forecasts indicating the slowdown of economic conditions, conservative credit targets have been determined for the segment. The determined targets reflect a moderate growth in the volume of credit for customers of this segment, while focusing on quality customers operating in economic sectors having a reasonable level of risk and fair profitability to the Bank. The Bank will also act towards the preservation of existing quality customers;
- Emphasizing the increase in profitability of the segment, while endeavoring to increase the volume of transactions with customers of the segment by intensifying foreign trade operations, securities operations, transfers, including by means of the CBC, checks and increasing off-balance sheet transactions requiring less capital allocation. In addition, the Bank will continue the process of adjusting credit margins to the risk level of customer credit;
- Widening operations with customers active in economic sectors preferred for business growth according to the Bank's policy, among which: focusing on transactions with local authorities and related corporations as against lowering the level of activity in economic sectors having a high risk level;
- Continuing the improvement of credit risk management processes and increasing control and monitoring processes, by way of early identification of customers facing financial difficulties, through a monitoring committee designated for the monitoring of such customers, adding guidelines regarding the granting of credit to the segment and monitoring deviations from established rules, as well as monitoring the development of the credit portfolio and the drawing of conclusions;
- The transition of branches into business branches for the service of the segment and the small business segment, as detailed in the small business segment.

ANTICIPATED DEVELOPMENTS IN THE COMING YEAR

In view of the significant lowering of the growth forecasts in Israel and in the world, a slowdown is expected in the business product and in private consumption alongside a decline in the import of goods and services (excluding defense imports). This situation may have an adverse effect on the business results of industrial and commercial corporations in the market. A slight regression is also anticipated in investments in equipment and machinery. Furthermore, the continuing slowdown is expected in exports (excluding diamonds) which may result in a decline in income and profitability of exporters.

In view of the above, a significant slowdown is expected in the rate of growth of bank credit to the middle market segment, both as regards applications for credit for the financing of working capital and for the financing of investments. Furthermore, in view of the growing risk level in the market, certain of the companies are expected to face difficulties in raising credit from the banking industry, a situation which will increase their difficulties even more.

CRITICAL SUCCESS FACTORS IN THE SEGMENT

- Ability to identify the needs of the customer and to adjust the banking products to his needs, providing a timely response;
- Ability to provide an overall and comprehensive service to the customer while showing professionalism and using advanced technological means;
- Maintaining an ongoing control layout reducing credit risk at the Bank and their "real time" identification, stressing the compliance issue;
- Determining a credit policy that matches the Bank's risk concept.

THE SEGMENT'S ENTRY AND EXIT BARRIERS

- Establishment of a branch layout spread out in line with the business potential;
- Training of professional and skilled staff familiar with the variety of products and operations;
- Investment in the development and maintenance of technological means servicing customers and the staff;
- The need to retain capital of a significant volume in granting credit where the risk assets comprise a material component (risk assets comprise a significant part of the segment operations mix, a fact that requires the allocation of capital in sizable amounts);
- The need for a variety number of products adjusted to customer needs.

PRIVATE BANKING SEGMENT

GENERAL

The private banking service layout focuses on a comprehensive banking service, initiating and specializing, to wealthy customers, with a commitment to prompt service regarding all customer needs and particularly in the investment field.

Customers of private banking, both Israelis and foreign residents, are classified as private customers holding financial assets at the Bank in an amount exceeding NIS 4 million in the case of Israeli customers and in an amount exceeding US$1 million, in the case of foreign residents (hereinafter : "private banking customers").

The move for the improvement of relating customers to this segment (see below) and raising the threshold for relating Israeli customers to the segment, did not materially affect the segment.

The segment's activity in Israel, for customers managing their accounts at the Bank branches, is conducted through four private banking centers, offering services: in Herzliyah Pituach and in Haifa – focusing on Israeli customers; and in Tel Aviv and Jerusalem – focusing on foreign resident customers.

For details regarding the overseas activities of this segment, see below "International activity".

STRATEGIC EMPHASES

In accordance with the Bank's strategic plan, the private banking department has been divided into two departments: the international private banking department, serving foreign resident private banking customers; and the Israeli private banking department, serving Israeli resident private banking customers.

In addition, the Bank acted towards the separation of international banking into a private international banking segment and a retail international banking segment, which is to serve foreign residents with financial assets deposited with the Bank, but of a volume lower than the minimum level required by private banking.

The private banking services, offered to Israelis and foreign residents, entitle customers to a comprehensive individual banking service, granted by a customer relations manager responsible for their account, as well as to high accessibility to investment consulting and financial products, including in the global area.

The private banking centers offer customers comprehensive banking services with a focus on financial investments and custom products management, and with the possibility of obtaining credit to finance customer investments.

In accordance with the credit policy, the private banking centers do not provide credit to customers required for business purposes. Customers interested in obtaining credit for their business activity are referred to the proper service layouts at the Bank.

The private banking layouts will continue to focus on expanding the Israeli and foreign resident customer base and in intensifying activities with them, while focusing on nurturing the continuing generation and maintaining proper risk management in the process of attracting new customers and servicing the existing ones.

Concurrently, the move for the transfer of customers, who do not match the private banking profile, to other suitable service layouts at the Bank will be completed.

As an integral part of the business plan, the Bank focuses on the upgrading of the private banking risk management processes. During the year, the risk management unit at the Customer Assets Division has been enlarged, and under it were appointed compliance trustees responsible for risk management issues at the private banking centers, and who report to the manager of the unit. A comprehensive training program for employees has been formed, dealing with money laundering prohibition and compliance, and which includes knowledge tests at the end of the training sessions. The current controls over account opening processes and existing accounts have also been intensified.

DEVELOPMENTS IN THE SEGMENT

As part of the Bank's strategic move to develop the wealthy customer segment, the Bank continued during the year to intensify the activity of the Israeli and international private banking.

The Israeli private banking field has focused on attracting new customers, intensifying the activity with existing customers and continue the attachment of existing Bank customers, who fall within the private banking customer profile, to the private banking centers in Herzliyah and in Haifa. On the other hand, customers who do not fall within he defined profile are transferred to the responsibility of other service layouts at the Bank.

As part of the formed strategy, a designated service concept has been defined for private banking customers, and a wide service envelop has been devised suitable for customers of this segment. Within this framework focused meetings on economic matters were held with customers as well as events with the participation of the Bank's senior management.

During the year, current and focused activity directed at private banking customers, was conducted in designated financial products items and complementary financial services.

As part of the expansion of operations, the Bank plans a gradual increase in the geographical coverage of the private banking centers so as to provide services to appropriate customers in additional geographical areas of the country.

Activity in the international private banking operations was focused on attracting new customers as well as intensifying operations with existing customers, and in continuation, the transfer of customers who do not fall within the private banking profile, to the responsibility of the international banking branches.

Concurrently, the reorganization process in the department, started with the separation of Israeli customer service from the international department, continued to be carried out.

As part of a plan for upgrading risk management processes in private banking, a comprehensive project of improving accounts of foreign residents has begun, including the closing of accounts and improvement of documents.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2012 amounted to NIS 24 million, compared with a loss in the amount of NIS 4 million in 2011.

The credit loss expenses amounted to NIS 10 million in 2012, compared to NIS 37 million in 2011, a decrease of 73.0%.

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 31,2012						
	in NIS millions						
Interest income, net							
- From external sources	(210)	-	(210)	181	-	181	(29)
- Intersegmental	342	-	342	72	-	72	414
Total Interest income, net	132	-	132	253	-	253	385
Non-interest financing income	1	-	1	9	-	9	10
Commissions and Other income	34	40	74	102	55	157	231
Total Income	**167**	**40**	**207**	**364**	**55**	**419**	**626**
Credit loss expenses	8	-	8	2	-	2	10
Operating and other expenses	129	43	172	352	51	403	575
Profit (loss) before taxes	30	(3)	27	10	4	14	41
Provision for taxes (tax savings) on profit	10	(1)	9	8	-	8	17
Net Income (loss) Attributed to the shareholders of the banking corporation	**20**	**(2)**	**18**	**2**	**4**	**6**	**24**
Return on equity (percentage)	15.6	(15.3)	12.8	0.6	661.6	2.4	6.4
Average Assets	1,449	14	1,463	5,098	-	5,098	6,561
Average Liabilities	17,977	-	17,977	20,031	-	20,031	38,008
Average Risk-assets	2,145	188	2,333	2,849	-	2,849	5,182
Average customers' securities	-	14,459	14,459	-	12,150	12,150	26,609
Average other assets under management	-	105	105	205	-	205	310
Components of Interest income, net:							
Margin from credit activity	26	-	26	63	-	63	89
Margin from deposits activity	106	-	106	190	-	190	296
Total Interest income, net	**132**	**-**	**132**	**253**	**-**	**253**	**385**

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 31,2011[2]						
	in NIS millions						
Interest income, net[1]							
- From external sources	(624)	-	(624)	56	-	56	(568)
- Intersegmental	782	-	782	123	-	123	905
Total Interest income, net[1]	158	-	158	179	-	179	337
Non-interest financing income[1]		13	13	(2)	-	(2)	11
Commissions and Other income[1]	67	44	111	99	46	145	256
Total Income	**225**	**57**	**282**	**276**	**46**	**322**	**604**
Credit loss expenses	34	-	34	3	-	3	37
Operating and other expenses	116	49	165	358	46	404	569
Profit (loss) before taxes	75	8	83	(85)	-	(85)	(2)
Provision for taxes (tax savings) on profit	26	4	30	(27)	(1)	(28)	2
Net Income (loss) Attributed to the shareholders of the banking corporation	**49**	**4**	**53**	**(58)**	**1**	**(57)**	**(4)**
Return on equity (percentage)	30.7	25.2	30.3	(27.8)	517.2	(26.9)	(1.1)
Average Assets	1,689	16	1,705	4,769	-	4,769	6,474
Average Liabilities	16,953	-	16,953	18,559	-	18,559	35,512
Average Risk-assets	2,574	200	2,774	2,487	-	2,487	5,261
Average customers' securities	-	13,061	13,061	-	12,272	12,272	25,333
Average other assets under management	-	2,105	2,105	144	-	144	2,249
Components of Interest income, net[1]:							
Margin from credit activity	29	-	29	66	-	66	95
Margin from deposits activity	129	-	129	113	-	113	242
Total Interest income, net[1]	**158**	**-**	**158**	**179**	**-**	**179**	**337**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

SERVICE TO CUSTOMERS

A "service envelope" is being offered to private banking customers, customized to the segment's customers' needs, and which harnesses the Bank's and the Group's resources in providing an optimal response to their needs and for an initiated activity with them.

Customers of this sector enjoy an array of banking services at the highest professional level in the private banking centers. Consultants, experienced in the field of financial investments in Israel and abroad, pension consultants as well as experienced bankers in the fields of credit and general banking are at the disposal of the customers.

The Israeli private banking provides service to customers six days per week, and office hours at the private banking centers in Haifa and Herzliyah have been extended.

The staff of international banking have a command of foreign languages, in accordance 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 complementary services by the Bank’s subsidiaries: trusteeship and portfolio management, compatible with the needs of this segment’s customers.

Business development department in private banking. The department assists in developing business with customers of this segment. The department also contributes to the Bank's involvement with Jewish communities abroad, while maintaining close contacts with organizations operating there.
A planning and business development unit acts to provide private banking customers with offers of value, particularly within the all-round marketing.
A product initiation unit acts to create unique products suitable for this segment of customers.
The advisory services department acts to create an infrastructure of research and local and international market surveys and in structuring investment models suitable for the needs of this segment of customers.

DEVELOPMENT IN THE SEGMENT'S MARKETS AND COMPETITION

The process of increased competition in the private banking segment continued in 2012. This was reflected both in price and commission competition and in the differentiation of the private banking layouts of Israeli banks, in accordance with the structure of the segment in each bank. Concurrently, the marketing and service efforts of foreign banks to the private banking sector have intensified, including those of Israeli banks operating abroad, and of insurance companies and investment houses, which approach the same target population.

MARKETING AND DISTRIBUTION

Most of the marketing efforts as regards private banking are based on the referral of customers. The marketing of products and of the all-round services are being conducted mainly through personal meetings and through small and focused conferences 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.

FINANCIAL MANAGEMENT SEGMENT

DEALING ROOM

The dealing room is engaged in three principal areas of activity: trade in currencies, trade in interest rates and trade in Israeli and foreign securities. 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. 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.
Combining the three said areas of operation, allows customers to obtain all commercial services under one station providing a uniform standard of service and of professional level.

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.

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.

ASSETS AND LIABILITY MANAGEMENT (ALM)

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, determination of transfer prices and management of the financial spread.

Capital management. The capital management process includes the determination of capital ratio targets, formation of a framework for growth in business activity that will enable reaching the Bank’s capital targets, the allocation of the risk asset budget to companies in the Group and to the business units and the monitoring of current operations. Several factors in the Bank and in the Group participate in this process. In addition, the asset and liability management group is responsible for the raising of funds on the capital market.

Liquidity risk management. The liquidity risk management is done by means of an internal model, from which the volume of liquid assets required to withstand stress scenarios is derived, and by means of ongoing analysis of trends in the mix and volume of the Bank’s deposits and credit. The Bank's Assets and Liabilities Management reviews the liquidity risk at the subsidiary companies, as it is reflected in their internal models.

Short-term liquidity and deposits. The asset and liability management unit operates a liquidity desk dealing with the short-term liquidity of the Bank (up to one month) in Shekel and in foreign currency, through Bank of Israel tenders, deposits and swap transactions. The desk provides interest quotations for deposits of large customers (super jumbo) in foreign and Israeli currency. The desk endeavors to invest the liquidity surplus in every currency and at each point of time.

Linkage base and interest rate exposure management. Evaluating market risk exposure in the Bank's balance sheet is done 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 President & CEO, determines the levels of exposure to interest rate risk at the various linkage segments within the framework of limits determined by the Board of Directors regarding the risk appetite.

Transfer prices and management of the marginal financial spread. The Assets and Liabilities Management computes on a daily basis the Bank's internal transfer prices for credit and for deposits. The transfer prices serve as a basis for computing the profitability of all credit and deposit transactions made at the Bank. The prices are updated in accordance with developments in the money and capital markets. The asset and liability management group determines the targets of the marginal spread for deposits and credit and monitors them on an ongoing basis.

Interest tables. The asset and liability management unit is responsible for the production and publication of deposit interest tables.

Development of financial models. The Assets and Liabilities Management is responsible for the maintenance of the models for the pricing and hedge of complex financial transactions, including deposits with optional linkage, exit points, early repayment forecasts for mortgages and more.

GROUP MANAGEMENT

In the capital management field the Bank conducts a well ordered process of capital planning on a Group basis, as well as the formation of a risk asset budget at the subsidiary and Bank segment of operations levels.

In the liquidity risk management field each subsidiary is individually responsible for its own liquidity risk management, on the basis of the methodology approved by the Bank. The Bank allocates liquidity to the subsidiary companies, to the extent required, in accordance with the internal models. The Bank's Assets and Liabilities Management is responsible for establishing liquidity transactions between the Group's companies.

In the market risk management field, the principal subsidiaries (Mercantile Discount Bank and IDB New York) independently manage their market risks, subject to limitations set by the Bank.

In the additional investments field, the principal subsidiaries (Mercantile Discount Bank and IDB New York) independently conduct their investments policy, subject to limitations set by the Bank.

MAIN DEVELOPMENTS IN THE SEGMENT

For details regarding the establishment of a unit that engages in a controlled diversity of the "nostro" securities portfolio, see "Nostro portfolio management policy" under "Securities" above.

"Nostro" portfolio. For details regarding the Bank's "nostro" portfolio and developments therein, see above "Securities" under "Development of assets and liabilities", Part "A" of the Annex to the Report of the Board of Directors and Note 3 to the financial statements.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

The segment's loss in 2012, not including the activity of the non-financial companies sub-segment, amounted to NIS 179 million, compared to a loss of NIS 112 million in 2011.

Total revenues, excluding non-financial companies segment, amounted in 2012 to NIS 457 million, of which NIS 298 million from domestic activity, compared with NIS 247 million in 2011, of which NIS 136 million from domestic activity, and they include three major components:

1. Profits from the Bank's "Nostro" operations (primarily from financial derivatives) in the amount of NIS 413 million, of which NIS 359 million from earnings on the sale of securities and from adjustments to fair value of trading securities, compared with NIS 332 million "Nostro" earnings in 2011, of which NIS 243 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 115 million in 2012, compared with NIS 196 million in 2011.
3. Income on international operations in the amount of NIS 16 million, compared to NIS 11 million in 2011.

Following are the principal data relating to the financial management segment:

	Domestic Operations	International Banking	Total	Domestic Operations	International Banking	Total
	For the year end December 31					
	2012			2011[1][4]		
	in NIS millions					
Interest income, net	159	58	217	[2]212	143	355
Non-interest financing income	60	123	183	(123)	7	(116)
Commissions and Other income	79	(22)	57	[6]47	(39)	8
Total Income	**298**	**159**	**457**	**136**	**111**	**247**
credit loss expenses	(2)	7	5	11	25	36
Operating and other expenses	688	89	777	[6]619	150	769
Net Income (loss) Attributed to the shareholders of the banking corporation	**[3](195)**	**16**	**(179)**	**[2][5](123)**	**11**	**(112)**
Return on equity (percentage)	(12.1)	5.2	(9.4)	(16.4)	3.5	(10.3)
Average Assets	65,342	15,933	81,275	55,599	15,952	71,551
Average Liabilities	24,700	9,145	33,845	24,302	8,700	33,002
Average Risk-assets	10,568	4,019	14,587	12,116	4,344	16,460

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(4) Reclassified, see "General" above, at the beginning of this Chapter.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

(6) Reclassified, see Note 1 C 5.3 to the financial statements.

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), 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 targets set for the segment for the year 2013, comprise mostly the maintenance of an adequate level of profitability, while maintaining a risk level in accordance with the risk appetite of the Bank, despite a low interest environment and a challenging macro-economic environment. The goal of the dealing room is to widen the distribution between income from customers and income from position management, while extending the controls circles.

NON-FINANCIAL COMPANIES SUB-SEGMENT

POLICY REGARDING NON-FINANCIAL INVESTMENTS

Within the framework of the strategic plan for the years 2011-2013, a reduced framework has been approved for new non-financial investments, in respect of which, an allocation of risk assets had been made in the framework of the strategic plan.

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 (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, 2012, the Bank was far from reaching the limitation.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

The sub-segment's net income in 2012 amounted to NIS 52 million, compared with NIS 67 million in 2011, a decrease of 22.4%.

Following are the principal data relating to the non-financial companies sub-segment:

	For the year end December 31	
	2012	2011[1]
	in NIS millions	
Interest income, net	2	6
Non-interest financing income	61	76
Commissions and Other income	2	(3)
Total Income	**65**	**79**
Operating and other expenses	7	6
Profit before taxes	58	73
Bank's share in operating income of affiliated	1	-
Net Income Attributed to the shareholders of the banking corporation	**52**	**67**
Return on equity (percentage)	54.6	77.3
Average Assets	824	718
Average Liabilities	729	721
Average Risk-assets	1,271	1,156

Note:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

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 MDB;
- **Investments in companies** (see hereunder).

NON-FINANCIAL INVESTMENTS POLICY

Within the framework of the strategic plan for the years 2011-2013, a policy regarding non-financial investments has been, among other things, determined, replacing the policy determined in 2007.

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, 2012*		
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	174	13.5	12.8	0.7	
Vitalife Fund	50.3	10	10	-	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	44.3	-	According to a letter from the management of the Fund, no further "calls" will be made.
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	41.3	8.7	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 Fund	55	5	4.9	0.1	Venture lending of the Dovrat Group, which engages in the granting of loans and credit facilities to technology companies.
Stage One Ventures Capital Fund	46.3	18.8	18.8	-	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. Invests in late stage technology companies.
Fortissimo Capital Fund	78	5	4.3	0.7	Turn around fund to technology based mature companies.
Edmund de Rothschild Europportunities	Euro 100 million	Euro 11.3 million	Euro 10.6 million	Euro 0.7 million	Private equity fund of the Rothschild Group.
Apax Europe VII	Euro 11 billion	Euro 7.4 million	Euro 7 million	Euro 0.4 million	A European private equity fund in the Apax Group, and is expected to operate mainly in Europe.
Plenus Venture Lending III Fund	120	15	12.2	2.8	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	109	5	4.4	0.6	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 realestate fund	Euro 416 million	Euro 10 million	Euro 9.6 million	Euro 0.4 million	Managed by the French AXA group.

* The amounts are presented in U.S. dollars, unless otherwise stated.

In the field of venture capital funds and private equity funds, the subsidiary DCMI participates in several funds, including (continued):

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, 2012*		
Fortissimo II Fund	110	20	15.1	4.9	"Turn around" fund for technology based developed companies.
Carmel Software Fund	171	0.5	0.5	-	
FIMI Opportunity V	820	70	4.8	65.2	Private equity fund.
Fortissimo III Fund	260	10	2.1	7.9	A private equity fund for technology and industrial companies with a growth potential which are at an "inflection point".

* 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, 2012 to US$161 million. As of that date, the balance of DCMI's investment commitments amounted to US$93 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 balance of the Bank's investment in the aforementioned fund, as of December 31, 2012, amounted to US$15 million. The said fund had discontinued operations and is now acting towards the realization of the remainder of its assets.

Furthermore, MDB is committed to investments in six venture capital funds. As of December 31, 2012, the investment of MDB in these funds amounted to US$2.9 million. As of December 31, 2012, the maximum commitment for the future investments in these funds amended to US$1.1 million.

Realizations. In 2012, five of the longstanding funds in the investment portfolio of DCMI: FITE, Stage One, FIMI IV, Fortissimo I and Plenus III. Regarding the realizations (principally, in respect of the said funds), DCMI has recognized gains in the total amount of NIS 69 million, compared with NIS 96 million in 2011.

Realizations in the first quarter of 2013. For details regarding realization, in respect of which DCMI is expected to recognize gross pre-tax gains of US$9.2 million, see Note 19 C 16 (d).

INVESTMENTS IN CORPORATIONS

Super-Pharm transaction. During the first quarter of 2013, DCMI signed a memorandum of understanding for the purchase of 10.4% of the share capital of Super-Pharm Israel Ltd. ("Super-Pharm") from the CEO of the company and from Leumi Partners. Super-Pharm owns a chain of stores marketing pharmaceutical and pharma products, cosmetics and toiletries in Israel, Poland and China. In total Super-Pharm operates 188 stores in Israel and over 40 stores in Poland and China. Consummation of the transaction is subject to a satisfactory due-diligence review, already started, the issue of final financial statements for 2012, and the signing of a detailed agreement to be approved by the authorized organs and by the regulatory authorities, to the extent required.

As part of investments in corporations several investments in several companies were made, including:

Investment in "dividend paying shares". The Bank's Board of Directors and the Board of DCMI have approved a plan for investment in dividend paying shares, within the framework of a total investment up to a maximum amount of NIS 150 million, in shares of public companies that distribute a significant part of their current profits by way of dividends to shareholders. During the fourth quarter of 2012, DCMI acquired, by off-market transactions, shares in four companies, as stated, in a total amount of NIS 38 million. Subsequent to the balance sheet date, DCMI purchased shares of another company in off the market transactions, in an amount of NIS 14 million.

Additional investments. DCMI is studying additional investments with a view of diversifying its sources of income.

Investment in "Menif" - Financial Services Ltd. 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 a return participating in profits. DCMI owns approx. 19.6% of the equity of Menif. For details regarding guarantees provided by DCMI, see Note 19 C 16.

Sale of investment in "KFS". For details regarding an agreement made in March 2009, for the sale of the investment in "KFS", and for details regarding the option agreement see Note 19 C 19 to the financial statements.

FURTHER DETAILS AS TO ACTIVITY IN CERTAIN PRODUCTS

CREDIT CARD OPERATIONS

STRUCTURE OF THE FIELD OF OPERATION

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").

As estimated by ICC, 80% of the adult population of Israel uses credit cards as a means of payment, the Israeli consumer holding an average of 1.3 cards in their possession. ICC estimates the number of cards in Israel at December 31, 2012 was 7.7 million. Furthermore, some 70 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.

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.

THE OPERATIONS OF ICC

ICC operates in two sectors of the main activity in the credit card market: issuance of credit card and 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"). As regards these cards, ICC issues and manages the card, bears the costs of management of the card and of theft and forgery damage. The banks provide the credit facilities to the customer and bear the credit risk involved with the card; (b) issuance of cards directly by ICC, mostly through clubs and unique organizations (hereinafter: "off-banking cards"). As regards to these cards ICC provides to the customer the credit facilities and bears the overall risk relating to transactions made by use of the card.

Within the framework of expanding the product basket offered by ICC to its customers, ICC offers to customers, who hold off-banking credit cards (by means of its subsidiary companies), loans for various purposes, and provides them with varied credit plans and spread out repayment schedules with respect to transactions effected by them through such credit cards, such as, credit transactions, deferred charges, dividing the monthly payment to fall before and after the charge date, withdrawal of cash by installments, and so forth.

ICC clears "VISA", "Diners" and "MasterCard" credit cards that are valid in Israel and abroad, as well as "Isracard" credit cards (in Israel only). In addition, ICC provides clearing services for online transactions for various businesses, though the scope of this activity has decreased significantly in the past two years.

Clearing operations include the clearing of credit card transactions made in Israel, by way of "Point of Sale" appliances (POS appliances) located at trading houses.

In addition, ICC offers trading houses related services, which include, among other things: discounting of credit card transaction vouchers, advance payments for transactions effected and the granting of advances on account of future payments to trading houses with which the company is engaged in clearing agreements.

Following are quantitative data regarding the activity of ICC:

Number of valid cards[3]	As of December 31,			
	2012		2011	
	The total number of cards	Of which: active cards[5]	The total number of cards	Of which: active cards[5]
	in thousands			
Bank cards[1]	1,246	1,085	1,184	1,030
Off-banking cards[2]	732	522	611	457
Total	**1,978**	**1,607**	**1,795**	**1,487**

Transactions turnover[4]	For the year ended December 31,	
	2012	2011
	in NIS millions	
Bank cards	42,172	39,564
Off-banking cards	11,302	9,888
Total	**53,474**	**49,452**

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.

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

Net income in 2012 amounted to NIS 172 million, compared with NIS 184 million in 2011, a decrease of 6.5%.

The credit loss expenses amounted to NIS 23 million in 2012, compared with NIS 20 million in 2011, an increase of 15.0%.

Following are principal data relating to the credit card operations:

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
	For the year ended December 31,2012				
	in NIS millions				
Interest income, net					
- From external sources	265	32	18	5	320
- Intersegmental	(35)	(10)	(1)	-	(46)
Total Interest income, net	230	22	17	5	274
Non-interest financing income	10	-	-	-	10
Commissions and Other income	753	72	56	16	897
Total Income	**993**	**94**	**73**	**21**	**1,181**
Credit loss expenses	23	-	-	-	23
Operating and other expenses	752	50	32	10	844
Profit before taxes	218	44	41	11	314
Provision for taxes on profit	67	9	8	2	86
Net Income Attributed to the shareholders of the banking corporation	**116**	**26**	**23**	**7**	**172**
Return on equity (percentage)	19.4	39.3	60.9	36.9	23.7
Average Assets	8,267	415	440	116	9,238
Average Liabilities	2,137	882	923	246	4,188
Average Risk-assets	8,026	899	523	236	9,684
Components of Interest income, net:					
Margin from credit activity	230	22	-	5	257
Margin from deposits activity	-	-	17	-	17
Total Interest income, net	**230**	**22**	**17**	**5**	**274**

Following are principal data relating to the credit card operations (continued):

	Households	Small Businesses	Corporate Banking	Middle Market Banking	Total
	For the year ended December 31,2011				
	in NIS millions				
Interest income, net[1]					
- From external sources	253	30	18	7	308
- Intersegmental	(38)	(10)	-	(1)	(49)
Total Interest income, net[1]	215	20	18	6	259
Non-interest financing income[1]	20	-	-	-	20
Commissions and Other income[1]	767	53	54	19	893
Total Income	**1,002**	**73**	**72**	**25**	**1,172**
Credit loss expenses	20	-	-	-	20
Operating and other expenses	691	46	44	16	797
Profit before taxes	291	27	-	9	327
Provision for taxes on profit	86	8	7	2	103
Net Income Attributed to the shareholders of the banking corporation	**155**	**13**	**12**	**4**	**184**
Return on equity (percentage)	17.0	22.5	31.5	-	17.9
Average Assets	8,161	312	430	130	9,033
Average Liabilities	759	901	1,295	1,344	4,299
Average Risk-assets	12,140	769	519	255	13,683
Components of Interest income, net[1]:					
Margin from credit activity	215	20	18	6	259
Margin from deposits activity	-	-	-	-	-
Total Interest income, net[1]	**215**	**20**	**18**	**6**	**259**

Note:
(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

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 Antitrust Commissioner. The Antitrust Commissioner is involved extensively in the field of credit card activity. For details as to the arrangements between the credit card companies and for details regarding an amended cross-clearing arrangement, see Note 33 B 1 to the financial statements.

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.

Banking Act (Licensing) (Clearing of charge card transactions). The Banking Act (Licensing) (Amendment No. 18), 2011, was published in the Official Gazette on August 15, 2011. The Amendment relates to the following four matters:

- Regularization of the clearing market by means of the granting of clearing licenses by the Bank of Israel, while certain provisions of the Banking Ordinance will apply to whoever obtains a clearing license, including all the provisions of the Banking Act (Customer service);
- The opening to competition of the issuance market in a manner that the Supervisor of Banks, following consultation with the Antitrust Commissioner, will be empowered to determine that a clearing agent who clears at least 20% of the total amount of transactions made in Israel in the previous calendar year shall be declared "A Clearer with Wide-Ranging Activity", and to compel such a clearing agent to enter into a cross-clearing agreement for the clearing of credit cards of an issuer, in cases where that clearing agent refuses on unreasonable grounds to enter into such an agreement with an issuer;
- The opening to competition of the clearing market, where, within the framework of the law, a duty has been imposed upon an issuer who issued in any calendar year at least 10% of the total number of credit cards issued in Israel, or where 10% of the transactions as above have been executed by means of his credit cards, being an issuer with "Wide-Ranging Activity", to enter into a cross-clearing agreement with any clearing agent, unless he refuses to do so on reasonable grounds. Notwithstanding, the Minister of Finance, following consultation with the Supervisor of Banks and the Antitrust Commissioner, may allow an issuer not to engage with a clearing agent;
- Regularization of the discounting market – the Act regularizes the discounting market and imposes various restrictions upon clearing agents, including the forbiddance of discrimination between discounting companies, forbiddance to refuse engagement with discounting companies and forbiddance of subjecting clearing services to additional services. Also, providers of discounting services must register with the Ministry of finance as providers of currency services.

The law entered into effect upon its publication in August 2011, apart from the provisions relating to opening the clearing market to competition which entered into effect on May 15, 2012. In January 2012, ICC, LeumiCard and IsraCard were defined as "issuer having a wide-ranging activity" (within the meaning of this term in the said legislation amendment). The Supervisor of Banks extended the date for ICC for obtaining a clearing license until March 2014.

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.

Amendment of Proper Banking Management Directive No. 411 - Credit Card Companies. An amendment to Directive No. 411 applying to credit card companies was published on January 12, 2011, within the framework of which, the Supervisor of Banks intends to regularize the management of risks involved in conducting illegal transactions by means of credit cards.

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 international organizations 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. The clearing aspect includes upgrading and/or acquisition and/or development of sophisticated POS 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.

Upgrading of the information systems. A new financial system was installed in 2011 at ICC. The system brought about, among other things, improvement of the control capabilities in various areas over the financial operations of the organization, shorten the period for closing the books by a quicker settlement of transactions in the system, shorten and improve controls regarding purchases, improvement of budgetary control, and higher compatibility with compliance requirements generally and separation of duties requirements in particular.

During the past year, the implementation of a number of follow-on projects in this field have been completed: GRC system for the monitoring and control of the ERP system, including SOX aspects, an ABC model system for costing analysis and a collection system.

In addition, infrastructure was set-up for applications in the field of cellular communications.

A new authorizations and SWITCH system for the clearing side is planned to be activated during the first quarter of 2013.

CRITICAL SUCCESS FACTORS

- An operating network including technological information systems, teleprocessing and advanced infrastructures;
- A developed and effective risk management system;
- High-quality, experienced human capital.

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.
- The need to obtain a license from the international organizations to clear the brands that they own;
- Deployment of a communications layout that will enable the clearing or the communication with Automatic Bank Services Ltd. that operates such a layout in Israel.

MARKET ENTRY BARRIERS

Principal entry barriers in the issuance field:

- Activity as an issuer requires the existence of an extensive, complex, cost and investments abundant, 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. Particularly a distribution chain should be established for credit cards through agreements with banks and/or customer clubs;

- High financial stability which is required for the purposes of raising funds for financial activity, i.e. the ability to borrow funds in very large volumes 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;
- Ability to provide a guarantee by the controlling banking corporation;
- The existence of a recognized and efficient system for rating credit risks.

Principal entry barriers in 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 ("digital purse");
- 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.

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 MDB). 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" "IsraCard" 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 included in 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. These clubs comprise unique customer groups who enjoy benefits tailored for them. In addition, ICC offers its customers attractive marketing campaigns in participation with leading trading houses in the Israeli market, and maintains several advertising and marketing channels through the Internet, television, direct mailing, etc.

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, and serve as liaison officers with the trading houses, even following the engagement by the primary clearing agreement.

COMPETITION

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 MasterCard credit cards.
- IsraCard, a group of private companies all of which are controlled by Bank Hapoalim Ltd., issues 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 compared 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.

The clearing field. The players in the field of credit card clearing includes:

- ICC, which clears VISA, MasterCard credit cards, IsraCard and Diners credit cards (through Diners, exclusively);
- IsraCard, which clears IsraCard, "American Express" (exclusively), MasterCard and Visa;
- LeumiCard, which clears VISA, MasterCard and IsraCard credit cards.

DEVELOPMENTS IN THE SEGMENT IN 2012

"IsraCard" credit cards clearing arrangement. On May 14, 2012, IsraCard Ltd. and ICC signed a license agreement and a cross-clearing agreement for IsraCard credit cards. The agreements enable ICC, for the first time, to approach trading houses and to offer clearing the IsraCard brand through ICC. It should be noted that the market share of the IsraCard brand is approx. 17% of the clearing market. For additional details, see Note 33 to the financial statements.

A joint issuance agreement between ICC and owner banks. For details as to the changes in the terms of the agreement for a joint issue of ICC with the Bank and with FIBI, respectively, see Note 33B 3 to the financial statements.

An agreement regarding the "cellular purse". On February 6, 2013, ICC signed an agreement with Cellcom Israel Ltd. ("Cellcom"), with respect to cooperation in the issuance of an off-banking charge card ("the card") by ICC, intended for the Cellcom Group customers, within the framework of a joint enterprise of the parties. The parties will act towards the integration of the card within the cellular purse based upon an advanced technology. The agreement establishes the engagement between the parties, further to the memorandum of understandings signed on July 6, 2012.

The agreement shall remain in effect for a period of ten years, as of the date of signature thereof, and thereafter shall be automatically extended for an unlimited number of set periods of five years each. The agreement states the circumstances under which the engagement may be prematurely terminated, in accordance to a format determined in the agreement.

The agreement is subject to regulatory approvals, to the extent that these are required.

International electronic trade clearing activity. In view of the reduction in the volume of the international electronic trade clearing operations, the Board of Directors of ICC decided on June 17, 2012, to transfer these operations, which hitherto were conducted in the international operations department, to the business department and to the risk management department. It should be noted that the liquidation proceedings of ICCI UK, which in the past had provided professional services in respect of international electronic trade clearing operations, were completed in October 2012.

For details regarding the demands by clusterers, see Note 33 to the financial statements.

MATERIAL AGREEMENTS

An agreement with the Allon Group. For details regarding the agreement in the matter of YOU Club, see Note 33 A to the financial statements.

Agreements with banking corporations. ICC is engaged in agreements with various banking corporations (including the Bank and Mercantile Discount Bank) for the purpose of the issue of credit cards to its customers. Issue of credit cards is made jointly by ICC and the banking corporation, where its status with the International VISA Organization permits issue of the cards. In other cases, issue of the card is made by ICC and distribution to customers is made by the banking corporation.

For details regarding a joint issue agreement with Mizrahi-Tefachot Bank and regarding the grant to Mizrahi-Tefachot Bank of an option to purchase up to 10% of the share capital of ICC, see Note 33 B 4 to the financial statements. For details regarding a joint issue agreement with Union Bank and regarding the grant to Union Bank to purchase up to 3% of the share capital of ICC, see Note 33 B 5.

Club 365 agreement. On December 1, 2011, ICC signed an agreement of principles with Club 365 Ltd. (hereinafter : "Club 365") for the establishment of an off-banking credit card club. The credit cards are to be issued by ICC and marketed through all the companies incorporated within the Club 365: viz. Hamashbir Latzarchan, New Pharm, Office Depot and companies which will join Club 365 in the future.

Within the framework of the agreement of principles, it has been determined that the credit cards will be issued as combined cards of Club 365 to existing and new members of the Club, and holders of such cards will be entitled to benefits and terms granted on a current basis to customers of the company in addition to benefits and discounts granted to members of the Club 365, while creating a beneficial differentiation for holders of the credit card.

The agreement of principles determines the manner of attracting new customers, advertising and marketing by both parties, as well as the consideration to which Club 365 will be entitled in accordance with operating indices determined in the agreement.

In addition, provisions have been included allowing a change in the model of cooperation between the parties into a model for the joint holding in the enterprise, subject to the provisions of the Law and regulatory requirements, to the extent existing. The detailed model for the joint holding in this enterprise is subject to approval of the Boards of Directors of ICC and of the Bank.

The period of engagement between the parties will be ten years, though after five years each of the parties may decide to terminate the engagement, subject to giving a prior notice in writing of twelve months.

The commercial launching of the joint operation was achieved in the first quarter of 2012.

Extension of the period of the "PowerCard" agreement. On July 22, 2010, ICC signed an agreement with "PowerCard" (2000) Ltd. and with Fishman Chains Ltd. (hereinafter: "the Agreement"). The Agreement extends until December 31, 2015, the validity of a prior agreement signed by the parties, with certain amendments. The Agreement establishes the obligations and rights of the parties within the framework of joint activities aimed at promoting loyalty to the chains participating in the "PowerCard Club" on the one hand, and the distribution of credit cards issued by ICC on the other hand.

A joint issuance agreement with H&O Club. On December 29, 2010, ICC entered into an agreement with H&O Fashion Chains (2003) Ltd. (hereinafter : "the Agreement"). The Agreement extends until December 31, 2015, the validity of a previous agreement entered into by the parties, with certain changes. The Agreement establishes the rights and duties of the parties within the framework of joint operations, the aim of which is to promote loyalty to the chains participating in the H&O Club on the one hand, and the distribution of credit cards issued by ICC on the other hand.

Arrangements made between the credit card companies. For details regarding the arrangement for the cross clearing of VISA cards, for details regarding an amended cross-clearing arrangement, and for details regarding a cross clearing tripartite agreement of VISA and MasterCard charge cards, see Note 33 B 1 to the financial statements.

CLEARING OF INTERNATIONAL ELECTRONIC TRADE TRANSACTIONS

For details regarding the police investigation and the seizure of documents and computer material of ICC, see Note 33 C to the financial statements.

SEASONAL FACTORS

The seasonality in the fields of issuance and clearing depends on the seasonality of private consumption in Israel.

BUSINESS GOALS AND STRATEGY

The issuance field. Leading the market through the exhaustion of the banking channel and offering solutions adapted to customer needs, issuance of charge cards in the off-banking channel in existing customer clubs, as well as through the cooperation with various entities for the establishment of additional customer clubs.

ICC is striving to become a significant player in the consumer credit market, through the issuance of off-banking charge cards as an infrastructure for increasing the credit to customers. ICC is striving for a position of strength as an entity that provides varied credit services (including through credit cards), without dependence on banks and developing 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.

ANTICIPATED DEVELOPMENTS IN THE COMING YEAR

Changes that occurred recently or which are anticipated and which may affect credit card operations:

- Reduction in the cross-commission rate – see Note 33 B 1 to the financial statements;
- The opening of the IsraCard market to clearing – see under "Regulations, legislation and arrangements" above;
- Change in terms of the joint issuance agreement with FIBI and the Bank – see Note 33 B 3 to the financial statements.

OPERATIONS IN THE CAPITAL MARKET

DISCOUNT INVEST

As part of the business strategy focusing on the customer and the variety of his needs, in 2012 the Bank launched a wide move in the capital market field – "Discount invest". This move offers the Bank's customers a wide and varied array of advanced technology and services layouts for capital market operations.

"Discount invest" offers innovative technological applications, the most noticeable of which is "Discount trade" – an advanced trading system, which enables customers active on the capital market, complete independence and direct communication with the Stock Exchange, while using decision supporting tools for executing their operations. Alongside the technological innovation, subscribers of "Discount trade" enjoy a level of service and unique availability of the Bank's dealing room. The service affords communication with a designated telephonic support center throughout the trading hours. The integration of the advanced technological tool and the telephonic support provides the ultimate solution for investors active on the capital market.

The service was extended in October 2012 also to foreign securities operations on the U.S. Stock Exchanges.

Within the framework of "Discount invest", the Bank positions a high bar for service, adapted to the type of activity of the customer, with maximum availability. Advisory services in the Bank's branches are rendered by qualified investment consultants who provide personal service during the operating hours of the branches. Advisory services may be further obtained from the central telephonic investment support office until 23:00 hours, Sundays to Thursdays. The service provides continuous

consulting services to investors subscribed to the TeleBank service, including foreign securities.
Customers having investments in amounts of between NIS 700 thousand and NIS 4 million, obtain services from nine countrywide investment centers, which provide specialized service, similar to that of an investment house. Thus, the customer enjoys a service experience distinguished from the banking industry. The investment consultants in these centers are personally available for customers throughout the market trading hours and also for prearranged appointments even after that. In addition to advisory services specializing in investments, customers enjoy also consulting services in tax and retirement issues, "second opinions" regarding their investment portfolio and varied off-banking services, such as: capital market workshops etc.
An additional innovation relates to the pricing of commissions. Customers of the investment centers, excluding the users of "Discount trade", enjoy varied service channels at attractive prices. For example: the "Invest Gold" channel offers the total comprehensive services provided by the center in consideration for a fixed quarterly payment.
Customers having financial wealth enjoy a novel layout of private banking centers for Israeli customers, including a professional and specialized investment consulting service as regards both the domestic and the international capital markets.
Alongside the above, the Bank has upgraded the service for all types of mobile telephones. The application installed by Discount is adapted to the Blackberry, Android and IPhone and versions and enables the receipt of information and the execution of capital market operations. In addition, customers can enjoy the "Discount SMS" service, which provides information regarding market indices at the end of trading.

TREND OF EVENTS AND DEVELOPMENTS IN THE MACRO-ECONOMIC ENVIRONMENT

The mutual funds market. The mutual fund market increased in 2012 by NIS 27.7 billion, from a level of NIS 142.4 billion at the end of December 2011 to a level of NIS 170.1 billion at the end of December 2012. Net positive deposits in all types of mutual funds were recorded in 2012, excluding the stocks funds in Israel, which recorded a negative accumulation.
The assets of funds specializing in bonds in Israel grew during the said period by NIS 24.6 billion, mainly due to increases in the assets of State bonds funds (NIS 13.4 billion), and of other bonds funds (NIS 9.7 billion). Furthermore, a fair increase was recorded in the foreign bonds funds (NIS 2.6 billion). In contrast, a slight decrease was recorded in the stocks funds in Israel (NIS 321 million).
The provident fund market. The provident fund market achieved in 2012 a positive return at an average rate of 9.66%. The said increase reflects the increases in the various indices of the Stock Exchange in 2012.
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 2012 amounted to NIS 318,844 million, compared to NIS 293,933 million at the end of 2011, an increase of NIS 24,911 million (8.4%).
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 2012 a net negative accumulation in the amount of NIS 3,805 million. This compared to a net negative accumulation of NIS 3,741 million in 2011. The said data reflects the effect of changes in regulation with respect to provident funds.
New pension funds market. In 2012, the new pension funds achieved an average positive return of 11.22%. According to the data published by the Capital Market Division of the Ministry of Finance, the new pension funds in total had a positive accrual amounting to approximately NIS 15.8 billion in 2012, compared to a positive net accrual of approx. NIS 13.46 billion in 2011. The volume of the new pension funds amounted to approx. NIS 126.3 billion in 2012, compared to approximately NIS 100.3 billion in 2011, an increase of approx. NIS 26 billion (approx. 26%).

The basket certificate market. According to data published by the Tel Aviv Stock Exchange, the slowdown in the development of the market continued in 2012, and 18 new basket certificates were issued during the year in contrast to 26 in 2011. The total of 440 basket certificates were traded at the end of December 2012 and the value of the public holdings therein amounted to NIS 58 billion, of which, 266 basket certificates based on domestic and international share indices and 174 basket certificates based on domestic bonds, short-term loans (MAKAM) and commodity indices.

Capital market. For details regarding developments in the capital market in 2012, see "Capital market" above under "Main developments in Israel and around the world in 2012".

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

The regulatory framework relating to the capital market operations continues to be updated on a current basis and is expected to continue and influence the Bank's activities in this line of operation, including the pension consulting field.

LEGISLATION AND REGULATION AMENDMENTS REGARDING PENSION SAVINGS

The plan for intensifying competition in the pension savings market. On November 30, 2010, the Ministry of Finance issued a plan for the improvement of the market and for intensifying competition and transparency in the pension savings area. Further to this plan, the Ministry of Finance published in the years 2011-2012 circulars and other legislation material with a view of developing the pension savings market and increasing its efficiency.

Electronic signature. On August 10, 2011, the circular, "Computerized Graphic Signature" was published, which permits use of a signature which is electronically retained in a graphics file, including an electronic signature. The circular regularizes the use of a digital signature on documents that have to be signed by the customer, as part of a transaction performed by the holder of a pension license. The electronic forms system developed by the Bank, which enables the electronic signing of consultancy documents, became fully operative as regards pension consultancy in October 2012.

Supervision over Financial Services Bill (consultation, marketing and pension Clearing System), (Amendment No. 5) 2012. The said Bill was published on July 24, 2012, after being approved by the Ministers Committee on Legislation. The Bill proposes, among other things, to determine that an employer shall not be entitled to subject the carrying out of a transaction or the granting of a benefit involving a pension product to it being executed by a certain license holder, including a license holder who provides operating services to the employer. Notwithstanding, it proposes that the right of election of the employee should not include the right to elect the license holder, through whom the deposits in the pension product, which will be made by the employer.

Draft Regulations of Supervision of Financial Services (Provident funds) (Distribution commissions) Amendment, 2012. A second draft Amendment of these Regulations was published on May 10, 2012, in the matter of the application of a model for a uniform distribution commission for all pension savings products, changing the model presently determined in the Regulations. The draft states that distribution commission in respect of pension consulting with respect to a pension product, shall comprise two components: the one – at an annual rate of 0.20% of the volume of assets standing to the credit of the customer as regards the pension product; and the other – at a rate of 1.6% of the current deposits. This is different from the rate of distribution commission specified in the Regulations at the present time of 0.25% of the volume of assets standing to the credit of the customer as regards the pension product. The Regulations do not change the rate of distribution commission in respect of further education funds consulting.

Circular letter regarding "Power of attorney to license holders" (Circular Agents and Consultants 2012-10-3). On December 12, 2012, The Capital Market, Insurance and Savings Department at the Ministry of Finance issued a circular letter in the matter of "Power of attorney to a license holder", which is intended to improve the efficiency of work processes and remove technological obstacles. The circular institutes two uniform structures for forms of power of attorney, which only through them a license holder may refer to an institutional body. The first, a pre-consultation power of attorney, and the second, an ongoing power of attorney. The circular will enter into effect on May 1, 2013, while as regards customers in respect of whom a valid power of attorney exists (though not in the same version as required by the circular), the license holder will have to obtain from such customers a signed power of attorney form in the version required by the circular until July 1, 2017 and so long as actions taken with respect to the customer's products are not executed through the central pension clearing system.

Homogeneous interface. At the beginning of 2009, the Capital Market, Insurance and Savings Department at the Ministry of Finance started to regularize the process of transferring information in the pension savings field between license holders and the institutional bodies, this by means of determining uniform interfaces ("unified record") for the use of the institutional bodies, license holders, including the banks as consultants, and other users of information. Since then to date, the Ministry of Finance published successively five circulars regarding the uniform structure for the transfer of data, each such circular replacing and cancelling the previous one, while amending the previous one and expanding the structure and contents of the information and data items that are to be transferred between the producers of the data and its various users. The fifth circular in the series was published on January 7, 2013. The circular came into effect on February 14, 2013, in respect of certain of the instructions included therein, while the remaining instruction will come into effect on June 1, 2013.

Pension clearinghouse. During 2012, the Capital Market, Insurance and Savings Department at the Ministry of Finance continued to regularize the terms for the establishment of a central pension clearing system (hereinafter: "the clearing house") and for its operation. The first stage of the clearing operations is expected to begin activity in the course of the second quarter of 2013.

The Capital Market Department issued on August 15, 2012 a circular regarding "Compulsory use of the central pension clearing system" (Institutional bodies circular 2012-9-13). Among other things, the circular states that a license holder must connect to the central pension clearinghouse and also details the operations which a license holder has the duty to perform solely by means of the clearinghouse. In addition, the circular states that the users shall bear all costs regarding connection to the system and maintenance of such connection and shall be chargeable with service fees in accordance with the instructions of the Commissioner and the rules of the system as approved by him.

The instructions regarding the duty of connection to the system and the costs thereof entered into effect on the date of publication of the circular; the instructions regarding the duty of a license holder to refer to an institutional body requesting information that does not include identification details of a pension product managed in favor of a customer, shall become effective starting with the date on which these operations will be possible to perform by the system; the instruction regarding the duty of a license holder to refer to an institutional body transmitting to the institutional body the request of a customer for effecting operations on his behalf, or for the receipt of information regarding a customer's product, shall enter into effect on January 1, 2016.

On February 20, 2013, the Capital Market Division issued a draft circular in the matter of "payment for the use of the central pension clearing system", which determines the service fee which the company operating the clearing system is permitted to charge institutional bodies and license holders, in respect of certain transactions executed through the system. According to the draft, the circular will become effective on the date in which the system will become operational.

Draft circular "Reasoning document" (Brokers and consultants circular 2012-71). On October 31, 2012, the Capital Market Department published a draft circular in the matter of the "reasoning document", which, among other things, is intended to replace the instruction circulars to brokers and consultants 2009-10-1 and 2010-10-1, in the same matter.

The draft circular prescribes a standard version of the "reasoning document", concise and focused, to the extent possible, to be delivered to customers by the consultant or the pension marketing broker as part of the consulting or pension marketing process, and which is intended to facilitate and enable the customer to digest the mass of information, and have it digitally processed and communicated through the central pension clearing system. The draft circular details the manner of preparation of the "reasoning document", the information to be included therein, the time period in which a license holder has to keep a copy thereof and the duties of an institutional body in respect thereof.

Capital Market Enforcement Intensification (Legislation amendments) Act, 2011. The Capital Market Enforcement Intensification Act was published on August 17, 2011. According to this Act, the three Acts that are subject to the supervision of the Commissioner of the Capital Markets, Insurance and Savings at the Ministry of Finance ("the Commissioner"), dealing with insurance, provident funds and pension consulting will be updated. The Acts supervising insurance and provident funds, will establish the authority of the Commissioner with respect to supervision and administrative clarification as well as new arrangements concerning the imposition of monetary sanctions. Regarding the Pension Consulting Act, a more limited amendment is established, which will not add new arrangements regarding the imposition of monetary sanctions.

The preparations of the Bank and of the Group for the formation and implementation of the internal enforcement program regarding securities, includes, among other things, the pension consultancy field. For further details see "Legislation and supervision" hereunder.

Supervision over Financial Services Regulations (Provident funds) (Authorization to manage more than one provident fund), 2011. The Regulations were published in the Official Gazette on August 30, 2012. The regulations allow a management company until January 1, 2014, to manage more than one provident fund of the same kind, if the said funds are managed by different operators. In consequence of the above, a management company that manages several provident funds of the same kind through different operators will have to merge these funds into one fund until the said date, and to appoint one operator for the management thereof. The Bank operates, among other things, provident funds of a management company, which manages other funds of the same kind, through additional operators.

Draft Money Laundering prohibition Order (Identification, reporting and maintaining records duties for insurers, management companies, agents and consultants preventing money laundering and the finance of terror), 2011. On July 3, 2011, the Capital Market, Insurance and Savings Division at the Ministry of Finance issued a draft Order, consolidating under one framework the Money Laundering prohibition Order relating to the duties of an insurer and an insurance agents, and the Money Laundering prohibition Order relating to the duties of a provident fund and of a provident fund management company. Furthermore, the draft Order applies, for the first time, the duties of objective and subjective reporting, submission of documents and maintaining records, also to pension consultants.

LEGISLATION AND REGULATION AMENDMENTS REGARDING INVESTMENT CONSULTING, PORTFOLIO MANAGEMENT, UNDERWRITING, MUTUAL FUNDS AND CUSTODIAN SERVICES

The Regulating of Engagement in Investment Consulting, Investment Marketing and Investment Portfolio Management (Reports), 2012, were published in the Official Gazette on June 14, 2012. The regulations impose reporting obligations on portfolio management companies, including, inter alia, the obligation to provide the customer with a quarterly report, in the manner prescribed in the regulations and, with respect to a banking corporation engaged in the provision of consulting services, it is obliged to file a monthly report to the Authority, which is to include data pertaining to all transactions performed on the accounts to which consultation was provided during the month preceding the date of the report, from license holders employed by the banking corporation, while the license holders are personally obliged to report events pertaining to them. The Regulations will take effect six months after date of their publication in the Official Gazette. Notwithstanding, the Securities Authority conceded to the request of the banking corporations to defer the beginning of the monthly reporting to the Authority no later than January 15, 2013.

New regulation in the underwriting field. On September 20, 2011, the Securities Authority published for comments by the public a proposal for legislation amendments in the underwriting field. The proposal includes several amendments and improvements for the purpose of creating the desirable structure for the underwriting field. Among other things, it is proposed to change the definition the underwriter's identity similarly to that existing in the United States, in order to impose the duty on additional factors (any factor, except for the company, who performs marketing or distribution operations in respect of the issuance, shall be considered an underwriter, in everything related to his responsibility for disclosure in a Prospectus). It is also proposed to strengthen the position of the underwriter as a caretaker (for example, by raising the bar in respect of the qualifications required from an underwriter) and to update the conflict of interests principles regarding the operations of the underwriter.

On September 21, 2011, the Plenum of the Securities Authority approved the Securities Regulations Amendment Bill (Manner of Offering Securities to the Public), 2011, in the matter of reducing the number of players entitled to participate in the preliminary undertakings. The Amendment proposes to exclude several entities from the definition of investors permitted to participate in the institutional tender and purchase securities under a preliminary undertaking, including banking corporations and auxiliary corporations, in a manner that the investors that will be entitled to purchase securities under a preliminary undertaking will be those who manage funds on behalf of others and such institutions only.

On March 19, 2012, the Securities Authority issued instructions to the underwriting companies, to report to the Authority, until April 2, 2012, data that would enable the identification by name of trading operations conducted by them. Furthermore, the duty of updating the information applies to the said reporting in respect of any change in accounts, including providing information regarding new accounts and notice of discontinued use of existing accounts.

New regulations regarding Mutual Funds. The Mutual Investment Trust Funds Bill (Amendment No. 21) (Basket certificates and basket funds), 2012, was published on July 3, 2012, the purpose of which is to match the regulation applying to basket certificates and similar products to the regulation applying to mutual funds, this in order to prevent possible regulatory arbitrage between products similar in characteristics and in purpose of investing therein. Accordingly, the amendment to the Law suggests that the Mutual Investment Trust Law shall apply to any arrangement the purpose of which is mutual investment in securities and currencies and deriving mutual profits there from or from any transaction therein, which is not regulated by any other law, including also basket certificates.

In addition, on March 11, 2013, the Finance Committee of the Knesset approved the Mutual Investment Trust Regulations (Distribution commissions) (Amendment), 2013, in the matter of reduced distribution commissions charged to managers of mutual funds by distributors who are not investment marketing agents (principally banks).

New regulation in respect of investment portfolio management. In January 2013, the Securities Authority published the draft Regulations for the Regulating of Engagement in Investment Consulting, Investment Marketing and Investment Portfolio Management (The Duty of Appointment and Qualifications of Officers in a Large Portfolio Management Company), 2013, which is designed to inject substance into the Corporate Governance for Mutual Funds Managers and Portfolio Managers (Legislation amendments) Act, 2011, with the aim, among other things, of applying a new corporate governance order to the large portfolio management corporations, stemming from the understanding that in order to maintain efficient supervision and control mechanisms, professional personnel having the appropriate education and experience have to be employed, whose qualifications would allow them to face the challenges existing in the capital market, considering the volume of assets being managed and the many risks threatening them. The essence of the proposed regulations is determining rules regarding the eligibility of directors, the officer in charge of internal control and the officer in charge of the internal compliance program, having regard to education tests and professional experience, as well as additional requirements intended to ensure that executives appointed to given positions are indeed suitable to fulfill them.

In addition, on July 24, 2012, the ISA published a draft instruction to the large portfolio management corporations with respect to the remuneration of external directors, following the Corporate Governance for Mutual Fund Managers and Portfolio Managers Act (Legislation amendments), 2011, which imposes on large portfolio management corporations duties in the matter of corporate governance, including the duty to appoint external directors. The aim of this instruction is to ensure appropriate remuneration of the external director, in order to enable the recruiting of suitably eligible directors and create correlation between the responsibility imposed on directors and the remuneration to which they are entitled. According to the instruction, a large portfolio management corporation shall pay to an external director an annual remuneration and a remuneration in respect of participation in meetings as stated in the Companies Regulations (Rules regarding remuneration and reimbursement of expenses to external directors), 2000, not being subjected to the value of the assets managed by the corporation. The actual amount of the remuneration that will be determined by a large portfolio management corporation, shall, among other things, in fact be influenced by the qualifications of the director and by the complexity of the tasks he will be required to perform, in view of the characteristics of the operations of the corporation and the portfolio it manages.

New regulation regarding investment consulting. On July 24, 2012, the Knesset approved in first reading the Bill for the regulation of engagement in investment consulting, marketing of investment and management of investment portfolios

(Amendment No. 19) (General investment consulting and general investment marketing), 2012. The Bill deals mostly with the separate and distinct regulation of engagement in general investment consulting and in general marketing of investments (differentiating it from specific consulting/marketing modified to the needs of a particular customer), which are not deemed to be investment consulting catering to the needs of a particular person, and which does not include interaction of a personal nature between the consultant and his targeted customer population. Providing such service would not require a license under the regularized engagement law, but shall be subject to strict disclosure duties.

Regularizing Investment Brokerage Bill, 2010. The Israeli Securities Authority published on August 22, 2010, the Regularizing Investment Brokerage Bill, 2010. This Bill is designed to replace the Regularizing Engagement in Investment Consultancy, in Marketing Investments and in Management of Investment Portfolios Law, 1995, and to apply to all investment brokers, including analysts, brokers, dealers and providers of securities deposits services. This law is designed to establish an infrastructure for the formation for a regulatory council that will supervise the activities of brokers and will determine rules governing all areas of their operations.

Following a study of the comments on the proposed Bill made by the public, the Authority has decided to focus on the preparation of a legislative infrastructure for the regularization of the broker/dealer operations, and in continuation study the establishment and organization of the "Council", as proposed in the Bill.

Regularization of custodian services in Israel. On January 16, 2013, the Supervisor of Banks informed of the adoption of the recommendations of the inter-office committee for the regulation of custodian services in the capital market in Israel, published in January 2012. The recommendations of the committee were designed to determine basic norms in the field of providing custodian services, with a view to align them with international standards in this field and to increase the uniformity of the regularization applying to operators in this field in Israel. Banking corporations are required to implement the recommendations of the committee as from October 1, 2013, except for several requirements regarding custody services provided directly as well as all requirements applying to providing custody services as a broker, which will apply as from July 1, 2014. Also, an independent audit by a certified public accountant, at least once a year at a custodian or brokering agent, as required by the recommendation of the committee, shall be first made in respect of the year 2014. In the future, the Supervisor of Banks intends to integrate the recommendations of the committee with the proper banking management directives. Until such time, clarifications regarding the manner of implementation of the recommendations of the committee will be published, if required, by way of "questions and answers".

Prevention of front running. On September 15, 2011, the Securities Authority published a proposed Bill prohibiting front running operations by financial brokers, as defined in the proposed Bill, who, through the role they play, obtain information regarding securities transactions which their customers intend to make, and may themselves precede their customers and transact operations in that same security based on those anticipated transactions and/or communicate such information to another party. The proposed Bill includes a wide definition of the broker group to which the Bill is intended to apply, including also a banking corporation, a stock exchange member, a license holder under the Act regularizing engagement in investment consulting, etc.

Regulation with respect to voting on the Internet. The Securities Act Memorandum (Amendment No.) (Internet voting system), 2012, was published on October 29, 2012. The proposed Bill is designed to establish the legal infrastructure for the creation of an internet voting system, through which holders of securities will be able to vote at various meetings through the Internet. This move is intended to increase the involvement of securities holders in meetings and realize their voting power.

The Internet voting system to be established by the Securities Authority will connect Stock Exchange members to potential voters. Stock Exchange members will be required, on the one hand, to submit to the system all the data regarding the potential voters holding securities through them, and on the other hand, to deliver to these potential voters the information required by them for the purpose of voting, including control passwords and information regarding the relevant meeting.

The duties of Stock Exchange members in connection with the possibility of the Internet voting will be determined by Regulations under the Companies Act (and not by Regulations under the Securities Act, as proposed in the preliminary draft).

SCALE OF OPERATIONS AND NET INCOME

Net income recorded from operations in 2012 amounted to NIS 57 million, compared to NIS 89 million in 2011, a decrease of 36.0%.

Following are principal data relating to operations in the capital market:

	Domestic operations						International operations:	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the year ended December 31,2012							
	in NIS millions							
Interest income, net								
- From external sources	-	-	1	-	-	1	-	1
- Intersegmental	-	-	-	-	-	-	-	-
Total Interest income, net	-	-	1	-	-	1	-	1
Non-interest financing income	7	3	2	-	-	12	-	12
Commissions and Other income	224	36	47	10	40	357	55	412
Total Income	**231**	**39**	**50**	**10**	**40**	**370**	**55**	**425**
Credit loss expenses	174	34	39	8	43	298	51	349
Profit (loss) before taxes	57	4	11	2	(3)	72	4	76
Provision for taxes (tax savings) on profit	14	1	3	1	(1)	18	-	18
Net Income (loss) Attributed to the shareholders of the banking corporation	**43**	**3**	**8**	**1**	**(2)**	**53**	**4**	**57**
Average Assets	10	4	31	1	14	60	-	60
Average Liabilities	-	-	1	-	-	1	-	1
Average Risk-assets	410	71	115	19	188	803		803
Average customers' securities	34,064	7,088	90,787	7,319	14,459	153,717	12,150	165,867
Average other assets under management	1,576	344	590	194	105	2,809		2,809

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

	Domestic operations						International operations:	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Total	Private Banking	Total
	For the year ended December 31,2011[(2)]							
	in NIS millions							
Interest income, net[(1)]								
- From external sources	-	-	1	-	-	1	-	1
- Intersegmental	-	-	-	-	-	-	-	-
Total Interest income, net[(1)]	-	-	1	-	-	1	-	1
Non-interest financing income[(1)]	31	15	-	6	13	65	-	65
Commissions and Other income[(1)]	230	35	49	12	44	370	46	416
Total Income	**261**	**50**	**50**	**18**	**57**	**436**	**46**	**482**
Credit loss expenses	181	33	36	11	49	310	46	356
Profit before taxes	80	17	14	7	8	126	-	126
Provision for taxes (tax savings) on profit	23	6	2	3	4	38	(1)	37
Net Income Attributed to the shareholders of the banking corporation	**57**	**11**	**12**	**4**	**4**	**88**	**1**	**89**
Average Assets	11	5	30	1	16	63	-	63
Average Liabilities	-	-	2	-	-	2	-	2
Average Risk-assets	467	92	116	33	200	908	-	908
Average customers' securities	34,324	8,574	85,985	10,593	13,061	152,537	12,272	164,809
Average other assets under management	1,328	364	412	287	2,105	4,496	-	4,496

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

DEVELOPMENTS IN THE OPERATIONS

Re-pricing of commissions on securities operations. For details regarding the instruction of the Supervisor of Banks requiring a re-pricing as above, see Note 34 to the financial statements.

A change in the format of pension consulting services at Mercantile Discount Bank. On July 26, 2012, the Capital Market, Insurance and Savings Department at the Ministry of Finance, consented to the discontinuation of the pension consulting services of Mercantile Discount Bank as from December 31, 2012, and gave its approval to transfer customers of Mercantile Discount Bank that receive pension consulting services, by signing their consent to the transfer of the appointment from Mercantile Discount Bank to Discount Bank.

On September 30, 2012, the Supervisor of Banks issued a permit for the provision of pension consulting services at the branches of Mercantile Discount Bank by consultants of Discount Bank, subject to the terms determined by him.

Customers who previously had received pension consulting services from consultants of Mercantile Discount Bank and did not sign their agreement to the said transfer, ceased as from January 9, 2013, to be pension advised customers of Mercantile Discount Bank. If, in the future, these customers will wish to enjoy once more pension consulting services at the Mercantile Discount Bank branches, they will have to undergo anew the full process of pension consulting. The change in the format of operation was carried out within the framework of the plan for business focusing and greater efficiency at the Mercantile Discount Bank (See "Main investee companies" below).

During the last quarter of 2012, Discount Bank and Mercantile Discount Bank completed the preparations for the transfer of

customers receiving pension consulting services from the latter bank, for the discontinuation of pension consulting services at branches of Mercantile Discount Bank provided by its consultants and the beginning of pension consulting services at Mercantile Discount Bank branches by consultants and systems of Discount Bank.
During January 2013, Discount Bank completed the establishment of its pension consulting desks at branches of Mercantile Discount Bank.
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 banks were prohibited, for the most part, from charging commissions in respect of the purchase and sale of mutual fund units.
Pension consulting. The Bank provides since 2008, pension consulting services to its customers and also to individuals who are not the Bank's customers.
The Bank provides pension consulting services with respect to provident funds, pension funds, further education funds and insurance products through pension consultants operating at the Bank branches and investment centers.
Public awareness as to the importance of pension planning had grown in recent years, and as a result, the demand for pension consulting services provided by the Bank has grown significantly.
A number of systems and auxiliary tools have been developed as part of the pension consulting services support layout:
- Pension consulting system – a computer system devised as a decision support tool for the pension consultant in recommending and choosing pension products for the customer. This system is being adjusted and updated in accordance with regulatory requirements and business needs;
- Rating system – a system which rates the provident funds, further education funds and the new pension funds, based on a unique model developed by the Bank;
- An automatic forms system including a graphic signature, for the production of operational instruction forms addressed to the institutional bodies with which the Bank has distribution agreements, based on the results of the pension consulting;
- Presentation of a customer portfolio on the direct channels – the Bank's customers who receive pension consulting services, and who have permission to access the direct channels (the Internet or the Bank's automatic service machine) may view the details of the pension products included in their portfolio;
- Organization intranet portal – this is a portal providing professional support to consultants and Head Office personnel, which is being updated in all matters on an ongoing basis.

The Bank is obliged to enter into engagements with all institutional bodies managing provident funds, new pension funds as well as further education funds, which wish to do so, with the exception of insurance companies. As of date of preparation of these financial statements, the Bank entered into distribution agreements with most of the institutional bodies operating in the pension market, for the distribution of products managed by them, in consideration for a distribution commission at rates and payment terms identical to those for an identical service. The maximum distribution commission rate is determined by Regulations, and the commission is payable in respect of pension assets (excluding insurance products) of customers receiving pension consulting services from the Bank. In 2012, the Bank entered into a distribution agreement with an additional institutional body – DS Provident Funds and Pension Ltd.
Increasing efficiency. An increasing efficiency plan was put into effect in 2012 in respect of the whole pension consulting layout: in relation to the number of consultants at the branches, Head Office personnel and development teams.
At the "ADIF" conference for the year 2012, the Bank was elected as leader in the banks pension consulting layout category, in the yearly rating by insurance, pension and financial newspaper reporters and the readers of "ADIF".

Trading services in the capital market. The Bank provides various trading services in securities:

- Discount trade - a service intended for customers who operate independently in the capital market, and which includes an advanced dealing center and a state-of-the-art Internet trading system.
- An interface for securities operations on the Internet website.
- A designated trading interface for securities operations of institutional bodies.

Sale of the basket certificate operations (2011). For details regarding the sale of the basket certificates operation, which had been required due to changes in legislation, see Note 19 C 21 to the financial statements. In respect of this sale, the bank recorded net gains of NIS 29 million in 2011.

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 adopted a policy of terminating 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., and suitable guidelines have been determined within the framework of the procedures applying to the operations of the Bank and of the relevant subsidiaries in the Group. The Bank acts in accordance with this policy.

Merger of the portfolio management companies. On January 1, 2012, the merger of Mercantile Capital Markets Ltd. with and into Tachlit Discount Portfolio Management Ltd. (formerly Tachlit Investment House Ltd.) came into effect. The main object of the merger was to simplify the corporate structure of the portfolio management field at the Discount Group, its merger and consolidation under one legal entity, thereby achieving savings and reducing duplicity.

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS

Securities. On December 31, 2012, the balance of securities held for customers amounted to NIS 122 billion, including approx. NIS 7.2 billion of non-marketable securities, compared to NIS 105.4 billion as at December 31, 2011, including NIS 7.5 billion of non-marketable securities, an increase of 15.7%. For details as to income from security activities, see Note 25 to the financial statements.

In addition, the balance of securities held on behalf of customers at the MDB as of December 31, 2012, amounted to NIS 10.0 billion, compared with NIS 11.3 million in December 31, 2011, a decrease of 11.5%.

Investment portfolio management. On December 31, 2012, Tachlit was managing 2,002 investment portfolios, which together were valued at approx. NIS 3,963 million, as compared to 1,890 portfolios valued in total at approx. NIS 4,488 million as at December 31, 2011. The above data point to an increase of 5.9% in the number of portfolios managed and to a decrease of approx. 11.7% in the monetary value of the managed portfolios. The increase in the number of portfolios, accompanied by a decrease in the overall monetary scope, reflects a downward trend in institutional customers, which is characterized by a small number of portfolios and high volumes, and growth in the private customers share, which is characterized by a relatively large number of portfolios and relatively low volumes.

Pension advisory services. In the course of 2012, the Bank provided pension consulting services to some 9,000 new customers. In addition, the Bank attracted some 1,000 additional customers, who previously had received this service from Mercantile Discount Bank and who gave their written consent to the transfer. The total cumulative assets of customers receiving pension consulting services from the Bank as at December 31, 2012, crossed for the first time the NIS 10 billion bar, amounting to NIS 10.1 billion, of which accumulation relating to customers transferred from Mercantile Discount Bank amount to NIS 0.23 billion.

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 further 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.

Following the 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 Discount-Portfolio Management.

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.

An institutional body pays a commission to a distributor, who is a license holder (pension consultant, marketer or pension broker), in respect of customer products which the institutional body manages, to the extent that the distributor had been appointed by the customer. The customer may at any time revoke the said appointment and/or transfer it to another license holder, and as from that date, the institutional body will pay the commission to the new license holder (if appointed) and the payment of commission to the previous pension consultant will be discontinued as from that date. Accordingly, competition over a customer is expected between all license holders and institutional bodies.

At the present time, most of the banks are active in the pension consulting market.

GOALS AND BUSINESS STRATEGY

- 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.

CONSTRUCTION AND REAL ESTATE ACTIVITY

MARKET DEVELOPMENTS

General. The growing activity in the construction and real estate sector continued in 2012 compared to 2011. The housing field expanded at a more moderate rate compared to previous years, alongside stagnation in non-housing construction and in infrastructure.

The volume of investment in residential construction grew in 2012 at a rate of 5.8%, further to a growth of 12.5 % in 2011. Notwithstanding, a decline was observed in investments in housing construction in the second half of 2012, at an annualized rate of 5%, compared with an annualized growth rate of 7.5% in the first half of the year.

The volume of investments in non-housing and other construction remained almost unchanged – a growth of almost one percent compared with 2011, compared to a growth of 4% in the previous year.

The following developments occurred in the various operating segments in 2012:

Residential construction

- Prices of residential units – The Owner-Occupied Housing Price Index rose by 5.7% in the last year. The rise in the index resulted mainly from the low interest rate environment, which contributed to the continued demand for housing units as against beginnings of construction projects in volumes that do not cover the cumulative shortage created in the last decade;
- Beginnings of construction projects – the construction of 39,790 residential units began in 2012, compared to 45,600 units in 2011. This reflects a reduction of 13% compared to the corresponding period last year, though it is significantly higher than the average of beginnings of construction projects in the last decade.

Demand for mortgage loans. The balance of mortgage loans increased in 2012 by NIS 17 billion (6.8%) to a level of NIS 269 billion. The Bank of Israel has acted to reduce the demand for mortgage loans by introducing new limitations (from November 2012, see below) on the maximum financing ratios allowed in respect of the purchase of a residential unit. Indications that the measures taken by the Bank of Israel led to a reduction in demand for mortgage loans are yet to be seen.

The Bank of Israel interest rate. Interest in real terms, calculated as the difference between the Bank of Israel interest rate and the anticipated capital market inflation for one year ahead, was negligible in 2012, though higher than that prevailing in the period in which housing prices rose sharply. A negative interest rate in real terms was recorded in the fourth quarter of 2012. This low interest rate supports the continued demand for residential units and the moderate increase in housing prices.

Luxury apartments. According to the Tax Authority's transaction database, a decline of 17% was noted in the monetary volume of transactions involving residential units costing over NIS 10 million and a decline of 23% in the number of transactions in 2012, compared with 2011. About 52% of the transactions involving luxury apartments were made in Tel Aviv.

Income generating real-estate - office buildings. A reduction in prices was felt during the second half of 2012 in the Tel Aviv area and in the peripheral area of Tel Aviv. Notwithstanding, occupancy rates remained stable. The construction of a significant number of office building projects is expected to begin in the near future, thus significantly increasing the supply of office space.

Income generating real-estate - commercial buildings. Occupancy rates are high with stability in rental prices. However, there is a significant number of construction beginnings of commercial centers, which will increase supply in the coming years.

Infrastructure. This sector in Israel mainly includes 3 areas: transportation (roads, railway lines and light rails), water (desalinization and sewage treatment) and energy (private power producers), and is in the midst of an acceleration in investments. The State of Israel has invested in recent years billions of NIS in infrastructure projects.

The most notable projects in this field are the "Dorad" power station, the Carmel tunnels, the desalinization plants Hadera, Ashdod and Sorek, the "Rotem Plain" power station, the military training bases center project, The police training center, the expansion northwards of Trans Israel Highway no. 6, The Government Archives, power production by use of renewable energy and more.

Real estate activity abroad. Investments by Israeli corporations in entrepreneurial and income generating real estate in certain Western European markets, U.S. and Canada, due to the following developments.

- North America – selective use of business opportunities for the acquisition of income generating properties at low prices. During 2012, the capitalization rates of income generating properties in the U.S. reached their lowest level since the end of 2008. The continuing recovery of the economy and the low interest rate environment are anticipated to support a continuation in the decline of the capitalization rates.

  The Canadian real estate market is demonstrating, over a number of years, stability and high occupancy rates. These trends typify all segments of income generating real estate in Canada (commercial, office and industrial). The stability of the Canadian economy and the low interest rate environment expected in the coming years, will continue to support the positive trend with regard to the capitalization rates of income generating properties in the near period.

- Europe – the capitalization rates of income generating real estate in most European countries have not returned to their level before the crisis. It is expected that the low interest rate will continue to support this sector, though its relative effect is limited so long as recession in the European economy and the limited supply of credit by banks persists. A symbiotic connection exists between all countries in the Eurozone and the East European countries, so that if a further deterioration occurs in the European economies, this will have an adverse effect on the commercial real estate sector, with regard to rates of return, rental income and occupancy rates.

DEVELOPMENTS IN THE ACTIVITIES OF FINANCING RESOURCES

Companies operating in this sector issued in 2012 corporate bonds amounting to approx. NIS 7.3 billion, compared to NIS 7.5 billion in 2011. Most of these funds were raised towards the end of the first half of the year by large real estate corporations having a high credit rating.

The returns on bonds of listed corporations operating in this field increased and so did the margin over the riskless interest rate, so that a number of these corporations will find it difficult to refinance their credit.

EXPECTED DEVELOPMENTS IN THE ACTIVITY

Residential construction - Central region. The low levels of construction beginnings during the last decade (about 32 thousand housing units per year until 2009) compared to the addition of 39 thousand households per year has created a cumulative shortage in the supply of residential units. In view of the continued trend of levels of construction beginnings that are similar to the demand, the residential units shortage is expected to continue in the short term. Concurrently, the low interest rate environment has increased the demand for residential units, including the demand of investors.

The Bank estimates that the base data of low supply combined with the low interest rate environment is expected to lead the continuation of the current trend in the residential units prices.

At this stage, it is not possible to assess the effect of the new limitations imposed on the mortgage loan market by the Bank of Israel in November 2012, nor the effect of the measures which the new Government will take, if at all, in the matter of housing costs.

Residential construction in the periphery. In view of the continued rise in the prices of residential units, demand has been diverted to peripheral areas.

Income generating property - office space. In view of a significant volume of supply of office space, it is expected that prices and occupancy rates will decline, particularly in areas where projects of a significant volume are in the process of construction.

Income generating property - commercial space. Stability is expected in the short term in the demand for quality commercial properties, accompanied by stability in rental prices. However, a significant increase in construction beginnings may lead to a decrease in rental prices in the long term.

Infrastructure. Additional investments are expected in the coming years in amount of billions of NIS. The total amount of investments expected in P.P.P. projects (Public Private Partnerships) in Israel in the period to 2015 is estimated at NIS 30 billion. A growth in the scope of investments is anticipated in this area stemming from extensive national projects that are in various implementation stages (principally in the format of "public private partnership - PPP" of various types), concerning water projects, transportation, energy and electricity (including the establishment of private power stations operated by natural gas and/or photo-voltaic energy).

DIRECTIONS OF BUSINESS DEVELOPMENT IN THE MARKETS ACTIVITIES

The Bank defined the following fields of activity in preferred areas for the allocation of credit facilities:

- Closed housing project financing, including small projects, in low volume of finance, in central demand areas in central Israel and in peripheral areas, while maintaining a distribution of credit to borrowers in this field;

- The purchase of new lands available for building in preferred areas in the center of the country and in peripheral areas, where in respect of which the Bank intends to finance housing and/or commercial building projects in the form of closed project financing;
- Financing projects in the national infrastructure field, in cooperation with other banks and/or institutional bodies, that include identified and secured long-term repayment resources having a high certainty level;
- Financing of income generating properties projects, mostly in the field of shopping malls and commercial centers in demand areas, by entrepreneurs having financial strength, while securing in advance a significant part of the potential rental earnings.

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:

- Reducing the risk level inherent in the credit portfolio to this sector by focusing on financing operations in areas where the Bank has a positive experience with, and concurrently by reducing credit having a high level of risk;
- The financing of projects will be made under rules and restrictions determined by the Bank for providing finance to this sector, including restrictions on the concentration of borrowers and restrictions on sub-operations in this sector;
- Preference for financing borrowers having high financial strength and experience in this field, with whom the Bank has positive experience in transacting business;
- In view of the required specialization in this field, credit to the real estate sector will be mostly handled by the real estate and infrastructure department;
- 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 closed project financing will be carried out under minimum requirements, including borrower's equity capital, required project profitability, compliance with stress tests and more;
- The financing of income producing properties will be conditional upon the existence of financially stable tenants and the repayment ability servicing the debt.

SCALE OF OPERATIONS AND NET INCOME

General. In view of the increased activity in the field of residential construction in 2012, 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 Act against the utilization of the banking loan facility.

Net profit from operations in 2012 amounted to NIS 308 million, compared with NIS 168 million in 2011, an increase of 83.3%.

The credit loss expenses amounted to NIS 42 million in 2012, compared to NIS 220 million in 2011.

The results of operations in the real estate segment have been affected by different trends characterizing the activity of the borrowers in the domestic and overseas markets, as detailed below:

Following are principal data relating to construction and real estate activity:

	Domestic operations				International operations			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the year ended December 31,2012							
	in NIS millions							
Interest income, net								
- From external sources	48	597	117	762	124	10	134	896
- Intersegmental	(5)	(314)	(17)	(336)	(25)	(4)	(29)	(365)
Total Interest income, net	43	283	100	426	99	6	105	531
Non-interest financing income	-	1	-	1	-	-	-	1
Commissions and Other income	19	114	27	160	14	3	17	177
Total Income	**62**	**398**	**127**	**587**	**113**	**9**	**122**	**709**
Credit loss expenses	(1)	(35)	13	(23)	13	52	65	42
Operating and other expenses	10	69	33	112	48	18	66	178
Operating Income (loss) before taxes	53	364	81	498	52	(61)	(9)	489
Provision for taxes (tax savings) on operating income	19	129	28	176	19	(14)	5	181
Net Income (loss) Attributed to the shareholders of the banking corporation	**34**	**235**	**53**	**322**	**33**	**(47)**	**(14)**	**308**
Return on equity (percentage)	57.5	17.0	16.7	21.2	10.4	(38.8)	(3.2)	14.1
Average Assets	802	13,108	3,138	17,048	2,966	1,545	4,511	21,559
Average Liabilities	671	2,265	810	3,746	688	144	832	4,578
Average Risk-assets	792	18,392	4,201	23,385	4,214	1,629	5,843	29,228
Components of Interest income, net:								
Margin from credit activity	37	274	94	405	83	3	86	491
Margin from deposits activity	6	9	6	21	16	3	19	40
Total Interest income, net	**43**	**283**	**100**	**426**	**99**	**6**	**105**	**531**

Following are principal data relating to construction and real estate activity (continued):

	Domestic operations				International operations			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Corporate Banking	Middle Market Banking	Total	Total
	For the year ended December 31,2011(2)							
	in NIS millions							
Interest income, net(1)								
- From external sources	62	850	123	1,035	100	9	109	1,144
- Intersegmental	(10)	(588)	(29)	(627)	(24)	-	(24)	(651)
Total Interest income, net(1)	52	262	94	408	76	9	85	493
Non-interest financing income(1)	4	38	5	47	-	-	-	47
Commissions and Other income(1)	17	36	24	77	3	2	5	82
Total Income	**73**	**336**	**123**	**532**	**79**	**11**	**90**	**622**
Credit loss expenses	(10)	80	(14)	56	61	103	164	220
Operating and other expenses	22	63	32	117	31	8	39	156
Operating Income (loss) before taxes	61	193	105	359	(13)	(100)	(113)	246
Provision for taxes (tax savings) on operating income	21	65	36	122	(6)	(38)	(44)	78
Net Income (loss) Attributed to the shareholders of the banking corporation	**40**	**128**	**69**	**237**	**(7)**	**(62)**	**(69)**	**168**
Return on equity (percentage)	39.6	11.2	27.3	14.8	(14.5)	(97.6)	(26.4)	8.0
Average Assets	1,018	13,191	3,088	17,297	1,980	1,004	2,984	20,281
Average Liabilities	694	1,891	784	3,369	483	39	522	3,891
Average Risk-assets	1,328	19,121	4,205	24,654	2,192	1,307	3,499	28,153
Components of Interest income, net(1):								
Margin from credit activity	44	252	87	383	67	9	76	459
Margin from deposits activity	8	10	7	25	9	-	9	34
Total Interest income, net(1)	**52**	**262**	**94**	**408**	**76**	**9**	**85**	**493**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

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, 2012 decreased to a rate of 17.29% (21.5% at the end of 2011). This, in view of the completion of the merger with Discount Mortgage Bank. Concurrently, starting from the second quarter of 2012, a large borrower, most of whose profits stem from overseas operations, has been excluded, in accordance with the criteria determined recently by the Supervisor of Banks, with respect to the exclusion of borrowers from the credit concentration limitations.

Real estate Taxation (Betterment and Acquisition) Act (Amendment No. 71), 2011. On August 1, 2011, the Knesset passed the said Act, the object of which is to increase the supply of residential units, as an additional effort to counteract rising prices in the housing market. The Amendment includes a number of provisions, the principal of which is that as from January 1, 2013, the exemption from land betterment tax applying to the sale of an entitled residential unit once in four years shall be abolished, and replaced by an exemption applying to such sale once in eight years in the period 2013 to 2021. The Treasury is trying to instigate a move for the abolition of the exemption in order to increase the State's revenues from these taxes; however, it encounters difficulties in executing this move.

Government decision regarding the housing chapter of the Trachtenberg Committee report. In March 2012, the Government decided to adopt the housing chapter of the Trachtenberg Committee report, including: the marketing of some tens of thousands of residential units during the coming five years; additional budget for assistance in rental payments by "qualified tenants"; doubling the municipal tax on apartments not in use; a levy of up to 10% of the apartment price imposed on builders who do not execute approved building projects; budgetary assistance to "evacuate and rebuild" projects, etc. These decisions are intended to increase the supply of residential units and reduce housing prices in Israel. Accordingly, a proposed Social-Economic Change Bill (Legislation amendments) (Housing), 2012, has been formed for the implementation of the Government decision in the matter of changes in the rules for municipal taxes.

In addition, further to the said Government decision, the property Tax Act (Betterment and Acquisition) Bill, 2012, has recently been formed, which proposes to tax delays in residential construction projects. Due to the dissolution of the Knesset, it is not possible to asses at this stage if and when the proposed amendment will be passed.

Housing projects designed for rental (Decision No. 1248 of the Israel Land Administration, January 2012). In accordance with this resolution, individuals answering the criteria will be entitled to long-term rental periods. The land for building will be marketed in one of the following channels:

- Channel A: Tender on the rental price – the price for the land would constitute about 30% of the assessment by a governmental land assessor. Participants in the tender will compete on the lowest rental price for a residential unit. The rental period shall not fall below ten years. According to this channel, 20% of the residential units will be available for rental on the open market, the rental price in respect of 40% of the residential units will be regulated and 40% of the residential units will be available for sale on the open market.
- Channel B: A tender on the price of the land – Competition over the price of land intended for construction of residential units to be sold on the open market, with no minimum price for winning the tender. The rental price for 25% of the residential units will be regulated. 75% of the residential units are at a non-controlled price. The rental period shall not fall below ten years, and where tenders relate to a marketed location that will comprise of over 100 residential units and the marketing will be effected under alternative "B", the rental period shall not fall below a consecutive period of twenty years. Under both alternatives, the controlled price shall be determined in the tender or by the Israel Land Authority, for residential units leased to entitled tenants. The size of the residential units: shall not exceed 100 sq. meters in areas not declared as national priority areas, and 120 sq. meters in areas declared as national priority areas.

National Land Planning (TAMA 38) – Amendment No. 3 to TAMA 38 entered into effect in June 2012. The Amendment allows the construction of up to two additional floors on an existing apartment building, the closing and construction of an open floor, the construction of a part floor on the roof of the building, enlarging the area of existing floors in the building, enlarging floors for the construction of additional residential units in the building. As stated, the amendment permits the construction of an additional floor free of additional tax to that applying to the addition previously constructed, all these subject to the decision of the Local Planning Board and on condition that the whole building will be reinforced.

VAT Reimbursement Fund in respect of guarantees under the Sales Act - Guarantees under the Sales Act as well as the facilities for Sales Act guarantees issued by a banking corporation to a purchaser of the residential unit covering the payments for the purchase of the residential unit, have, until now, been taken into account in their full amount for the purpose of the sectorial limitation. These amounts included the VAT component. The Minister of Finance published a decision to establish a fund that will ensure the reimbursement of VAT to banks in circumstances where guarantees under the Sale Law are activated. The aim of the mechanism created upon the establishment of the fund is that exposure of banking corporations to risk in case a Sale Law guarantee is activated shall not include the VAT component. This will enable the reduction of the exposure amount included in the limitation stated above, and will allow the allocation of additional credit. The said mechanism is designed to operate for a defined period. It should be noted that the terms of the mechanism have not yet been finally established and that it is not implemented as yet.

SERVICE TO CUSTOMERS OF THE SEGMENT

Most of the business activity in the real estate and construction segment is carried out by the Bank's real estate and infrastructure department. 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, mostly with respect to holding companies, the principal activity of which centers on the holding of companies in the real estate field.

Within the framework of the real estate and infrastructure department operates a unit specializing in complex transactions for the finance of investments in national infrastructure projects (energy, electricity, water and desalinization plants and toll roads, mostly by the PPP method). The unit engages in allocating appropriate finance packages with the participation of institutional investors (who have advantage in raising long-term financing resources) or in cooperation with other banks in financing the transaction.

MDB provides the service to customers of this segment by means of the real estate department dealing with all real estate companies conducting business with this bank and engaged in entrepreneurship that includes financing through the "closed project finance" method, for construction projects principally residential buildings (handled by the construction project finance department), contract construction, income generating real estate and real estate holdings (handled by the real estate department).

CRITICAL SUCCESS FACTORS OF THE OPERATIONS

The critical success factors of the segment include:

- Professional and skilled manpower;
- Proper monitoring and control over the credit granted to this segment;
- Understanding of the market and the consistent analysis thereof, including all its aspects, the entrepreneurs, the construction contractors, the competing financiers, the demand for housing and investments, the regulation and exogenous effects. The ability to respond to identified opportunities and concurrently the ability to respond to identified threats and risks;
- Current communication with customers, qualitative service, continued customer satisfaction as regards the quality of service and the financing of projects that had been completed;
- Providing prompt response to applications for credit and other related services;
- The offering of competitive terms from the aspect of project financing terms, the modification of the financial structure to the risk levels, adjustments to the capital requirements, which the entrepreneur has to provide, as a function of the quality of the entrepreneur, quality of the specific project, the levels of demand and of advance sales, the scope of the project and the number of its stages, the housing units offered and the existing competition in the same demand area as well as the consideration of additional parameters;
- Use of specific analyzing and monitoring tools assisting in the decision making process and in the control during the period of project financing;
- Adequate understanding and mapping of the market is required in order to identify risks/opportunities in various sectors, e.g. standard residential construction, luxury residential construction, rental office and commercial property.

THE MAIN ENTRY AND EXIT BARRIERS OF THE OPERATIONS

Customers of the sector conduct business with several banks at any given time, so that the relative advantage of the operations is based upon the Bank's long-term relationship 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, mainly among small and medium customers who are particularly affected by the limited availability of financial resources for the contribution of capital.

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 Bank's maximum rate of exposure 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.

In the infrastructure field, where the period of operation/yielding of the project is relatively long, the banking system has an advantage in financing the initiation and construction stage (short to medium term) in contrast to the need to combine institutional bodies in the long-term financing.

The directives that had been determined following the recommendations of the Hodek Committee, which requires the obtaining of guarantees turned companies in this segment into preferred targets for institutional bodies due to pledges on real estate assets which they are able to provide as security for loans. Nevertheless, medium and small size customers are still highly dependent upon the banking industry in obtaining finance for their operations.

Following the rise in the risk level applying to certain of the corporations in this segment, as reflected in the returns on bonds issued by them, the terms for obtaining off-banking finance have become tougher, including the demand for security, stricter underwriting requirements and the determination of conditions and financial covenants.

STRUCTURE OF THE COMPETITION PREVAILING IN THE OPERATIONS AND CHANGES THEREIN

Most of the competition in this activity takes place within the banking industry.

Institutional bodies have established units designed to raise credit for the finance of long-term non-marketable assets.

In financing infrastructure projects and income generating properties in Israel competition exists with local banks and institutional bodies (such as insurance companies and pension funds).

Some of the institutional bodies provide guarantees under the Sales Act to purchasers of 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.

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 to acquisition groups;
- Credit for current finance and/or investments in Israel, and in exceptional cases also for 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 ACTIVITY

DEVELOPMENTS IN THE MORTGAGE MARKET

In 2012, the mortgage market continued to be typified by intense competition between the banks in this market. The volume of mortgage loans granted amounted to NIS 47 billion, an increase of 4% compared with 2011.

	For the nine months ended December 31		
	2012	2011	
	in NIS millions		Rate of change
Housing loans granted out of bank's own funds by the mortgage banks, excluding internal recycling of loans	46,631	44,720	4.3
Loans from State funds	272	153	77.8

SECTORS OF OPERATION

Loans financing the purchase, renovation or construction of residential units. Loans financing the purchase of residential units, the renovation or construction thereof, taken by individuals. These loans constitute most of the activity in the mortgage loan field.

Multi purpose loans secured by a mortgage on an apartment unit. Loans collateralized by a mortgage on a residential unit, granted to individuals for various purposes (other than business purposes).

Acquisition groups. The Bank grants credit to groups of individuals joined together for the purpose of a joint building project by means of an acquisition group. Evaluation of the risk involved in the project and the management of the credit line, if approved, are performed by the project finance unit of the Corporate Division. Approval of the individual mortgage files is conducted in designated branches, specifically defined for this purpose.

Supporting activity - Mortgage related insurance. As an additional security for credit, the bank requires its customers to purchase property insurance and life assurance.

The Bank holds a subsidiary, Discount Mortgage Home Insurance Agency (2005) Ltd., which acts as an insurance broker. MDB also owns an insurance agency, Marbit Insurance Agency (1996) Ltd. These insurance agencies operate independently and sell insurance through a telephone service separate from the Bank’s and DMB's telephone services, respectively.

BUSINESS STRATEGY

The merger of Discount Mortgage Bank with and into the Bank that was completed in 2012, enables the Bank to market mortgages having an overall view of the customer. The mortgage product was added to the basic product basket offered to the Bank's customers. The Bank focuses its operations in this field on the preservation of existing customers.

THE IMPLICATIONS OF THE MERGER WITH DMB ON OPERATIONS

Conduction of the merger project. The merger project was conducted as a cross-organization project, led by the Banking Division with the assistance of outside consultants. Work teams, in which representatives of DMB participated, conducted various aspects of the merger, focusing on the risk management of these merger aspects.

Organizational changes. Upon the consummation of the merger of the operations of Discount Mortgage Bank with and into the Bank, the mortgage consultants have settled into the various branches of the Bank, and a regional mortgage officer has been appointed to coordinate the mortgage operation in each region. Concurrently, a mortgage department has been established at the Banking Division, which is responsible for loan operations intended to finance the purchase of residential units by individuals, including the finance of one-floor construction, as well as to finance by way of granting loans for any purpose secured by a mortgage on the residential unit owned by the borrower, granted to individuals not for business purposes. The department is responsible for the approval of mortgages having a high risk profile, underwriting of credit following its approval and examination of loan portfolios prior to the granting of the loans. The department also assists in the current handling of existing loans, by operating a central settlement unit and units monitoring the appropriateness of collateral offered to the Bank, with a focus on life insurance and insurance of the asset. The collateral underwriting unit, responsible for the manner of registration of the collateral, and the collateral monitoring unit furthering the manner of the registration of the collateral, have been subjected to the Bank's legal advisory group. The collection operations have been subjected to the collection department at the Banking Division. The mortgage loans center is subjected to the direct banking department of the Banking Division. The Bank operates two specialized centers: a sales center dealing with approaches of customers seeking a new loan, including current assistance provided to the customer during the process of approval of the loan, and a customer relations center servicing existing customers. Operations involving the finance of acquisition groups are conducted, as above said, by the construction projects unit of the Corporate Division, which is responsible for approval of projects, the monitoring of their progress and the release of funds of group members. The underwriting of the various mortgage files of group members is to be performed by the branches qualified for this purpose at the Banking Division.

Additional operations performed by DMB have been transferred to various Head Office units at the Bank.

Conversion of the information systems. On December 23, 2012, the Bank completed the transition of the customer data of DMB from the loan management system of DMB to the Bank's systems. Completing the transition of the data enabled the closing down of the system while managing all mortgage loans using the Bank's systems.

Policy regarding mortgage operations. The Bank's policy with respect to mortgage operations has been approved within the framework of the merger. The policy defines the required criteria for securing the quality of credit and reducing risks involved therein, including criteria for the screening and rating of borrowers and credit applications, examination of the repayment ability of borrowers and guarantors for the debt, the type of collateral securing the loan, credit margins, the manner of credit pricing, as well as principles for performing the monitoring and control over credit and collateral. The policy determined various limitations on mortgage operations, both at the individual borrower level and the combined credit operations level.

Upon the merger, the Bank activated a rating model, used in the approval of the transaction and its pricing.

In the past, the Bank granted mortgage loans covered by assisted insurance provided by EMI – Ezer Mortgage Insurance Company Ltd. A limitation has been determined in this matter, regarding the combined exposure to the insuring company. On the background of the Directive of the Supervisor of Banks regarding the limitation of the financing ratio in respect of housing loans, the Bank no longer approves loans covered by the said insurance.

Service. The Bank has seventy-seven branches providing mortgage services through about one-hundred mortgage consultants. The Bank plans to expand this service to additional branches in 2013.

The above stated is considered forward looking information, which reflects the plans of the Bank's Management as of date of publication of this Report. Economic changes on the one hand and restrictions on the Bank's expenditure budget on the other hand may have an impact on expanding the service to additional branches and on the pace of expanding this service.

SCALE OF OPERATIONS AND NET INCOME

The volume of housing loans granted. In 2012, the volume of housing loans granted amounted to NIS 2,728 million, compared to NIS 4,066 million in 2011, a decrease of 33%. The above amount includes some NIS 289 million of loans recycled in 2012, compared to NIS 377 million in 2011, a decrease of 23%.

Net profit of the segment in 2012 amounted to NIS 63 million, compared to NIS 43 million in 2011, an increase of 46.5%. Profits in 2011 were affected by the provision included in respect of the anticipated expenses of the merger between the Bank and DMB.

The credit loss expenses. In 2012, a decrease in the expenses in the amount of NIS 6 million was recorded, compared to a decrease of expense in the amount of NIS 8 million in 2011.

Following are principal data relating to the mortgage activity:

	Domestic operations			
	Households	Small Businesses	Middle Market Banking	Total
	For the year ended December 31,2012			
	in NIS millions			
Interest income, net				
- From external sources	250	47	5	302
- Intersegmental	(96)	(19)	(3)	(118)
Total Interest income, net	154	28	2	184
Non-interest financing income	9	3	-	12
Commissions and Other income	38	2	-	40
Total Income	**201**	**33**	**2**	**236**
Credit loss expenses	-	(6)	-	(6)
Operating and other expenses	134	8	1	143
Profit before taxes	67	31	1	99
Provision for taxes on profit	25	11	-	36
Net Income Attributed to the shareholders of the banking corporation	**42**	**20**	**1**	**63**
Return on equity (percentage)	5.9	27.1	3.4	7.7
Average Assets	19,641	1,127	321	21,089
Average Liabilities	492	14	-	506
Average Risk-assets	9,619	963	301	10,883
Average other assets under management	1,074	-	-	1,074
Components of Interest income, net:				
Margin from credit activity	154	28	2	184
Margin from deposits activity	-	-	-	-
Total Interest income, net	**154**	**28**	**2**	**184**

Following are principal data relating to the mortgage activity (continued):

	Domestic operations			
	Households	Small Businesses	Middle Market Banking	Total
	For the year ended December 31,2011[2]			
	in NIS millions			
Interest income, net[1]				
- From external sources	209	39	4	252
- Intersegmental	(57)	(15)	(2)	(74)
Total Interest income, net[1]	152	24	2	178
Non-interest financing income[1]	(4)	(2)	-	(6)
Commissions and Other income[1]	43	3	-	46
Total Income	**191**	**25**	**2**	**218**
Credit loss expenses	(2)	(6)	-	(8)
Operating and other expenses	149	10	1	160
Profit before taxes	44	21	1	66
Provision for taxes on profit	16	7	-	23
Net Income Attributed to the shareholders of the banking corporation	**28**	**14**	**1**	**43**
Return on equity (percentage)	4.1	15.7	-	5.3
Average Assets	19,124	1,099	272	20,495
Average Liabilities	1,357	50	-	1,407
Average Risk-assets	9,448	1,192	221	10,861
Average other assets under management	1,326	-	-	1,326
Components of Interest income, net[1]:				
Margin from credit activity	152	24	2	178
Margin from deposits activity	-	-	-	-
Total Interest income, net[1]	**152**	**24**	**2**	**178**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Reclassified, see "General" above, at the beginning of this Chapter.

LEGISLATIVE RESTRICTIONS

Supervision over Financial Services Regulations (Insurance) (Maximum insurance commission fees in relation to housing loans), 2012. The regulations were issued on September 24, 2012, according to which the commission fees payable by an insurer to an insurance broker with respect to comprehensive property insurance sold in connection with a housing loan, shall not exceed 20% (including VAT) of the insurance fee collected by the insurer from the insured. The regulations will enter into effect on January 1, 2013. The Regulations will apply to commission fees payable in respect of housing loan contracts becoming effective as from January 1, 2013, or contracts renewed after that date.

Proposed amendment of the Banking Order (Early repayment commissions), 2012. On November 15, 2012, the Supervisor of Banks published a proposed amendment of the Banking Order, which would become effective thirty days from date of publication of the amendment to the Order. The date of publication is still unknown. The essence of the proposal relates to a change in the formula used for the computation of the early repayment commission pertaining to loans granted by a banking corporation for the purchase of a residential unit or as a mortgage on a residential unit, to customers who were granted loans carrying interest at a higher rate than the average interest rate as published at date of taking the loan. For such customers, the formula for calculating the commission will be based on the average interest rate as known on the date of repayment as against the average interest rate as known on the date of granting the loan. In the event that the interest rate on the date of granting the loan is lower than the average interest rate in effect on the date of granting the loan, the formula will be based on the known average interest rate at date of repayment as compared with the interest rate of the loan (namely, the computation formula will remain as in the past). According to the proposal, the amendment shall apply to all early repayments made as from date of the amendment to the Order becoming effective.

Furthermore, in accordance with the proposal, the commission for not providing an early repayment notice will be abolished upon early repayment in the case of death of the borrower. The proposal includes also a change in the arrangements of notices by the customer prior to the making of an early repayment, as well as a change in the manner of disclosure that has to be given to the customer upon early repayment.

GUIDELINES AND DIRECTIVES OF THE SUPERVISOR OF BANKS DESIGNED TO RESTRAIN THE MORTGAGE MARKET

In the years 2010 to 2012, the Supervisor of Banks published several instructions designed to restrain the mortgage loan market, as detailed below:

- **Letter of the Supervisor of Banks in the matter of developments in the risk pertaining to housing loans from July 11, 2010.** Within the framework of the letter, banking corporations were required to reexamine their credit portfolios and their credit policy with respect to mortgage loans, and to verify that their policy agrees with the risk appetite as defined in their business strategy as well as record an additional provision in respect of housing loans.
- **Letter of the Supervisor of Banks in the matter of leveraged housing loans from October 28, 2010.** Within the framework of the instruction, banking corporations were required to increase the risk weight of their housing loans, in accordance with criteria for amount, ratio of finance and type of interest pertaining to the loan.
- **Guidelines by the Supervisor of Banks regarding housing loans at variable interest rate from May 3, 2011**. Within the framework of the guideline, banking corporations are prohibited from granting a housing loan carrying variable interest, where the intervals at which the interest rate may be changed are shorter than five years, in respect of a part of the loan exceeding one third of the total loan amount. It is also required to provide disclosure to costumers that have taken loans carrying variable interest in respect of a part exceeding one third of the total loan.
- **Letter of the Supervisor of Banks dated January 1, 2011, in the matter of a group allowance in respect of housing loans.** Within the framework of this letter, banking corporations are required to record group allowance for credit losses in respect of housing loans, in addition to the allowance for credit losses based on the extent of arrears, and this in view of the fast growth in housing loans, which has not yet been expressed in the allowances based on the extent of arrears.
- **A Directive limiting the financing rate applying to housing loans from November 4, 2012.** The Supervisor of Banks issued a draft directive limiting the financing rate (LTV) relating to housing loans, which applies to loans that have been approved in principle since November 1, 2012 and thereafter (the directive states certain conditions under which a banking corporation would be permitted not to apply the said limitations to a housing loan approved in principle after the said date. It has also been clarified that an approval in principle granted before the said implementation date shall be considered an expired approval in principle, if the period in which the rate of interest determined in respect of which is maintained, has elapsed).

  In accordance with the Directive, a banking corporation shall not approve a housing loan that finances more than 70% of the value of the property, excluding housing loans serving the purchase of the first residential unit of the borrower, where the maximum financing rate will be 75%. The maximum financing rate in respect of housing loans serving the purchase of investment residential unit is 50% (investment residential unit – according to the reporting to the Tax Authority, including a residential unit purchased by a foreign resident). The said limitations shall not apply to a housing loan granted for the purpose of repayment of an existing housing loan, including refinancing, in an amount not exceeding the amount of the existing loan, as well as to a housing loan, which over 50% thereof is financed by State funds and which is guaranteed by it.

  The publication of the Directive comes in continuation of earlier measures adopted by the Supervisor of Banks in relation to housing credit, and is intended to reduce the significant implications of a realization of a crisis in the real estate market, through the reduction of the risk inherent in the banking housing credit portfolio and the reduction of the risk inherent in housing loans financing a high ratio of the property value.

Draft of "Update of Guidelines Regarding Residential Real Estate". On February 18, 2013, the Supervisor of Banks published a draft of a directive that astringents the rules for the measurement of credit risk in the housing loans field, including:

- Increasing the risk weight on housing loans with a financing rate of between 45% to 60% of the property's value to 50%, instead of the current 35%, with regard to loans granted from January 1, 2013 and thereafter.
- Increasing the risk weight on housing loans with a financing rate of more than 60% of the property's value to 75%, instead of the current 35%, with regard to loans granted from January 1, 2013 and thereafter.
- Retaining an allowance for credit losses calculated on a group basis, which is maintained with respect to housing loans, at a rate of no less than 0.35% of the gross loans. According to the draft, this directive is to be implemented with effect from the first quarter of 2013. (The aforesaid does not apply to housing loans for which an allowance is maintained according to the period in arrears or where the allowance is calculated on a specific basis.)

According to a preliminary assessment made by the Bank, based on data as of December 31, 2012, implementation of the draft in its present format, would have increased the group allowance at the Bank and at MDB by an amount of NIS 29 million.

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 FIBI.

COMPETITION

The mortgage loan sector was characterized in recent years by mergers of mortgage banks that had been operating as separate entities, with the commercial banks owning them. This sector is characterized by high competition, which is distinctly price inclined. Among other things, the competition is affected by the bank's view of the mortgage product as a base product for the preservation of existing customers and as a tool for attracting new customers.

MARKETING OF MORTGAGE PRODUCTS

The Bank does not act at the present time in initiative marketing of mortgage loans. As stated, the granting of a mortgage loan is made while focusing on existing customers and the activity is conducted by the Bank's branch layout.

Housing loans in MDB are granted through specialized branches of this bank.

INTERNATIONAL OPERATIONS

GENERAL

The foreign operations of the Discount group are mainly conducted by subsidiary companies in the United States and in Uruguay (including representative offices in Latin America) and in Europe, through the subsidiary company in Switzerland and the Bank's London Branch.

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 guidelines of the Supervisor of Banks, a board of directors of a banking corporation, which operates or intends to operate by means of overseas extensions, is required to discuss and approve a comprehensive policy document with respect to the operations 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.

On April 22, 2012, the Bank's Board of Directors adopted Discount Bank Group's risk appetite declaration, which had been formed as part of the process of evaluating the capital adequacy, in which it had been determined, among other things, that the risks assets rate in respect of the operations of overseas extensions shall not exceed 30% of the risk assets of the Group. In addition, specific limitations have been determined in respect of each of the Bank's overseas extensions.

On December 31, 2012, the calculated rate of the Bank's exposure with respect to overseas extensions stood at 19.47% of total risk assets.

The Bank monitors the development of the risks assets in respect of its operations in overseas extensions.

Overseas regulatory supervision. Operations of the international segment in the various countries are subject to supervision on the part of the appropriate authority in the country in question.

It should be noted that starting with April 2013, a reform in the supervisory layout over financial institutions in Britain will take effect. This reform was admitted as part of the conclusion drawing process by the British Government, following the global financial crisis. The reform states that instead of the existing supervisory authority – FSA (Financial Services Authority), two separate supervisory units will be established, as follows:

The PRA (Prudential Regulation Authority) was set up as a unit of the Bank of England to supervise the stability of financial institutions.

The FCA (Financial Control Authority) was set up as an independent unit to supervise financial institutions from the consumer aspect. The Bank's London branch is subject to both the said authorities.

SCALE OF OPERATIONS AND NET INCOME

Net profit of the operations in 2012 amounted to of NIS 68 million, compared with a loss of NIS 41 million in 2011.

The credit loss expenses in this segment amounted to NIS 162 million in 2012, compared to NIS 339 million in 2011, a decrease of 52.2%.

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 31,2012			
			in NIS millions			
Interest income, net	(1)-	148	256	253	58	715
Non-interest financing income	(1)-	-	-	9	123	132
Commissions and Other income	(1)-	46	43	157	(22)	224
Total Income	**(1)-**	**194**	**299**	**419**	**159**	**1,071**
Credit loss expenses	(1)-	80	73	2	7	162
Operating and other expenses	(1)-	104	156	403	89	752
Operating Income before taxes	(1)-	10	70	14	63	157
Provision for taxes on operating income	(1)-	11	23	8	47	89
Net Income (loss) Attributed to the shareholders of the banking corporation	**(1)-**	**(1)**	**47**	**6**	**16**	**68**
Return on equity (percentage)	(1)-	(0.1)	6.2	2.4	5.2	3.7
Average Assets	13	6,184	7,475	5,098	15,933	34,703
Average Liabilities	17	2,049	2,064	20,031	9,145	33,306
Average Risk-assets	13	7,864	10,008	2,849	4,019	24,753

(1) Amounts lower than NIS 1 million.

Following are the principal data relating to the international operations (continued):

	Households	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Total
	For the year ended December 31,2011					
	in NIS millions					
Interest income, net[1]	[2]-	104	338	179	143	764
Non-interest financing income[1]	[2]-	(2)	-	(2)	7	3
Commissions and Other income[1]	[2]-	47	69	145	(39)	222
Total Income	**[2]-**	**149**	**407**	**322**	**111**	**989**
Credit loss expenses	[2]-	158	153	3	25	339
Operating and other expenses	[2]1	41	198	404	150	794
Profit (loss) before taxes	(1)	(50)	56	(85)	(64)	(144)
Provision for taxes (tax savings) on profit	[2]-	(18)	18	(28)	(75)	(103)
Net Income (loss) Attributed to the shareholders of the banking corporation	**(1)**	**(32)**	**38**	**(57)**	**11**	**(41)**
Return on equity (percentage)	(62.0)	(12.1)	2.3	(26.9)	3.5	(2.3)
Average Assets	8	3,423	8,907	4,769	15,952	33,059
Average Liabilities	19	1,543	2,103	18,559	8,700	30,924
Average Risk-assets	11	6,329	10,741	2,487	4,344	23,912

Note:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Amounts lower than NIS 1 million.

TAXATION

For details regarding taxation of overseas banking subsidiaries, see "Taxation" hereunder.

DEVELOPMENTS IN THE SEGMENT

IDB New York. In the course of 2012, IDB New York continued to improve the efficiency of its representative offices in Latin America, as well as continued to develop its operations, including through the opening of an additional private banking branch in the New York area and the establishment of a company in Hong Kong for the reissue of documentary credits.

Asset-Backed Securities. For details as to the Group's investments in asset backed Securities, see above "Securities" under "Developments of Assets and Liabilities", part A of the Annex to the Report of the Board of Directors.

IDB (Swiss) Bank. For details regarding a claim submitted by a former senior officer of IDB (Swiss) Bank, see "Additional legal proceedings" under "Legal proceedings" below.

SERVICE TO SEGMENT CUSTOMERS

Europe. IDB (Swiss) Bank is a Swiss subsidiary, wholly owned by Discount Bank. IDB (Swiss) Bank operates branches in Geneva and Zurich and provides solutions to both foreign residents and Israeli customers, regarding advanced private banking services and investment management in an international financial center.

A representative office of IDB (Swiss) Bank operates in Israel providing information and promoting the business of IDB (Swiss) Bank in Israel, as well as performing the procedures required for an application regarding the opening of a customer account in an overseas bank.

Discount Bank branch in London focuses on middle market banking services to Israeli and local customers and to corporations in the UK and in Western Europe. The main activity of the branch comprises the granting of credit to the real estate sector, to the hotel sector and the financing of foreign trade in the fuel and energy field.

The branch provides foreign trade services that include, documentary credits and the discounting of bills.
In addition, the Bank has a representative office in France (Paris). The Bank studies the continued operation of the representative office.
America. IDB New York ("IDB Bank") is the largest of the Israeli banks operating overseas.
This bank maintains four branches in the New York area, one branch in Florida, two branches in California and one branch in the Cayman Islands.
IDB Bank has an Uruguayan banking subsidiary, Discount Bank (Latin America), and representative offices situated in Latin America and in Israel.
A representative office of IDB New York operates in Israel, providing information, promoting the bank's business in Israel and providing services related to applications by customers for the opening of a bank account in a foreign country.

SERVICES AND PRINCIPAL PRODUCTS OF IDB BANK

Credit. IDB New York provides bank credit to a wide array of U.S. and Israeli corporations, operating in the U.S., to their shareholders and to private banking customers.
Middle Market. IDB New York grants credit to the middle-market segment, operating in various fields in the New York metropolitan area, South Florida and Los Angeles. The principal business sectors in which IDB New York is active are commercial real estate, apparel and related products, foodstuffs, finance companies, non-profit organizations, the health industry as well as financing local operations of Israeli corporations. Customers are being offered a wide array of services and finance, including the management of customer accounts, guarantees, customer credit, collection, advances against sale invoices and inventory, import finance as well as online cash management.
Asset based Lending. These loans include the financing of inventory and trade receivables and allow the financing of working capital through the leveraging of the customer's current assets.
Factoring. This activity serves a wide range of corporations in a variety of business activities. This involves instituting credit facilities against trade receivables of the customer. This type of bank credit increases the level of reliance of the borrower on his customers and improves the collection process from such customers. One of the advantages of this type of operation is the ability to match a factoring package to the needs of the specific customer.
Commercial Real Estate Lending. The principal products are credit facilities and documentary credits as well as loans at fixed or variable interest rates financing the purchase of real estate, in particular industrial and commercial real estate and the finance of multi family projects, including long-term loans for stable projects and participation in loans with other U.S. financial institutions. Providing finance as above is made by the use of high standards securing a high level of credit quality. In addition, the bank provides various credit services to the local private banking customers.
Personal banking. IDB New York provides a selection of banking products and services, including personal and business checking accounts, capital market transaction accounts, fixed-term deposits and innovative services for online banking operations to private banking customers and corporations.
International Private Banking. IDB New York provides professional private banking services to non-U.S. resident customers. These services are typified by personal banking based on presence in Latin American countries and Israel and the development of stable and long-term personal relations with its customers.
Deposits received from non-U.S. resident customers, which include deposits from the Bank's customers in Uruguay, comprise today most of the deposits made by customers of IDB New York. Bankers of the international division provide to these customers products and services of IDB Capital, a subsidiary of IDB New York, engaged in brokerage and trade on the capital market. International private banking customers enjoy also investments and trusteeship services, as described below, and a variety of structured products. In addition, the bank provides various credit services to international private banking customers.
Private banking services to U.S. customers. These are U.S. resident customers having a high level of personal wealth as well as corporations operating locally. These customers enjoy exclusive services of personal banking as well as an array of

complementary products, including products and services provided by IDB Capital, as stated above, through four branches of IDB New York in the New York area.

Investments and Trust Department. IDB New York offers investment management and trust services to international private banking costumers and to U.S. resident private banking customers, with required changes in accordance with the differences in their type of activity and personal preferences.

EXPOSURE TO RISKS AND RISK MANAGEMENT

RISK PROFILE OF THE DISCOUNT GROUP

The Discount Group is engaged in a wide range of financial operations involving risk taking. The geographical and business spread of the Group and the size of the subsidiaries in Israel and abroad in relation to the operations of the parent company expose the Group to an environment having a variety of different business and regulatory characteristics, which contribute to the spread of the risk.

The major external effects, to which the Group is exposed, are:

- **The capital requirements from the banking industry.** The guidelines of the Supervisor of Banks regarding the implementation of the Basel III principles and the requirement for a minimum core capital ratio that should not fall below 9%, as from January 1, 2015, constitute a challenge for the whole banking industry and are expected to influence the ability of the banking industry, including the Discount Bank Group, to develop business activities involving a higher volume of risk assets;
- **Developments in economic markets in Europe and the U.S..** A slow growth rate is anticipated in the United States in 2013, while the recession will continue in the Eurozone. However, recovery is expected in the second half of the year. The Group follows and monitors the various developments, and has determined indicators for the monitoring of the different exposures;
- **The domestic real estate market.** The real estate sector has the highest exposure rate concerning borrower operations in Israel. The Group endeavors to improve the spread of the credit portfolio;
- **Regulatory changes.** A trend of increased legal and regulatory requirements is being noticed in recent years in Israel and the world over, including the exterritorial application of the law, particularly as regards compliance and prohibition of money laundering, which increase the disclosure and reporting duties of banking corporations, requiring infrastructure preparations and integration of the changes among bank employees. Alongside the various regulatory changes, an increased enforcement trend is noticed in different areas (investment consulting, labor laws, antitrust laws, privacy protection, etc.). The Bank is performing a focused activity towards the improvement of compliance culture and verification of compliance with legal and regulatory demands;
- **Business continuity.** The regional geopolitical situation and the tension with Iran require the Bank to prepare for the facing of stress situations and for the strengthening of business continuity processes. In this respect, the Bank has made preparations in accordance with Proper Banking Management Directive No. 355 in the matter of business continuity, and from time to time it performs various exercises testing the preparedness of the Bank and the Group for various possible scenarios.

Operating efficiency ratios. The improvement in operating efficiency ratios is included among the central targets of the Group, by means of cutbacks in expenditure and structural and procedural changes that would lead to utilization of synergies within the Group. Notwithstanding, this issue remains a significant challenge in view of erosion in profitability and in income resources of the banking industry, as stated, and the structure of the Group's expenses.

In addition to the wide-ranging risk factors mentioned above, the Group is performing a process of identification and assessment of the unique major risk factors to which the Group is exposed.

RISK FACTORS TABLE

As part of the group risk management, and in accordance with the requirements of the Supervisor of Banks in the matter, the Group performs an identification and analysis of risks to which the Group is exposed, divided into types of risks and main business lines, in accordance with the group methodology for the risk profile evaluation.

Banking corporations in Israel are required to include in their annual 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.

The risk factor table presented below, according to the said requirement, comprises the conclusive product of the annual assessment process and includes a self evaluation of the level of risk exposure made by the Bank's Management, based upon the tools and methodologies developed by the Group for the identification and assessment of risks inherent in current operations.

The annual evaluation process relates to the characteristics of activities unique to the Group, and the Table reflects the risk map and identification of the Group's vulnerable areas constitute a basis for evaluation of capital requirements in respect of the Group's unique risk profile within the framework of Pillar II of the Basel principles.

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. In order for this evaluation to be valid, it should be performed by means of advanced models, most of which are not available to the Group at this stage.

Therefore, the risk evaluation and its effect, as presented in the table below, is a subjective assessment by the Bank's Management formed, as abovesaid, according to the methodology for group risk profile assessment, based on the identification and evaluation of the risk inherent in the activities of the Group, taking into consideration the existing control layout, which is reflected in the risk management quality evaluation. The said methodology serves the Group also for the purpose of evaluation of the adequacy of its capital, within the framework of the ICAAP report.

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. Risk environment	Medium-High	A risk stemming from factors and events outside the Group: economic, social, political and geopolitical events, in Israel and abroad, which might affect the Group risk profile. This, by materially impairing the ability of the Group to attain its goals and by damaging its profitability and market share. Assessment of the risk is based upon various additional stress tests and scenarios. Assessment of the effect of the risk remained at a "medium-large" level, in view of the geopolitical and financial uncertainty, which is reflected, among other things, in the capital markets and the non-financial markets in Israel and abroad, the growing cybernetic risks and the increasing regulatory demands as well as the preparations required for their implementation.
2. Overall impact of credit risk	Medium-High	The risk of material impairment in the Group's value and its profitability, as a result of the deteriorating ability of borrowers to honor their obligations. The Group manages this risk by way of implementing strategy, policy and limitations on exposure, relating, among other things, to the volume and quality of the portfolio, borrower and sectorial concentration, collateral, credit control, etc. Assessment of the effect of the risk remained at a "medium-large" level, higher than the specific assessments relating to the risks, quality and concentration of the credit portfolio, due to the continued uncertainty in the risk environment and the scope of the Group's structural exposure. Notwithstanding, the Bank's strategy is focused on improving the quality and composition of the credit portfolio and on improving the quality of risk management and controls, while preparing for the implementation of the directives of the Supervisor of Banks, issued towards the end of 2012, with respect to the management of this risk.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk Factor Impact	Risk description
2.1. Quality of borrowers	Medium	The risk of material impairment in the Group's value and its profitability, as a result of a high evaluation of the quality of borrowers and/or of the value of the collateral, in relation to their proper evaluation. The Group monitors this risk in accordance with its credit policy and the policy regarding reliance on collateral. Assessment of the effect of the risk remained at a "medium" level, despite the reduction in expenses for credit losses and improvements in the process of underwriting and monitoring credit and the reduction in emerging risks.
2.2 Industry concentration risk	Low-Medium	The risk of material impairment in the Group's value and its profitability, as a result of deterioration of the business activity of a certain economic sector. The Group's policy regarding sectorial concentration is conservative. However, a relatively high concentration exists in the real estate and construction sector, characterizing the banking groups in Israel. Assessment of the effect of the risk remained at a "low-medium" level, in view of a low structural risk, relatively to the industry, in view of the determination of an outline in the credit policy for improvement of the mix of the portfolio.
2.3. Borrower/groups of Borrowers	Medium	A risk of the impairment in the value of the Group and its profitability stemming from a decline in the business activity of a borrower/large group of borrowers. Directives of the Bank of Israel determine limits for the concentration of indebtedness of borrowers and groups of borrowers. The Group complies with limitations, analyzes and monitors exposure as well as the activity and solidity of borrowers and borrower groups, as stated. In assessing the exposure, the effect of the financial crisis on large borrowers and groups of borrowers in the market, has been taken into consideration, as well as the volume of capital, which the Bank is required to allocate in respect of this risk. Assessment of the effect of the risk remained at a "medium" level, in view of the stability in various concentration indices and compared with the industry.
3. Overall impact of market risks	Low-Medium	A risk of the material impairment in the value of the Bank and its profitability as a result of changes in economic parameters in the different financial markets that affect the value of the Bank's assets or its liabilities. The Group acts for the management of market risks on an economic and accounting base, aspiring to create a stable and long-term economic value, under given accounting considerations and considerations affecting the capital planning. The types of the Group's principal market risks are interest risk including its components, exchange rate and inflation risk, shares and derivatives risks. Assessment of the effect of the risk remained at a "low-medium" level. On the one hand, there is a decline in the volatility of risk factors, and accordingly a decline in the Group's sensitivity, and improvements in the quality of management were made. On the other hand, the capital requirements emphasize the exposure in accounting terms.
3.1. Interest rate risk	Medium	Interest risk constitutes a material risk to profits or to capital, stemming from movements in interest rates. Changes in the rate of interest affect both the economic value of the equity capital of the Group (economic aspect) and the regulatory capital of the banks in the Group (accounting aspect). The main sources of the risk are re-pricing, a change in the yield graph, exposure to interest base risk and the optionality inherent in different financial instruments. Assessment of the effect of the risk remained at a "medium" level, in view of the scope of exposure from an accounting aspect and the effect of the risk environment. On the other hand, exposure from an economic aspect has declined.
3.2. Inflation rate risk	Low	A risk of the material impairment in the value of the Bank and its profitability as a result of changes in inflation due to the difference between assets and liabilities, including the impact of derivatives and future transactions. Assessment of the effect of the risk remained at a "low" level, due to the immaterial exposure in relation to the volume of operations and capital and the quality of the proper management of the control thereof.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk Factor Impact	Risk description
3.3 Exchange rate risk	Low	A risk of the material 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 derivatives and 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. In consequence of the change in the structural position, the risk of impairment of the capital base, due to changes in the U.S. dollar exchange rate, has increased. On the other hand, the effect of the exchange rate on the capital ratios has been eliminated. Assessment of the effect of the risk remained at a "low" level, since the structural risk is limited in relation to the volume of operations and the Group's equity capital and the quality of the proper management of the control thereof.
3.4. Share price risk	Low	The risk of material impairment in the Group's value and its profitability, as a result of changes in share prices or in equity instruments (including funds) held by it. Assessment of the effect of the risk remained at a "low" level, due to the nature of the Group's holdings and the quality of the proper management of the control thereof.
4. Liquidity risk	Low	The risk of material impairment in the Group's value and its profitability, as a result of the inability to satisfy the Group's liquidity needs and/or uncertainty existing as regards the availability of resources. Realization of the risk means that the Group might face difficulties in honoring its obligations due to unexpected developments, and would be compelled to raise funds and/or realize assets in a manner that would result in a material loss to the Group. Assessment of the effect of the risk remained at a "low" level, principally in view of the high liquidity level in the markets and in the Group and the quality of the proper management of the control thereof.
5. Operating risk	Medium	Risk of a material loss due to impropriety or failure of internal processes, human errors, fraud and embezzlements and the absence of proper checking and control processes, failure of the Group's systems, or as a result of external events. The Group examines on a current basis, both the exposure to operational risk, including exposure to IT risks, and its realization events. The Group applies controls over the different processes and consistently strengthens preparedness in the matters of business and technological continuity. Assessment of the effect of the risk remained at a "medium" level despite organizational changes, made for the purpose of efficiency and which create exposure in the short-term as well as increase the risk in the technological environment, due to extensive actions conducted to improve the risk management processes in the Group, including the strengthening of preparedness in the matters of business and data protection continuity.
6. Legal risk	Low - Medium	Legal risk is a risk of a material loss resulting from the lack of ability to legally enforce the performance of an agreement, or from legal suits to which the Bank is a party. Legal risk includes the regulatory risk stemming from changes in the Law, including changes in legislation, in Court decisions and principally in the guidelines that are being published frequently by the regulatory bodies, to which the Group is subject, and which impose various duties upon it. The Group has not suffered material losses as a result of this risk and the estimation is that the legal controls applied by the Group are appropriate. The evaluation of the effect of the risk was raised from the "low" level in 2011 to a "low-medium' level in this year, due to a multitude of regulatory requirements and the need to prepare for their implementation, this despite the high quality of management thereof.

RISK FACTORS TABLE (CONTINUED)

The risk	Risk Factor Impact	Risk description
7. Compliance, Money Laundering and Financing of Terror risks	Medium	A risk whereby the Group will be affected by a legal or regulatory sanction, sustaining as a result a material financial loss, or damage to its reputation as a result of non-compliance with the provisions of the law or regulation, applying to it in the area of Bank/customer relations and/or in the field of prohibition of money laundering and prevention of the finance of terror. The Group operates current monitoring and control tools, which reduce this risk and acts to improve them. The evaluation of the effect of the risk remained at a "medium" level, despite the multitude of regulatory requirements, this, due to significant improvements made by the Group to the quality of risk management and the positioning of these issues at the central focus of the Group's work plans.
8. Reputation risk	Low-Medium	Risk of material impairment in the Group's business condition, so far as to cause liquidity difficulties as a result of damage to the Group's image, following various publications, correct or erroneous, as viewed by customers, suppliers, correspondent banks, investors, regulatory authorities and others. A negative image might be created as a result of the materialization of a large number of factors, all together or separately, such as: embezzlement, damage to profitability or to capital adequacy, collapsing systems, etc. The evaluation of the effect of the risk remained at a "low-medium" level, due to the quality of management of the risk.
9. Strategic risk	Medium	Strategic risk is a business risk, either of action (such as misled business decisions or improper implementation of decisions), or neglection (such as lack of response to changes in competition), the realization of which might cause a material impairment in profitability, equity, reputation and/or the Group's long-term positioning, thus preventing the Group from maintaining its position as a relevant and significant member of the banking system. The evaluation of the effect of the risk remained at a "medium" level, due to the fact that the evaluation of the risk in 2011 reflected the effects of the risk environment, increased capital requirements and erosion of the banking system's income sources in Israel and abroad, while on the other hand, improvements were made in the risk management quality and the Group is in the midst of establishing strategic planning and a multi-annual capital outline.

PRINCIPLES OF RISK MANAGEMENT

A global trend exists in recent years for the recognition of the risk management field as an essential component in a banking corporation and for emphasizing the need of establishing the risk management concept and its integration across all activities of the corporation in its current operations and in the business decision making process.
The Group operates in Israel and abroad through the Bank, subsidiary companies, branches and representative offices, in all areas of banking and financial services. Accordingly, the Bank is studying the various risks to which the Group is exposed from a forward looking Group standpoint.

GROUP RISK MANAGEMENT

Risk management, including all its different components, is conducted on a group basis. Policy documents, tools, methodologies and infrastructure developed by the parent company are delivered to the subsidiary companies, which are responsible for their adoption, subject to adjustments required by their special operational characteristics. In recent years, the Group acts continuously towards the improvement and tightening of the management, supervisory and control capabilities of the Group, and for the improvement of Group management capabilities, while establishing strategic moves from a Group standpoint and utilizing synergies within the Group.
In this framework, various functions have been defined having group responsibilities who are trusted to act towards the realization of their professional responsibilities while improving the quality of control and of the group risk management,

constantly forming and improving mutual interfaces and involvement in significant decisions taken by subsidiaries.
Risk managers at the subsidiary companies administratively subject to the CEO of the subsidiary, but are guided professionally by the Group's Chief Risk Manager.

RISK MANAGEMENT POLICY AND OBJECTIVES

The risk management concept formed by the Group, reflects and applies the spirit of the guidelines and rules detailed in the Basel II guidelines document and of the directives of the Supervisor of Banks regarding this matter, and it is established in a series of infrastructure documents and policy documents for the management of the various risks. These have been approved by the Bank's Board of Directors and their aim is to outline the comprehensive infrastructure for risk management at the Bank and in the Group. This concept includes extensive addressing of corporate governance aspects of risk management, including the roles of the Board of Directors, senior Management and the definition of authority and responsibility of the functionaries taking part in the risk management processes. Furthermore, the documents define the tools and mechanisms for the identification, measurement, evaluation, control, monitoring and reporting of exposure to risks, including risk appetite and stress tests.
The risk management policy documents are consistent with the developing regulation in the risk management field and with the business reality, and are delivered for adoption to the major subsidiaries, subject to the required adjustments.
The risk management policy documents combined with the Group strategy, the work plans and the restrictions on risk appetite, constitute the basis for the formation of specific policy documents as well as for determining the various responsibility and authority scopes of the different control functions, in obligating work procedures.
The Bank and the Group are implementing an ongoing a process of integrating the organizational structure for risk management and regulation of identification, supervision, monitoring, reporting and control processes regarding risk management and the monitoring of the Bank's risk profile in the policy documents (as detailed above) and in supporting procedures, which define the responsibility and authority of the various control circles and the organizational functions operating there from.
The various policy documents express and provides a supporting framework for methodologies, tools (models) and infrastructure established by the Bank for the purpose of assessing and evaluating the various risks and define the control processes used for the evaluation of the Group's exposures and risk profile, whilst examining and verifying the propriety of the capital held against these risks. In this respect, we should note the use of various quantitative tools enabling the management of risk through varied statistical models (such as models for the credit rating of borrowers, models for assessment of market risks, etc.) as well as by means of methodologies and qualitative tools allowing an orderly and systematic process of identification, evaluation and monitoring of developments in risk and exposure. Alongside tools used for the current management of risk, the Group uses various scenarios in order to examine the exposure to risks under various scenarios and stress situations, as detailed hereunder.
In order to monitor that the major subsidiaries adopt the policy, the tools and the methodologies formed, with changes required by their operations, the integration and application of the methodologies and tools used in the management of risk is monitored. The methods and work procedures regarding risk management, in Israel and abroad, are examined and updated from time to time, in accordance with changes in the internal and regulatory business environment.

RISK MANAGEMENT TOOLS

RISK APPETITE

The declaration of risk appetite relates to the maximum level of risk, which the Group is ready to accept, considering its risk capacity, in order to attain its goals in the ordinary course of business and in stress tests. The risk appetite declaration reflects the risk preferences of the Board of Directors and is approved by it in accordance with the strategic plan and the capital planning.

The risk appetite declaration includes the definition of risks, which the Group accepts in the ordinary course of business and under stress tests, as well as 'top' restrictions with respect to the material types of risk. It also includes a description of the desired business directions and those that should be avoided, including reference to business focuses and growth generators, which comprise the basis for policy determination and specific restrictions with respect to each risk. The "top" restrictions are drafted both as a "qualitative" declaration and as a "quantitative" declaration (which include, among other things, the targets of capital adequacy, return on equity, capital ratios under stress tests, concentration of the credit portfolio and others), in accordance with the type of risk.
In April 2012, the Board of Directors approved the updated risk appetite declaration, which reflects the Group's desired risk level.
The risk appetite declaration is examined and updated on an annual basis, in accordance with changes in the business and regulatory environment, the capital outline and the required capital cushion, in relation, among other things, to new vulnerability areas and to the results of stress tests.

STRESS TESTS

The Bank uses forward looking stress tests as a complementary tool for the risk management processes, the aim of which is to alert Management of unexpected severe results relating to the variety of risks, and to provide indication of the capital that would be required to absorb losses in case of serious upheaval. Furthermore, the importance of stress tests is reflected in challenging the capital planning processes and in determining the risk appetite for vulnerability areas identified by the scenarios.
In 2012, a uniform methodological framework was defined to establish an orderly work procedure for the implementation of stress tests at the Bank and at the subsidiary companies, which details the methodology and the models used by the Group to evaluate the effect of stress tests on credit risks, market risks and on certain components of the statement of income.
The methodology that had been developed combines the examination of the effects of stress tests examining the effects of changes in macro-economic parameters on the statement of income items, using internal models developed by the Bank, and the examination of the effects of stress tests on identified vulnerability areas/specific risk centers. The examination and evaluation process is conducted by the business functionaries. The said combination provides the Bank flexibility and relative speed in running a variety of scenarios with different sensitivity analyses on the one hand, and specific examination of the exposures on the other hand, while addressing the Group's unique risk characteristics and increasing the usefulness of the tool in the hands of the business factors and the risk management group, in determining specific restrictions, in defining the risk appetite and in forming alternative plans for situations in which the risk might materialize.

APPROVAL OF NEW PRODUCTS

In accordance with guidelines of the Supervisor of Banks, prior to the introduction of new products/operations, it is required to perform an orderly and systematic process ensuring the identification and evaluation of all risks inherent in the new product/operation, while examining their effect on the risk profile and verifying the propriety of the infrastructure and controls supporting their operation. The said process has been established in a designated policy and in supporting work procedures applied by the Bank and the Group. The subsidiaries have been guided to deliver for examination and approval of the parent company requests for approval of operation of new products that are material to the operations of the subsidiary.
Integration of the process at the Group level contributes to the ability to identify and evaluate new risks being created, and verify proper preparations and hedge of such risks by means of supporting work processes, infrastructure and controls.

RISK PROFILE EVALUATION

The Bank's and the Group's risk profile evaluation is performed by an orderly and methodical process, through a group methodology, which is at the base of the process for evaluating capital adequacy, the ICAAP (see a wider discussion below). Changes in the risk profile are examined on a quarterly basis, within the framework of the exposure document, compiled by the Risk Management Group. This serves as an evaluation tool assisting the Bank's Board of Directors in the monitoring of changes in the risk profile, while verifying that the Group does not exceed the determined risk appetite.

The report presents the position of the Chief Risk Officer with respect to changes in the risk profile, inter-alia, based on changes in the business and regulatory environments and while examining compliance with limitations and various indicators used for the monitoring of exposure, also by comparison with the banking system. Within the framework of the document, examination is made of material changes in the quality of risk management, including their effect, and quality and effectiveness of the risk management processes, and additional subjects and issues are raised, which enable the focusing of the discussion and risk based decision making.

MODEL VALIDATION

In accordance with the guideline of the Supervisor of Banks of October 2010, the Bank has developed and is implementing a policy with respect to the validation of models, the aim of which is the minimizing of potential risks stemming from reliance on financial models that had not been validated or examined in a proper manner. The policy document, which defines processes designed to ensure that the models used by the Bank are validated as required, was delivered to the principal subsidiaries for adoption, with the necessary modifications. Furthermore, a process has been established for the implementation of the validation findings.

The Bank maintains a catalogue of models, which includes a mapping of models and their priority regarding validation, in accordance with established definitions as to the substance of the model and criteria determining priority for validation.

During 2012, the Bank completed the process of validating models with a high level of priority. These were found to be properly suited for the purpose for which they had been developed. The validation process of the remaining models of medium and low priority, continues.

TRAINING, EXERCISING AND INTEGRATION OF RISK MANAGEMENT CULTURE

The Bank places considerable importance on the improvement and integration of the risk management culture throughout all echelons of the organization. This activity is performed both by the second circle (as defined hereunder, in the item "Control circles") and by the different control functions in the business divisions, which serve as knowledge base integrators in the fields of risk management, with a focus on the compliance risks, money laundering and operational risks management. The employee training and instruction processes include orderly training programs, knowledge tests, training in designated areas, formation of routine work procedures and risk focused controls as well as seminars on various subjects related to improvement of the culture, such as: drawing conclusions, analysis of material failure events, etc.

Due to the nature of the operational risk, the Bank holds an annual instruction program, where in each year the instruction is directed at different levels of duty. Instruction programs for all Bank employees are conducted periodically in order to integrate the operational risk management culture. Most of the instruction programs are conducted from a Group perspective and include the major subsidiaries in Israel.

In addition, with respect to the business areas, and the credit area in particular, instruction and training sessions are conducted periodically, with the aim of improving and updating the existing knowledge base and employees' professional level, including the study of failure events.

RISK MANAGEMENT CORPORATE GOVERNANCE

The Discount Group adopts a corporate governance framework in accordance with the Basel guidelines and the directives of the Supervisor of Banks, established as stated, in a series of infrastructure and policy documents regarding the various risks.
The Board of Directors, its committees and the Management place considerable importance on the establishment of a risk management culture, and endeavor to strengthen the professional stature and performance of the various control functions. This is expressed, among other things, by the allocation of resources and direction towards the improvement of existing monitoring, control and reporting processes.
The risk management structure at the Bank includes five principal lines: the Board of Directors, the Management, and the three control circles, as detailed below.

THE BOARD OF DIRECTORS

The Board of Directors is responsible for the Group's business affairs and for its financial soundness, and its operating framework is defined in accordance with Proper Banking Management Directive No. 301 and is established in work procedures supporting its activities and the activities of its different committees.
The Board is responsible for outlining a strategy and policy that would enable realization of the business goals from a long-term standpoint and maintain the stability of the Group. The Board acts to achieve a tightened and strong connection between the strategic planning process, capital planning and forming the risk appetite declaration, in a manner that would be consistent with the business strategy. The Board is responsible for outlining the risk management policy and for supervising changes in the risk profile, in accordance with the risk appetite and the various restrictions determined under it.
The operation of the Board of Directors is performed by the plenum of the Board and/or by its sub-committees on different subjects, by means of current, periodic and designated discussions, including from a Group standpoint.
Control and monitoring of risk management is conducted by the various committees of the Board, the principal of which are:
- **The Board of Directors' Risk management committee.** The committee assists and advises the Board in fulfilling its duties, verifying the existence of effective risk management processes in the Bank and in the Group. The Committee discusses and recommends to the Board on a policy for the management of the various risks and supervises the implementation of the policy determined by the Board;
- **The Audit committee.** The committee examines the effectiveness of the internal control group through the various audit and control functions, monitors their findings and, among other things, is responsible to advise to the Board ways in which to rectify them. For the purpose of fulfilling its duties, the audit committee relies on the independent control functions, including the internal control group, the compliance, money laundering and finance of terror prohibition functions.

MANAGEMENT

The Bank's Management has many responsibilities as regards the risk management in the Bank and the Group. The policy documents (see above) include wide references to the tasks of the Management as an "organ" in the risk management field, where, in general, each task under the Board of Directors' responsibility, requires the prior attention of the Management – holding preliminary discussions, performing control and supervision tasks and forming recommendations for the Board of Directors. The Management is responsible for applying the risk management model and policy, maintaining control and supervision over the quality of risk management and the propriety of the risks measurement and evaluation. The Management acts through the Chief Risk Officer and the risk management group and through the risk managers committee.

COMMITTEES AND FORUMS

Different forums and committees operate within the framework of the Management, which contribute to and assist the Management in its risk management tasks. The principal forums and committees headed by the Chief Risk Officer, are: the risk managers committee, stress tests forum, model validation committee and new products committee. Furthermore, a large number of designated committees regarding different fields of activity operate at the Bank. These committees are, among other things, involved in the risk management process. Among these may be mentioned the different credit committees, assets and liabilities management (ALM) committee, market and liquidity risks forum, the Group operational risk controllers forum, and more.

The risk managers committee. The committee constitutes the central forum by which risk management is being conducted. This committee holds current discussions regarding all matters required to promote and improve the risk management processes at the Bank and at the Group, including: methodologies, regulatory directives, accepted practice and such like; holding consultations regarding risk management matters; presentation of reports and formation of recommendations regarding the risk management field; deciding on the means and tools required for risk management; monitoring developments in risk exposure compared with policy and restrictions on exposure as determined by the Board of Directors, and holding a periodic discussion with respect to realized material risks (failure events) and the ways for minimizing them.

The Bank's Chief Risk Officer heads the committee, the members of which are members of the Management who are risk managers at the Bank as well as the risk managers of MDB and of ICC.

In addition, the following Group forums are operating:

- **Group stress tests forum.** A forum headed by the Chief Risk Officer, the object of which is to recommend to the Management and the Board on parameters of stress tests to be examined as well as scenarios which require capital allocation;
- **Group model validation committee.** A committee headed by the Chief Risk Officer, the object of which is to approve risk management models at the Bank and the group and to recommend to the Board on the approval of the policy and the cataloguing of models;
- **New products/operations committee.** A committee headed by the Chief Risk Officer, the object of which is to examine whether new products or operations comply with characteristics that require approval by the Bank's Board of Directors, in accordance with the new product policy.

The Board of Director's Committees, the Management committees and the different forums assist the Management and the Board to conduct in-depth discussions, which contribute to the improvement of the quality of control and management at the Bank. The various committees and forums convene on a periodic basis, certain of which on a group basis, and enable the focused formation of products brought for approval and comments by the Management and the Board, while examining and presenting an analysis and alternatives for the decision, and in many cases, the determination of clear indices supporting the decision making process.

CONTROL CIRCLES

The risk management concept at the Group is based upon three control circles participating in the current risk management:

- **Risk bearers (first control circle).** All units of the Bank and in particular business units that accept risks and are responsible for the current management of such risks through control procedures conducted by the business functions in the front office as well as in the middle and back offices, which comprise designated control units operating in the business divisions. These units are sometimes responsible for the formation of "business strategy and policy", for its realization and for the implementation of the "risk management policy" in relation to the risks accepted within the framework of their operations. In recent years, the Group has strengthened their status, qualification and independence of the different control functions operating within the first control circle, and these functions are guided professionally by the Risk Management Group and the Chief Risk Officer, as detailed below.

- **Chief Risk Officer and the Risk Management Group (second control circle).** This circle is responsible for the overall risk management framework at the Bank. See below.
- **Internal audit (third control circle).** The internal audit has a central role in the risk management field, from a Basel standpoint, being subject to the Chairman of the Board, and as such, independent of the first and second control circles, and assisting the Management and the Board in the efficient and effective realization of their duties and responsibilities. Among other things, the internal audit conducts a current and independent review of the Risk Management Group and of the evaluation of the Group's risk profile, including efficiency and effectiveness of controls and of the resources allocated to a proper risk management, as well as an examination of the reliability and timing of reports to the Supervisor of Banks and to regulatory authorities.

RISK MANAGEMENT GROUP (SECOND CONTROL CIRCLE)

A Risk Management Group was formed at the Bank in 2010. Heading the Group is the Chief Risk Officer, who is also a member of the Management who reports to the President & CEO independently from the business lines that create the risk. The Chief Risk Officer is required also to assist the Board of Directors in fulfilling its duties regarding risk management, and he has full access to the Board of Directors and to the Board's Risk Management Committee. The Chief Risk Officer is responsible for the management of all risks at the Bank and the Group, within the framework of the second control circle, excluding legal and regulation risks, which are the responsibility of the Chief Legal Adviser, and financial reporting risks, which are the responsibility of the Chief Accountant (which receive support in the methodological field from the second control circle).

Risk management has been defined by the Bank as a function having Group responsibility. Accordingly, special emphasis is being put on tightening the interfaces with the subsidiaries and the overseas extensions and on the guidance provided to them regarding the adoption of processes and tools in methodologies determined by the parent company, with the required adjustments. Among the main tasks of the group may be mentioned the identification and correct evaluation of the exposures and verification of capital adequacy, ensuring the long-term stability of the Group, taking into consideration, among other things, changes in exposures and in the business and regulatory environment, compliance with risk appetite as determined by the Board of Directors, involvement in material processes of decision making and in strategic processes, such as the planning of capital, with the aim of verifying the integration of risk management aspects in these processes and the examination of their effect on the risk profile at the Bank and the Group, as well as current reporting to the Management, to the Board of Directors and to committees of these organs, as a risk based management tool.

The Risk Management Group combines under it the independent functions of risk management, comprising the managers and units of credit risk management, market and liquidity risks, operational risk and IT risks as well as units for the management of compliance risk and prohibition of money laundering and finance of terror risks. The managers of the risk management units operate, as stated, as the second control circle and conduct a variety of processes for the measurement, evaluation and control of risk and the development of methodologies. In addition, the Chief Risk Officer is responsible for control functions, including the credit controller, as well as functions in charge of supervision and evaluation processes, including supervision and control procedures over subsidiaries and overseas extensions, processes for the integration of the risk management culture, in accordance with the policy documents and the process for the evaluation of capital adequacy.

BASEL II AND THE REGULATORY CAPITAL REQUIREMENTS

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 recommendations intended to ensure proper regulation with respect to capital adequacy of banks in the various countries (hereinafter: "Basel II"). The "Basel II" guidelines have been regularized in Israel within the framework of Proper Banking Management Directives Nos. 201-211.

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. For additional details, see hereunder.
- **Second pillar - Supervisory evaluation (SREP - Supervisory Review and Evaluation Process).** 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"). For additional details, see hereunder.
- **The third Pillar – "market discipline".** The banking corporations are required to present proper disclosure and expand the reporting to the public regarding the risks involved in their operations, in a manner that would enable the public to better understand the overall risks to which they are exposed, the way in which such risks are being managed and the amount of capital allocated in their respect.

FRAMEWORK FOR MEASUREMENT AND CAPITAL ADEQUACY ACCORDING TO THE FIRST PILLAR OF BASEL II

The framework for the measurement and capital adequacy, as adopted by the Supervisor of Banks, applies to the Discount Group headed by the parent company, Discount Bank. The said framework applies also to a banking corporation and auxiliary corporations of the Discount group: MDB and ICC.

The framework is being implemented on a consolidated basis and there is no difference between subsidiaries included on a consolidated basis in accordance with generally accepted accounting principles and the supervisory consolidated basis of the framework. For details of the principal subsidiaries of the group, see "Main investee companies" and Note 6 to the financial statements.

Investments in financial companies, in which the Bank has a material influence and which are included in the Bank's books in accordance with generally accepted accounting principles, are deducted from capital for the purpose of implementation of the Directive. The principal investment in an affiliate as stated above, is the investment in the First International Bank.

CAPITAL REQUIREMENTS

- **Credit risks.** The capital requirements in respect of credit risks are computed according to the standard approach, in the basis of external credit ratings;
- **Market risks.** The capital requirements in respect of market risks are computed according to the standard approach;
- **Operational risks.** The capital requirements in respect of operational risks is computed, as from the year 2012, in accordance with the standard approach, according to which, the gross income from the various business lines is multiplied by a different coefficient for each business line, which fluctuate between 12% and 18%, as determined in the instruction.

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.
For additional details, see above "Capital Management" under "Capital Resources".

THE ICAAP PROCESS - CAPITAL REQUIREMENTS ACCORDING TO THE SECOND PILLAR OF BASEL II

The internal capital adequacy assessment process (hereinafter: "ICAAP") is a self evaluation process performed within the framework of the second Pillar of Basel II, which is intended to ensure a continuous capital adequacy of the Group in relation to its risk profile.
The ICAAP is a continuous process that includes an annual assessment of the capital adequacy, at a Group level, presented to the Supervisor of Banks in Israel as part of the ICAAP report, and which is examined by the Supervisor of Banks within the framework of the supervisory review process (hereinafter: "SREP"). During the year, following the submission of the annual report, the Chief Risk Officer monitors and supervises changes in the risk profile, ensures the capital adequacy, while monitoring and examining developments in risk assets and capital.
From the standpoint of the Basel II framework, the ICAAP is a process complementing the instructions of the first Pillar, providing obligatory framework for capital allocation.
In this process, the banking group is required to evaluate, by itself the adequate volume of capital requirements in relation to the risks to which it is exposed and to the quality of its risk management. Accordingly, the ICAAP includes an examination of all risk management processes in the Bank Group, including corporate governance of risk management, identification of material risks to which the Group is exposed, quantification of the overall exposure to risk in terms of capital and performing a comparison between the volume of exposure and the Bank's capital resources at the present time and from a forward looking standpoint, in order to determine whether the Bank's capital is adequate to ensure the financial stability of the Group and to provide a response to market cycles and to long-term stress periods.
As part of the ICAAP, banking corporations are required to reassess their capital requirements, both in respect of risks that were addressed by the first Pillar and material risks not addressed by it, and determine, subjectively, what is the adequate level of capital required in respect of such risks (capital adequacy assessment).
The additional risks included in the second Pillar are composed of risks not addressed by the first Pillar, where it is possible to compute the extent of related exposure and the capital allocation required in their respect on a quantitative basis (such as: concentration risk, interest risk in the banking book) and from qualitative risks, which are examined within the framework of the comprehensive examination of the capital adequacy (such as: reputation risk, compliance risk, strategic risk, legal risk, etc.). Furthermore, within the framework of the second Pillar, banking corporations are required to perform stress tests in order to examine their capital position.

DISCLOSURE IN ACCORDANCE WITH THE THIRD PILLAR OF BASEL II

The Basel II guidelines broaden the qualitative and quantitative disclosure requirements in the matter of credit risk, market risk and operating risk exposure management.
Qualitative and quantitative disclosure regarding the various risks is presented above and below in the Chapter "Exposure to Risk and Risk Management".

It should be noted that certain data, the disclosure of which is required according to the third Pillar of Basel II, is presented in the Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "B", items 1-7).
Furthermore, the said Annex includes a table relating the disclosure requirements according to the third Pillar to the data presented in the Report (Part "B", item 8).

BASEL III

The recommendations of the Basel Committee, "Basel III", are intended to improve the stability of banks in crisis periods (translation of the instructions is available on the website of the Bank of Israel). As part of the lesson learnt from the global crisis that started towards the end of 2007, The Basel Committee has decided that the core capital of banks comprises the principal component for the absorption of losses, in the ordinary course of business as well as in crisis times, therefore, the maintenance thereof at an appropriate level is required in order to avoid damage to the financial corporation. The Basel III recommendations are expected to apply in the various countries as from 2013. The recommendations refer to several principal issues:

- Improving the quality of capital;
- The addition of a requirement for leverage ratio management;
- The addition of a requirement for capital in respect of counterparty risk in derivative transactions;
- The definition of a quantitative framework for liquidity, which dictates the liquidity ratio for a period of one month, and an additional liquidity ratio for a period of one year, the manner of their computation has to reflect also stress tests;
- Supervision that would review the risk to the financial system beyond the risk to a certain sector or a certain financial institution.

Within the framework of the said recommendations for improvement of the quality of capital, the Basel Committee recommends, among other things, that the core capital components should be strengthened and that its minimum ratio should be increased. See wider discussion below in the item "Draft instructions for risk management".

Directive in the matter of the minimum core capital ratios. For details regarding the Guideline of the Supervisor of Banks, according to which, starting January 1, 2015, banking corporations will be required to attain minimum core capital ratio of 9%, see Note 14, subsection 5, to the financial statements.

The Bank is making the necessary preparations in order to comply with the determined requirements.

Preparations for the implementation of Basel III in Israel. During 2012, the Supervisor of Banks operated, jointly with the banks, work teams for the formation of a format for the adoption of the Basel III guidelines in Israel.

At the same time, the large banks were required to submit a quantitative impact study (QIS) presenting an assessment of the effects, under certain assumptions, at the end of the implementation period of the Basel III regulations (the year 2022), based on data as of December 31, 2011. On June 17, 2012, the Bank submitted a quantitative evaluation, as stated. In the absence of guidelines regarding new capital instruments, the submitted evaluation had been prepared at this stage on the basis of the assumption that the core capital would not include new capital instruments.

On May 28, 2012, a circular of the Supervisor of Banks regarding “Basel III – Positions of the Supervisor of Banks” was distributed. A draft was attached to the circular that includes the Supervisor of Banks positions as of that date with regard to the manner that the Basel III regime is to be implemented in Israel, with regard to the definition of the capital base and with regard to strengthening the risk coverage.

The circular included an outline of the further process of the adoption of Basel III, as follows:

- Once the results of the quantitative impact study are received and analyzed, the Supervisor of Banks will form a supplementary draft, which will include, inter alia, reference to the requirements from the aspect of the additional Tier 1 capital adequacy ratio, the Tier 2 capital adequacy ratio and the total capital adequacy ratio, as well as including implementation timetables (transition provisions);

- Further on, requirements will be formulated with regard to equity debt instruments, which qualify for inclusion in the capital base, with regard to conversion triggers, and non-viability points;
- The requirements in connection with liquidity management and the restriction of leverage will be formulated during 2013.

For details regarding draft circular letters in the matter of the adoption of Basel III in Israel, see below. For additional details, including the Bank's evaluation regarding the effect of the adoption of the new instructions, see "Capital resources" above.

REGULATORY FRAMEWORK FOR RISK MANAGEMENT

INSTRUCTIONS PUBLISHED DURING 2012 AND IN THE BEGINNING OF 2013

Proper Banking Management Directive No. 301 – "the Board of Directors". On December 31, 2012, the Supervisor of Banks issued an amendment to Proper Banking Management Directive No. 301 in the matter of the roles of the Board of Directors. The Directive includes amendments in accordance with the changes in Proper Banking Management Directive No. 310 in the matter of "Risk management", in Proper Banking Management Directive No. 311 in the matter of "Credit risk management" and in the public reporting directives in the matter of allowances for credit losses;

Proper Banking Management Directive No. 310 – "Risk management". On December 27, 2012, the Supervisor of Banks issued Proper Banking Management Directive No. 310 in the matter of "Risk management". This Directive replaces the old Directive No. 339 and also the letter of the Supervisor of Banks in the matter of December 2009, and details and defines the risk management concept, including the required management procedures for each type of risk, across all the operations of the corporation, with the aim of supporting the ability of the banking corporation to identify and respond to developing risks in an efficient and timely manner. The Directive addresses the minimum processes and standards in the risk management environment and defines central concepts in relation to risk management processes with the aim of forming a uniform language. Furthermore, the Directive defines the control circles required by the Supervisor of Banks, with everything based upon "corporate governance principles" and "supplementary instructions for the second pillar" of the Basel Committee. Prior to the publication of the final Directive, the Bank had made preparations for the implementation of the instructions by performing gaps reviews in respect thereof, and prepared supporting work plans for the implementation of the new Directive;

Proper Banking Management Directive No. 311 – "Credit risk management". On December 27, 2012, the Supervisor of Banks issued the Directive. For additional details, see below in "Credit risk management";

Proper Banking Management Directive No. 339 – "Market and interest risk management". On December 27, 2012, the Supervisor of Banks issued the Directive. For additional details, see below in "Market and interest risk management";

Proper Banking Management Directive No. 342 – "Liquidity risk management". On January 16, 2013, the Supervisor of Banks issued an update to Directive No. 342. The effective date was fixed for July 1, 2013 (excluding the implementation of the stable financing ratio, the effective date of which was fixed for December 31, 2013). For additional details, see below in "Liquidity risk management";

Proper Banking Management Directive No. 350 – "Operating risk management". On December 27, 2012, the Supervisor of Banks issued the Directive. For additional details, see below in "Operational risk management";

Proper Banking Management Directive No. 355 – "Business continuity management". On July 9, 2012, the Supervisor of Banks issued the Directive. For additional details, see below in "Operational risk management".

DRAFT INSTRUCTIONS REGARDING RISK MANAGEMENT

Draft amendment of Proper Banking Management Directives in the matter of "Basel III". On December 30, 2012, the Supervisor of Banks issued a draft amendment of Proper Banking Management Directives Nos. 201-205, 208 and 211, which includes amendments of existing measurement rules regarding capital adequacy ("Basel II" principles), as well as new guidelines designed to integrate the principles of the Basel Committee document published in December 2010 ("Basel III" principles) relating mainly to the improvement of the "capital base" quality and to enhancing "risk coverage", as detailed hereunder:

- Stricter criteria have been introduced for the recognition of capital components that would be included within the framework of the Tier I capital and would principally include: share capital, retained earnings and capital reserves (including premium on shares);
- A new capital tier has been added – "additional Tier I" to include perpetual capital debt instruments (which may be eligible for early redemption only after five years from date of their issue and subject to a prior approval of the Supervisor of Banks) and which include mechanisms for "loss absorption", including: Discontinuation of interest payments to holders of the instrument, at the exclusive discretion of the issuing banking corporation;
- The differentiation existing in the "Basel II principles" between the two types of capital in Tier II ("Tier II" and "Upper Tier II") has been cancelled and accordingly the capital of Tier II will include only one tier. Furthermore, stricter criteria have been applied for the recognition of capital debt instruments issued by the banking corporation, as "Tier II capital components".
- On the other hand, banking corporations will be permitted to include within the framework of "Tier II" capital components also the balance of the allowance for credit losses computed on a group basis (subject to a maximum amount equal to 1.25% of the weighted average risk assets in respect of credit risk, as defined in the instructions).
- Stricter regulatory adjustments in respect of the capital means have been introduced, as well as additional components to be deducted from the Tier I capital, including:
  - Accounting adjustments in respect of the bank's credit risk (DVA) included in the fair value of liabilities regarding derivative instruments.
  - Deferred tax assets the realization of which is based on the future profitability of the banking corporation.
  - "Excess deferred taxes" comprising the balance of the deferred tax assets derived from timing differences, which exceeds 10% of the Tier I capital (until January 1, 2017 – the part exceeding 15% of the Tier I capital).
  - A minimum total capital ratio of 12.5% is to be determined for weighted average risk assets.
- The draft amendment includes "transitional instructions" permitting the gradual adoption of the new guidelines included in the draft amendment relating to the stricter criteria for the recognition of capital and for deductions from capital, as follows:
  - The requirements for the deduction of "excess deferred taxes" shall be applied gradually in the years 2014-2016 (hereinafter: "the transitional period") and shall be adopted in full as from January 1, 2017. The gradual adoption will include the deduction of a certain part only of the "excess deferred taxes" (as defined in the amendment), and the recognition of the other part as a "risk asset".
  - Whereas the debt notes that had been issued in the past by the banking corporations do not comply with the criteria for the recognition as a "Tier II" capital component (due to the fact that they do not include a loss absorption mechanism), it is proposed to establish in the transitional instructions a mechanism for the gradual adoption of the criteria for the recognition as regulatory capital of the said debt notes, which will apply in the years 2014-2022 (hereinafter: "the transitional period"), according to which the said debt notes will be partly recognized as "Tier II" capital in the transitional period, at diminishing rates, until their complete elimination at the end of the transitional period.

A binding version of the said instructions has not yet been published and no date has been fixed for their initial adoption.

Draft Proper Banking Management Directive No. 319. On June 26, 2012, the Supervisor of Banks issued a draft amendment of Proper Banking Management Directive No. 319, in the matter of credit control. In the said Draft, the emphasis has been shifted from quantitative indicators to qualitative indicators and to products required from the operation of the credit unit. The draft extends the responsibility of the credit controller, and among other things, includes requirements for focusing on the assessment of risk and on the considerations applied by the business factors when making decisions involving the granting of credit, for examining the quality of credit decisions, the appropriateness of the classification and the allowance and for examining the credit policy.

Draft Proper Banking Management Directive in the matter of interest risk management. On December 2, 2012, the Supervisor of Banks issued a draft amendment of Proper Banking Management Directive in the matter of interest risk management. The draft was distributed as part of adjusting the Proper Banking Management Directives to the recommendations of the Basel Committee and to standards accepted in leading world countries. The draft is designed to regulate the requirements and expectations of the Supervisor of Banks from the banking corporations in everything related to the management of interest risk.

CREDIT RISK MANAGEMENT

Credit risk is the risk of damage to the Bank's value and 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 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, independent risk control and evaluation, and the factors engaged in the audit.
Hereunder is included reference, as the case may be, to the principal subsidiaries - IDB New York and Israel Credit Cards ("ICC"). In view of the fact that MDB 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.

PROPER BANKING MANAGEMENT DIRECTIVE NO. 311 – "CREDIT RISK MANAGEMENT"

On December 27, 2012, the Supervisor of Banks issued Proper Banking Management Directive No. 311, in the matter of "credit risk management", which is to come into effect January 1, 2014. The Directive adopts the Basel Committee's guidelines and global leading supervisory authorities' concept with respect to credit risk management. Among other things, the Directive defines the structure of credit risk management required from a banking corporation, and the distribution of authorities regarding credit risk management among the various functionaries in the banking corporation. These requirements comprise an adoption of the approach, according to which, in order to support proper credit decisions making, a high level of involvement by an independent factor in the business units is required. In particular, such involvement is required in the formation of the credit policy, in determining ratings in the classification of debts and in the determination of allowances for credit losses. It has also been determined that decisions regarding the approval of material exposure shall take into consideration the opinion of the risk management function.
Banking corporations are required to present the plan of application of the Directive to the Supervisor of Banks, no later than July 1, 2013.

THE BANK'S STRATEGY AND POLICY WITH RESPECT TO CREDIT RISK MANAGEMENT

CREDIT RISK MANAGEMENT POLICY

The credit risk management policy is aimed at establishing an infrastructure for credit risk management at the Bank and at the Group, in a manner that would contribute to attaining an adequate return for the risk taken (in risk adjusted terms), in accordance with the determined risk appetite, while understanding the credit risk profile of the Bank and the Group and ensuring that the level of capital reflects this risk profile.
The approach forming the basis for the policy is the definition of the framework for credit risk management, and the responsibility of the functionaries at the Bank involved in the identification, measurement, monitoring and control processes regarding the credit risk that the Bank accepts.
The credit risk management policy determines, among other things, the organizational structure of the risk management, the

role of the control functionaries, the credit risk appetite declaration, restrictions and limitations for credit risk acceptance, criteria for credit approval, the credit approval process, credit risk identification process, processes for the measurement and evaluation of credit risk factors and reporting procedures regarding exposure to credit risk.

CREDIT STRATEGY AND POLICY

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 Bank's policy and strategy documents are discussed and approved by the Management and the Bank's Board of Directors on an annual basis. Due to the crisis in 2008, 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 strategy is determined with respect to various areas and activities, among them: economic sectors, large borrowers and borrower groups. Special emphasis is put on economic activities having a material and unique credit exposure, such as: the acquisition of means of control, holding companies, leverage finance, the diamond sector, real estate and project financing, housing loans, acquisition groups, capital market participants and credit provided by the London Branch.

A policy has been determined 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).

In addition, the regulatory limitations imposed on banking corporations within the framework of directives of the Supervisor of Banks as to industry concentration, single borrower, group of borrowers, a banking borrower group, the credit policy of the Bank and of its subsidiaries include internal restrictions and lines of operation. The Discount Group complies with these limits.

In addition, the credit policy established criteria and guidelines for the granting of credit, a pricing methodology and rules intended to reduce the credit risk through collateral and its management.

The Bank's credit policy includes detailed rules regarding collateral, with reference to obtaining collateral, managing the different types of collateral and the rate of reliance thereon. As a general rule, the Bank grants credit to its customers against collateral of various kinds, including liquid assets, fixed assets and pledges and guarantees of all types. To the extent possible, the collateral is modified to the credit secured by it as regards to the credit period, currency of the loan, redeemed or renewable credit. A valuation of the collateral is made on a periodic basis. In addition, the credit policy determines maximum reliance rates according to the nature of the collateral.

Credit policy of IDB New York. The credit policy of the subsidiary, which is approved each year by its Board of Directors, establishes rules for the granting of credit according to the following categories of concentration: 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.

In addition, the policy document determines 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. The credit policy also determines the credit authorization hierarchy, and the roles of the business and control units.

The credit policy of ICC. The credit policy which is approved by the Board of Directors of ICC at least once a year, determines limitations to the different lines of operation.

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

- **Business units.** 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.

Credit committees. The Bank has determined a scale of credit authority for managers and the various credit committees, reaching up to the Board of Directors.

Presented below is a list of the Bank’s credit committees, as determined by the Board of Directors:

- 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 Banking Divisions);
- Local credit committees (in accordance with the business unit to which the customer belongs).

The credit committees discuss and make decisions in matters of credit, both as regards to applications for new credit and as regards to existing indebtedness. Committee discussions include a review of the debtors, including their compliance with credit terms, changes in the profitability of credit, developments in their financial condition, evaluation of the level of exposure to changes in exchange rates, the debtor's credit rating, etc.

In January 2013, the Board of Directors approved a new credit authority hierarchy, in accordance with the new Proper Banking Management Directive No. 311, which reduces the involvement of the Board in credit approval, focusing it mostly on the approval of transactions that are exceptional in relation to the determined policy.

Presented below are the control units in the various divisions:

- **Credit management unit at the banking division.** The unit manages the corporate credit risk at the banking division vis-à-vis the business functions in the division (business centers and regions), the control, collection and compliance department and various functions at the Bank, such as the accounting group and the risk management group.

  The unit is responsible, among other things, for providing an opinion and for approval of credit by a second signature on credit applications, participation in the various credit committees, responsibility for the drafting of methodologies, procedures and training concerning the corporate credit in the division, quality reasonableness examinations, rating of indebtedness and industry classification of the division customers.
- **The control and compliance department at the banking division**, which includes the following units:
  - **The control and compliance unit** deals with across the board audit reports as regards to procedures, locating major deficiencies, taking measures to avoid their recurrence and performance of risk focused controls.
  - **Credit control unit** performs current monitoring and control of accounts of the business sector customers, control of debtor reports for the early identification of troubled customers, current activity for the reduction of accounting write-offs in respect of customers examined on a group basis, monitoring customers showing negative indicators or irregular operations, control over mortgage activities and performance of risk focused controls.

- **Debt monitoring unit** identifies accounts having "negative characteristics" in order to avoid credit failure, and performs account monitoring through the "Red Lights" system. In addition, the unit performs in-depth control over consumer credit at all branches of the Bank.
- **Business control unit** is responsible for performing conclusion drawing investigations, monitoring of exceptional performances of units and industry developments, control over the proper industry classification, management of monitoring lists, control over credit approved under personal authority, examination of exogenous effects on the credit portfolio and performance of risk focused controls.

- **Credit risk management unit at the Corporate Division**, which includes the following units:
  - **"Second opinion" unit.** A unit engaged in rendering independent opinions, being part of the underwriting process (in the process of an in-depth analysis of credit applications in accordance with defined criteria), validation of indebtedness rating and review of certain stress tests in relation to the credit portfolio;
  - **Business control units** monitor deviations from credit terms and signs of deterioration in the financial condition of customers with a view of early identification of weaknesses in the credit portfolio. This process is based on periodic irregularity reports and ongoing follow-up of customers in respect of whom "red flags" have been identified and the monitoring thereof by way of conducting a "follow-up list". Furthermore, the unit is engaged in the sample test of the value of collateral and is responsible for control and warning reports with respect to the value of the collateral, the validation of evaluations, etc.;
  - **The Economic department,** 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; and development and absorption of methodologies and tools supporting a specific analysis of credit transactions, financial statements analysis, repayment ability evaluation, valuation of collateral and analysis of credit reasonableness.
  - **Credit management and operation unit in the Corporate Division** 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; The unit is also responsible for the writing of a part of the credit and collateral procedures at the Bank.
  - **The valuation unit,** the duties of which are to examine, render independent assessments and validate the estimates made of the value of real estate serving the Bank as collateral for credit, while determining the maximum value of assets used as collateral.
  - **Credit documents control unit.** This unit is in an advanced stage of establishment. Its main duties will be: examination of the regularity of the credit and collateral documents, formation of a concluding opinion and control over missing items. The unit will report deficiencies in credit and collateral documents to the division management and to other control factors at the Bank.

Treatment of troubled debts. 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 in the corporate division and deals with large credit files, and the collection department, responsible for customers of the Banking Division, managing small credit files.

THE SECOND CONTROL CIRCLE

- **Credit risk management department.** The duties of the department, 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 (in cooperation with the business factors), all this in order to define the "risk appetite", to monitor and verify that the credit portfolio is managed in accordance with exposure limitations approved by the Board of Directors;
  - Challenging the credit policy documents of the Bank and its subsidiaries;
  - Analysis of the credit risk profile relating to vulnerable areas at Group level;
  - 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 allowance, according to the directive of the Supervisor of Banks concerning defective debts;
  - Evaluation of the credit risk profile of the Bank and of the Group and reporting to the Board of Directors within the framework of the exposure document and the ICAAP report;
  - The development of methodologies for the quantification of stress tests and the examination of their impact on the portfolio of the Bank and of the Group.
- **The credit control unit** evaluates, independently of factors approving the credit, the quality of the specific borrower and of the Bank's credit portfolio. The unit renders an opinion on the quality of borrowers rating and also examines documents of the collaterals in compliance with the Bank's policy and procedures. Furthermore, the unit takes part in the independent review process for the examination of the adequacy of the allowance for credit losses. The sample test includes the Bank's principal borrowers, according to that required under Proper Banking Management Directive No. 319. The unit reports to the Bank's Chief Risk Manager.

THE THIRD CONTROL CIRCLE

The internal audit performs sample test checks of credit files. In addition, it examines the procedures for approval of the credit granted, and its management and tests whether work procedures are in line with the Bank's procedures. 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 a structured one, which begins with the interface between the customer and the customer relation officer at the Bank, the writing of the application, analysis of the application, stage 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 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.

Credit underwriting in the mortgage field is performed through a comprehensive examination of the borrower, with emphasis on his solvency, and an examination of the transaction, its purposes and the collateral pledged to secure the credit.

Within this framework, inter alia, the following examinations are performed: a review of the borrower's business, his income and his expenses; his personal characteristics; his solvency; the overall impression of the consultant with regard to the borrower; the borrower's credit history; and the borrower's present rating and his rating history in the Credit Scoring system.

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 allowances at the appropriate time. The process of classifying debts as problematic and determination of allowances 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. The process includes:

- Identifying and locating borrowers having negative indications, by means of the "red light" system and follow-up lists;
- 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" (debts under the definition of "under special mention", "substandard" and "impaired");
- The creation of allowances that reflect the Bank's expected loss at a specific level. In determining the allowances, the Bank's Management relies on information at hand regarding the borrower, such as: financial soundness and/or owner guarantees, scope and quality of the collateral held, estimate of the present value of the future cash flows of the debtor;
- Recording allowances that reflect the Bank's expected loss at a group level. In determining the allowances, the Bank's management is based upon information at hand regarding the borrower, such as: their credit rating, the classification of the debt, the economic sector, the scope and quality of the collateral and an assessment of the risk environment.

Credit underwriting process at IDB New York. The credit policy states that the underwriting process shall begin with the business units that specialize in a particular segment of customers and act in accordance with specific procedures. The credit risk management unit, which is subject to the chief risk officer in IDB New York, 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.

Evaluation of credit risk at IDB New York is based on an internal rating model. The model is divided into two stages of analytical processes, Borrower Risk Rating and Transaction Risk Adjustment, which determine the rating of the customer.

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 RISK MEASUREMENT AND REPORTING SYSTEMS

Measurement and reporting systems. The Bank uses several 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 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. In addition, the system supports the process of analyzing financial statements and evaluation of floating pledges.
  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, among other things, 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;
- An information system used for assessing the profitability of a single portfolio and of a business unit (under development is the enlargement of the system in respect of assessment of yield from an individual customer);
- The Bank has integrated a computerized system for the computation of risk assets on a Group level, in accordance with Basel II guidelines.

Exposure document. In accordance with of the Supervisor of Bank's directives, the Bank prepares in each quarter an exposure document relating to all credit exposure, including: the volume and composition of the Group's credit portfolio, concentration of the portfolio, linkage segments, segments of operation, economic sectors, large borrowers and large borrower groups. The document also examines the quality of the credit portfolio according to the distribution of the borrowers' credit rating, the volume of the troubled debts and the credit loss expenses. Furthermore, the document relates to compliance with restrictions set by the Supervisor of Banks and the internal restrictions set by the Bank and the Group for control and monitoring purposes. The exposure document is presented to the Bank's Board of Directors.

CREDIT RISK MITIGATION

General qualitative disclosure regarding the credit risk mitigation. According to the Basel II guidelines, banking corporations may obtain relief from capital requirements with respect to usage of methods of credit risks mitigation (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.

Collateral management and control processes. The Bank's credit policy includes detailed rules on the subject of collateral, including management and control processes thereof, performed by the different control units, as well as in the Legal Advisory Group, as mentioned above.

The mitigation of credit risk relating to different entities. The Bank's policy is to enter into transactions in financial derivatives only with entities with which an ISDA agreement had been signed. This agreement leads to a mitigation 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.

Occasionally, a credit support annex (CSA) to the agreement is also signed, which regularizes with the issue of collateral in respect of derivative transactions, and 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 entities with which ISDA agreements had been signed.

MDB applies off-balance sheet netting with respect to transactions in derivative instruments with entities with which netting agreements had been signed that comply with ISDA rules. Most entities active in derivative instrument transactions have signed the ISDA agreement.

The mitigation of clearing risks. The clearing of derivative transactions with foreign banks and financial institutions constitutes the main source for the Bank's exposure 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 mitigate clearing risks, the Bank, where possible, performs the clearing of dual transactions in the principal currencies with banks, using CLS.

MITIGATING THE RISK IN RESPECT OF CREDIT CONCENTRATION

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.

Mitigating the credit risk in respect of the concentration of borrowers/groups of borrowers. The Bank performs an ongoing monitoring of the situation of large borrowers/ groups of borrowers with indebtedness exceeding 10% of the Bank's equity) 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 the borrower groups, 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 large borrower groups.

Mitigating the 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. 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 sector.

Mitigating credit risk in respect of holding companies and credit granted for the acquisition of means of control. The Group, and mostly the Bank, have granted credit to holding companies and to finance the acquisition of means of control. The principal repayment ability of the loan is based upon the cash flows of the active investee companies, which is transferred to the holding companies by way of dividends, management fees and repayment of shareholders' loans.

Due to the high dependence of the repayment ability of the investee companies, held directly or indirectly by the holding company, on the quality of the collateral, the credit granted to holding companies for the acquisition of means of control is regarded as an area having a high risk profile.

In view of this risk, a target was set in 2012 for a reduction of the said exposure, within the framework of which a work plan was formed detailing the goals of such reduction in relation to specific borrowers. The Bank complied with the determined exposure reduction target. The credit policy for 2013 outlines a three-yearly plan for continuing the reduction of exposure to holding companies and to means of control, in accordance with the Bank's risk appetite. It should be noted, that the credit policy includes a restriction on the volume of exposure to holding companies and to means of control. The restriction is set in absolute terms (based on the existing framework) and in relative terms to capital and to the overall credit portfolio.

Quantitative disclosure in respect of this matter is presented in an Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "B", item 4).

ADDITIONAL DISCLOSURES

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

As part of the Bank's preparation for the implementation of the instruction in the matter of "Measurement and disclosure of impaired debts, credit risk and allowances for credit losses", which is being implemented since January 1, 2011, the Bank acted towards the development of methodology and statistical tools for the determination of allowances for credit losses.

QUANTITATIVE DISCLOSURE REGARDING CREDIT RISK

Segmentation of credit risk according to main credit exposure types

Gross credit risk exposure

	December 31, 2012	Average in 2012[1]	December 31, 2011	Average in 2011[1]
	in NIS millions			
Credit	150,718	153,930	157,532	152,220
Bonds	35,874	34,878	31,343	26,534
Others[2]	7,450	7,567	7,715	7,756
Guarantees and other liabilities on account of clients[3]	59,891	60,050	60,065	60,646
Transactions in derivative financial instruments[4]	1,567	1,721	1,769	2,056
Total	**255,500**	**258,146**	**258,424**	**249,212**

Footnotes:

(1) The average is computed on a quarterly basis.

(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).

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 acts according to the standard mapping and with the framework published by the Supervisor of Banks.

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 Bank's policy as regards the management of counterparty credit risk is based on the counterparty credit risk management policy document, which is brought for approval of the Board of Directors at least once every two years. 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 arises both with respect to banks and international financial institutions and with respect to customers.

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.

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

- Exposure to foreign banks and financial institutions - the back office unit at the finance 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 finance division performs a comparison of actual exposure to the approved framework, on a daily basis, and if required, at higher frequency, in accordance with market conditions. Evaluation of the exposure includes the use of stress tests and of internal models designed for this purpose. 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. These limitations have, among other things, been designed to provide response to market liquidity risks, stemming from a possible difficulty in operating in large volumes in markets having a low trading activity.

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 average period to maturity, 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.

From time to time, the Bank makes changes in the future exposure coefficients used for the assessment of contemporary credit risk exposure regarding derivative financial instruments, this in the light of developments in market conditions.

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 Bank's credit rating would be reduced. Accordingly, in such cases a situation may arise where the Bank will be required to provide the foreign bank with collateral in higher amounts (in case of profit on derivatives to the foreign bank).

Quantitative disclosure in respect of this matter is presented in an Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "B", item 5).

ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

Credit risks in financial instruments. The Bank's operations in derivative financial instruments involve special risk factors, including credit risk. The singularity of credit risk in such transactions stems from the fact that the stated value of the transaction does not necessarily reflect the credit risk involved therein. For further details, see above "General disclosure regarding exposure to credit risk of counterparty" under "Credit risk management".

Note 20 to the financial statements presents details of operations in derivative instruments - scope, credit risk and maturities. Part B of the aforementioned Note presents details of credit risk with respect to derivatives by counter party, on a consolidated basis. Presented below are further details.

The Annex to the Report of the Board of Directors, forming an integral part thereof (Part C, Item 1), contains further details of the data presented in the said Part B of the Note.

Securities financing transactions (SFT). The Bank has customers who are active on the capital market and who act according to complex strategies and carry out transactions that involve the borrowing and lending of securities, Margin Lending transactions and operations in marketable and non-marketable derivatives.

The monitoring of these operations is performed by means of computer systems that measure in real time the requirement for collateral with respect to the activity facilities and the collateral actually existing.

The credit policy includes limitations on the total volume of customer activity and limitations on the volume of holdings of specific securities or groups of securities.

REPO transactions. IDB New York conducts "reverse repo" transactions as part of its asset and liability management. Such transactions are being made with financial institutions having an "A" and above credit rating, with whom ICMA agreements have been signed regularizing the manner in which such transactions are executed.

SECURITIZATION EXPOSURE

IDB New York invests in several types of securitized securities (including secured bonds of the CLO type, purchased during 2012), 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.

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

Quantitative disclosure in that issue is brought in the Annex to the Report of the Board of Directors, forming an integral part thereof (Part B, item 6).

CREDIT EXPOSURE TO FOREIGN FINANCIAL INSTITUTIONS

General. 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.

Developments in world markets. The crisis in the Eurozone intensified during the first half of the year, on the background of a worsening in the fiscal position of the peripheral countries, and the credit rating of nine of the Eurozone countries has been downgraded. As from July 2012, the Eurozone debt crisis has calmed down following the announcement by the European Central Bank (ECB) that it will purchase bonds of the peripheral countries in unlimited amounts, with the aim of protecting the European currency. The purchase of these bonds is conditional upon a request for assistance being made by the country in question. The relaxed market resulted in a decline in returns on government bonds of the peripheral countries. Furthermore, additional budget cuts in Greece and the approval of an additional bailout package for Greece have reduced concerns regarding the possibility of Greece leaving the Eurozone.

General elections were held in Italy in February 2013, the results thereof indicate a difficulty in setting up a stable government that would continue with the reform policy and cutbacks in government deficit. Accordingly, uncertainty has somewhat increased.

The recession in the Eurozone continues to cloud the markets. Economic growth in the Eurozone recorded a regression of 0.6% in 2012. The Purchasing Managers and Consumer Confidence indices in Europe continue at levels indicating the continued pessimism of businesses and consumers in the Eurozone, although the rate of contraction is moderating have reduced concerns regarding the possibility of Greece leaving the Eurozone.

The S&P rating agency lowered the credit rating of France to "AA+" and of Spain to "BBB-". Furthermore, the credit rating forecast for Germany and the Netherlands was lowered to "negative". Greece's credit rating was upgraded to "B-", following the approval of the bailout package for Greece. Moreover, the rating agency Moody's downgraded Great Britain's credit rating to AA+.

In accordance with the Bank's policy, exposure of the Group to financial institutions in the PIIGS (Portugal, Ireland, Italy, Greece and Spain) countries was reduced in 2012 to a negligible level. The Bank maintains a careful credit policy and is monitoring developments and volume of exposure to key markets and to markets of the countries at risk. This is performed on an ongoing basis and at the Group level, within the framework of an inter-division forum. The Bank's dealing room monitors these markets in order to obtain a comprehensive picture and to react in real time to currency risks in accordance with the risk profile of each customer and the approved credit facilities. Moreover, the business divisions perform on an ongoing basis, a comprehensive examination with respect to customers who might be adversely affected by the crisis in Europe.

As seen from Schedule "F" to the Management Review below regarding "Exposure to foreign countries", the direct exposure of the Group to the said country is not material and in a downward trend. However, it is not possible at this stage to evaluate the indirect effect, particularly if a global crisis develops as a result of the crisis in the said countries.

The manner of managing credit risk applying to foreign financial institutions. 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 selective basis, mainly at banks in the U.S. and Western Europe, 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. This process was performed in respect of the vast majority of financial institutions with which the Bank transacts business in financial derivatives;

- 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;
- An information system that assists in obtaining a picture on a Group basis regarding exposure to foreign banks and financial institutions.

With respect to the management of exposure to foreign financial institutions, it should be noted that:

- A reduction in the rating of a foreign bank and/or deterioration in its financial data are weighted into the model, and where necessary, the Bank reduces its credit facility accordingly;
- The financial institutions unit of the Corporate 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;
- The Bank manages exposure to financial institutions in South America through IDB New York, which specializes in emerging markets.

Credit exposure to foreign financial institutions. The Bank's credit exposure to foreign financial institutions comprises mostly of exposure to banks and investment banks. As seen from the data presented hereunder, about 78% of the exposure as of December 31, 2012, is to financial institutions rated "A-"rating or higher.

The states in respect of which the Bank has exposure as stated above as of December 31, 2012, include, inter-alia, the United States, Great Britain, Germany and Switzerland.

No losses in respect of impairment of securities have been included in respect of the exposure to financial institutions in 2012.

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, 2012		
Present credit exposure to foreign financial institutions[(6)]			
External credit rating[(7)]			
AAA up to AA-	2,116	373	2,489
A+ up to A-	4,411	270	4,681
BBB+ up to BBB-	1,267	7	1,274
BB+ up to B-	506	6	512
Not rated[(8)]	206	54	260
Total present credit exposure to foreign financial institutions	**8,506**	**710**	**9,216**
Balance of problematic bonds	60	-	60
	As at December 31, 2011		
Present credit exposure to foreign financial institutions[(6)]			
External credit rating[(7)]			
AAA up to AA-	3,788	196	3,984
A+ up to A-	2,526	483	3,009
BBB+ up to BBB-	484	-	484
BB+ up to B-	413	-	413
Not rated[(8)]	204	57	261
Total present credit exposure to foreign financial institutions	**7,415**	**736**	**8,151**
Balance of problematic bonds	*62	-	*62

* Reclassified in order to include a certain bond classified as impaired.

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 and the problematic balance sheet credit risk are stated net of the credit loss expenses.

(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 20 to the 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 3 to the financial statements).

(7) According to Moody's rating, and in its absence, the Fitch rating or S&P.

(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 A1 and above.

In addition to the exposure presented in the above table, as of December 31, 2012 and 2011 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, variable percentage of the outstanding balance of a future transaction, in the amount of NIS 251 million and NIS 234 million, respectively.

CREDIT RISK IN HOUSING LOANS

General. On May 15, 2011, the Supervisor of Banks issued a Directive, according to which banking corporations are required to include in their annual and quarterly financial reports disclosure regarding credit risk in respect of housing loans, and the action taken by them within the framework of management of such risk. In addition, the disclosure is to include quantitative data regarding exposure to housing credit and regarding various characteristics indicating the quality of the housing credit portfolio of the banking corporation.

The activity of granting housing loans by the Group, was mostly done by Discount Mortgage Bank (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank) and was transferred to the Bank, and is presented with the activity done by Mercantile Discount Bank (hereinafter named together as "the Group").

Developments in the field of housing loans. A growth was recorded in recent years in the demand and in the volume housing loans granted. This stemmed from increasing demand in the housing market and from rising prices resulting from the shortage in the supply in residential units in relation to the said demand.

The rise recorded in the volume of housing loans granted (including a rise in the average amount of loans) exceeded the economic growth rates and the rates of increase in the standard of living and in income of households. Therefore, certain concerns arise that these developments might adversely effect the quality of the housing credit portfolio and increase the exposure of the banking industry to credit risk.

Measures taken by the Group. Accordingly, the Group employed stricter control over credit in this area. The measures adopted by the Group include among other things:

- Limitation on the volume of loans that might create an encumbrance on the borrower. As a rule, it is not the group's practice to approve housing loans the anticipated monthly amount of repayment of which exceeds 35% of the free income of the borrower.
- As from the effective date of the regulatory restriction, the bank does not grant credit at a rate exceeding 75%.
- The use of "safety factors" (durability tests) in the loan approval process. Prior to approval of the loan facility, the Group studies possible implications that might arise from theoretical changes in market variables (principally, an increase of 2-3 basis points in the annual interest rate) - on the repayment ability of the borrower.
- Reduction in the volume of credit granted in loan channels where the interest rates changes at high frequency (prime and linked variable interest from one to five years), in accordance with the restriction determined by the Supervisor of banks.
- Determination of exposure policy in respect of special segments: acquisition groups, foreign residents, all-purpose loans, etc.
- Current use of theoretical scenarios, including stress tests, for the sensitivity analysis of anticipated changes in the Bank's exposure to credit risk - as a derivative of changes in the tested parameters.
- Maintaining current monitoring of developments in the housing market, including: changes in prices of property, changes in the volume of monthly repayments of loans, etc.
- Entering into specific arrangements with borrowers who meet difficulties in honoring the periodic repayment terms of the original loans.
- A credit rating model for mortgages was launched by mid 2012.

Quantitative data. The volume of the Group's housing loan portfolio as of December 31, 2012, amounted to NIS 20,092 million (December 31, 2011 - NIS 20,075 million). The volume of housing loans granted by the Group in 2012 amounts to NIS 2,728 million, of which NIS 289 million in respect of recycled loans (in 2011, NIS 4,066 million and NIS 377 million, respectively).

Following are data regarding certain risk characteristics of the Group's housing loans portfolio as of December 31, 2012:

	%
Rate of housing loans financing over 75% of the value of the Property	13.0
Rate of housing loans, the monthly repayment amount of each exceeds 35% of the income of the borrower	18.2
Rate of housing loans carrying variable interest rate of the total amount of the housing loan portfolio(1)	64.3

Footnote:

(1) Loans in which the interest rate change frequency exceeds five years were included in computing the ratio.

ADDITIONAL DISCLOSURE REGARDING CREDIT RISK IN RESPECT OF SIGNIFICANT EXPOSURE TO BORROWER GROUPS

In view of the intensification of the negative trends in global financial markets and the concern regarding the possible future implications upon the Israeli economy, the Supervisor of Banks has guided the banking corporations to include in their reports, starting with the report as of September 30, 2011 and until the report for September 30, 2012, information regarding the existing credit risk at the reporting date with respect to groups of borrowers, the net indebtedness of whom, on a consolidated basis, after the permitted deductions according to Section 5 of Proper Banking Management Directive No. 313, exceeds 15% of the equity of the banking corporation.

At the beginning of 2013, in view of the uncertainty as regards trends in world financial markets and their possible influence upon the Israeli economy, banking corporations have been required to continue and report material exposure to borrower groups, in accordance with the said guidelines, this until the interim financial statements for September 30, 2013.

Following are data regarding significant exposure to groups of borrowers as of December 31, 2012:

Group of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk	Potential off-balance sheet exposure in respect of derivative instruments
	in NIS millions			
A	2,904	217	3,121	70

* Off-balance sheet credit risk includes the potential credit exposure in respect of derivative instruments, in the amount of NIS 70 million.

Credit to this group is characterized by a high level of dispersion of borrowers composing this group and high industry dispersion. The rating of the group (as a weighted average of the specific ratings of each of the group members, based on the Bank's internal rating model) is higher than the average rating of the credit portfolio.

The Bank maintains a continuous monitoring process over the large borrowers groups, performs periodic reviews assessing the risk attributed to each group, and as regards certain of the groups, even performs an examination of the stress tests and their effect on the repayment ability. The Bank complies with all regulatory restrictions relating to credit concentration aspects.

DEFINITION OF PROBLEMATIC DEBTS

The identification and classification of debts as "problematic debts" is performed according to classifications determined by the Public Reporting Directives and according to criteria specified in this Directive: "impaired debts", "substandard debts" and "debts under special mention".

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" and Note 4 to the financial statements.

CREDIT RISK IN RESPECT OF LEVERAGED FINANCE

Definition of leveraged finance. The Bank defines credit for transactions for the finance of acquisition of means of control, as defined in Proper Banking Management Directive No. 323, in which the financing ratio exceeds the norm, 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. In view of the complexity involved in such transactions, the Bank takes great care in granting such credit and acts in accordance with a credit policy unique to this field. Furthermore, transactions for the finance of acquisition of means of control are being reviewed twice a year and reported to the Bank's Management and Board of Directors.

Proper Banking Management Directives determined restrictions regarding the finance of acquisition of means of control, which the Bank abides by.
For additional details in respect of this matter, see Annex to the Report of the Board of Directors, comprising an integral part thereof (Part "C", item 2).

MANAGEMENT OF MARKET RISKS

Market risk is the risk of impairment of the Bank's equity and profitability stemming from changes in financial markets which have an effect on the Bank's assets or liabilities: interest rates, foreign exchange rates, inflation, prices of securities, product prices, the fluctuations in these parameters and in other economic indices.
Market risks are presented in this review on a Group basis, including the Bank, Mercantile Discount Bank, IDB New York, IDB (Swiss) Bank, ICC and BLD, the severance pay fund for the Bank's employees (hereunder in this section: "the Group")
During 2012, the Supervisor of Banks issued an amendment to Instruction No. 310 in the matter of risk management, following which, Instruction No. 339 in the matter of market and interest risk management has also been amended, and in particular, the sections detailing the risk management principles, which are included in Proper Banking Management Directive No. 310, have been cancelled, and it has been determined that the market risk management unit will now be subject to the Chief Risk Officer.

STRATEGY AND POLICY

The Bank has three policy documents relating to market risk that had been approved by the Board of Directors.
Market risk management policy. The market risk policy is intended to define the framework of financial risk management in the Bank's current activity. The policy document determined the principles for the Group policy and the organs responsible for the implementation of market risk management tasks.
Determining the Group risk appetite in respect of the market risk of the Group, includes, among other things, group limitations in terms of VaR, in terms of exposure to base risks, in terms of the maximum impairment in economic value under stress tests and upon a parallel change in the interest graphs.
Financial management policy defines the principles of market risk management for the first circle (risk acceptance), including reference to the tasks of the Finance Division, the responsibility of the functionaries involved in market risk management processes and their authority. The current management processes at the Bank are conducted subject to a supplementary document – document issued by the Head of the Finance Division, which defines specific procedures and principally an additional layout of limitations enabling a more conservative management of exposure to market risks.
Nostro investments management policy determines principles and rules for the management of the Bank's nostro portfolio, with all its components, control and risk management processes involved in the operation of the nostro portfolio management unit.
Market risk management policy of subsidiary companies. The boards of directors of the banking subsidiaries have determined policies regarding the maximum exposure to market risks, on the basis of the principles of the Group policy, as detailed in the market risk management policy document. Market risk management and measurement methodologies were modified to those applied by the Bank, taking into consideration the specific characteristics of operations of each subsidiary.
The current management of market risks is conducted separately at the Bank and at each of its main banking subsidiaries. Notwithstanding, the Bank frequently reviews, the market risk appetite of the Bank, its banking subsidiaries and of the Group as a whole. Reports regarding the Group's compliance with the limitations on exposure to market risks are presented before the Board of Directors within the framework of the risk document.
Main changes in exposure policy and risk management procedures. At the end of 2011, it was decided on a renewed definition of the structured exposure in respect of exchange rate risks regarding the Bank's investment in IDB New York.

Following this, the Board of Directors decided on the changes in the main Group limitations:

- Raising the limitation on the VaR from 3% to 4% of the capital attributed to the shareholders (hereunder in this Chapter: "the capital");
- Raising the limitation on the equity's economic value in stress tests from 12.5% to 17.5% of the equity attributed to the shareholders;
- Changes in the range of distribution of the equity among the various linkage segments.

In addition, the Board approved changes in the manner of exposure monitoring, and in particular:

- A change in the structure of limitations on the erosion of equity's economic value in stress tests (see below "Analysis of losses in stress tests");
- Determination of a limitation on sensitivity to interest risk in each of the linkage segments.

STRUCTURE AND PROCESSES

Within the framework of the processes conducted in the various control circles, the following should be mentioned:

The first control circle. The Finance Division coordinates the Bank's overall financial activity that includes both the business factors (those who take the risk) and the back office and middle office (the control factors).

The second control circle. The second circle includes the market and liquidity risks management unit which operates within the framework of the risk management department, the duties of which are:

- Reporting to the Board of Directors and the Management regarding market risk, while performing complementary and independent analysis of the calculations made by the first control circle, including stress tests and market risk management processes at the Bank and at the principal subsidiaries;
- Verifying that the exposure limitations are consistent with the limitations defined by the risk appetite declaration and that they include all the market risk factors existing in the ordinary course of business and in stress tests and examination of their effectiveness;
- Development of models and appropriate tools for the evaluation and management of exposure to market risk;
- Computation of capital allocation to market risk;
- Review of the extent of compatibility of the risk management policy to regulatory instructions, which the Board of Directors decided to implement;
- Review of the effectiveness of the market and liquidity risks management processes.

Current management and supervision. Current management and supervision in the area of market risks management are performed, among others, by the following committees:

- **Asset and liability management committee (ALM committee).** The committee is headed by the President & CEO and meets once a month. The role of the committee is to determine the Bank's assets and liabilities management policy, to determine exposure limits for market and liquidity risks based on a situation evaluation of expected developments in the market and subject to limitations determined by the Board of Directors and to study the profitability of the various activities as well as abiding by the capital adequacy targets;
- **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. The forum is responsible for the current management of the Bank's linkage base and interest rate exposure, within the framework of the targets outlined by the assets and liabilities management committee.

PROCESSES

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.
The Bank's procedures requires those who accept the risk and the control factors to report of any exceptional events, e.g. loss exceeding the predetermined limit, deviations from limitations and so forth. The Head of the Finance Division determines how these deviations should be dealt with as well as the reaction to exceptional developments in the various markets.
In addition, internal limitations determined by the Head of the Finance Division, are monitored on an ongoing basis.

MEASUREMENT AND REPORTING

Measurement of exposure to market 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. In addition, simulations are conducted by the system, 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 MDB in computing its exposure to market and liquidity risks.
IDB New York. Measurement of the exposure to market risks is performed by the first circle (Treasury) through an independent risk management system (V Ten) providing a computation of risk assessments at monthly intervals. The risk management controls the exposure to market and liquidity risks and performs independent calculations of stress tests.

RISK MITIGATION

Hedging of market risk policy. The Bank's policy 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.

QUANTITATIVE DISCLOSURE

(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).
Management in practice of the daily exposure is performed on the basis of economic positions in the various linkage segments, which differ from the accounting positions which may be seen in Note 17 to the financial statements.
The differences between these positions might be divided into the following groups:

(a) Certain economic adjustments to the managed position: Non-inclusion of profits or losses stemming from changes in market value of foreign currency bonds or CPI linked bonds (in relation to the purchase value together with accumulated interest); the addition of fixed assets denominated in foreign currency as a financial asset; Transfer of non performing impaired debts in foreign currency to the shekel linked segment.
(b) Reference to subsidiary companies: the linkage balance sheet is on a consolidated basis and includes all subsidiaries, while the managed position includes the managed positions of the main subsidiaries only; The exposure to foreign currency in the severance pay fund for Bank employees (BLD) is not included in the linkage balance sheet, due to the fact that only the difference between the severance pay provision and the value of the deposits with the fund is presented in the Bank's balance sheet. On the other hand, the exposure is included in the managed position.
(c) Timing of position computation: the managed position is computed on the basis of the capital data as of the end of the previous quarter together with changes occurring during the last quarter until date of the computation. These changes are based on data that is not final as it is known at date of computation. On the other hand, the position in the linkage balance sheet is computed on the basis of audited or reviewed data, as the case may be, respectively, which is made after three months or two months following the end of the reporting period, respectively.

Since the beginning of 2012, exposure to linkage base risks is measured and managed as a proportion of the capital.

The mix of investments 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 actual distribution of investment of the equity in relation to the set limitations (the data is stated in relation to the equity):

		Third quarter 2012				2011			
		Range of exposure							
Segment	Limitation	Period end	from	to	average	Year end	from	to	average
CPI linked	60%-(60%)	26%	18%	28%	22%	29%	21%	36%	28%
Foreign currency	15%-45%	28%	27%	29%	28%	25%	2%	25%	3%

The table shows the limitations after their update in 2012.

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 equity as of December 31, 2012.**

	The Bank's capital sensitivity of changes in exchange rates			
	in NIS millions			
Segment	10%	5%	-5%	-10%
USD	250	120	(123)	(256)
EUR	(17)	(8)	7	19
Other Foreign Currencies	(8)	(4)	4	8

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. It should be noted that following the cancellation of the hedge on the investment in IDB New York, the ratio of capital to risk assets is no longer sensitive to changes in exchange rate.

(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 including certain economic amendments. 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

Fair value of financial instruments. Most of the Bank's financial instruments 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 Bank's value 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)

	Israeli currency		Foreign currency[2]			
	Non linked	CPI linked	US$	Euro	Other	Total
	In NIS millions					
	December 31, 2012					
Financial assets[1]	106,722	25,530	49,238	5,782	3,794	191,066
Amounts receivable in respect of derivative and off balance sheet financial instruments [3]	81,574	3,163	49,019	12,774	7,876	154,406
Financial liabilities[1]	(96,090)	(22,050)	(54,136)	(8,410)	(4,169)	(184,855)
Amounts payable in respect of derivative and off balance sheet financial instruments [3]	(91,059)	(4,689)	(41,757)	(10,299)	(7,576)	(155,380)
Net fair value of financial instruments	**1,147**	**1,954**	**2,364**	**(153)**	**(75)**	**5,237**
	December 31, 2011					
Financial assets[1]	106,363	26,692	48,559	6,753	3,796	192,163
Amounts receivable in respect of derivative and off balance sheet financial instruments [3]	78,844	2,398	44,946	13,069	8,345	147,602
Financial liabilities[1]	(96,630)	(21,789)	(55,009)	(8,930)	(4,231)	(186,589)
Amounts payable in respect of derivative and off balance sheet financial instruments [3]	(85,490)	(5,129)	(39,530)	(10,801)	(7,980)	(148,930)
Net fair value of financial instruments	**3,087**	**2,172**	**(1,034)**	**91**	**(70)**	**4,246**

For footnotes to the table see next page.

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

	Fair value of financial instruments, excluding non-monetary items(4)							Change in fair value	
	Israeli currency		Foreign currency(2)						
Change in interest rate	Non-linked	CPI linked	US$	Euro	Other	Offsetting effects	Total	Total	Total in %
	in NIS millions								
	December 31, 2012								
Immediate parallel increase of 1%	805	1,930	2,034	(134)	(74)	(4)	4,557	(680)	(13%)
Immediate parallel increase of 0.1%	1,093	1,948	2,357	(151)	(76)	-	5,171	(66)	(1%)
Immediate parallel decrease of 1%	1,479	1,976	2,337	(162)	(77)	(4)	5,549	312	6%
	December 31, 2011								
Immediate parallel increase of 1%	2,759	2,161	(1,209)	77	(66)	(2)	3,720	(526)	(12%)
Immediate parallel increase of 0.1%	3,048	2,172	(1,036)	56	(64)	-	4,176	(70)	(2%)
Immediate parallel decrease of 1%	3,433	2,184	(1,236)	29	(61)	(2)	4,347	101	2%

(1) Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.
(2) Including Israeli currency linked to foreign currency.
(3) 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.
(4) 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.

For details regarding the effect of changes in interest rates on the fair value of problematic debts, see Note 21 c.

The net change in fair value, in unlinked Israeli currency and in dollars, stems primarily from cancellation of the hedge of the investment in IDB New York.

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 of the Bank's operations, and takes into consideration additional data that represent the economic approach to the management of exposure of the economic value of the Bank's equity to changes in interest rates. Among others, taken into 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.

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.

The principal differences between the computation of exposure according to accounting fair value and economic exposure (BPV) are as follows:

(a) The distribution of credit current account balances is made only in computing the economic exposure;
(b) The computation of the accounting fair value made use of graphs that take into consideration credit margins. Computation of the economic exposure made use of graphs representing the Bank's transfer prices and include only the risk to the Bank;
(c) The difference in population and the allocation to the linkage segments, mostly: non performing impaired debt (at its accounting fair value remains in the segment in which it was originally included, while in the economic fair value it is

classified to the non-linked segment), optionally linked deposits (at accounting fair value are presented in the principal segment, while at economic fair value they are analyzed according to their basic financial components, each component being allocated to its respective linkage segment).

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

	December 31, 2012				
The change in interest rates	Non-linked	CPI linked	US dollar	Other foreign currency	Total
	In NIS millions				
An increase of 100BP in interest rates	(155)	17	77	15	(46)
A decrease of 100BP in interest rates	173	(23)	(371)	(9)	(230)
	December 31, 2011				
An increase of 100BP in interest rates	(200)	10	179	7	(4)
A decrease of 100BP in interest rates	222	(14)	(555)	(10)	(357)

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 on the group's exposure was set to a change of 1% in the interest graphs at 7.5% of the equity. This, in addition to the limits determined by the Bank and banking subsidiaries on this risk assessor. In 2012, the Bank and the Group complied with the determined exposure limits.

In addition to a scenario of a parallel move in the interest graphs, the exposure to non-parallel changes in the various interest graphs is also being studied.

Measurement of the risk at the Bank is performed in weekly intervals and exposure estimates at Group level are being monitored 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 entities authorized for this purpose.

Recently, the Bank has also begun measuring the margin risk, the risk of a loss stemming from a change in margins between the various interest graphs.

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 Bank's activity 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 are details of the effect of hypothetical changes of 100 base points in the interest rate applying to the banking book:

The change in interest rates	Non-linked	CPI linked	US dollar	Other foreign currency	Total
			In NIS millions		
			December 31, 2012		
An increase of 100BP in interest rates	(141)	25	37	14	(65)
A decrease of 100BP in interest rates	162	(31)	(330)	(8)	(207)
			December 31, 2011		
An increase of 100BP in interest rates	(166)	13	188	8	43
A decrease of 100BP in interest rates	190	(16)	(562)	(9)	(397)

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 including assumptions regarding early repayments:

	As at December 31, 2012			As at December 31, 2011		
	Shekels			Shekels		
	Non-linked	CPI linked	Foreign currency and foreign currency linked	Non-linked	CPI linked	Foreign currency and foreign currency linked
			In NIS millions			
Total Assets	188,296	28,693	128,483	185,207	29,090	125,468
Total Liabilities	187,149	26,739	126,347	182,120	26,918	126,481
Average maturity (years):						
Assets	0.96	3.70	0.84	0.96	3.44	0.84
Liabilities	0.76	3.79	0.66	0.70	3.81	0.72
Average maturity gap	**0.20**	**(0.09)**	**0.18**	**0.26**	**(0.37)**	**0.12**
IRR gap	**2.70**	**0.94**	**1.87**	**2.82**	**0.45**	**1.93**

(3) THE VALUE AT RISK (VAR)

General. As detailed above, the Bank implements various measures to manage exposure to market risks, in addition to a statistical 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 Bank's overall activities. 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 Bank's value (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 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.
0The 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:

	December 31, 2012	December 31, 2011
	in NIS millions	
Estimate of VaR amount (in NIS millions, Group)	195	131

The weight of the VaR in relation to the equity as of December 31, 2012 is 1.6%, compared with 1.2% at the end of 2011.
The growth in the Group's exposure stems from the creation of the structural position to the tune of the value of the investment in IDB New York, designed to protect the minimum capital ratio.
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 Bank's economic value. The validity of the model is tested according to quantitative deviation of the loss amount from the VaR estimate. Weekly observations made in 2012, showed only one case of deviation from the VaR assessment at the Bank's level, in the amount of NIS 22 million. The tests that had been implemented to date confirm the model’s validity.
Limitations of the VaR model. As stated, the VaR constitutes a statistical tool that bases assessment of the value at risk on previous market performance and on assumptions regarding future cash flow performance. The limitations of the model are sourced in:
- The model assumes that the changes in risk factors are divided normally. While this assumption is required for approximation purposes, it does not necessarily reflect market performance;
- The computation of the VaR for a holding period of ten days assumes that the positions are realizable or could be terminated within that period. In certain market circumstances such an assumption may not materialize and the loss would be greater;
- Utilization of a significance level of 99% disregards losses that may be realized beyond this level of significance (distribution tail);
- The historical data used might not include stress situations.

Accordingly, the VaR does not assess a loss that may occur in stress situations in the market 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 a stress test (as detailed below).

(4) LOSS ANALYSIS IN EXTREME SCENARIOS (Stress Tests)

Global and domestic markets are subject to periodic instability resulting from events related to a general crisis (e.g. war, political upheaval, natural disaster, etc.) or to turbulence in financial markets. Stress situations are generally characterized by significant changes in interest rates, exchange rates, or in exceptional volatility in these factors, which deviate from normal 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.
Stress Tests enable the examination if the possible implications of changes in risk factors. Thus constituting a complementary layer for the examination of the overall exposure to market risks performed in accordance with the VaR model.
Exposure of the Bank and of its principal subsidiaries is examined under a wide variety of some 12 stress tests, that include changes in interest rate curves (parallel and not parallel), changes in major currency exchange rates and in the CPI and changes in the spreads of investments in corporate bonds.

Following are details of the main stress scenarios implemented at the Bank:
- Scenario of deterioration in the security situation in Israel;
- Scenario of a financial crisis in the U.S.A.;
- Scenario of a global rise in prices;
- Scenario of a crisis in emerging markets;
- A global crisis scenario originating in the European government debts crisis.

In addition, technical and historical scenarios are also activated.

The Group limitation on the maximum erosion of the equity's economic value was updated during the year following the creation of an economic position in the volume of the value of investment in IDB New York and the cancellation of the hedge in respect thereof. Prior to the update, two deviations from the limitation had been recorded, in a volume of 0.4% and 0.6% of the equity.

At the beginning of 2013, the Bank's Board of Directors decided on a change in the manner of monitoring of the Group's exposure in terms of erosion of the value in stress situations. The new monitoring method defines a set of limitations and is based on macro-economic evaluations as to the probability of one or another scenario.

(5) THE NII (NET INTEREST INCOME) MODEL AND THE EaR (Earning at Risk) MODEL

The EaR index measures the sensitivity of the anticipated financing income to changes in market returns. The financing income forecast is compiled on the basis of the NII model. In addition to testing the sensitivity of the economic value of the equity attributed to the Bank's shareholders, the effect of changes in interest rates on financing income is also being examined. This examination is implemented through dynamic simulation of the net interest income for the coming year, and is intended to test the impact of various strategies for asset and liability management on the Bank’s future interest income.

The EaR model is the principal model for the management of interest rate risks at IDB New York and at IDB (Swiss).

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

Creditory current accounts spread model. For purposes of assessing the exposure to interest risks, the Bank assumes that a significant part of creditory current account balances is not expected to be withdrawn immediately ("the stable part") and therefore it may be spread over a number of years. This in accordance with the behavioral assumptions, which are being updated on a quarterly basis.

Within the framework of the calculation of interest rate exposure in this segment, the "stable part" of the outstanding creditory current account balances is spread in accordance with estimates of its stability level made by the risk manager (asset and liability management). The calculation is being updated on a quarterly basis. Any change in the calculation methodology is presented for approval by the asset and liability management committee in consultation with the CRO. Material changes in the results of the computation are reported to the risk management committee and to the Board of Directors within the framework of the exposure document. The spread is made on a quarterly uniform basis, from one to seven years. The "stable part" is defined as 90% of the minimum monthly averaged outstanding balance in the past two years. The difference between the "stable part" and the actual outstanding balance of current account deposits is treated as a short-term liability. The level of the minimum outstanding balance is examined on an annual basis.

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. The model operated by the Bank is based on historical data of early repayments.

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 STANDARDIZED 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 standardized approach, as prescribed by Proper Banking Management Directive No. 208. The allocation of capital to market risks is done as follows:

- Interest rate and equity 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 "average period to maturity" method;
- Foreign exchange rate risk - allocation in respect of the Bank's overall activity;
- Options risk - 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 (Basel II guidelines):

	Capital allocation as of	
	December 31, 2012	December 31, 2011
	In NIS millions	
The Bank:		
Interest rate risk*	130	124
Foreign exchange rate	29	11
Equity risk	-	-
Options risk	20	15
Total for the Bank	**179**	**150**
Allocation in terms of risk assets	2,238	1,875

* Including the specific risk in the amount of NIS 2.4 million and NIS 6.2 million in the years 2012 and 2011, respectively.

The allocation to market risks in risk asset terms comprises 1.65% of the total risk assets as of December 31, 2012, compared with 1.38% as of December 31, 2011.

The increase in the allocation of capital to market risks stemmed mostly from the change in the Bank's foreign currency position.

(8) MANAGEMENT OF TRADING POSITIONS

The Bank distinguishes between exposure created in the course of managing the Bank's assets and liabilities 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 limits 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 management 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 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 the loss that might be incurred as a result of changes in base assets and the volatility thereof, which affect the value of such options, including standard deviations.
The Bank's Board of Directors has set out guidelines regarding the permitted activity in options both as regards overall volume and in terms of the maximum impairment in value under stress tests and in case of a moderate scenario.
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 limitations set by the Board of Directors were recorded in 2012.

(10) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

The Board of Directors has determined the mode of the Bank's operation in derivative financial instruments, maximum volume of activity and the range of financial instruments in which the Bank may engage (whether on behalf of its customers of or its own account). 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 Bank’s customers, 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, including regular options and "exotic" options of certain types and acts also as a "market maker" for some of which. 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.
In addition, the Bank has determined limits to the combined exposure to certain currencies of all Bank customers. Several deviations from the said limitations were recorded during 2012.
Market exposure created as a result of transactions in derivative financial instruments, both as regards linkage base and as regards interest rates, is included within the framework of the various limits imposed by the Board of Directors on exposure to linkage base, interest rates and options. In addition, limitations have been set on the nominal volume and for instruments of certain types also a limitation on the number of open transactions at any given moment. The total exposure and compliance with the Board of Directors limits are being measured and controlled on an ongoing basis by the Middle Office.
No material deviations from limitations set by the Board of Directors were recorded in 2012.

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

	December 31	
	2012	2011
	in NIS millions	
Hedging derivatives	1,525	686
ALM derivatives	156,154	[(1)]152,364
Other derivatives	17,857	[(1)]19,092
Credit derivatives and SPOT foreign currency	1,549	2,274
Total	**177,085**	**174,416**

Footnote:
(1) Corrected computation of the nominal value of "Futures" transactions.

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 D 6 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 "ALM 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 "ALM transactions" are computed, 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 "ALM transactions". The effect of the above was an increase in the non-interest financing income by NIS 75 million in 2012, compared with a decrease of NIS 51 million in non-interest financing income in 2011.
Details of financing income from derivative financial instruments are presented in Note 24 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 OF THE LIQUIDITY RISK

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. As this involves an uncertainty situation, in which the liquidity risk always exists, the Bank has determined the limitation of maximum exposure to liquidity risk.
Amendment of Proper Banking Management Directive No. 342. In January 2013, the Supervisor of Banks issued an update to the Directive regarding "Liquidity risk management", with effect from July 1, 2013. The update contains highlights in the matter of management and assessment of liquidity management, based on experience accumulated since the publication of the previous Directive and on conclusions drawn from audit work performed in this respect at banking corporations. This as an interim period move until the updating in full of the Directive, in accordance with the two documents of the Basel Committee, with the necessary modifications, and on a date to be determined: the one, a document of September 2008, dealing with the principles for proper management and supervision over liquidity risk; and the other, a document of January 2013, which is part of the Basel III documents.

POLICY

The Bank manages its liquidity risks subject to the policy of liquidity risk management, approved by the Board of Directors and reflecting the guidelines of the Regulator on the subject and the accepted principles in this matter. The policy includes reference to a number of stress tests, the structure of the resources of funds, the liquidity cushion and the fixing of limits regarding the various risk assessments. The policy includes in addition the Bank's plan for dealing with a liquidity crisis, including defining indicators used for the identification of trends in the liquidity risk. Furthermore, the liquidity risk management policy document has defined a layout of indicators to be used in identifying trends in liquidity risk situations, and it also included a plan for the preparations in respect of a liquidity crisis.

Limitations on the exposure to liquidity risks. The limitations determined by the Board of Directors in the policy document, refer to a number of risk assessments as well as to the structure of assets and liabilities. No deviations from the determined limitations were recorded at the Bank in 2012.

STRUCTURE AND PROCESSES

THE INTERNAL CONTROL MECHANISMS FOR AVOIDANCE OF DEVIATION FROM POLICY:

- A Business Liquidity Forum is run convening at least once a week discussing the liquidity situation and examines the application of decisions made by management factors.
- A forum dealing with the adequacy of the model constituting a joint committee of the risk management and assets and liabilities management, the duties of which are to review the adequacy of the parameters used in the model, the methodology of their determination and risk limitation, and to provide recommendations for changes in the managed pressure level.

Asset and liability management committee (ALM committee). This committee is headed by the President & CEO and meets once a month. See above "Management of market risks".

MEASUREMENT AND REPORTING SYSTEMS

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.

The internal model examines the effect of various stress tests upon the Bank's assets and liabilities, whether arising from events having a specific effect on the Bank's liquidity or arising from general economic system developments.

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 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.

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

The policy document regarding liquidity risk management was updated in the second quarter of 2012.
For additional details see "Liquidity and the raising of resources in the Bank".

OPERATIONAL RISKS

An operational risk is defined in the directives of the Bank of Israel as a loss risk resulting from faulty data processing systems, human error and the lack of proper checks and controls.
The operational risk is inherent in all business lines, products, systems and the work processes performed at the Bank. Accordingly, awareness and management of the operational risk at all levels of duty are of importance.
Towards the end of 2012, a unit has been established, which has the responsibility of acting as the second control circle of the embezzlement risk management at the Bank. Its object is to verify that the embezzlement risks are being managed closely and consistently by all risk center managers, including the monitoring of warnings suspected as prima facie unauthorized operations performed by employees.
Proper Banking Management Directive regarding operational risk management. On February 14, 2012, the Supervisor of Banks issued the directive regarding the management of operational risks. The directive is based on the Basel Committee guidelines from June 2011, which were detailed in the "Principles for the Proper Management of Operational Risk" document. The Bank and the subsidiaries studied the directive and the new principles therein, including the implications of implementing these principles. The Discount Group complies with the instructions of the Directive, the central principles of which matched the policy and vision of the Group's risk management. The Directive will become effective on January 1, 2013, except for Section 29 thereof, regarding taking the operational risk into consideration in internal performance measurement and pricing mechanisms, which will become effective on January 1, 2014.

POLICY

Operational risk management policy. The Bank endeavors to manage the operational risk in accordance with the policy document, including the operational risk appetite declaration and monitoring thresholds. The subsidiary companies have adopted the policy with the required adjustments. In accordance with Proper Banking Management Directive No. 350 in the matter of operational risk management, the policy was updated. The risk management committee decided to recommend to the Board of Directors to approve the updated policy, which will be brought to the Board for approval at a near date.
The objectives of the operational risk management policy are to define and communicate the operational risk management requirements to all the Bank's and group'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;
- Defining a clear frame of work at all levels of the Bank, supporting operational risks management;
- Defining the operational risk appetite and setting risk thresholds and the monitoring manner thereof. This definition will allow efficient, responsible and expense efficient operational activity;
- 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;

- 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 operational risk management at the Bank;
- The Risk Management Group is responsible for the implementation of operational risk management by defining optimal work processes and procedures in this field, including a training program for all echelons of the Bank, in order to strengthen awareness of the operational risk management culture;
- Identification and evaluation of the risks and controls will be conducted on a current and periodic basis. An examination, analysis and self evaluation of the operational risk management and their scale are to be performed every three years, 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 operational risk evaluation methodology, while giving special attention to the control environment. Current updating shall be made following changes in work processes, use of new information technology systems or entry into new activities or new products.

STRUCTURE AND PROCESSES

Organizational structure of the operational risk management function. The Chief Risk Manager bears the overall responsibility for the management of this risk at the Bank and the Group. Each Division or Group Head is responsible for the management of operational risks inherent in his area of activity. In addition, operating risk controllers serves at all of the Bank's divisions and Groups, the duty of which, among other things, is to assist the division or Group 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 reports to the Chief Risk Manager, is in charge of formulating the operational risk management policy and is responsible of verifying its implementation while providing the necessary tools in this respect, 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 culture of managing the operating risks within the units of the Bank and the Group.

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 enables an efficient and overall Group management of the operational risks in the Group.

Operational risk controllers' Forum. The Forum, headed by the chief risk officer, meets once every quarter and also meets as a Group Forum twice yearly.

MEASUREMENT AND REPORTING SYSTEMS

Risk evaluation methodology. The risk evaluation methodology has been formed by the Risk Management Group and is used by the Bank and its subsidiaries in their current evaluation, both of existing risks and of risks involved in new work processes and new products. The methodology is examined periodically in order to ensure its effectiveness and relevance.

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 evaluation of the fundamental and residual risk level in qualitative terms.

Operational risk survey. The operational risk survey is one of the tools used by the Group for the periodic identification and evaluation of operational risks to which the Group is exposed. A Group operational risk survey, which began in the last quarter of 2011, is expected to be completed in the first quarter of 2013. The survey is being performed with the assistance and guidance of an external consulting company.

Operational risk management system. The information system for the management of operational risk has been fully integrated at the Bank and at most of the subsidiaries. Integration at the remaining subsidiaries will continue in 2013. The system enables monitoring, analysis and reporting of operational risks at the Discount Group. The system enables Group management in accordance with the risk evaluation policy and methodology.

Operating failure events. 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 Bank is setting up a data base concerning the realization of operating failure events based on reports by the Bank's different risk centers. The Bank endeavors to achieve a wide and comprehensive data base of failure events. 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.

RISK MITIGATION

Current management of operational risks. The Bank examines on an ongoing basis exposure to operational risks and implements measures for the mitigation in the material risks level. The risk centers managers are taking steps towards the implementation of the risk mitigation 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 mitigation plans is reported to management and the Board of Directors on a quarterly basis. In addition, the risk centers managers update the risk maps on a regular basis, following the implementation of controls (information systems, procedures, reports etc.), identify and evaluate risks and controls applying to new work processes or following changes in existing work processes. The internal failure events database enables the validation of the risk evaluation performed by the risk center managers and an examination on a current basis of the necessity for a re-evaluation of the risk.

Mitigating exposure to operating risks through the purchase of insurance. The means applied by the Bank with a view of mitigating 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, found in personal safe deposit boxes at 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$150 million.

In addition, the Bank purchased an "Expanded Fire" policy to insure its property, an insurance covering its liability under law for bodily harm in the amount of US$50 million, and employer liability insurance in the amount of US$30 million.

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

PREPARATIONS BY THE BANK FOR CONTINUED BUSINESS OPERATIONS

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, in all their chain of supply, from one end to the other: infrastructure, computer, hardware, software, communications, human resources, etc. All these will assure the Bank's continuing business operations under extreme circumstances, while providing an array of services to the Bank's customers at a reasonable level of service.

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.

POLICY

The policy documents and the business continuity management strategy were updated during 2012 as well as the methodology of crisis management and exercise. These documents are in the process of approval.

STRUCTURE AND PROCESSES

During 2012, the Bank completed most of the adjustments and updates required by Proper Banking Management Directive No. 355 "Business continuity management". A survey of business continuity risks has been made and the multi-annual work program was updated to upgrade the preparedness of the Bank for the maintenance of business continuity.

Exercise. A significant part of the high preparedness level for business continuity management is the performance of exercises and training. The work processes related to business continuity are examined as part of the Bank's exercise program and conclusions are drawn as to their improvement.

Several exercises were conducted during the year for increasing the Bank's preparedness for business continuity events:

- Exercising the Bank's Management in managing an ongoing and escalating crisis;
- "Turning point 6" exercise – a national exercise regarding an earthquake scenario, within the framework of which, the Bank conducted several exercises involving the business and operational fields;
- Exercise of activation of alternative locations;
- Information technology system intrusion detection exercise;
- Activation of alternative locations of subsidiaries.

Management of business continuity events at the Bank. During the year, the Bank managed business continuity events following the "Pillar of Cloud" military operation and following the general strike. These events were managed in a manner which maintained the current operation of the Bank.

MEASUREMENT AND REPORTING SYSTEMS

The mapping of business continuity risks, the evaluation and monitoring thereof is being conducted as part of the identification and evaluation of operational risks and it is managed by means of the operational risk management system. This assists the Bank in managing the risk effectively and with a high degree of transparency.
An additional system supporting this process is the crisis management system, integrated at the Bank during the year. As part of the integration process of the system, procedures were formed and relevant information fed into it.

INFORMATION TECHNOLOGY RISK MANAGEMENT

General. The IT layout is a central component in the proper operation and management of a banking corporation, in view of the information, including all its aspects and ramifications, having a decisive influence over the stability of the corporation and its development. Information technology risks are risks deriving from the use or the non-use by a corporation of information technology and/or the dependence of a corporation thereon.

STRATEGY AND POLICY

The Bank has the following policy documents with respect to information technology:
- Information technology policy, the essence of which are managing and operational information technology aspects;
- Data protection policy, the essence of which is guiding principles for maintaining reliability, confidentiality and availability of information;
- Information technology risk management policy, the substance of which comprises basic principles for the reduction of exposure of the Group to the realization of these risks.

STRUCTURE AND PROCESSES

The Head of the Technology and Planning Division serves as the information technology risk manager at the Bank and the Group.

RISK MANAGEMENT UNITS

First circle. Two central units operate in this circle – IT risk department and data protection department.
- **IT risk management department.** The responsibility of the department is to outline the IT risk policy; to guide the computer units at the Bank and at the Group regarding the management of IT risks, and to supervise the implementation of the policy in this matter; to outline control processes designed to assure that exposure to IT risks will not deviate from the determined maximum risk tolerance, and exposure limits determined in accordance therewith and to periodically perform a self evaluation of the risk and effectiveness of the risk management process.
- **Data protection department.** In the framework of the department, operates various contents specialists in the field of data protection. The department is responsible for outlining the data protection policy at the Bank and the Group; guiding the different units in the IT and Planning Division, in the Bank and in certain subsidiaries in matters of implementation of data protection aspects in the various systems and supervise the implementation of its recommendations; implement various control processes for the evaluation of the data protection quality, including tests of system penetrations by an independent factor, and more.

Second circle. A designated function operating in the risk management group at a Group level, which is responsible for: independent verification of the appropriateness of risk management processes; challenging information technology risk mapping; monitoring compliance with determined limitations on risk tolerance; verifying effective risk management in strategic projects with respect to information technology; and an independent evaluation of the fairness of preparations made by the information technology group with respect to emergency situations and/or stress situations.

CENTRAL COMMITTEES

Two group committees operate in the Group headed by the Head of the Technology and Planning Division.

- Information technology risk management committee. The committee is responsible for the examination of the information technology risk management policy, examination of risk and material failure events in the IT risk field and the drawing of conclusions, examination of the determined tolerance threshold for information technology risks, and more.
- Data protection supreme steering committee. The committee is responsible for the examination of threats and material and/or new risks in the field of data protection, examination of exceptional events, providing operating guidelines and acting to minimize risk performing, monitoring and control over the implementation of data protection policy, and more.

THE CORE PROCESSES FOR RISK MANAGEMENT

The core processes are based on the three central circles in the risk management world, with the required adjustments to the information technology world, including: the mapping of all of the Bank's systems in order to evaluate the level of importance of each system to the Bank's business activity and to evaluate the existing control environment of the system, assessment of the exposure to the realization of business risks, such as: credit risk, market risk, compliance risks, etc. deriving from a failure of one of the systems, and more.

In addition, IT risk surveys and data protection risk surveys are being performed in the systems of the Bank, at intervals that match the criticality of the system and the risk inherent therein.

These processes allow effective focusing on areas and systems that had been identified as having the highest risk of disrupting business operations. They also enable the formation of a multi-annual work plan as well as a rapid adjustment of the risk management strategy and the risk map, in accordance with changes occurring at the Bank and/or in its operation environment.

REPORTING

The Head of the IT and Planning Division reports, on a fixed frequency, to the Management and to the Board of Directors, on cases of deviation from the limit of risk tolerance in the field of information technology at the Bank and at the subsidiaries in the Group, the operations of which are dependent upon computer services provided by the Bank. He also reports risks at a "very high"/"high" level of exposure, material failure events and rectifying measures taken in their respect, and more.

BUSINESS CONTINUITY

As part of the Bank's preparations to ensure its business continuity, the Bank has at its disposal a "hot" backup site, manned and operating continuously, which is capable of providing support for the Bank's core processes and for additional processes in the event that the production site is put out of operation. In addition, the Bank is in the midst of a project designed to reduce the risk of damage to both databases by a site where an additional copy of the data is maintained on a set of disks (this in addition to the two existing sets and to the backup layout using cassettes that exists at the Bank).

THE IMPLICATIONS OF DATA PROTECTION RISKS AND CYBERNETIC INCIDENTS

General. On December 5, 2012, the Supervisor of Banks issued a circular intended to regulate the disclosure required as regards data protection risks and cybernetic events, based on disclosure guidelines issued by the U.S. Securities and Exchange Commission (SEC) in October 2011. All this on the background of the increasing dependence of banking corporations and credit card companies on computer technologies in conducting their business, following which, data protection risks have intensified, being reflected in more frequent and serious cybernetic events.

According to the circular, to the extent that cybernetic events comprise a risk to the ability of the banking corporation to record, process, summarize and report data in a proper manner, the banking corporation has to consider them in determining whether a material weakness exists as regards the effectiveness of controls and procedures applying to disclosure.

The said disclosure is included in reports as of December 31, 2012 and thereafter.

Threats in the cyberspace. As a general rule, threats in the cyberspace are defined as threats that may cause a shutdown of systems, preventing material services, material damage to confidentiality and completeness of data and performance of hostile actions and fraud. In recent periods, we are witnessing a global intensification of this threat, both regarding the scope of attacks as well as their sophistication.

In 2012, there were no one or more cybernetic incidents that materially affected the products or services offered by the Bank or by the Group, their relation with customers or the competitive conditions. The Bank is preparing for the realization of the implementation program, in accordance with guidelines of the Supervisor of Banks in the matter.

Structure and processes. A data protection manager serves at the Bank, who is directly subject to the Head of the IT and Planning Division. For details regarding the duties of the data protection department, see above.

Attainment of the data protection goals is achieved through the implementation of a set of protection means, monitoring and control. Starting with policy and procedure outlines, determination of areas of responsibility and authority, installation of protection and reinforcement technologies, and ending with monitoring methods and treatment of security incidents.

Data protection surveys and penetration tests to the Bank's systems are performed by independent external companies specializing in data protection and IT risks. The frequency of performing a survey in respect of each system is determined according to the criticality of the system and the risk inherent therein.

Protection of the Bank's sites. In accordance with the Bank's policy in the matter, systems preventing unauthorized access as well as systems monitoring and identifying deviation from authorized activities are integrated into the Bank's systems. Protection of the marketing sites and of the Bank's operations is continuous. The Bank operates a data protection center that operates continuously throughout the year (24 hours per day 365 days per year), and is responsible, among other things, for the identification and warning of any activity intended to damage the Bank's sites or its customers (by means of imitation sites). The Bank's operational sites that provide service to customers over the Internet, are protected by several layers of defense, which include protection components for hardware/ communication/and services providing information regarding attacks and hostile addresses. All protection layers are monitored and reported to the data protection center. The Bank performs current operations to increase awareness and improve the organizational culture with regard to data protection aspects, which include, among other things, training sessions, distribution of policy documents, memos and marketing accessories.

As part of risk management, the Bank investigates various incidents, gains insights and draws conclusions. Such insights, together with data protection surveys enable the Bank to map gaps that should be rectified and determine preferences in the treatment thereof, on the basis of which the Bank establishes work plans.

ENVIRONMENTAL RISKS

In the Supervisor of Banks' guidelines regarding the exposure to environmental risks and their management, various possible aspects regarding the exposure of banking corporations to environmental risks are detailed and the need to relate to these risks individually is emphasized. 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. Damage to reputation may also be recognized as part of environmental risk, as a result of the possibility that relation to a factor causing damage to the environment might be attributed to the banking corporation.
The Bank's credit policy for 2013 in the matter of environmental risk was updated in December 2012. The said policy applied the Supervisor of Banks' guidelines in this matter, the aim of which is to manage and reduce the Bank's exposure to credit risks deriving from environmental risk.

LEGAL RISKS

According to Proper Banking Management Directive No. 350 of February 14, 2012, the legal risk forms part of the operational risk, defined therein as risk of losses due to improper or failure of internal processes, employees and systems, or due to external events, where the legal risk is defined as including, but not limited to exposure to fines or other punitive action stemming from supervisory activity as well as from individual arrangements.
Among the principal legal risks, the following may be mentioned: ignorance of the law, taking into account the many changes occurring in it from time to time, absence of legal certainty regarding the applying law, default in identifying changes in the law, retroactive changes in the law, erroneous legal advice, business activity without legal support, use of inappropriate standard documents, non-compliance with the law and/or regulations, which might result in monetary sanctions and/or criminal liability of the Bank and/or of its staff.
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 treatment and monitoring such risks.
The Bank's Board of Directors approved in October, 2012, the legal risk management policy document of the Discount Group.

REGULATION RISKS

Regulatory risk forms part of the legal risk, and 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 is a risk of material financial loss or damaged reputation which a banking corporation may sustain as a result of a legal or regulatory sanction, as a result of failure to comply with legal or regulatory rulings.
Compliance risk at the Bank is being managed by the compliance officer with respect to consumer regulatory instructions, in accordance with Proper Banking Management Directive No. 308 (with respect to regulations in the matter of money laundering and finance of terror prohibition, see below "Officer in charge of money laundering prohibition").
The operations of the Bank and of its subsidiaries are subject to various consumer instructions (laws, regulations, orders and directives regulating banking operations in Israel with respect to bank/customer relations), both in areas of banking activity and in other areas.
Non-compliance with consumer regulations might expose the Bank to sanctions originated from regulatory provisions (such as: fines, monetary sanctions, etc.), to criminal liability of the Bank and its officers, monetary losses and reputation risks.
New activities at the Bank, frequent changes in consumer regulation, and a multitude of consumer regulation instructions applying to the Bank and to its subsidiaries relating to existing and new fields of operation, require modification of the infrastructure supporting the duties stemming from these instructions.
Policy document regarding management of compliance risk. The policy document for compliance risk management had been approved by the Bank's Board of Directors, and was applied, with the necessary modifications, on the subsidiary companies, with the exception of IDB New York. The policy document establishes basic principles taken from the Basel II documents regarding compliance aspects and corporate governance principles. The document defines the structure of control circles supporting the management of compliance risk and areas of responsibility, details the main core procedures of the operation of the compliance officer and the principles for the management of Group risks.
Supporting infrastructure. Different kinds of infrastructure exist at the Bank to verify implementation of the regulation – computer, control, integration (procedures) and training infrastructure. As part of the examination of a new activity or a new regulation, examinations are performed with respect to the infrastructure supporting the activity/regulation and its agreement with the risk deriving from the new activity/regulation. Furthermore, in accordance with Proper Banking Management Directive No. 308, an infrastructure survey is being performed once every five years, the object of which is to verify that the Bank is prepared for the implementation of compliance with duties stemming from the consumer instructions. An infrastructure of procedures exists at the Bank, designed to enforce compliance with the various requirements of the consumer regulatory provisions. The procedures are updated from time to time in accordance with the regulatory directives and in accordance with the various activities performed by the Bank. Concurrently the systems supporting compliance with the said regulatory provisions within various activities are being updated, and training sessions are conducted for their integration among the staff.
Control and supervision. Compliance with the provisions of the consumer regulations are enforced on a regular basis by means of various control and supervision systems - the compliance officer, compliance trustees and internal audit. With a view of improving control mechanisms and tightening supervision over compliance to regulatory provisions, as stated, including in the matter of money laundering prohibition, the Bank has appointed compliance trustees at various organizational levels (branches, regions, divisions, as the case may be, and the compliance officer).
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. According to Proper Banking management Directive No. 308, the Compliance Officer is responsible for coordinating the Bank’s actions regarding compliance with consumer regulations.

The positions of the compliance officer and of the officer in charge of money laundering prohibition were manned in the past by two different office holders. In February 2013, a chief compliance officer was appointed, who is a senior manager reporting to a vice president who coordinates and manages both fields together.
The compliance officer acts in this role also at several subsidiary companies of the Bank. Other subsidiaries in Israel have appointed their own compliance officers in accordance with the said Directive, and the Bank's compliance officer communicates with them on an ongoing basis. Between the compliance function at the Bank and the compliance functions at the subsidiary companies, an interface exists for the purpose of updating and coordination within the framework of which, among other things, operates a permanent forum of compliance officers of the Group in Israel, which convenes in each quarter. In addition, action is being taken to tighten the interface with the compliance functions at the Bank's overseas extensions (IDB New York, IDB (Swiss) Bank and the London Branch).
For the purpose of his work, the Compliance Officer is assisted by the coordination committee that meets once in every quarter.
The compliance officer monitors the Bank's preparations for the implementation of the duties imposed on it under the consumer regulations, involved in an active manner in the preparations for a new activity at the Bank, for the purpose of verifying compliance of the Bank with the said duties relevant to the Bank's new activity, and monitors the rectification of various deficiencies in complying with the consumer instructions. The compliance officer submits quarterly reports that include a summary of his operations, to the Bank's President & CEO as well as to the CEO's of the subsidiaries in which he serves as a compliance officer. In addition, the compliance officer submits to the Bank's President & CEO, to the CEO's of the said subsidiaries and to their Boards of Directors, an annual report summarizing his operations of the Bank and of the subsidiaries.
In accordance with Proper Banking Management Directives and at intervals determined therein, the Bank conducts an infrastructure survey that includes mapping of the consumer instructions applying to the Bank and the duties stemming from them, the potential exposure arising from the non-fulfillment of the said duties and the preparations for their implementation are being monitored by the infrastructure supporting the fulfillment of duties (work procedures, computer infrastructure and other means of control).
In order to increase awareness to the importance of compliance, the Bank conducts study sessions on the subjects of compliance among the staff, including managers in general, and of compliance with the consumer instructions relevant to the work environment of specialized groups of employees in particular.
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. As stated, the unit of the officer in charge forms a part of the Bank's Risk Management Group.
The subsidiaries in Israel as well as the Bank's overseas extensions that are subject to this requirement, have also appointed an officer in charge ,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, 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.
The officer in charge of money laundering prohibition communicates with the subsidiaries in Israel and with the Bank's foreign extensions for the purpose of monitoring the implementation of the Bank's policy and regulatory directives regarding money laundering prohibition and the finance of terror on a Group basis and this in accordance with the Group's policy. This activity is

supported by the integration of the unit of the officer in charge of money laundering prohibition with the Bank's Risk Management Group.

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.

Following legislation amendments and directives of the Supervisor of Banks published during the preceding year, the Bank's Board of Directors approved policy amendments in the matter of "know your customer" as regards a passerby/third party, restrictions and limitations regarding transactions with parties operating in risk countries, prohibition on conducting activity with the enemy, prohibition on transactions with parties declared as assisting Iran's nuclear program and related programs, as published by the Israel Money Laundering and Terror Financing Prohibition Authority, and prohibition on the transfer of funds originating from or directed to bank accounts related to illegal gambling on the Internet

Disclosure regarding risks and limitations pertaining to relations with Iran or with the enemy. The Israeli Securities Authority published on November 27, 2012, a guideline under Section 36A(b) of the Securities Act, 1968, according to which a reporting corporation is required to disclose the risks and limitations to which it is exposed as a result of direct or indirect relations with Iran or with the enemy, including by power of provisions of the law, and which have or might have a material effect upon that corporation.

The Supervisor of Banks has applied the said guideline to all banking corporations and credit card companies.

The Bank strictly complies with the requirements of the law in this respect, including the provisions of the Money Laundering Prohibition Act, Trading with the Enemy Ordinance and the provisions of the Financing of Terror Prohibition Act and to the best of its knowledge it does not have relations, directly or indirectly, with Iran or with the enemy. Accordingly, the Bank has no material exposure in this respect.

Group policy regarding money laundering prohibition. A Group policy is updated and approved by the Board of Directors in each year in the matter of prohibition of money laundering and prevention of the finance of terror. The policy was updated and adopted in January 2012, with the required modifications, by the subsidiary companies and the overseas extensions. The policy document determines the Group's standards with respect to money laundering and the finance of terror as well as principles for management of this risk on a Group basis.

For details regarding an audit by the Bank of Israel in the matter of "Implementation of the provisions of the Prohibition of Money Laundering Law" at ICC, see hereunder in "Israel Credit Card Company Ltd." under "Main investee companies". For details regarding an audit by the Bank of Israel at MDB in the matter of “Compliance with the Prohibition of the Financing of Terror Law”, see below in “Mercantile Discount Bank Ltd.” under “Main investee companies”.

EFFECTS OF EXTERNAL FACTORS

MAIN DEVELOPMENTS IN ISRAEL AND AROUND THE WORLD IN 2012

DEVELOPMENTS IN GLOBAL ECONOMY

General. The global economy continued to expand at a moderate rate, with differences in the rates of growth between the major economies. The product in the United States expanded by 2.2% (1.8% in 2011). The improvement in real estate was noticeable, alongside the recovery in employment (mostly in the second half of the year) and the continuing growth in private consumption. On the other hand, the Eurozone entered into recession in the period under review, on the background of the continuing contracting fiscal policy alongside the developments in the debt crisis. The negative growth of the Eurozone product started during the second quarter and in total for the year it contracted by 0.6% (a growth of 1.4% in 2011). The unemployment rate in the Eurozone continued to grow during the year to a level of 11.7% at December 2012, with the weakening economy covering the peripheral countries as well as a number of the stronger countries. In particular, the growth rate in Germany declined from quarter to quarter (negative growth in the fourth quarter), and a negative growth in three quarters was recorded in France (excluding the third quarter). In Spain, Italy and Portugal, the product contracted in each of the quarters of 2012.

Due to measures adopted in China in 2011, for the cooling down of the economy and the weakness in global demand, a significant slowdown in growth was recorded in 2012, from 9.3% in 2011 to 7.8%. Notwithstanding, China's economy improved in the fourth quarter of the year with an accelerated growth rate.

The Eurozone debt crisis continued to be the focus in 2012, with an inconclusive development in the crisis. The Eurozone crisis calmed down in the first quarter on the background of the progress made in solving the crisis in Greece alongside the support given by the ECB to banks in the Eurozone and the supply of liquidity through medium-term loans. Furthermore, agreement between the ministers of finance of the Eurozone countries was reached in the first quarter regarding the increase in the volume of the bailout fund. On the other hand, on the background of Spain's announcement in the second quarter regarding the deviation from the deficit target for 2012, the general elections in Greece and in France (which raised concerns that measures for reducing the debt burden would not be implemented), alongside concerns regarding the stability of banks in Spain, the debt crisis intensified significantly. The intensifying of the crisis led the heads of the European Union to take several important decisions in order to solve the crisis (in particular, allowing the bailout funds to purchase government bonds and bank bonds). In addition, the ECB signaled the possibility of purchasing bonds issued by Spain in particular and by the peripheral countries in general, in any amount required in order to maintain the stability of the Eurozone (under certain conditions). These actions calmed down the financial markets and significantly moderated concerns as to further intensification of the crisis in the third quarter. This calm was maintained also in the fourth quarter of 2012. In total for the year, the CDS level of the PIIGS countries declined significantly in comparison with the end of 2011. However, the credit rating of France, Italy and Spain was downgraded in the period under review as well as that of the EFSF bailout fund. In addition, the credit rating forecast of Germany and Holland was reduced to "negative".

It should be noted, that in the focus of the global economic events in the fourth quarter of 2012, was the uncertainty regarding the U.S. "fiscal cliff" – the automatic cutback in the budget accompanied by the cancellation of tax benefits, as of January 2013. This, alongside the increase in the debt ceiling. A partial solution was attained at the beginning of 2013, which still left a significant measure of uncertainty.

On the background of the economic slowdown, both in developed and developing countries, which led to a moderation in demand around the world, a decline in the inflationary environment was observed during the reviewed period. The said decline facilitated the expansionary monetary policy of the central banks around the world. This policy included, among other things, the lowering of interest rates in certain of the developing markets and in the Eurozone (to a level of 0.75%), or leaving them at a low rate in the U.S. and Great Britain. Furthermore, measures were taken, such as the acquisition of financial assets, the granting of loans in order to supply liquidity to the markets and the reduction of the reserve ratio (in China).

Financial markets. Trading on equities markets around the world was affected in 2012 by the developments in the Eurozone debt crisis. This, alongside macro data of the leading economies, in particular the U.S.A. and China. These indicated a slowdown in the first half of the year and a certain improvement in the second half. In addition trading was affected by the monetary policy of the U.S. Federal Bank and by the uncertainty regarding the fiscal cliff solution. This, alongside the measures of the ECB and its pronouncements. As a result, leading equities indices around the world recorded volatility. It should be noted that on the background of the uncertainty regarding the U.S. fiscal cliff solution, the S&P 500 Index fell by 1%.

Following are the changes in the leading equities indices in the years 2011 and 2012:

Intex	Change in 2012	Change in 2011
S&P 500	13.4%	-
DAX	29.1%	(14.7%)

On the background of the trends mentioned above, sharp volatility was recorded in returns on U.S. government bonds for ten years. Concurrently, a decline was recorded in returns on long-term bonds of the German Government.

Return on bonds for 10 years	December 31, 2012	September 30, 2012	December 31, 2011
U.S.A.	1.76%	1.63%	1.88%
Germany	1.32%	1.44%	1.83%

Trading on world currency markets in 2012 was also characterized by volatility. In conclusion for the period, the U.S. dollar weakened against most of the leading world currencies.

Following are the changes in the U.S. dollar against selected currencies:

Exchange rate	Change in 2012	Change in 2011
EUR	(1.80%)	3.20%
JPY	12.60%	(5.20%)
GBP	(4.3%)	0.5%

The prices of commodities in the world were also affected by the said trends, this, alongside developments in the nuclear issue (which affected oil prices), the severe draught in the United States (which caused an increase in prices of agricultural commodities), the liquidity supply by the Federal Bank and trends in the U.S. dollar exchange rate. As a result thereof, prices of commodities recorded volatility, and in particular, the CRB Index fell by 5% in the fourth quarter of the year.

	Change in 2012	Change in 2011
The commodities index - CRB	(3.4%)	(8.3%)
The oil price (BRENT)	3.5%	13.3%
The oil price (WTI)	(7.1%)	8.2%

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY

GENERAL

A significant slowdown was recorded in 2012 in economic growth, from a rate of 4.6% in 2011 to a rate of 3.1% in 2012. In particular, in the last quarter of the year, the product grew by 2.4%, the lowest growth rate recorded since the beginning of 2009. Growth data in 2012, reflected a slowdown in all applications (excluding public consumption), alongside a slowdown in imports. A regression in foreign trade and in investments in fixed assets was recorded in the last quarter of the year.
It should be noted that despite the slowdown, the number of employed persons increased in 2012, alongside an increase in the participation rate. The rate of unemployment in the fourth quarter was 6.9%.

MAIN DEVELOPMENTS IN ECONOMIC SECTORS

During 2012, industrial production recorded a growth of 3.7%, this in continuation of a 2% growth in 2011. Most of this increase related to the hi-tech industries. With the elimination of this sector, industrial production grew by a marginal rate of 0.4%.
Turnover of the wholesale and retail trade grew in 2012 at a moderate rate of 1.1%, reflecting a 5.7% rise in turnover of the retail trade and a regression of 1.2% in turnover of the wholesale trade.

DEVELOPMENTS IN THE ACTIVITY OF THE ISRAELI ECONOMY WITH OVERSEAS MARKETS

A significant flow of direct investments in Israel by foreign residents, through banks, continued in 2012. On the other hand, in financial investments in marketable securities traded on the Tel Aviv Stock Exchange, realizations continued (short-term loans MAKAM in particular). This, on the background of the imposition of capital gains tax on Government bonds of up to one year.
Direct investments abroad by Israeli residents (through banks) recorded slight realizations in 2012. On the other hand, financial investments increased by 6% (most of which in equities). It should be noted that about one half of the financial investments were made by institutional bodies.

Investments in Israel by foreign residents	2012	2011	Change
	US$ billion		
Total direct investments through banks	5.5	6.4	- (13.0%)
Total financial investments in the Tel-Aviv Stock Exchange	(3.1)	(2.5)	
Of which: Government bonds and MAKAM	(3.9)	(3.1)	
Shares	0.43	0.66	- (36.0%)

Investments abroad by Israeli residents	2012	2011	Change
	US$ billion		
Total direct investments through banks	(0.30)	--	
Total financial investments (excluding banks)	5.40	5.10	- 6.0%

DEVELOPMENTS IN FOREIGN EXCHANGE RATES AND INFLATION RATES

The Shekel exchange rate in 2012 was mostly affected by the trading trend in world leading currencies, alongside the lowering of the interest rate by the Bank of Israel. In addition, the exchange rate was affected by evaluations as to the anticipated implications of natural gas production in 2013 and the geopolitical events in the region, led by developments in the Iranian nuclear program and the "Pillar of Cloud" (military defense operation) in the Gaza Strip. In total for the year, a positive net flow of non-financial investments in Israel was recorded on the one hand, and a negative net flow of financial investments on the other hand. As a result of the said developments, the exchange rate recorded volatility. In conclusion of the period, the Shekel strengthened against the U.S. dollar by 2.3% (weakening of 7.7% during 2011), while during the fourth quarter of the year, the Shekel strengthened by 4.6%. Against the Euro and against the effective nominal exchange rate, the Shekel strengthened by 0.4% and 0.8%, respectively.
During 2012, the Consumer Price Index (CPI) rose by 1.6%, compared to a rise in inflation of 2.2% in 2011. All the rise in the CPI was recorded during the period from January to September, while in the fourth quarter the CPI dropped by 0.5%. The main factors for the inflation in 2012 were the rise in housing, housing maintenance and food prices. On the other hand transportation and communication prices contributed negatively to the CPI.

FISCAL AND MONETARY POLICY

Fiscal policy. The Government deficit in 2012 (excluding the granting of credit) amounted to NIS 39 billion, comprising 4.2% of the GDP, compared to a deficit of NIS 28.6 billion in 2011 (3.3% of the GDP). Furthermore, compared with the targeted deficit as planned in the Budget Act for 2012, a deviation of NIS 18.5 billion was recorded. To a large extent, the said deviation from target was due to a shortage in tax collection as compared with the forecast. In addition, expenditure deviated from the budgeted amount by NIS 2.2 billion. It should be noted that the targeted Government deficit was adjusted upwards in the third quarter of the year, and concurrently, a number of decisions were taken in order to increase State revenues, among which the decision to increase the rate of VAT to 17%, starting in September 2012.

Monetary policy. In 2012, the Bank of Israel interest rate was lowered three times, from a level of 2.75% at the end of 2011 to a level of 2% at the end of the year. The interest rate was lowered twice by 0.25% in February and in July, on the background of the slowdown in economic growth in Israel and concerns regarding the worsening condition of the global economy and the Eurozone debt crisis in particular. The interest rate remained unchanged in the period from August to October, supported by reduced concerns regarding an immediate intensification of the Eurozone debt crisis and by the relaxation in the financial markets, also by the indications of economic growth at a rate similar to the previous quarters. The interest rate was again lowered in November, mostly on the background of signs indicating an intensification in the slowdown of economic growth.

THE CAPITAL MARKET

Trading in equities on the Tel Aviv Stock Exchange was conducted in 2012 mostly on the background of trends in leading markets in the world, alongside the implications of measures for the increase in market competition (in the communication sector in particular), as well as on the background of regulatory measures (particularly in the insurance sector) instituted by policy makers. Trading in equities was also affected by developments in the Iranian nuclear program and by the Pillar of Cloud military defense operation (in the last quarter of the year). As a result, equities prices reflected volatility. In total for the period, all principal indices of the Stock Exchange recorded increases.

Following are the changes in the leading share indices:

Index	Change in 2012	Change in 2011	Change in the fourth quarter of 2012
General share index	4.5%	(22.1%)	0.4%
TA 25	9.2%	(18.2%)	(0.3%)
TA 100	7.2%	(20.1%)	(0.5%)
TA banks	22.9%	(34.6%)	16.2%
Blutech 50	15.6%	(9.4%)	(7.6%)
Real-estate 15	14.1%	(23.2%)	13.6%

On the background of the said developments, the market value of shares and convertibles (excluding indices products) rose by 0.6% compared to the end of 2011, amounting to NIS 604 billion, at the end of December 2012. It should be noted that in 2011, the market value of shares and convertibles declined by 27%. The daily trading turnover in shares and convertibles during 2012 amounted to an average of NIS 1.1 billion, compared with NIS 1.7 billion in the corresponding period last year.

Trading in Government bonds in Israel in 2012 was mostly affected by the trends in returns on U.S. Government bonds, serving as a benchmark for the local market. This, alongside the lowering of interest rates in Israel, inflationary developments and the fiscal uncertainty.

To a large extent, trading in corporate bonds in 2012 derived from the trading trend in Government bonds. This, alongside the need of a number of the corporations to recycle debts of high volume and the implications of the recommendations of the Hodek Committee. It should be noted that the spread in returns between corporate bonds and Government bonds recorded a significant decline in 2012.

Index	Change in 2012	Change in 2011
General bonds	8.8%	2.5%
General Government bonds	7.9%	5.0%
Shekel Government bonds	7.0%	5.2%
Linked Government bonds	9.4%	4.3%
General Corporate bonds	10.2%	(1.2%)
Linked Corporate bonds	10.3%	(1.8%)
Shekel Tel-Bond	7.2%	5.0%

The raising of capital through the issue of corporate bonds amounted in 2012 to NIS 39.7 billion, a decline of 2.4% compared with 2011. Of this amount, bond issues to institutional bodies amounted to NIS 5.8 billion, compared with NIS 5.4 billion in 2011.
The daily average trading turnover in bonds in 2012 recorded an increase of 9% to NIS 4.1 billion. On the other hand, the daily trading turnover in MAKAM notes declined significantly by 46%, amounting to NIS 634 million on an average.

THE ASSET PORTFOLIO HELD BY THE PUBLIC

The value of the financial assets portfolio in the hands of the public increased during 2012 by 7%, amounting at the end of December to NIS 2.7 trillion.
Most of the increase was recorded in the second half of the year and reflected growth in all types of assets, except for assets linked to foreign currency.

Following is the distribution of the asset portfolio held by the public:

	For December 31	
	2012	**2011**
Shares	21.7%	21.5%
Non-linked assets	34.8%	35.0%
CPI linked assets	32.6%	32.0%
Foreign currency linked assets	10.9%	11.5%

PRINCIPAL ECONOMIC DEVELOPMENTS IN JANUARY-MARCH 2013[1]

Most of the indicators of economic activity in the U.S., published in the reviewed period, were positive and pointed to the continued improvement in employment and in the real estate market. A slight improvement was recorded in some of the indicators published in the Eurozone, however those still pointed to the weakness in the Eurozone economy. In particular, the unemployment rate reached a record level of 11.9%. Also the data published in China indicated a slight improvement in the economy.
The inflationary environment in the U.S. and in the Eurozone continued to be moderate. Concurrently, the expansionary monetary policy in these economies continued (in the US interest rate remained at a negligible level and in the Eurozone at a level of 0.75%). In the meantime, an act of increasing taxes was made at the beginning of January, as part of the solution for the "fiscal cliff", and the automatic cutback in the U.S. of US$85 billion, became effective at the beginning of March.
It should be noted that the relative calm regarding the debt crisis in the Eurozone continued, until the elections in Italy (held at the end of February 2013). The election results led to an increase in the level of concern regarding the implementation of an austerity policy in Italy and to a temporary uncertainty in the markets. It should be further mentioned that at the end of

1 All the data in this chapter refer to the period from January 1, 2013 to March 11, 2013.

February, the rating agency Moody's lowered the impeccable rating of Britain to Aa1, this on the background of the weakness in economic growth, which impedes the reduction in public debt.

Trading in the global stock markets around the world was mainly conducted on the background of the partial solution for the "Fiscal cliff" in the U.S., the calm in the Eurozone (until the end of February, as stated), the elections in Italy and the macro-economic data of the leading economies. In total for the period, the S&P 500 Index increased by 9.1% and the German DAX Index increased by approx. 5%. The U.S. dollar strengthened in the same period against most of the leading currencies and in particular against the Euro and the YEN by 1.3% and 11.1%, respectively. The CRB commodities index recorded stability in the reviewed period. The price of oil (of the WTI type) also remained almost unchanged. The U.S. long-term bonds recorded during the reviewed period a rise in returns.

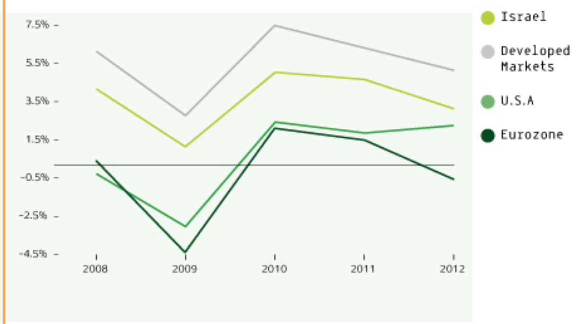
In Israel, indicators of economic activity, published in the reported period were rather mixed. The Bank of Israel's combined index increased in January by 0.2% (a moderate rate, though higher than the average for the second half of 2012, which stood at 0.1%). The annual inflation rate amounted to 1.5% in February, and housing prices (which are not included in the CPI) continued to rise.

Fiscal policy in Israel was conducted in the said period on the background of the absence of a budget for 2013. As a result, Government spending in each month (starting with January and until a budget is approved) is restricted to 1/12th of the budget for 2012. It should be noted that general elections were held in Israel in January and that the process of forming a government concluded in March.

Notwithstanding, after the interest rate for January was lowered to a level of 1.75%, the interest rate for February and March remained unchanged.

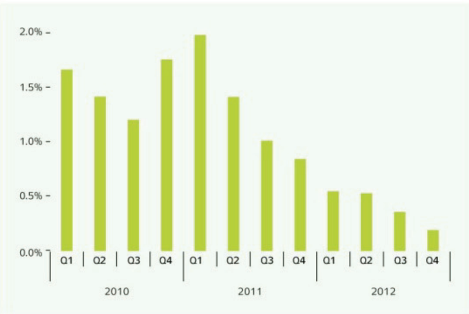
The Shekel strengthened during the period against the U.S. dollar and the Euro at the rate of 1.2% and 2.5%, respectively, and against the effective nominal basket of currency it strengthened by 2.7%. Share prices on the Tel Aviv Stock Exchange recorded volatility, when in total for the period the TA 25 and TA 100 indices increased by up to 5.0%. The long-term non-linked government bonds recorded an increase in returns. It should be noted that returns on the Tel-Bond indices declined during the period, with a decline in margins against government bonds.

Product Growth- Annual Growth Rate

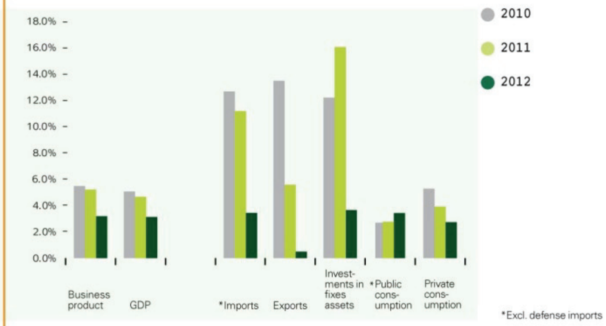


Central Bank Interest Rates in Selected Countries

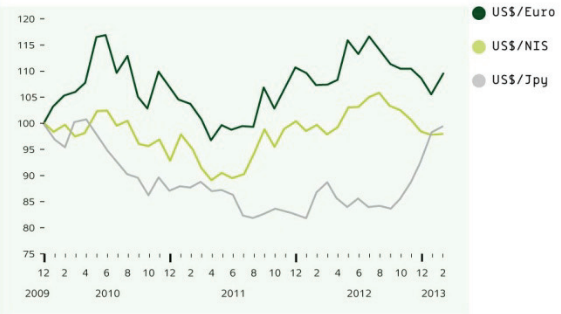
Quarterly Change in the Bank of Israel Combied Index



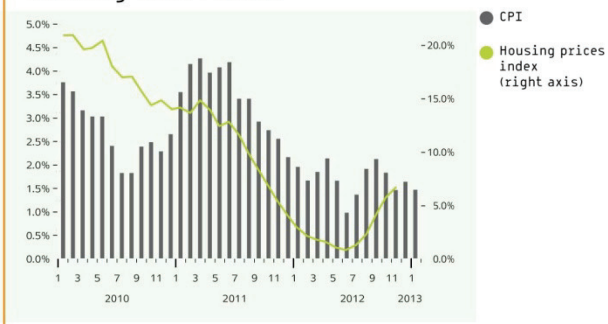
Growth in Israel



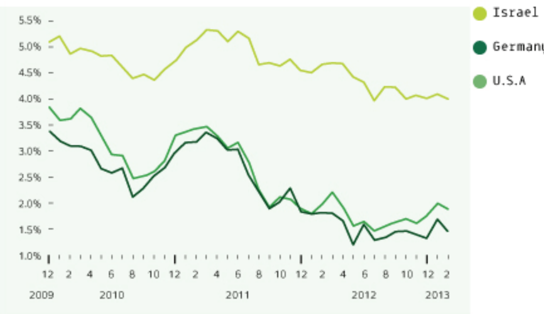
Exchange Rate-CPI, December 2009=100



Annual Change Rate in CPI and Housing Unit Prices

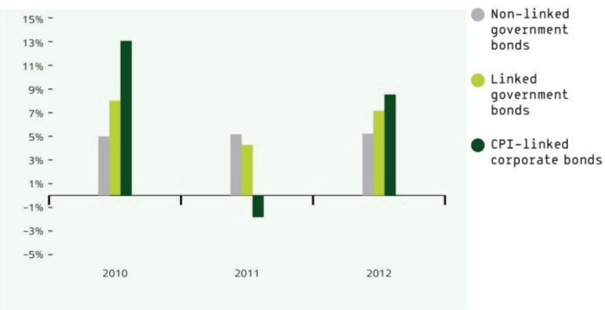


Return on Long-Term Government Bonds

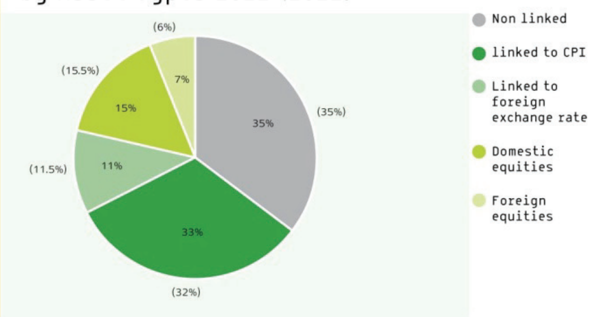


Leading Share Indices in Selected Countries- December 2009 = 100 Points

Annual Rate of Change in Selected Bond Indices



Distribution of the Public's Portfolio by Asset Types 2012 (2011)



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 Bank's operations, 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 the Bank's assets and the mode of reporting to the Supervisor of Banks and the public as to the Bank’s said operations.

Alongside these, the Bank is subject to a wide legislation that regulates its capital market operations both on behalf of customers an on its own behalf (for example: investment 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 Bank's operations, 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 Bank's and its subsidiaries' operations 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 and its subsidiaries 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.

A monetary sanction by most of the laws applying to the Bank's operations exists, 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 Bank's operations.

In view of the dissolution of the 18th Knesset, it is not possible to evaluate whether the continuity rule will apply to the following proposed Bills, and accordingly, whether the process of legislation will continue.

BANKING LAWS

THE BANKING ACT (LEGISLATION AMENDMENTS)

On March 19, 2012, the Banking Act (Legislation amendments), 2012, was published in the Official Gazette, intended to regularize the activities of a bank that does not have a core controlling interest therein.

Within the framework of the Act, provisions have been determined with respect to the appointment of directors for banking corporations with no core controlling interest, as well as instructions regarding the appointment and termination of directors, applying to banking corporations that are public companies, within the framework of which the ability of the Board to appoint

directors in the case of a bank having a core controlling interest, has been restricted, and it is determined that, as a general rule, they will be appointed by the general meeting of shareholders.
In the wake of the Act, the Supervisor of Banks has asked the banking corporations to examine their articles of association and align them with the amendment to the extent necessary, to cover both the possibility of the banking corporation will be managed as a corporation with a core controlling interest and also the possibility of it being managed as a banking corporation without a core controlling interest. (For details regarding a proposed amendment of the Bank's articles, tabled before a special meeting of shareholders of the Bank, see "Amendment of the Bank's articles"). In addition, the banking corporations have been required to provide the Supervisor of Banks, with the definition of the seven most senior officers in the corporation, regarding whom the corporation believes it has to implement a "Fit & Proper" test. In a letter dated June 19, 2012, the Bank submitted to the Supervisor of Banks a list of seven officers, as stated. In the last few days, the Bank received a letter from the Supervisor of Banks, approving the identity of the seven officers proposed by the Bank.

DRAFT DOCUMENT OF PRINCIPLES REGARDING THE DECENTRALIZATION OF THE CORE CONTROLLING INTEREST IN A BANK

On April 18, 2012, the Supervisor of Banks published a draft document of principles intended to regulate the process of sale of the core controlling interest in a bank in a decentralized manner, so that following the sale the bank will operate with no core controlling interest. The principles are designed to ensure that the former controlling shareholders will not continue to control the bank in practice, despite the withdrawal of the control permit, considering the fact that during the transitional period the former controlling shareholders may continue to hold a significant rate of means of control in the bank. The document of principles determines restrictions applying to the rights of the controlling shareholders in the transitional period in which the core controlling interest will be decentralized, among other, regarding the acquisition of means of control, the appointment of directors and the distribution of dividends.

DRAFT DOCUMENT OF PRINCIPLES REGARDING CONTROL OF REGULATED ENTITIES

In April 2012, the Supervisor of Banks and the Commissioner of the Capital Market published a draft document of guiding principles, which will serve as a basis for determining the criteria and terms for the granting of a control permit and a permit for holding means of control in regulated entities operating in the capital and money markets. The draft details the issues that would be regulated within the framework of the control permit, including determination of a minimum rate of holdings, limitations on the manner of holding and as regards the finance of acquisition of means of control.

PROPOSED BANKING ACT (SERVICE TO CUSTOMER)(AMENDMENT - DUTY OF NOTICE TO CUSTOMER PRIOR TO EFFECTING A TRANSACTION) BILL, 2011

The private Bill tabled before the Knesset on July 25, 2011, passed its second and third reading on July 3, 2012, by the Economics Committee of the Knesset. According to the proposed Bill, a banking corporation shall not demand the immediate repayment of a loan and shall not institute legal proceedings against a customer in respect of non-compliance with the terms of a loan, unless notice in writing of such action is delivered to the customer, by personal delivery, at least 21 business days prior to taking action. In this notice, the bank has to explain to the customer the implications of such collection proceedings.

ANTITRUST

ANTITRUST ACT - MONETARY SANCTIONS

The Antitrust Act (Amendment No. 13), 2012, was published on May 14, adding to the Antitrust Act provisions determining the

authority of the Antitrust Commissioner to impose a monetary sanction in a maximum amount of NIS 1 million for an individual and up to NIS 24 million for a corporation, in respect of various violations of the Act, as well as a mechanism for the imposition of the sanction.
Among other things, a corporation may not insure or indemnify controlling interests, officers or staff in respect of a monetary sanction. Notwithstanding, it is permitted to indemnify or insure a person in respect of disbursements made in respect of proceedings involving a monetary sanction, subject to a provision permitting such a payment being contained in the articles of the corporation.
Within the framework of the said Amendment No. 13, the Antitrust Commissioner has been authorized to impose monetary sanctions in respect of various violations of the Law, including in respect of an unreasonable refusal of a monopoly to supply or acquire a monopolized asset and in respect of misuse of a monopolistic position. A notice on behalf of the Antitrust Commissioner was published in the Official Gazette on October 24, 2012, stating the acts and omission, in respect of which it would be possible to impose a monetary sanction on monopoly owners. Upon the publication of the announcement, the authority of the Commissioner to impose a monetary sanction in respect of practices detailed in the announcement, took effect.
The Antitrust Authority issued two Opinions at the end of July 2012, as follows:

- Guidelines regarding the use of enforcement proceedings by way of monetary sanctions, within the framework of which are detailed those violations in respect of which the principal enforcement tool considered by the Authority is a monetary sanction;
- Guidelines regarding the considerations of the Antitrust Commissioner in determining the amount of a monetary sanction, including: the period of violation; the damage which the violation might have caused to competition or to the public; the involvement of the violating entity in the violation and the extent of its influence over it; the existence or absence of prior violations and more.

EXEMPTION FROM A BINDING ARRANGEMENT WITH RESPECT TO THE HOLDING AND JOINT ACTIVITY WITHIN THE FRAMEWORK OF ABC AND BCC

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 was provisionally extended in November 2011, march 2012 and May 2012. On September 20, 2012, the Commissioner granted an additional provisional exemption to ABC for a period of six months, within the framework of which, Automatic Banking Services ("ABS") has been obliged to sell its network of ATM machines within a period of eight months, and it has been determined that his decision regarding the transaction gathering system will be given within six months. The Commissioner has also granted the Bank Clearing Center ("BCC") an additional provisional exemption for a period of three months for the purpose of an in-depth examination of the debits and credits clearing operations. With respect to connecting fees for new members, the Commissioner would allow ABS and BCC to charge the amount of the direct cost of connection to their systems, with the computation of the cost being approved by him in advance. The provisional exemption granted to the bank clearing center (BCC) was extended on December 20, 2012, for an additional period of three months. This in order to allow the continuation of the examination, as stated.

CONSORTIUM AGREEMENTS FOR THE GRANTING OF CREDIT

The Antitrust Commissioner informed on February 28, 2011, that she had reached the conclusion that the consortium arrangements for the granting of credit, made between banks and insurance companies and between themselves, should continue to exist, and she detailed the conditions, which subject to their existence, she does not intend to enforce the provisions of the Antitrust Law, 1988 upon the said arrangements. The announcement extends the effect of prior announcements issued by the Commissioner with respect to the consortium arrangements, with certain changes, for a period of two years. On February 26, 2013, the Commissioner announced of the extension of the announcement for a period of an additional year, until February 28, 2014, unless further announcement is issued before the end of this period.

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, under the power of which, Regulations and Orders have been enacted over the years. Also amended was Proper Banking Management Directive No. 411, and the Supervisor of Banks issued clarifications and circulars in the matter. This set of legislation imposed upon banking corporations as well as on additional subsidiaries (like the company for Portfolio Management - Tachlit Discount) identification, verification, reporting and record maintenance duties regarding customers and customer accounts managed 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 Prohibition of money laundering Act (Amendment No. 10), 2012. On May 14, 2012, Amendment No. 10 to the Prohibition of Money Laundering Act was published, which relates mostly to the application of the money laundering rules also to traders in precious gems (this amendment will enter into effect upon the publication of an Order applying to traders in precious stones). Furthermore, Amendment No. 10 added the possibility for the transfer of information from the Israel Money Laundering Prohibition Authority to other factors in addition to those existing today.

Prohibition of Money Laundering (Amendment No. 10) Bill, 2011. The Bill passed its first reading on December 2011, and transferred on to the Constitution, Law and Justice Committee of the Knesset for preparation for the second and third readings.

The essence of the Bill is the cancellation of the "turning a blind eye" exception included in the offence section relating to transactions in assets with the knowledge that they are forbidden, so that following the amendment, effecting such a transaction turning a blind eye to the fact that it is forbidden, would constitute an offence.

Prohibition of Money Laundering Act (Amendment No. 11) (Providers of business services) Bill, 2012. This Government proposed Bill passed its first reading on May 11, 2012, and was passed to the Constitution, Law and Justice Committee for preparation for its second and third readings. Its main provision is applying the provisions of the Prohibition of Money Laundering Act to Lawyers, accountants, tax consultants, real estate brokers and providers of custodian services. All this with respect to certain operations of a financial nature.

Proposed amendment of the Prohibition of Money laundering Order. Following consultations with the Internal Security Minister and with the Minister of Justice, and after obtaining the approval of the Minister of Justice, the Governor of the Bank of Israel submitted on August 18, 2011, to the Constitution, Law and Justice Committee of the Knesset a proposal for the amendment of the Prohibition of Money Laundering Order.

The principal changes proposed in the amendment to the Order are a change in the criteria regarding the reporting of an unusual operation (in a manner that requires reporting in case of concern or a reasonable base for concern that an operation is prohibited under the law or under the Prohibition of Financing of Terror Act), establishing the duty of performing the process of "know your customer" in the Prohibition of Money Laundering Order (in addition to Proper Banking Management Directive No. 411), authorizing a banking corporation to determine alternative identification and verification measures other than those prescribed by the Prohibition of Money Laundering Order, etc.

The Constitution, Legislation and Justice Committee of the Knesset discussed the proposal for the amendment of the Order, and on June 26, 2012, on the background of the disagreement regarding the criteria for the reporting of unusual operations, the representatives of the Bank of Israel asked the Committee not to approve the Order, so that it could be amended following a reexamination.

It should be noted, that the change in the criteria for reporting an exceptional transaction, as described above, has been established in the circular letter issued by the Supervisor of Banks on February 17, 2013, in the matter of “Collection of questions and answers on the implementation of the Prohibition of Money Laundering Order and Proper Banking Management Directive No. 411”.

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 and further on was amended several times. 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.

Struggle against the Nuclear Program of Iran Bill, 2012. The Act was published in the Official Gazette on August 5, 2012.

The highlights of the Bill are as follows:

- A Minister Committee established under the Act was empowered to declare a foreign entity as assisting Iran in advancing its nuclear program, or in obtaining weapons for mass destruction or means for the delivery of such weapons (hereinafter: "a foreign assisting entity") and also in respect of a foreign entity being a corporation, which as such maintains business relations with Iran;
- Once an entity has been declared a foreign assisting entity, any economic activity with it is forbidden, unless permission has been granted by the Minister Committee;
- Economic activity involving a foreign assisting factor without permission shall be considered an offence, which is a predicate offence under the Prohibition of Money Laundering Act;
- Reporting duties have been imposed with respect to an assisting foreign entity, and the matter is subjected to prohibition of money laundering governance;
- Once an entity is declared as maintaining business relations with Iran, a bank is prohibited from investing in it, unless permission in this respect is obtained from the Minister Committee;
- Investment in a corporation maintaining business relations with Iran without permission is considered an offence.

The Bill introduces amendments also in the Trade with the Enemy Ordinance – intensifying the punishment in respect of trading with the enemy offence, determines a reporting format regarding trade or reasonable suspicion of trade with the enemy, determines that the officer responsible for compliance with the provisions of the Prohibition of Money Laundering Act, will also be responsible for compliance with the said duties, etc. The Bill abolishes and replaces the Prohibition on Investment in Corporations maintaining Business Relations with Iran Act, 2008.

The provisions of the Act regarding the amendment of the Trading with the Enemy Ordinance, and the establishment of bodies responsible for announcements under this Act, entered into effect upon its publication. The remaining provisions of the Act will enter into effect upon entry into effect of the regulations to be published by the Minister of Finance with respect to the required announcements under the process of declaring factors in accordance with the Act.

For details regarding certain aspects relating to money laundering prohibition, within the framework of the Increasing of Tax Collection and Enforcement Intensification Bill, see "Taxation" hereunder.

THE COMPANIES LAW AND CORPORATE GOVERNANCE

COMPANIES ACT (AMENDMENT NO.18), 2012

The Companies Act (Amendment No.18), 2012, was published on July 17, 2012. The Amendment states that an expert has to be appointed in the case of a creditor arrangement that includes bondholders among the creditors. The task of the expert is to examine the suggested debt arrangement according to various criteria, among others, alternatives for the suggested arrangement, including the dilution of existing shareholders of the company and the allotment of shares to the bondholders, a liquidation of the company alternative, and so forth. The expert has to submit to the creditors and to the Court, an opinion prior to the voting on the suggested arrangement. It should be noted that the expert is not granted the right to veto the suggested creditor arrangement and that the Court is not obligated to adopt his opinion. The amendment came into effect on September 1, 2012.

COMPANIES ACT (AMENDMENT NO.19), 2012

The Companies Act (Amendment No.19), 2012, was published on July 17, 2012. The Amendment constitutes a fundamental amendment of all creditor arrangement procedures under Section 350 of the Companies Act. The Amendment extends significantly the authority of functionary in charge of the "stay in proceedings" process in order to assist in this process. Among other things, the holder of office has been granted the authority to make use of the pledges granted to the creditors, including the sale, rental or other use of the pledged assets, or the use thereof for the raising of finance for current operations, on condition that proper protection has been granted to the creditors. The Court has the authority to decide whether proper protection of creditors is in place, and only if convinced of the matter, will allow the holder of office to make the proposed use of the pledged assets, and only on condition that such use serves the object of the Company's recovery.

The Act will enter into effect on January 17, 2013, however the Court is empowered to instruct, if it is convinced that the matter is just and equitable in the circumstances, that the provisions of the Act, in whole or in part, shall apply also to a pending case brought before the Court before the effective date.

At this stage, it is not possible to assess the impact of this Amendment on the Bank.

COMPANIES ACT (AMENDMENT NO. 20), 2012

On December 12, 2012, the Companies Act (Amendment No. 20) Bill, 2012 (the "Amendment") in the matter of the terms of office and employment at public and corporate bonds companies, entered into effect. The Amendment is based on the recommendations of the Neeman Committee, established to examine private bills proposing the reduction in remuneration differentials in the economy. The Amendment imposes the duty on public companies of adopting a policy with respect to the terms of office and engagement of company officers within nine months since date of the Act entering into effect, which, among other things, would relate to considerations and criteria detailed in the Amendment.

Within the framework of such considerations, a company should relate, among other things, to the objects of the company, attainments of goals, risk management, the officer's contribution to profits maximalization, the qualifications of the officer, remuneration differentials between officers and other employees and their effect on labor relations in the company, as well as the possibility of determining a ceiling for variable components. In addition, instructions have been determined in respect of considerations to be taken into account in determining retirement awards, as well as instructions regarding variable components comprising a part of the remuneration.

Furthermore, companies are bound to establish a remuneration committee; the composition thereof complies with requirements applying to the audit committee. The remuneration committee shall recommend to the Board of Directors remuneration policy and shall approve the office and engagement terms of company officers.

The Amendment includes instructions with respect to the approval of the remuneration policy and remuneration terms of company officers, pursuant to which it is prescribed, among other things, that the remuneration policy and terms of employment and service of the President & CEO require to be approved at the general meeting, by a majority of the shareholders who do not have a controlling interest or a personal interest ("a special majority").

It has been further determined that until the approval of a remuneration policy, the provisions of the amendment shall not apply to the approval of extending terms of office, which had been determined prior to the amendment taking effect, with no changes in such terms.

As a result of the Amendment, the Board of Directors has established a remuneration committee, the composition of which complies with the requirements of the Amendment. The Bank has made preparations to implement the requirements that it is subject to as a result of the Amendment, and within this context is acting to align the remuneration policy that it approved in January 2010 to the requirements of the Amendment.

SECURITIES LAW

IMPROVEMENT OF ENFORCEMENT PROCEDURES AT THE ISRAELI SECURITIES AUTHORITY (LEGISLATION AMENDMENTS) ACT, 2011

The Improvement of Enforcement Procedures at the Israeli Securities Authority (Legislation Amendments) Act, 2011 was published on January 27, 2011.The Act includes a reform in the enforcement authorities of the Israeli Securities Authority (hereinafter – "the Authority"). In addition to the enforcement authority already granted to it earlier on, the Act also grants the Authority administrative enforcement authority as regards individuals and corporations in respect of violations of the Securities Laws, including the Securities Law, the Regularizing of Engagement in Investment Consultancy Law and the Mutual Investment Trust Law (hereinafter: "the Securities Laws").

The administrative enforcement empowers the Authority to adopt an array of enforcement measures, including the imposition of significant fines and monetary sanctions on licensed employees and company officers who violated their duties under the Securities Laws, removal from engagement in securities business, suspension of the license and indemnification of the party injured by the violation.

Furthermore, the Law requires the CEO of the corporation to supervise and adopt all reasonable measures to avoid violations by the corporation and its employees (hereinafter: "supervisory responsibility"). Violations, as above, constitute a breach of the supervisory responsibility, unless satisfactory procedures had been instituted by the corporation to avoid such violations, the CEO had appointed an officer on his behalf to supervise the existence of such procedures including training of the corporation's employees, and the CEO and adopted reasonable measures for the rectification of the violations and avoiding recurrence thereof.

The Law limits the possibility of insuring and indemnifying individuals and corporations in respect of sanctions imposed within the framework of the administrative enforcement process.

The Bank has installed and is maintaining a layout of procedures designed to ensure compliance with the law and regulations, inter-alia, the Securities Laws. Furthermore, the Bank appointed officers whose duty is to supervise compliance with the provisions of the law.

CRITERIA FOR THE RECOGNITION OF AN INTERNAL ENFORCEMENT PLAN IN RESPECT OF SECURITIES AND INVESTMENT MANAGEMENT

The securities Authority issued on August 15, 2011 a document headed "Criteria for the recognition of an internal enforcement plan in respect of securities and investment management". This, following the coming into effect of the Law for the Efficiency of Enforcement Procedures at the Securities Authority (Legislation amendments), 2011, (see above). The document includes criteria for the recognition of an internal enforcement plan of a corporation, which the Israeli Securities Authority is expected to examine when coming to determine whether use of such enforcement plan should be considered to the credit of the corporation or individuals therein. Among other things, the document details yardsticks for the recognition of the said plan as an efficient plan, namely, a plan that in fact created the integration of the law and compliance therewith, such as: responsibility of the Board of Directors and Management for the formation, adoption and implementation of the enforcement plan; modification of the plan to the requirements of the corporation and to its unique circumstances, following a review of business activity and performance of a compliance survey regarding securities laws; determination of procedures and handling arrangements; the appointment of a compliance officer, the proper implementation of the plan at all levels; supervision and updating; treatment of failures and violations and the drawing of conclusions there from.

The Bank's Management and Board of Directors have approved a comprehensive plan of action, subjected to a timetable, for the formation of an internal enforcement plan with respect to securities, suitable for the Bank and for the Group, having regard to the criteria published by the Israeli Securities Authority on the matter and to the relevant regulatory requirements, taking into consideration to the procedures and processes existing at the Bank. In continuation of that stated above, the Board of Directors appointed a compliance officer responsible to the Bank's Chief Legal Advisor, adopted an enforcement policy and acted for the formation of an enforcement plan which is implemented at the Bank. In accordance with the said plan, the Bank and the group companies are acting towards the carrying out of the said plan.

TAXATION

INCREASING OF TAX COLLECTION AND ENFORCEMENT INTENSIFICATION BILL (PROVISIONAL INSTRUCTION), 2012

On November 5, 2012, a proposed Bill on behalf of the Government was published in the matter of increasing of tax collection and enforcement intensification.

The Bill proposes legislation amendments with respect to the Money Laundering Prohibition Act and to various Tax Acts (including the Income Tax Ordinance, the VAT Act, the Property Tax Act and the Excise on Fuel Act) with the object of intensifying enforcement of tax laws, reducing the volume of tax evasion in Israel, increasing and improving efficiency of tax collection, improving the gathering of information and reporting to the tax authorities, and combating money laundering operations and the phenomenon of "black capital".

UNIFORM CONTRACTS

UNIFORM CONTRACTS ACT (AMENDMENT NO. 4), 2012

The Uniform Contracts Act (Amendment No. 4), 2012, was published on July 12, 2012. The Amendment states that a condition in a uniform contract, which provides that linkage of the price or another payment under the contract to whatever index, so that rise or decline in the index shall not benefit the customer, is prima facie a discriminating provision. The Bank has made the required changes in the relevant forms in use by it, as required by the said Amendment.

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"). On January 10, 2010, FIBI filed an appeal with the Supreme Court against the ruling of the Uniform Contracts Court. As part of the appeal, the parties have submitted a motion that included consent regarding certain of the issues in respect of which FIBI had appealed. On September 19, 2012, the Supreme Court ruled in the appeal filed.

On November 13, 2012, the Supervisor of Banks instructed banks to correct the contracts in use by them in accordance with the ruling of the Supreme Court in the appeal. According to the Letter, the Bank has to amend and adjust until April 1, 2013, the customary contracts at the Bank with respect to housing loans, in accordance with the ruling of the Supreme Court, this in respect of new customers. Furthermore, the Bank is required to adjust until October 1, 2013, all the customary contracts at the Bank in accordance with the ruling of the Supreme Court, this with respect to new customers. The Bank has to publish a notice regarding the ruling of the Supreme Court in the next annual mail sent to customers as well as on the Bank's Internet site, including a link to the Court ruling. The Bank is preparing for the implementation of the instructions of the supervisor of Banks.

U.S. LEGISLATION

DODD FRANK

A wide reform – the Dodd-Frank Wall Street Reform and Consumer Protection Act – was approved in the U.S. in July 2010. The Reform regulates the operations of banks and financial institutions in the U.S., as well as the operations of financial institutions operating outside the U.S. and which provide financial services to U.S. citizens or who operate through U.S. brokers, such as U.S. custodian services etc.

The Reform may affect various activities of the Group, such as the Bank's dealing room operations in everything relating to activities having a U.S. relationship, including, among other things, operations with U.S. counterparties, with U.S. customers, or through U.S. brokers.

The dates of implementation of the legislation vary according to the various requirements stemming from the Law, certain of which have not yet been determined, though a part of the target dates applied already in the course of 2012.

In view of the many objections to a part of the requirements of the Reform, the scope of the various instructions is not yet clear, and changes may be made therein, which might affect the application of the instructions as regards the Bank.

Following are several fields included in the reform:

Living Will. As part of the Reform, it is determined that foreign banking organization (FBO), the global total assets of which on a consolidated basis is in excess of US$50 billion, and which operate in the U.S., to prepare and submit to the U.S. authorities a plan of action, in respect to their entities operating in the U.S., a plan of operation - "living will" - in the case of insolvency. The Bank is preparing to submit to the authorities in the U.S. an action plan as stated with regards to IDB New York.

Volcker Rule. The Volcker Rule has been enacted within the framework of the Dodd Frank Reform, which, among other things is intended to restrict the activity of banks to "traditional" banking operations (the granting of credit and similar activities) and to prevent their exposure to risks related to investment activity having a higher risk potential. The two central restrictions imposed on financial institutions under the Volcker Rule are the prohibition on propriety trading in derivatives, securities and other instruments, and the prohibition on sponsoring activities or on investment in private equity funds and hedge funds, all this where a "U.S. factor" is involved in any of the above mentioned activities.

Even though the final regulations of this instruction have not yet been issued, the instruction entered into effect on July 21, 2012, granting a period of two years for its implementation, until July 21, 2014. It is expected that during the period of preparation the financial institutions will devise a plan of action for the implementation of the instruction, in order to be ready for its full implementation at the end of the period.

The Bank is examining the effect of the legislation upon its operations and the changes that would be required (if at all) during the period of preparation.

Swap Rule. Constitutes legislation intended to regularize trading in non-marketable derivatives (OTC). According to this legislation, large participants in the market, considered "swap dealers" or "major swap participants", as such terms are defined in the legislation, will have to register with the U.S. authorities (SEC, CFTC). According to an examination made by the Bank, as of 2012, with respect to its derivatives operations, the Bank is not required to register, as stated. Another part of the legislation with respect to trading in non-marketable derivatives relates to changes in the manner of effecting the trade and clearing of transactions of this kind through engagement with a third party, who would perform the central clearing (CCP). The Bank is studying the implications of this matter on its operations as well as the operating and digital system changes that would be required as part of the implementation of the legislation.

For details regarding changes in U.S. tax legislation, see under "Taxation" below.

VARIOUS LEGISLATION MATTERS

PROPOSED BILL INTENDED TO PROMOTE COMPETITION AND REDUCE CONCENTRATION, 2012

On July 9, 2012, the proposed Bill was published, based on the recommendations of the Committee for the Increase of Competition that were adopted by the Government of Israel in April 2012.

The Bill proposes to determine various instructions, the aim of which is to separate a controlling interest in a significant non-financial asset from a controlling interest in a significant financial asset, and according to which a significant non-financial corporation or whoever controls it, is prohibited from controlling or holding means of control in a significant financial entity, at a rate exceeding 10% (or a lower rate to be determined, though not below 5%). It is further proposed to impose restrictions on the simultaneous service of directors in significant non-financial corporations and in significant financial corporations. It should be noted that according to the Bill, both the Bank and FIBI might be regarded as a significant financial corporation.

It is further proposed to determine instructions the aim of which is to restrict the ability to hold control by means of pyramid structures in which the rights of the controlling interest in the capital of an entity differ from his voting rights therein.

In addition, it is proposed to empower the regulators to take into consideration also matters of competition and concentration within the framework of the procedures for allocation of assets by the State.

For details regarding the interim report of the team for examining the increase in competition in the banking industry, including actions taken by the Supervisor of Banks for the implementation of the team's recommendations, see Note 34 to the financial statements.

THE MONETARY LAWS BILL, 2011

On June 20, 2011, the Knesset passed the first reading of the Monetary Laws (Civil Codex) Bill, 2011. The Bill has been formed as a civil code regularizing the legal relations layout under the civil law. At this early stage, the effect of the Bill on the Bank is unclear.

THE PLEDGES BILL

The Pledges Bill was published by the Government on March 12, 2012, and passed its first reading by the Knesset on March 20, 2012. The present version of the Bill contains several provisions that might adversely affect the level collateral held by banks, however, at this stage, the Bank is unable to assess the effect if and when the Bill becomes law.

DRAFT REGULATIONS REGARDING EQUAL RIGHTS FOR THE HANDICAPPED (ADJUSTMENT OF ACCESSIBILITY TO SERVICES)

On December 18, 2012, the Labor, Welfare and Health Committee of the Knesset approved Regulations regarding equal rights for the handicapped (adjustment of accessibility to services). The Regulations will become effective six months after their publication. To the best of the Bank's knowledge, the regulations have not yet been published in the Official Gazette.

According to the said regulations, the Bank is required to make accessibility adjustments with respect to services provided by the Bank to its customers. Among other thing, the said accessibility adjustments relate to the Bank's internal design branches; the Bank's service desks; the automatic devices at the disposal of the Bank's customers; the information provided to the Bank's customers; the Bank's call center; the Bank's Internet website; signposts at the Bank; auxiliary instruments that the Bank has to provide to its customers.

The Bank is examining the implications of the Regulations upon its operations and is preparing to implement the requirements stated therein.

ABUNDANCE OF LEGISLATION INITIATIVES

The year 2012, 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 2012 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".

ADDITIONAL ISSUES IN THE DESCRIPTION OF THE GROUP

STRUCTURE OF THE BANKING GROUP

The Bank's Group is composed of commercial banks in Israel and overseas and financial services companies. Total investment in the investee companies as at December 31, 2012, amounted to NIS 9.2 billion, compared with NIS 9.1 billion on December 31, 2011.

Following is the distribution of net income (loss) by the Group's structure:

	Contribution to Group's results		Contribution Disregarding the effects of hedge of investment	
	2012	2011	2012	2011
	In NIS millions			
Banking Activity:				
Commercial banks:				
In Israel - the Bank (including branches overseas)	176	(25)	177(1)	219(1)
- Mercantile Discount Bank	191	162	191	162
- First International Bank(2)	56	98	56	98
Overseas - Bank extensions	115	330	114(1)	86(1)
Other Activities:				
Israel Credit Cards	152	163	152	163
Other financial services	114	118	114	118
Net income	**802**	**847**	**802**	**847**

Notes:

(1) The Bank in Israel created in the past, a surplus of liabilities in foreign currency, constituting hedge for the Bank's investment in Discount Bancorp, Inc., and IDB (Swiss), with the aim of avoiding exposure to fluctuations in the exchange rate of the shekel against the U.S. dollar and the Swiss Franc. In the Bank's Statement of Income in Israel, income and expenses arising from exchange rate differentials on the surplus of liabilities mentioned above are presented under the item "non-interest financing income". This income and expenses 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 income of investee companies, net of tax effect".
This method of treatment effects the presentation of the Bank's after-tax income and on the contribution of the overseas extensions to net income.

(2) For details regarding the provision for impairment of the Bank's investment in shares of FIBI and changes in the provisions for taxes in respect of the Bank's share in the earnings of FIBI, see Note 6 d and e to the financial statements.

MAIN INVESTEE COMPANIES

At the end of 2012, 16.3% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 20.6% were assets of overseas consolidated companies and branches. The contribution to the net income by the consolidated companies in Israel amounted to NIS 409 million in 2012 (NIS 448 million in 2011). The contribution to the net income by overseas consolidated companies amounted to NIS 115 million in 2012 (NIS 324 million in 2011), and the contribution to the net income by affiliated companies amounted to NIS 103 million in 2012 (NIS 104 million in 2011).

The total contribution by both domestic and overseas investees companies to the Bank's net results amounted to NIS 627 million in 2012, compared with NIS 876 million in 2011, a decrease of 28.4%.

Disregarding the effect of the hedge of the investment in an oversea subsidiary, net of the tax effect (2011 – overseas subsidiaries), the contribution of both domestic and overseas investees to the Bank's net results in 2012, would have been NIS 626 million, compared with 673 million in 2011, a decrease of 7.0%.

Following are the main developments in principal investee companies.

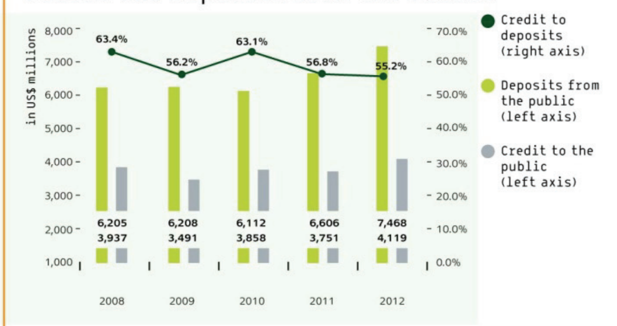
DISCOUNT BANCORP, INC.

Discount Bancorp, Inc. (hereinafter: "Bancorp") is a fully owned and controlled 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 consent. The data presented hereunder in this section have been taken from Bancorp's audited financial statements.

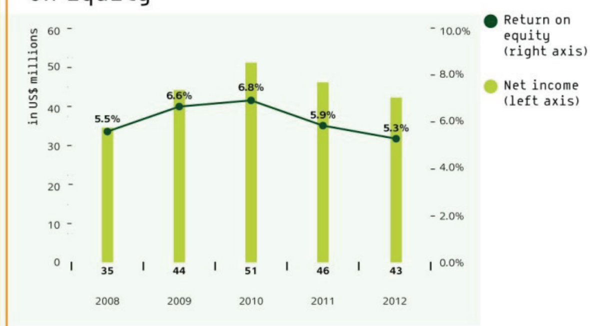
	In US$ millions		
Balance sheet items	December 31, 2012	December 31, 2011	Rate of change in %
Total assets	9,984	9,488	5.2
Total credit to the public	4,119	3,751	9.8
Total deposits from the public	7,468	6,606	13.0
Total equity	838	788	6.3
Ratio of capital to risk assets	15.4%	16.5%	
Income statement items for	2012	2011	
Net income attributed to the Bank's shareholders	43	46	(6.5)
Return on equity	5.3%	5.9%	

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.
The contribution of the Bank's investment in Bancorp to the Bank's net results reached a negative amount of NIS 121 million in 2012 (after deducting a provision for taxes of NIS 36 million), compared with NIS 327 million in 2011 (after deducting provision for taxes of NIS 26 million).
The said contribution is comprised of Bancorp's net income in 2012 (after deducting the provision for tax as aforesaid) translated into NIS terms, compared with net income of NIS 133 million (after deducting a provision for taxes as aforesaid) and in addition to exchange rate differentials on the investment of NIS 194 million in 2011.
In 2011, alongside the exchange rate differentials on the said investment, the Bank in Israel recorded financing income in respect of the surplus foreign currency liabilities that the Bank created as coverage for the investment in Bancorp.
Early redemption of a subordinate capital note. In December 2008, IDB New York issued to the Bank a subordinate capital note in the amount of US$75 million, redeemable in three equal payments in the years 2015-2016. This subordinate capital note was prematurely redeemed on March 15, 2012.

Bancorp- Development of Credit to the Public and Deposits from the Public



Bancorp- Net Income and Return on Equity



MERCANTILE DISCOUNT BANK LTD.

Mercantile Discount Bank Ltd. ("MDB") is a fully owned and controlled subsidiary of the Bank. At the end of 2012, MDB operated through 79 branches, similar to the end 2011.

	In NIS millions		
Balance sheet items	December 31, 2012	December 31, 2011	Rate of change in %
Total assets	26,530	25,039	6.0
Total credit to the public, net	16,629	15,716	5.8
Total deposits from the public	22,254	20,981	6.1
Total equity	1,889	1,764	7.1
Ratio of capital to risk assets	15.0%	13.2%	
Income statement items for	2012	2011	
Net income attributed to the Bank's shareholders	191	162	17.9
Return on equity	10.8%	9.6%	

The ratio of capital to risk assets. On January 25, 2011, the Board of Directors of MDB resolved that the total capital adequacy ratio of this bank shall not fall below 13%.

The principal factors affecting the business results of MDB in 2012, as compared with 2011: an increase in the non-interest financing income (an increase of NIS 55 million); a decrease in other income (a decrease of NIS 13 million), a decrease in operating and other expenses (a decrease of NIS 23 million), and an increase in the effective tax rate.

The increase in non-interest financing income is due, primarily, to a NIS 50 million increase in dividend income and gains from the realization of securities, and from a NIS 36 million decrease in net expenses, from activity in derivative financial instruments. On the other hand, a NIS 20 million allowance for impairment of certain bonds and shares was recorded in the reporting period. The decrease in operating expenses is due, primarily, to a 5.3% decrease recorded in payroll expenses, which is explained by, among other things, a NIS 22 million allowance that was recorded last year with respect to a voluntary retirement program.

Distribution of dividend. During the reported period, Mercantile Discount Bank has distributed a dividend in the amount of NIS 150 million.

Business focusing and increasing efficiency at Mercantile Discount Bank. At the end of 2011, MDB's Board of Directors approved an activity framework for the 2012 work plan, which included two main elements:

- Business focusing, including: intensifying middle market and retail operations, bolstering investment consulting operations, and changing the mode of operation of the foreign currency dealing room and in the pension consulting field, basing this on services received from the Bank;
- Increasing efficiency, including: significantly reducing manpower, mainly at the head office, reviewing the branch layout and merging the collection units.

In 2012, MDB acted to implement the plan and, inter alia, took the following measures:

- Expansion of the credit and deposit targets in the 2012 work plan in the retail and middle market segments. Accordingly, most of the credit growth in 2012 took place in the retail segment;
- Performing changes in the organizational structure in order to create an infrastructure that will contribute to intensifying the retail activity. Within the framework of these changes, the middle market activity was transferred from the Retail Division to the Corporate-Middle Market Division;
- Launch of a voluntary retirement program for 40 head office employees, at a total cost of approx. NIS 45 million. Approx. 73% of those targeted joined the program during 2012;
- Recruitment of investment consultants, in accordance with the determined targets;

- Review of the Bank’s branch deployment and adjusting it to profitability and targets. At the end of the process it was decided to merge one of MDB's branches in the central region with one of the neighboring branches in the region (this will take place in 2013);
- The move to change the mode of operation in the pension consulting field at MDB was completed (see "Capital Market Activity" above).

Audit performed at Mercantile Discount Bank in the matter of compliance with the "Prohibition of the financing of terror". On May 3, 2012, the Bank of Israel delivered to Mercantile Discount Bank an audit report in the above matter, following an audit performed in the second half of 2010. The report included findings relating to various aspects of the work performed by the units engaged in this field, most of which had been rectified during the period from date of the audit. Mercantile Discount Bank is required to complete correction of the deficiencies within one year from date of receipt of the report and is preparing accordingly.

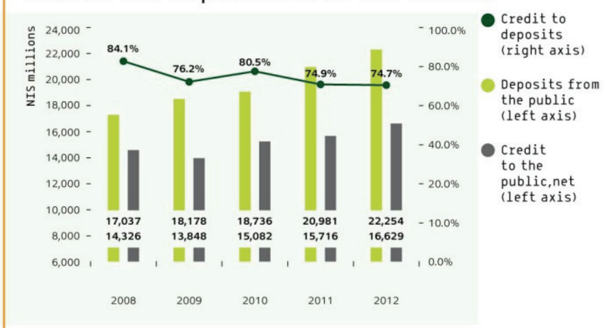
The Management of Mercantile Discount Bank has no information as to whether all procedures related to this audit have been completed. This matter will be examined by the Bank of Israel on the basis of the findings of the report and the response of Mercantile Discount Bank.

Change of CEO. At the meeting of the Board of Directors of Mercantile Discount Bank held on August 28, 2012, Mr. Jacob Tennenbaum informed of his decision to retire from office of General Manager of Mercantile Discount Bank. Mr. Tennebaum will continue in office until the end of March 2013.

On October 31, 2012, the Board of Directors of Mercantile Discount Bank decided to appoint Mr. Uri Baruch for office of CEO of Mercantile Discount Bank, with effect as from April 1, 2013.

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 12.6 to the financial statements.

Mercantile- Development of Credit to the Public and Deposits from the Public



Mercantile- Net Income and Return on Equity

ISRAEL CREDIT CARDS LTD.

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2012, the Bank owned 71.8% of the equity and 79.0% of the voting rights in ICC. At this date, the First international Bank held the balance of the rights in ICC.

According to reports of FIBI, the Board of Directors of that bank has directed its Management to review the advisability of continuing the holding of the investment in shares of ICC, while examining the possibility of sale of all the ICC shares held by FIBI.

ICC operates "VISA", "Diners" and "MasterCard" credit cards.

	In NIS millions		Rate of change in %
Balance sheet items	December 31, 2012	December 31, 2011	
Total assets	9,149	8,723	4.9
Total equity	1,046	1,128	(7.3)
Ratio of capital to risk assets	16.8%	16.7%	
Income statement items for	2012	2011	
Total Income	1,118	1,116	0.2
Net income attributed to the Bank's shareholders	209	229	(8.7)
The contribution to the Bank's business results	150	163	(8.0)
Return on equity	17.8%	20.6%	

The ratio of capital to risk assets. On February 27, 2011, the Board of Directors of ICC adopted a policy according to which, the total capital ratio to risk assets of the company shall not fall below a rate of 15%.

Changing the capital structure of ICC. In December 2012, ICC's Board of Directors approved a scheme for the change in the company's capital structure, within the framework of which the company distributed in December 2012 a dividend in a total amount of NIS 171 million, alongside the raising of Tier II capital in the amount of NIS 86 million. This agreed with the minimum capital targets that had been determined by ICC's Board of Directors, and with the growth targets of the company.

Distribution of dividend. During 2012, ICC distributed dividends in the amount of NIS 291 million (the Bank's share is NIS 209 million). During 2011, ICC distributed dividends in the amount of NIS 195 million (the Bank's share is NIS 140 million).

Change of CEO. On January 15, 2013, Mr. Doron Sapir commenced office as CEO of ICC. Mr. Sapir replaced Mr. Israel David, whose office as CEO of the company was terminated on January 17, 2013.

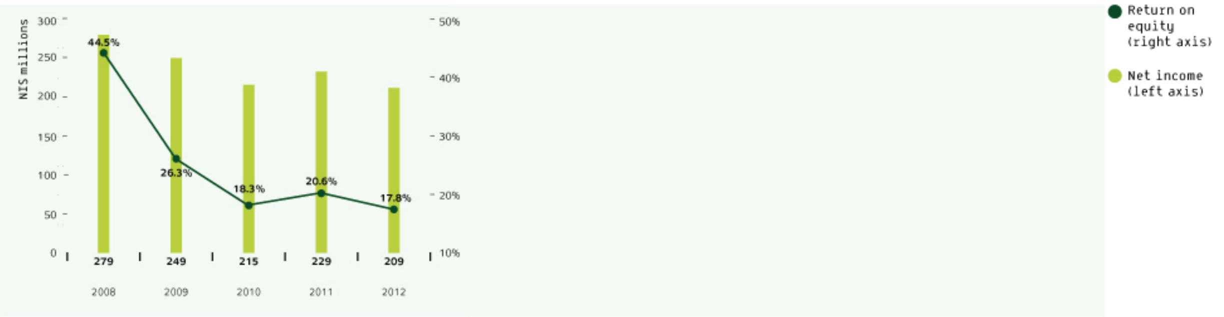
Audit at ICC regarding "The Implementation of Prohibition of Money Laundering Law". An audit report was received by ICC on June 20, 2010, in which were detailed deficiencies found during an audit, which prima facie constitute a violation of various provisions of the Law. Among other things, ICC has been instructed in the audit report to correct the deficiencies mentioned in the report and to determine procedures and modes of operation in order to comply with the provisions of the Law and Regulations. The rectification of deficiencies has been concluded. On September 23, 2012, ICC received notice from the Supervisor of Banks regarding the submission of a motion for the imposition of a monetary sanction, in view of the audit findings. On December 26, 2012, the Sanctions Committee of the Bank of Israel discussed the application for the imposition of a monetary sanction.

For details regarding the police investigation and the seizure of documents and computer material of ICC, see Note 33 C to the financial statements.

For details regarding activity in the credit card field in Israel, see "Credit card operations" under "Further details as to activity in certain products" above and Note 33 to the financial statements.

For details regarding lawsuits and motions to approve them as class action suits filed against ICC, with respect of the following matters: the charge of an issuer commission (this claim has not as yet been submitted to ICC or to the Bank), the withdrawal of money from ATMs and the granting of credit by means of the "You Active" charge card, see Note 19 C to the financial statements items 13.4, 13.5 and 13.10, respectively.

Icc- Net Income and Return on Equity



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, 2012, the Bank held 26.45% of its share capital and voting rights. For details regarding the agreement with FIBI Holdings Ltd., in the matter of the Bank's ownership of shares in FIBI, which, among other things, limits the period in which Discount Bank shall have the right by which FIBI Holdings shall continue to support the appointment of one quarter of the directors of FIBI from among candidates recommended by Discount Bank and for details regarding the timeline determined by the Antitrust commissioner for the reduction in the interest held by Discount Bank in FIBI, see "Material agreements" below and Note 6 E (1) to the financial statements. In accordance with the provisions of the agreement, the Bank deposited with a Trustee shares which grant it voting rights in excess of 11.09%.

	In NIS millions		Rate of change in %
Income statement items for	2012	2011	
Net income attributed to the Bank's shareholders	577	480	20.2
The contribution to the Bank's business results	56	98	(42.9)
Return on equity attributed to the shareholders	9.5%	8.5%	
	September 30, 2012	December 31, 2011	
Ratio of capital to risk assets	14.94%	13.1%	

An opinion in the matter of the provision for impairment in value. For details regarding the opinion obtained by the Bank with respect to the impairment of its investment in shares of FIBI, see Note 6 E (3) to the financial statements. The opinion[2] is available for perusal, with the consent of the provider thereof, via the Israeli Securities Authority MAGNA website, via the Tel Aviv Stock Exchange MAYA website and via the Bank's website.

For details regarding lawsuits and motions for their approval as class action suits, filed against FIBI with respect to the following matters: the ruling of the Antitrust Commissioner that binding arrangements have existed between the banks, the charge of an issuer commission, withdrawal of money from ATMs, the value date attributed to payments made by borrowers directly to the debt execution office, and operations in contradiction of a "transaction permit", see Note 19 C to the financial statements, items 13.2, 13.4, 13.5, 13.9 and 14, respectively. For details in the matter of the ruling of the Antitrust Commissioner that binding arrangements have existed between the Banks, see Note 19 C item 15 to the financial statements.

[2] The English translation of the Opinion is available for perusal at the Bank's website.

ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

Israel Discount Capital Market and Investments Ltd. (hereinafter: "DCMI"), a fully owned and controlled subsidiary 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).

	In NIS millions		Rate of change in %
Balance sheet items	December 31, 2012	December 31, 2011	
Total assets	855.5	787.1	8.7
Total equity	121.6	62.1	95.8
Income statement items for	2012	2011	
Net income attributed to the Bank's shareholders	59.7	74.4	(19.8)
The contribution to the Bank's business results[1]	56.0	75.0	(25.3)

Footnote:
[1] Differences between net income and the contribution to the Bank's results is derived from differences in implementation of generally accepted accounting principles

During 2012, DCMI, through a subsidiary, participated in 24 public offerings of securities and in 12 private placements with a total volume of approx. NIS 9.9 billion (48 public offerings and 1 private placement with a total of approx. NIS 17.7 billion in 2011), and in two brokerage transactions (2011 - one private consulting transaction). Of the said issues in 2011, one private transaction of a total amount of NIS 1 billion was made by the Discount Group.

DIVIDENDS

The Bank has not distributed dividends to its shareholders since 1996, excluding the distribution of dividend in October 2008 in the amount of NIS 250 million, and except on the Bank's cumulative preference shares, in an annual amount of £24 thousand (see Note 13 B and E (4) to the financial statements), which the Bank distributes each year. The main limitation affecting the Bank's ability to distribute a dividend in the recent years was the capital base limitation.

For 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 (2) to the financial statements. For details regarding the limitations set in the Supervisor of Banks' directives, see Note 13 E (3) to the financial statements.

Distribution of dividend. The Bank's Management believes that it would not be possible to distribute a dividend in 2013.

FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2012, the investment in buildings and equipment amounted to NIS 2,962 million, compared with NIS 3,080 million at the end of 2011, a decrease of 3.8%.

Most of the premises on which the Bank's business 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, 2012, was approx. 167 thousand square meters, compared to 171 thousand square meters in the end of 2011. Of this area, approx. 111 thousand square meters were freehold property and

approx. 56 thousand square meters leasehold property (2011: 113 thousand square meters were freehold property and 58 thousand square meters leasehold property). At the end of 2012, approx. 81 thousand square meters served the Bank's branches and the remainder served the head office, similar to 2011.
For details as to the Bank's investments in buildings and equipment, see Note 7 to the financial statements.

INFORMATION AND COMPUTER SYSTEMS

GENERAL

The information and control systems stand at the core of the Bank's operations 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 12,000 work stations (PC's) and 1,700 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 protection technologies.
Over 500 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 MDB.
Over the years the Bank has developed efficient, stable and effective computer solutions with respect to all business areas in which the Bank operates. Solutions that had been developed with respect to core systems, within the framework of the "Ophek" project, are among the most advanced existing at present at 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. The Bank continues to upgrade and replace systems in accordance with its needs, all subject to budget limitations and strategic plans.
For details as to the cost of in-house development of computer software, see Note 7 H to the financial statements.
Major suppliers. The Bank has a large number of major suppliers from Israel and abroad 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.

LOCATIONS OF THE OPERATION

The Bank's mainframe systems are located at two different sites, 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 Bank's information systems. The Bank's two computer sites 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 Bank's operation. 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 for each site. 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 Bank's branches, so that in case of failure at the central computer site, the secondary location begins operations without losing any entry.

In addition, an infrastructure was established for a third copy of data, in a third location, under the "Hosting" model.

At this stage, a full third copy of production data of the MF computer exists, and it is planned to transfer to it the data of critical systems of the open environments.

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 importance of survival and availability of IT is steadily increasing in view of the great technological development in recent years and its implications on the Bank, in view of the cyber threats that are growing in severity and frequency, and in view of the growing volume of use of information technology products in contrast to manually operated products. Therefore, the Bank views the protection of data as a primary goal and invests vast resources in order to protect the data on hand.

The principal risks involved in damage to data protection is the damage to privacy and confidentiality of the Bank's information, as well as to its customers and employees, the realization of cyber threats (see "IT risk management" above), hostile use of information by users of the system, disruption of data stored on the system, damage to the availability and survival of systems and information, damage to the Bank's business and to its reputation.

Data protection at the Bank is governed and regulated in accordance with various statutory provisions, including the Privacy Protection Law and its regulations, the Computer Law, the Supervisor of Bank’s Proper Banking Management Directives, and particularly Directive No. 357, standards, data protection policy as approved by the Bank’s Management and Board of Directors, SOX and Basel II.

The Bank’s links to the Internet for any purpose whatsoever, is separated from the central banking system providing information to Bank employees, who perform banking activity on an ongoing basis. Thus, the exposure to the risk of hostile activity against real data at the Bank is significantly reduced.

Data protection activity is implemented in accordance with a strategic plan, approved by the Bank’s Management and Board of Directors.

The systems and projects that are under development and that are under maintenance are closely supported by professional instructors.

The Bank operates continuously a data protection center the purpose of which is to identify risks and breaches in the data protection system (see "IT risk management" above). 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.

In accordance with the risks outline and in accordance with Directive No. 357, risk surveys and intrusion checks are performed with the prescribed frequency, and as a result thereof mitigation measures and mandatory reporting are implemented.

Access to data and privilege levels are controlled by means of designated staff and systems for authorization and password administration, with the administration processes and management tools undergoing major improvement and reorganization.

The Bank takes ongoing action to intensify awareness and improve the organizational culture from data protection aspects, which include, among other measures, training, distribution of policy documents, manifestos and marketing aids.

The Bank has established the majority of the actions and processes in procedures, and the Bank’s Data Protection Unit is involved in the approval of all of the Bank’s procedures in order to ensure the early identification of actions that create data protection risks.

PRINCIPAL PROJECTS EXECUTED IN 2012 AND ARE EXPECTED TO CONTINUE DEVELOPMENT IN 2013

1. Investment consulting - a project that began in 2011 and once completed will replace the existing consulting system. Development of a decision supporting system, management control reports, interfaces between systems improving the efficiency of processes, maintaining of leadership in the banking industry and an increase in assets subject to consulting services.
2. e-Banking – a group of projects upgrading the Bank's Internet website and adapting it also to middle-market small and middle sized customers, as well as other projects, such as the cellular and the new securities website.
3. The capital market move – a project, the object of which is the shortening of the response time to market events, adaptation to a competitive market and increasing the volume of operations. The project began in 2010. During 2012, the project provided the Bank with several new tools for use in the trading field systems.
4. MIS – the establishment of a management information system for decision making functions in the Bank, including management indices and the measurement of organizational performance. The project began in 2010.
5. Projects designed for compliance with regulatory requirements, such as prohibition of money laundering.

In the course of 2011, a new strategy was prepared for IT in the Group, from which a multi-year work plan for IT projects was derived, which has been in effect since the beginning of the second quarter of 2012.

The Bank’s budget for 2013 in respect of projects for the development of information systems, including for information system development projects, amounts to NIS 284 million. This, compared with NIS 328.5 million in 2012.

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 the Bank's development programs 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 date of publication of the reports, 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 publication of the reports.

INVESTMENTS AND EXPENSES IN RESPECT OF THE INFORMATION TECHNOLOGY SYSTEM

Banking corporations are required to disclose, as from the annual report for 2012, investments and expenditure relating to the information technology system (within the meaning of this term in Proper Banking Management Directives).

Expenditure in respect of the information technology system includes payroll and related expenses, outsourcing, acquisitions or right of use licenses, depreciation of equipment and buildings and other expenses – communication expenses, buildings and equipment maintenance expenses etc. The total expenditure is presented divided between software, hardware and other – including administration, maintenance and computer services, data protection expenses etc.

The balance of the information technology system assets is presented divided between software, hardware and other – mostly buildings used by the information technology system.

The allocation of payroll and related costs is based upon attribution to subunits, allocation of building depreciation and maintenance costs is based on area proportions. For details regarding the accounting policy applied with respect to the capitalization of software costs, see Note 1D(12) to the financial statements.

It should be noted that the allocation of acquisition and right of use license costs is based on an estimate, as software components, required for the operations of hardware systems, are integrated within them. It should also be noted that the allocation of indirect and other expenses related to the main components (software, hardware and other) was also based upon an estimate.

	December 31, 2012			
	Consolidated			
	Software	Hardware	Other	Total
	in NIS millions			
Expenses in respect of the information technology system, as included in the income statement:				
Payroll and related expenses	124	77	23	224
Acquisitions or license fees not capitalized to assets	37	1	-	38
Outsourcing expenses	53	17	5	75
Depreciation expenses	347	92	8	447
Other expenses	98	26	35	159
Total	**659**	**213**	**71**	**943**
Additions to assets in respect of information technology system not charged as an expense:				
Salaries and related expenses cost	88	-	-	88
Outsourcing costs	160	-	-	160
Acquisition or license fee costs	23	33	-	56
Equipment, buildings and real estate costs	19	37	9	65
Total	**290**	**70**	**9**	**369**
Balance of assets in respect of the information technology system:				
Total amortized cost	1,057	211	122	1,390
Of which: in respect of salaries and related expenses	784	-	-	784

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", "Discount", "Discount taking you personally" and "Israel Discount Bank", which include the Bank's logo. 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: "Key", "Discount key", the trademark of the key chart, "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" "Cal Choice", "WWW.Card" and "Cal fix".

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 Bank and ICC have the status of a "principal member" in the MasterCard Worldwide organization, which has granted them licenses to use the "MasterCard", "Cirrus" and "Maestro" trade marks in Israel as well as issuance and clearing licenses for credit cards under these brands 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 has a conditional, non-exclusive license for the clearing of credit cards of the "IsraCard" brand.

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 17.0% of the payroll expense and of the profit, respectively.

TAX ASPECTS OF THE DIRECTIVE REGARDING IMPAIRED DEBTS

The Givoli Committee, appointed by the Commissioner of Income Tax to examine the tax aspects relating to doubtful debts of banks, submitted its conclusions in 1992. Though the recommendations of the Givoli Committee have not been reflected in legislation amendments, in practice, the banks with the acquiescence of the Commissioner of Income Tax acted in accordance with the principles laid out by the committee.

Implementation of the Directive regarding "measurement and disclosure of impaired debts, credit risk and allowances for credit losses" requires preparations for the treatment of the tax aspects relating to such implementation. Accordingly, in 2010-2011, the banks, by means of the Union of Banks, negotiated with the Tax Authorities as to the timing of recognition for tax purposes of the credit loss expense to be recorded in the books in accordance with the Directive. An agreement with the Tax Authorities in the matter was signed in February 2012.

Among other things, the agreement states that with respect to large debts (over NIS 1 million), the allowance will be allowed as an expense, and in the event of a collection being made settling of accounts will be done with the tax authorities. With respect to small debts, the allowance will not be recognized as an expense, although actual writeoffs will be recognized in the two years following the year in which the allowance was made. It was also determined, that allowances in respect of "retail debts" made until December 31, 2010, and not yet recognized under the previous agreement, shall be deductible tax wise, in five equal yearly amounts, starting with the tax year 2011. It was also determined that allowances for credit losses recorded upon the initial implementation of the directives of the Supervisor of Banks and taken directly to retained earnings as of January 1, 2011, shall be deductible tax wise in five equal yearly amounts, starting with the tax year 2011.

A QUALIFIED INTERMEDIARY (Q.I.) STATUS

The Bank has been granted the status of Qualified Intermediary (QI), as defined by the U.S. 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.

CHANGES IN THE U.S. TAX LEGISLATION

New tax laws have been enacted in the United States intended to apply to financial institutions outside the U.S. within the framework of the Foreign Account Tax Compliance Act (FATCA). According to these rules, financial institutions outside the U.S. will be obligated to enter into an agreement with the U.S. Tax Authorities, under which, among other things, they will have to disclose and report to the U.S. Authorities about accounts defined as U.S. Accounts. The above rules are expected to have implications on the Bank's activities involving customers having connection to the U.S.

The provisions of the FATCA are intended to take effect in the beginning of 2014, gradually over a number of years. Under this Act, financial institutions outside the United States will have the obligation to submit reports regarding accounts that are defined as "U.S. accounts". Duties for tax deduction, documentation and identification regarding such accounts will be imposed, and such financial institutions will have to enter into a binding contract regarding these accounts with the U.S. Internal Revenue Authorities (IRS).

A financial institution that will not abide by the said regulations will be exposed to a significant sanction of deducting tax at the rate of 30% from payments to the bank and/or its customers due from U.S. sources.

A draft Regulations for the implementation of the Act was published in February 2012. Final Regulations were published in January 2013. The Bank has began analyzing the final Regulations, the changes since the last draft, and the implications on the Bank's activity.

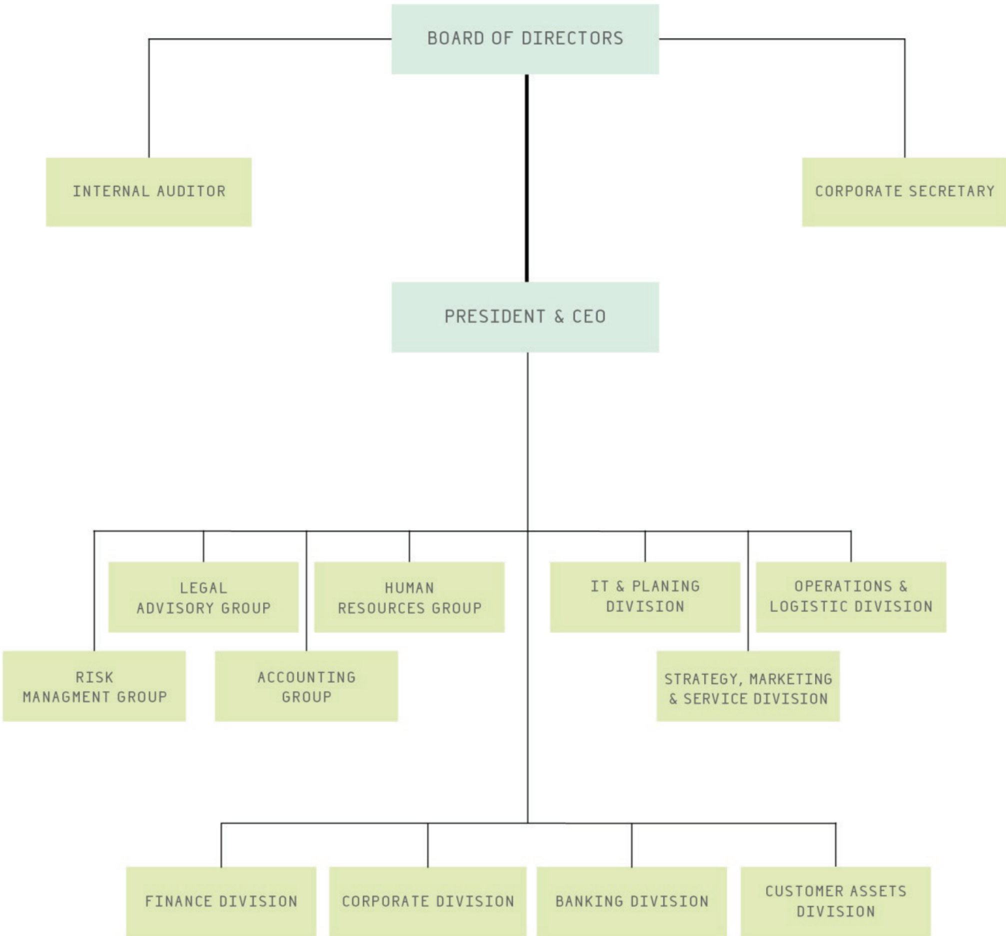
Preparations by the Group for the implementation of the Regulations. The Bank is in the midst of the preparation process, at Group level, for complying with the timetable in respect of the instructions becoming effective, and even now, is taking various actions in order to comply with the provisions of the FATCA instructions, including digital preparations, publication of work procedures and guidelines regarding activity with customers.

Establishment of an inter-office team for the examination of the implementation of the instructions. On August 2, 2012, the Ministry of Finance announced the establishment of a team, headed by the Commissioner of State Revenues that will examine the implementation in Israel of the FATCA provisions, including examination of the possibility of their implementation by means of an agreement between the State of Israel and the United States, which might facilitate the implementation by financial institutions and will recommend a proposed outline. The team includes representatives of the Ministry of Finance, the Bank of Israel, the Securities Authority and the Ministry of Justice.

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

HUMAN RESOURCES

Organizational Structure Chart



LABOR FORCE AND PAYROLL COSTS

There were 6,167 employees in full-time positions in the Bank in Israel (not including the Bank's branches abroad) at the end of 2012, compared with 6,340 at the end of 2011, a decrease of 2.7%. The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas branches) dropped in 2012 and amounted to 6,178, as compared to 6,430 in 2011, a decrease of 3.9%.

There were 9,942 full-time positions in the Group in Israel and abroad at the end of 2012, compared with 10,211 at the end of 2011, a decrease of 2.6%. The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2012, was 10,016, compared with 10,240 at the end of 2011, a decrease of 2.2%.

It should be noted that the "Bank" data presented in this Chapter include data in respect of DMB, which was merged this year with and into the Bank.

Following are the labor force data of the Group and the Bank, in terms of positions[(1)]:

	As of December 31		Monthly average in	
	2012	2011	2012	2011
The Bank in Israel	6,167	6,340	6,178	6,430
Domestic subsidiaries	2,976	3,052	3,033	2,998
Group total in Israel	**9,143**	**9,392**	**9,211**	**9,428**
Overseas branches	34	33	33	35
Overseas subsidiaries	765	786	772	777
Group total overseas	**799**	**819**	**805**	**812**
Group total overseas and Israel	**9,942**	**10,211**	**10,016**	**10,240**

(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 payroll cost in their respect has been capitalized to fixed assets.

Following are details of the cost per position, in NIS thousands[(1)]:

	2012	2011	Change in%
The annual average direct cost per employee position in the Bank in Israel	226	235	(3.8)
The total annual average cost per employee position in the Bank in Israel	359	350	2.6
The average annual overall payroll cost per employee of the Group in Israel and abroad	344	338	1.8

(1) The 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.

HUMAN RESOURCES ACCORDING TO SEGMENTS OF OPERATION

The positions stated according to segments of operation include positions of direct employees of the segment and positions of head office staff of various levels, the cost of their employment had been allocated to the segment. The calculation of the number of positions, as stated, is based on a model for the allocation of costs used by the Bank, as adjusted in the circumstances and on the basis of assessments.

Human resources according to segments of operation:

						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Financial Management	Total
				For the year ended December 31,2012				
Average number of positions in the segment	4,746	1,603	1,215	749	588	7	1,108	10,016
Of which: Management positions	661	262	295	177	125	3	234	1,757
				For the year ended December 31,2011[(1)]				
Average number of positions in the segment	5,049	1,657	1,159	840	597	6	933	10,240
Of which: Management positions	659	289	281	201	124	3	213	1,769

(1) Reclassified, See "General" at the beginning of "Activity of the Group according to principal segments of operations"

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 decades, 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.

Within the framework of the new collective labor agreements, signed in June 2011 and approved by the Board of Directors on June 13, 2011, the validity of the Labor Charter was extended until December 31, 2016, and it has been agreed that unless otherwise informed by one of the parties to the other party by notice in writing of up to three months prior to the said date, the validity of the Labor Charter will be extended for one additional year, being repeated in each year.

Rights of association. The Bank's tenured employees 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 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 the Bank's retirees are organized. The Bank assists the retirees' committee and allows it to conduct activities at the Bank premises in Jerusalem, Jaffa and Haifa.

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.

PRINCIPAL CATEGORIES WITH RESPECT TO EMPLOYMENT CONDITIONS

The Bank's employees 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. The item in the collective labor agreement of June 2011, relating to the updating of grading and stages, changed certain of the employment terms of new employees engaged as regular employees as from January 1, 2012.

On December 31, 2012, there were 4,325 tenured employees in the Bank (December 31, 2011: 4,734 tenured employees). The majority of the Bank's tenured employees are permanent employees, while a minority constitutes new employees on a trial period.

Temporary employees. The engagement terms of temporary employees are mainly regulated in a number of special collective labor agreements, which specify their terms of employment. In the said labor agreement in the matter of the extension of the validity of the Labor Charter, the maximum temporary engagement period has been shortened in the said agreement in the matter of the extension of the effect of the Labor Charter, the maximum provisional period was shortened from five (with the possibility of extension of even up to seven years in special cases), to two years. This excluding in respect of employees engaged as tellers, concept branch and direct banking employees, whose maximum employment period is five years. Temporary employment may be terminated at any time, at the discretion of management. On December 31, 2012, there were 1,733 temporary employees in the Bank (December 31, 2011: 1,722 temporary employees), of which, 441 employees engaged by the Bank (December 31, 2011: 329 employees) and known as "computer temporaries". These employees are engaged in the IT field, and in accordance with an agreement dated 2002 between the Bank's Management and the representative committee of employees, may be engaged in a temporary status for a period of up to seven years. The item in the collective labor agreement of June 2011, regarding the engagement of computer employees, increased the quota of temporary computer employees which the Bank may engage, from the previous number of 350 to 750 employees.

According to the collective labor agreements to which the Bank is a party, the total number of temporary employees (excluding cleaning staff and temporary computer employees) is limited to 30% of the total number of the Bank's regular employees, as the number may be from time to time, starting with January 1, 2012.

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 the Bank's 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 would have reached approx. 103 positions. As of December 31, 2012, the Bank employed, in practice, 102 personnel (including members of management) under personal employment agreements (December 31, 2011: 119 employees engaged under personal contracts).

In addition, the Bank acquires services of manpower company employees and software houses. As of December 31, 2012, some 38 manpower company personnel were employed by the Bank. (as of December 31, 2011: 6 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, 2012, some 391 software house personnel were employed in the Bank. These employees are engaged mainly in software development tasks (as of December 31, 2011: 613 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]	Total temporary employees[1]	Manpower company employees	Software house[2]	Total
December 2010	4,446	1,963	29	839	7,277
December 2011	4,853	1,722	6	613	7,194
December 2012	4,427	1,733	38	391	6,589
Difference (December 2012 vs. December 2011)	(426)	11	32	(222)	(605)
Difference (December 2011 vs. December 2010)	407	(241)	(23)	(226)	(83)
Positions					
December 2010	4,510	2,006	20	860	7,396
December 2011	4,918	1,676	2	560	7,156
December 2012	4,470	1,789	26	368	6,653
Difference (December 2012 vs. December 2011)	(448)	113	24	(192)	(503)
Difference (December 2011 vs. December 2010)	408	(330)	(18)	(300)	(240)

Notes:
(1) Including the positions of Bank employees the cost of which has been capitalized to fixed assets: 2012 – 256 positions, 2011 – 370 positions, 2010 – 137 positions.
(2) Including the positions of software house employees included in the Bank's manpower data: 2012 – 125 positions, 2011 – 97 positions, 2010 – 54 positions.

DEVELOPMENTS IN LABOR RELATIONS

NEW COLLECTIVE LABOR AGREEMENTS

Agreements signed in 2011. Seven new collective labor agreements were signed in 2011:

- **A wage and selective supplement agreement for the years 2011-2012**, according to which all regular employees will receive an advance payment of an average of 6.5%, starting with January 2012. Discussion regarding the completion of the wage supplement will be held following the publication of the Bank's financial statements for the year 2012.
  Furthermore, a supplemental payment was determined for employees of the clerical level in respect of the year 2009, at the rate of 0.75%, with effect from January 1, 2011. The maintenance, until April 1, 2013, of industrial peace on the subject of wages was also agreed upon.
- **An agreement regarding the updating of grades and stages and the determination of maximum wage** for new employees enrolled or employees granted the status of regular employees, beginning January 1, 2012, for the clerical and managerial levels, including a change of part of the employment terms of existing employees of the "regular" status (including the cancellation of certain components, such as jubilee award, tuition fees for children of employees, refund of health insurance payments, etc.).
- **Application of pension arrangement** to new employees and to existing tenured employees wishing to join the scheme.
- **Extension of the validity of the labor code** until December 31, 2016. The agreement has also determined the shortening of the process for settling disputes between the parties to the labor code, and if not settled by the parties, submission of the dispute to an agreed arbitrator. The agreement further states that as from January 1, 2012, the employment period for employees of a "temporary" status shall be shortened to two years, and the trial period for employees of a "regular" status shall be shortened to one year, with an option for extension for an additional year subject to consent of the employees' representative committee.
- **Agreement regarding the cash redemption of vacation** to redeem in cash accumulated vacation periods, while reducing the number of vacation days that may be accumulated in the future.
- **Agreement regarding the employment of tellers and direct banking employees** enrolled as from January 1, 2012, for a period of up to five years, in accordance with employment terms stated in the agreement.
- **An agreement regarding temporary computer employees** that allowed the increase of the quota for employees engaged as temporary computer employees from 350 to 750.

Agreements signed in 2012. An additional collective labor agreement was signed on February 15, 2012, according to which, the tellers agreement (see above) shall apply also to staff of the same position employed in the various "concept" branches.

A collective labor agreement was signed on July 17, 2012, with respect to the absorption and placement of twenty-three employees of the former Discount Mortgage Bank, who belonged to the managerial echelon of that bank. According to the agreement, the said employees will be employed by the Bank according to personal employment agreements.

An agreement with respect to the transfer of the permanent staff of DMB to the Bank. An agreement was signed on May 3, 2012, between the Bank, DMB, and the DMB's employee committee and the New Federation of Labor. The agreement states that following the merger, the permanent employees of DMB would be absorbed at the Bank as tenured employees. The Bank's Management is to offer beneficial retirement terms to tenured employees preferring not to be transferred to the Bank. Furthermore, the agreement states that employment of temporary staff of DMB will terminate upon the merger, though a small number of such employees will be absorbed at the Bank as temporary staff.

The agreement prescribes, inter alia, that the basic salary (as defined in the agreement) of a permanent employee of DMB, who is transferred to the Bank, will be adjusted to the salary table of a Bank employee (as defined in the agreement), subject to the terms specified in the agreement.

REDUCTION IN THE LABOR FORCE

Retirement Plan 2011. The program was put into operation at the end of October 2011, and terminated in March 2012. Within the framework of the plan, the retirees had the right to choose between receipt of a capital amount at date of retirement or of a monthly pension payment.

Within the framework of the retirement plan 2011, 360 employees retired in the period to December 31, 2012 (four of which retired in 2011). For further details, see Note 16 g to the financial statements.

Conversion and reduction in the outsourcing workforce. In the years 2011-2012, the Bank took measures to reduce the employment of outsourcing staff by converting a certain number to a status of provisional computer staff. As a result of these measures, the workforce in this category was reduced by 222 employees in 2012 (2011 – 226 employees).

Employee retirement following the merger with DMB. At date of the decision regarding the merger, the personnel of DMB numbered 463 employees. 104 employees retired from office in the period until completion of the merger. The remaining 359 employees were transferred to Discount Bank upon the merger. The employment of some 36 employees was terminated during the second half of 2012. 30 other employees, whose employment was supposed to be terminated, have been engaged by the "Telebank" unit, to fill the shortage in the workforce of this unit. 14 additional employees are expected to retire from the Bank in the coming months.

A number of former members of management of DMB, including the former General Manager, continued to be employed by Discount Bank for a period of several months, in order to facilitate the operational integration of the mortgage activity at Discount Bank.

Early retirement plan at Mercantile Discount Bank. In the reported period, Mercantile Discount Bank launched a voluntary retirement plan in respect of about forty of its Head Office staff, at a total cost of NIS 45 million. Until the end of 2012, some 73% of the said staff have accepted the plan.

EFFECTS OF THE COLLECTIVE LABOR AGREEMENTS, THE RETIREMENT PLAN AND REDUCTION OF THE WORK PLACE

According to the Bank's Management's assessment, the labor agreement for the years 2011-2012, the vacation redemption agreement and the change in status of part of the outsourcing workers, would lead to an overall savings of between NIS 140 and NIS 150 million, on an annual basis. Savings in respect of the wage agreement is assessed compared with an average annual wage increase of 5%.

The updating of grades and stages agreement will lead to gradual savings in payroll expenses in the long run.

The Bank estimates that the annual savings as a result of employee retirement, as stated, amounts to NIS 165 million. The actual savings in 2012 was lower, due to the actual retirement date of employees.

The reduction in the workforce of outsourcing personnel and the transfer of a number of them to the position of temporary workforce reduced expenses. The conversion of staff and their direct employment as provisional computer staff, instead of engaging them through software houses, saves approx. NIS 6.5 million per annum for each one-hundred employees.

EMPLOYEE REMUNERATION

The principal salary components include the basic salary which includes a seniority increment, representation and signature fees to each employee in accordance with his seniority and position.

The basic salary constitutes the basis for salary increments and for the payment of split working hours' remuneration at the rate of 2.5% of the salary (to entitled employees only), shift remuneration (to entitled employees only), overtime, 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. The item in the collective labor agreement of June 2011, regarding the updating of grading and stages, changed the components and terms mentioned above, applying to regular employees engaged or converted to this status as from January 1, 2012. In addition, certain components have been cancelled in their respect and maximum salaries have been determined according to position and grading.

For some employees, payable overtime is subject to a prior 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"), except in respect of part of the temporary employees.

Most of the Bank’s employees are entitled to convalescence in an amount significantly higher than the amounts provided by law. Employees are also entitled to accepted provident and further 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, 2014 onwards) of 6% 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 cannot 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.

In accordance with the agreement from June 2011, the Bank provides for employee pension, as follows: employer contributions – 6% of the employees salary (including loss of ability to work where the employee elected executive insurance), minimum contributions by the employee – 5.5%, as well as a provision in the entire amount of severance pay at the rate of 8.33%, including the finality of the provision (according to Section 14 of the Severance Pay Act, concerning new employees – employees engaged as from June 2, 2011 - and existing employees, who chose this alternative, as from the date of choosing it).

The Agreement further specified that each new employee shall be entitled to pension insurance starting with the first month of his employment, and also that existing employees (regular) will be entitled to change to the pension insurance arrangement, if they so decide.

Employee award (2011). On April 29, 2012, the Bank's Board of Directors approved, in respect of the financial results for 2011, an award to the Bank's employees, employed in 2011 and employed at date of the decision in the amount of an average one basic monthly salary.

SPECIAL REMUNERATION TO MANAGERIAL PERSONNEL

Part of the managerial personnel is entitled to global overtime payment.

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, 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.

The item in the collective labor agreement of June 2011, regarding the updating of grading and stages, includes changes in some of the employment terms applying to new regular employees becoming Bank employees of this status as from January 1, 2012. In this connection, the average transfer payment has been reduced to 3% and maximum salaries have been determined according to classes in line with the accepted administrative grades at the Bank.

Staff members of the three most senior ranks at the Bank (Senior Executive, Assistant to the President & CEO, Senior Assistant to the President & CEO), are entitled to receive from the Bank a motor vehicle and a full funding of a home telephone line at that senior staff member's residence.

As at December 31, 2012, the staff of the managerial grade numbered 1,337 (December 31, 2011: 1,328 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 the Bank's senior officers, see Note 13 D to the financial statements.

REMUNERATION PLAN FOR MEMBERS OF THE BANK'S MANAGEMENT

For details regarding the remuneration plan for members of the Bank's management, see Note 16 J to the financial statements.

For details regarding the waiver by officers of the Group, of the award in respect of the year 2012, see Note 16J and Note 22G to the financial statements. The waiver by the officers, as stated, is estimated at NIS 18.6 million. (The said estimate assumes in certain of the cases that the qualitative index is similar to that of 2011, and that in other cases the quantitative indices had been weighted without the qualitative index).

WORK ON THE DAY OF REST

The Bank's personnel on duty at the computer center and security personnel 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

Following are details regarding the number of employees who retired from the Bank in the years 2008-2012:

The year	The total number of retired employees (including early retirement)	The number of employees who has elected early retirement
2012	429	356
2011	59	5
2010	62	13

The said Table reflects retirement data for the bank alone. For details regarding the scope of retirement among employees of DMB, see above.

LABOR RELATIONS OF THE PRINCIPAL SUBSIDIARIES

ICC. On December 21, 2011, ICC, the New General Federation of Labor and the national committee of ICC employees signed a special collective labor agreement, which specifies the terms of employment and the rights and duties of company employees (excluding certain employees to whom the agreement does not apply). Among other things, the agreement determines the right to long-service bonuses (Jubilee Bonuses) and to a onetime signing bonus.

The agreement shall remain valid until December 31, 2014, and will be renewed automatically each time for an additional period of three years, unless any of the parties will give notice to the other parties two month prior to the end of the period, of his wish to terminate or change the agreement.

Among other things, the agreement provides for an increase in salary for the year 2011, in accordance with the salary of the employee and with his relative period of employment, as well as for a selective annual increase in salary at an average rate of 3.5% for each of the years 2012, 2013 and 2014.

MDB. Labor relations with employees of this bank, except for those having a personal employment agreement, are principally based on a basic labor agreement - "labor statute" - and complementary collective agreements. These agreements determine, among other things, that wage terms, work and related terms shall be linked to those of Bank Leumi Le'Israel B.M.

PROMOTING THE EMPLOYMENT OF ULTRA ORTHODOX JEWISH WOMEN

ICC operates a customer service call center in Modiin Illit, which employs approx. 170 ultra orthodox Jewish women and constitutes an integral part of the Private Customers Department. This service call center is suited to the needs of ultra orthodox Jewish women who live in the region. The call center was examined and is meeting business targets and measures, and combines in an integrative manner between the business needs of the organization and the customers and the personal needs of the center's female employees.

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.

Improvement of enforcement of labor laws. On June 19, 2012, the Intensification of Enforcement of Labor laws Act, 2011, came into effect, the aim of which is "to intensify enforcement of labor laws and making it more efficient". The Act specified an administrative enforcement mechanism, which includes warnings and the imposition of monetary sanctions on employers who violate labor laws, which will serve as an alternative for criminal indictments. The law imposes extensive liability on employers with respect to their direct employees, as well as purchasers of services with respect to enforcement and securing the rights of personnel engaged on their premises in guard, security, cleaning and catering duties. The Act prohibits the engagement by entities ordering services and contractors supplying such services, in agreements which do not provide for basic wage terms for the personnel involved. The Bank is preparing in accordance with the requirements of the provisions of the law.

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 for the implementation of the Law, including the change in the method of recording employee attendance and continued communication with the Employee Representative Committee in this matter. It should be noted that the Bank operates a computerized attendance reporting system with respect to a large part of the non-organized employees.

Ruling in the matter of forced retirement on grounds of age. In December 2012, the National Labor Court issued an innovative ruling with respect to the duty of employers to consider approaches made by employees facing retirement on grounds of age (67 years), who are interested in continuing their employment. In accordance with the said ruling, employers must consider approaches made by employees based on the personal circumstances of each employee and not only on the requirements of the employer. In actual fact, several employees have already submitted such requests, and the Bank is preparing to act in accordance with the procedures required by the said ruling of the Court.

REMUNERATION POLICY IN A BANKING CORPORATION

In April 2009, the Supervisor of Banks announced that with a view of mitigating risks emanating from inappropriate incentive structures, banking corporations and companies under their control are required to adopt an appropriate remuneration policy. 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 principles detailed in the said document. 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 acceptance by the banking corporation. Banking corporations were 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 approved by the Board of Directors in January 2010. During 2010, the Bank established principles for the application of the Bank's remuneration policy, in line with the approved remuneration policy and according to the nature of operation at the various divisions of the Bank. The Human Resources Group is at the final stages of forming the application program, and upon its completion, it will be submitted to the Management and the Board of Directors for approval.

The remuneration policy document has been submitted to the principal subsidiaries in the Group. The Human Resources Group assisted the principal subsidiaries in the preparation of their own remuneration policy documents, and submitted its comments thereon prior to approval by the respective boards of directors of such subsidiaries.

The remuneration plans for the Bank's Chairman of the Board and for the President & CEO (see Note 22 F and G to the financial statements) and a remuneration plan for members of the Bank's Management (see Note 16 J) have been prepared in accordance with the principles of the remuneration policy adopted by the Bank. The remuneration plans formed in 2011 at ICC and at Mercantile Discount Bank, have also been prepared in accordance with the principles of the remuneration policy determined by the said subsidiaries.

The Bank has made preparations to implement the requirements that it is subject to as a result of Amendment No. 20 to the Companies Law (see "Legislation and Supervision" above), and within this context, the Bank acts to align the remuneration policy that it approved as abovesaid, in January 2010, to the requirements of the Amendment.

DEVELOPMENT OF HUMAN RESOURCES

Development of human resources at the Bank derived from the strategic focuses and reinforces the Bank’s ability to address successfully its business and organizational challenges, through:

- **Management and leadership** – establishing, cultivating and strengthening the managerial backbone, throughout its extent, by developing managerial leadership that supports strategy, focusing on the customer and contributing to business performance (performance, profitability and value maximization) and guidance towards the cultivating and development of the human capital.

(1) Long-term manpower planning
   - Managerial continuity ("bench depth") – an organizational process intended to secure a managerial cadre for the manning of key positions at the Bank. A map showing the managerial abilities required for core positions was prepared in 2012, key positions at the Bank have been mapped, and the Bank even began preparing development programs for the closing of gaps (enrolment, placement and training) for some of the key positions.
   - Career channel programs – forming a development channels map for the mobility and direction of the staff to role development and advancement in central engagement groups. A mapping was conducted in 2012 of the central development courses at the Bank's four business divisions.

(2) Development of acting managers – construction and maximum use of the workforce.
   - Academic enrichment for senior management of the Bank and of subsidiaries in the Discount Group as leaders of strategic subjects.
   - "Mofet" – a multi-annual personal development framework for a cadre of twenty-seven managers, having been identified as having potential for fulfilling senior executive roles;
   - "Power 200" – a cross-organization development of midlevel managers operating as an initiating managerial power. Cross-organizational apprenticeship is particularly emphasized as leverage for the integration of values and capabilities in the Bank's organizational and managerial culture.
   - "An executive training room" – a practical-implemental exercise environment, subject focused, for the maximization of the variety managerial skills and qualifications of the Bank's managers;
   - Development of an organic team – development programs at the organic level were launched in 2012 for the formation of a team, strengthening of the managerial role concept and the development of management expertise and apprenticeship among team heads at "Discount rapid" and compliance officers.

(3) Reserves – formation of the future managerial cadre
   - Training and classifying the reserves towards appointment for a role – "management reserve" (junior management) and "reserve for branch management" (middle management);
   - "Advanced banking" – a classifying development channel for the formation of a cadre having the potential for managerial roles at the branches;
   - "Horizons" - a development and training course for candidates for the position of branch manager. This course includes professional training, work experience in the branches and in the business units, management training and apprenticeship.

- **Personal development** serves as a central layer of the management reinforcement, and is performed through a variety of methods for improvement of qualifications, evaluation and feedback:
   - Assisting and advising managers when assuming new duties and/or on the job managerial training;
   - The mentoring of managers and units undergoing change – in view of the closing down of the credit centers and the concentration of operations at the business centers, the merger of branches and expanding the responsibilities and volume of activity of the customer preservation center;
   - "Reverse evaluation" – evaluation of managers by their staff and self-evaluation by the managers. On the basis of the said evaluations, managers are provided with a consulting feedback.
- **Improving professionalism and preservation of the professionals**
   - Enrollment and design of the human resource mix in a "desirable" profile, formation and integration of career tracks and training and preservation measures, adapted to a desired business behavior;
   - The core business positions regarding consulting, credit and the service and banking teams have been mapped. The requirements in each position have been defined, knowledge gaps have been identified and development and training layouts modified.
   - The formation of a training response was started with regards to the strategic move of strengthening the customer focus concept within the branch layout, including:

  - A managerial operating concept according to segments and a customer focused initiating service (training for twenty-three branches was conducted in 2012);
  - Referring general/personal calls to TeleBank – The training of service representatives and team heads of TeleBank and in the branches;
  - Training of the managerial team at the branches. Special emphasis was put in 2012 on the improvement of the professional level of branch managers and their deputies in the credit area (consumer credit and business credit). Furthermore, training in the areas of regulation (compliance, IFRS and instructions Nos. 301 and 313);
- Pension consultants - advanced banking training on the subject of pensions, focusing on the relations with the customers;
- Credit coordinators – a designated business training for the development of credit coordinators' professionalism as the professional arm of the business segment of the Banking Division. The training of credit coordinators began in 2012;
- Specialized professional raining in the IT field, project management and group guidance (qualification of eighteen midlevel managers as intra-organizational mentors with a view of establishing internal capabilities for the imparting of organizational culture and integration of change);
- As part of the aim for the professional development of human resources officers, unit managers and other office holders in the human resources group have been certified as qualification leaders, senior specialists and specialists by the Israeli Society for Human Resources Management;
- Short and applicable training sessions, including "distance learning". A part of the training was conducted by means of computerized learning; the uniqueness thereof is rapidly reaching the "work desk" of the employee and the imparting of a uniform and clear message to a large population;
- Strengthening the orientation towards the Bank and the banking industry – the improvement of knowledge and familiarity of employees making their first steps at the Bank, with the world of banking contents in general and with Discount Bank in particular.

- **Change management**

  Implementation of a multi-subject approach for the integration of change and its management in cross-organization strategic projects, while focusing on the human capital.

  A management of change methodology was put into action in 2012, within the framework of two strategic cross-organization projects:
  - The merger of DMB – management of the change in the training dimensions, personal consulting and mentoring of DMB managers engaged by Discount Bank, knowledge management and intra-organizational communication (absorption program, communicating motivated messages and welcome conferences).
  - Integration of the business model in private banking – mentoring the establishment of the Customer Assets Division with a focus on designated training and the positioning of the unit. Furthermore, an internal communication plan was established for the positioning of the new business model.

IMPROVEMENT OF SERVICE

The service concept of Discount Bank sees in the customer an individual who provides the Bank and its employees significance, work and a living. The Bank aspires to create for its customers a personal service experience, causing them to continue and choose it as their bank.

A training move continued in 2012 for the integration of the service concept in the Banking Division. Integration was combined into various projects, such as management by segments and referring calls to the Telebank. Concurrently, the move was completed with respect to private banking in Israel, for the integration of the service concept of the segment among all employees of the Division.

Measurement of the customer's experience. Measurement of the customer's multi-channel experience continued also in 2012 at the branches and investment centers. Measurement data is provided to the managers of the business units as soon as the findings are received and which constitute an infrastructure for the drawing of conclusions and analysis of strengths and weaknesses in providing response to customers. In cases where immediate intervention is required, the unit manager addresses the customer in providing a personal response. In addition, the response standard through direct banking has been updated, both in respect of the customer addressing the Bank by telephone and in returning a call to the customer who had contacted the Bank branches.

Handling complaints. The reduction in the number of complaints and the number of justified complaints were defined as a system objective also in 2012.

The focused effort in recent years led to the continued improvement in this field, the number of complaints received through the bank-customer relations department of the Supervisor of Banks at the Bank of Israel has declined, from 251 complaints in 2011 to 241 complaints in 2012, a 4% decline. The rate of complaints found justified in 2012, had dropped by 20%, from 39% in 2011, to 31% in 2012. The rate of complaints found justified declined from 21.2% in 2011 to 20% in 2012. It should be noted that the rate of justified complaints in 2012 reflects also complaints in the matter of mortgages following the merger with DMB. The grade awarded to the Bank by the Supervisor of Banks regarding the quality of complaint handling was 97.4% in 2012, compared to 98.7% in 2011.

KNOWLEDGE MANAGEMENT

Knowledge management constitutes an important layer in the management of employee professionalism and the quality of service at the Bank. The organizational portal on the Intranet system at Discount Bank comprises a central tool in Knowledge management. Knowledge management is designed to provide an answer to several central challenges: Accumulation of professional knowledge, its preservation and its reuse; Knowledge sharing; Turning covert knowledge into overt knowledge; Directing the required information to the user in the shortest possible time.

In 2012, the Bank started the mapping of its knowledge management processes and systems in relation to the Knowledge systems Standard of the Standards Institute of 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. In 2012, the Bank started an effort for the integration of the concept and process of drawing conclusions among risk center managers and compliance officers at the branches.

ORGANIZATIONAL CULTURE

The Discount code of ethics. The process of integrating the code in the organization continued in 2012, lead by managers according to the managerial chain.

Intra-organizational communication - "Taking you personally". The Bank is investing in the development of open and two-sided communication with its employees.

Within this framework, meetings at various levels are conducted, discussion groups and feedback processes, including:

- "Round tables" – "face to face" meetings of the President & CEO or of one of the management members with managers and employees;
- "Management in the field" - monthly tours of management members at branches and field units accompanied by senior managers from their head offices;
- Intra-organizational surveys.

With a view of broadening employees' knowledge and understanding as to the Bank's total activities and in order to deliver organizational messages, a variety of communication lines were also used during 2012, including: Senior Forum - a quarterly meeting led by the President & CEO; "Morning magazine" - a weekly television newscast presenting subjects standing at the core of the Bank's endeavor; Employee portal (Intranet); "Personal angle" - an Internet newsletter, which includes news and updates concerning various subjects of interest to employees; "Talking strategy" – "attachment" of managers to strategic and organizational processes in the Discount Group, as agents for communicating knowledge and its meanings; "Talking about results" - communication of business results and their implications to the management chain, with the aim of intensifying responsibility and the commitment of the individual and the unit to the Bank.

Measurement and evaluation. In 2012 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. Among other things, a new outline was formed for employee evaluation. This is a transparent evaluation process that encourages a dialogue between the employee and his manager serving as a platform for improving performance and enables a correlation between performance and remuneration. Evaluation procedures were established in 2012 and a designated computer system was acquired and adapted for conducting the evaluations, preparations have begun for training of all evaluating managers and a communication program was formed.

TRAINING

In 2012, the staff at the Bank received a widespread response to their professional requirements by means of extensive training and instruction towards the core position (qualification), improvement of business performance (proficiency) and elimination of performance gaps. Special emphasis has been given to the "personal touch" regarding each employee according to his knowledge requirements.

Learning is viewed by the Bank as a principal value. It supports the availability of qualified human capital for the realization of the Bank's business strategy and the advancement of its goals, while stressing the maximum and exhaustive use of available internal capabilities and constant improvement. The knowledge gaps in various areas were filled in during the year according to the identification of needs conducted at the various divisions. Among other things, a solution has been provided for development and training needs derived from regulatory instructions that have effect on the banking industry and/or consumer instructions.

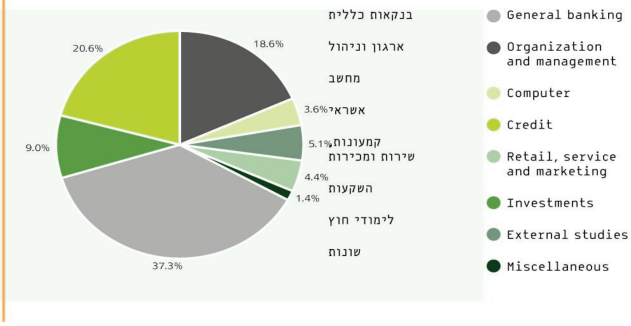
Scope of training. The number of training days in 2012 reached to 30,800 compared with 30,400 training days in 2011, an increase of 1%. The data regarding the number of training days relate to actual training days on the College premises, and it does not express the development, enrichment and extensive self study activities conducted in a variety of subjects and areas. Thus, in 2012, employees of the Bank performed 12,680 distant learning interactions, an addition of thousands of learning days.

INVESTMENT IN TRAINING AND DEVELOPMENT OF EMPLOYEES

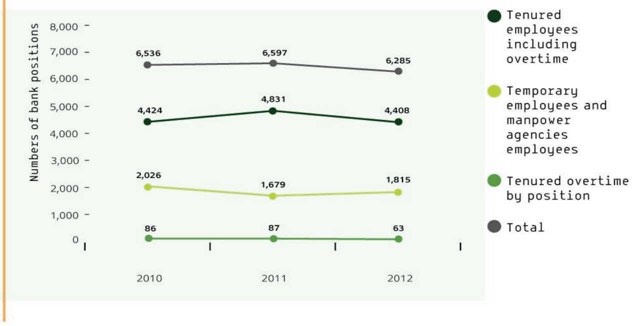
The Bank's investments in developing its human resources, in the training and shaping of an organizational culture amounted to NIS 11.3 million in 2012, compared with NIS 15.6 million in 2011. The amount includes the training of employees on various subjects of (developing and conducting training activities 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 Bank's training framework, 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 apprenticing training and in the preparation of training material. The cost in this respect is not included in the above amount.

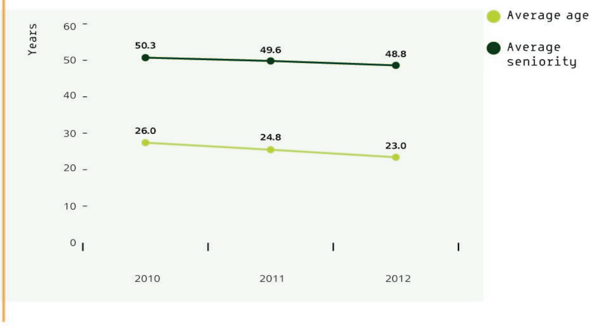
Training days



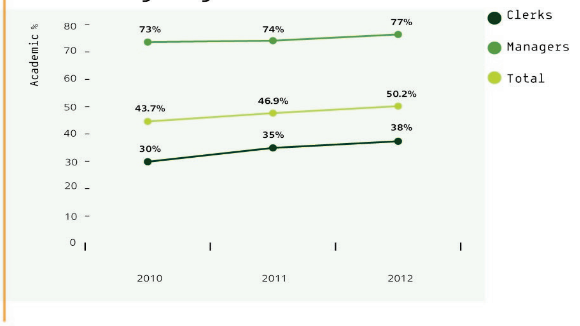
Number of bank positions



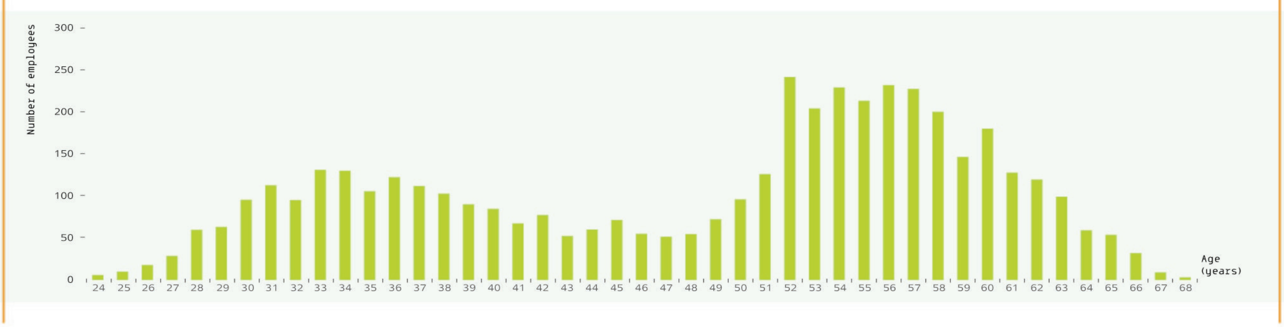
Average seniority and average age



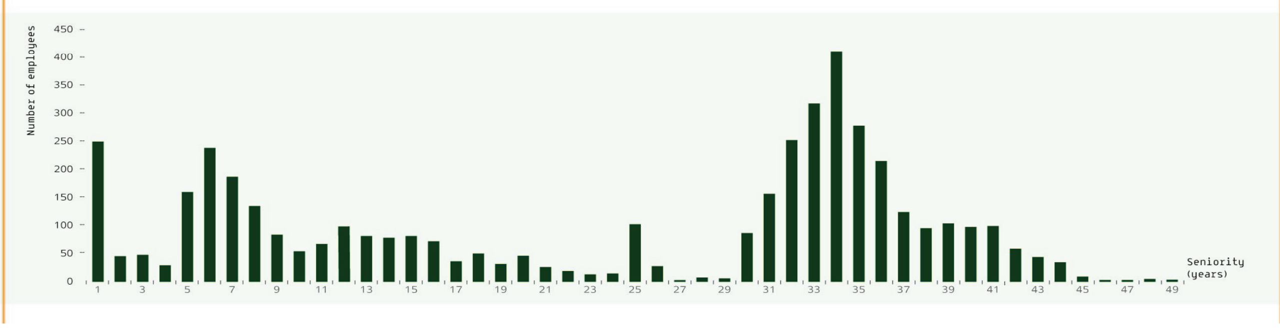
The rate of university graduates according to grade



Distribution of tenured employees by age- work force 12/12



Distribution of tenured employees by seniority- work force 12/12



CONTROL OF THE BANK

ENTITIES IN POSSESSION OF BANK SHARES

On December 31, 2012, and on a date proximate to the date of publication of this Report the Bronfman-Schron Group held 265,164,841 of the Bank's ordinary A Shares of NIS 0.1 each par value (hereinafter: "the ordinary shares"), comprising approx. 25.16% of the Bank's outstanding capital and of the voting rights therein.

The Bronfman-Schron Group’s holdings in the Bank’s shares are as follows:

159,098,904 ordinary shares, representing approx. 15.10% of the Bank’s issued capital and of the voting rights therein, are held by the limited partnership Treetops Acquisition Group LP (hereinafter: "Treetops");

106,065,937 ordinary shares, representing approx. 10.06% 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 Philip 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.

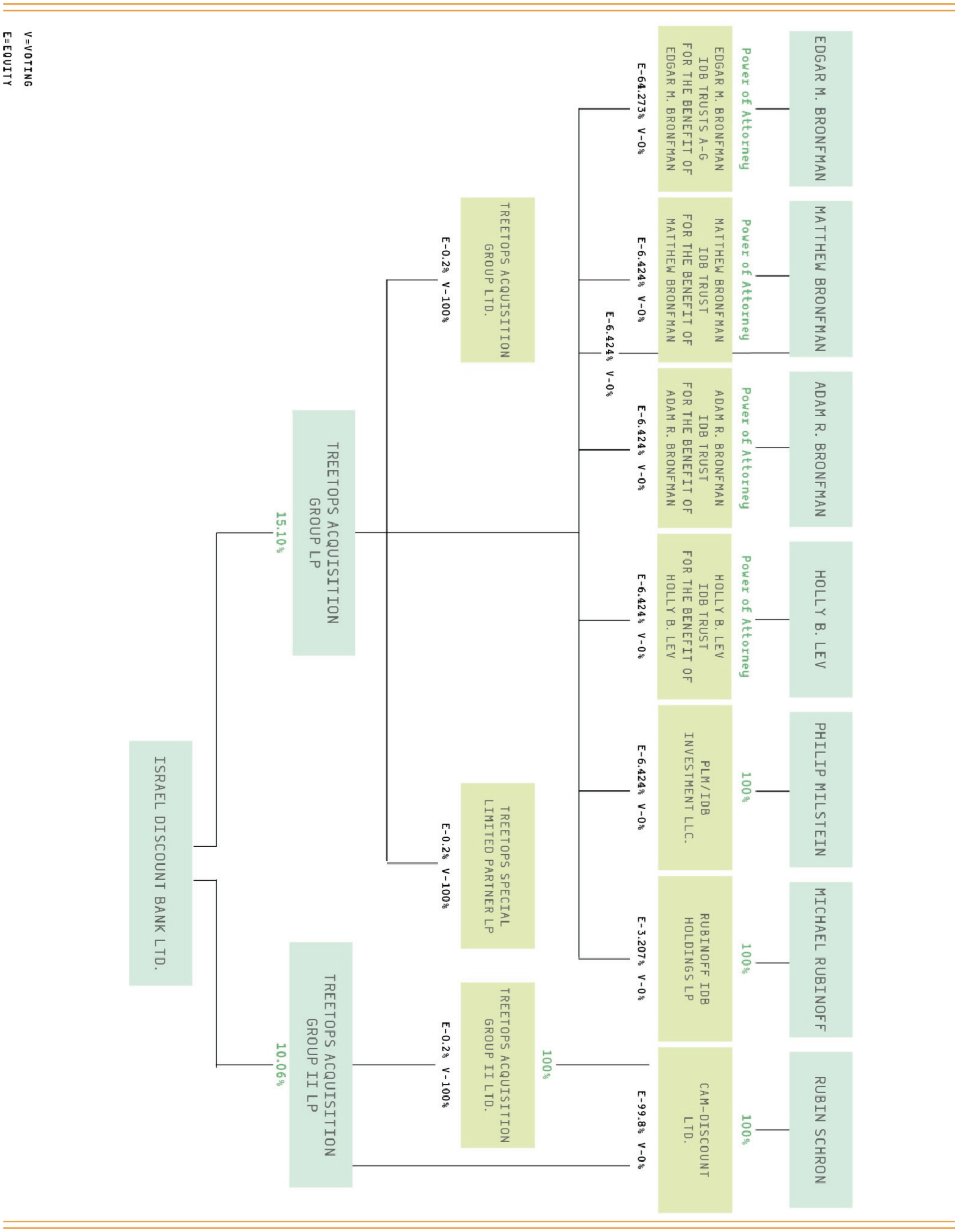
Treetops II is a limited partnership incorporated in the Cayman Islands. The limited partner of Treetops II is Cam Discount Ltd. (hereinafter: "Cam Discount"), that holds approx. 99.8% of Treetops II. Cam Discount is a company incorporated in the Cayman Islands, all the means of control wherein are held 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 arrangements between the buyers among themselves, see this chapter hereunder.

The ultimate controlling shareholders of the Bank are Messrs: Edgar M. Bronfman, Matthew Bronfman, Adam R. Bronfman, Holly B. Lev, Michael Rubinoff, Philip Milstein and Rubin Schron.

Controlling Shareholders of Israel Discount Bank Ltd.



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 (see below for details regarding an amendment to the permit, according to which the rate for a limited period, will be 25.01%). 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. (See below for details regarding an amendment to the permit, according to which the rate for a limited period, will be 25.01%).
   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 int shares, the Group shall maintain the minimum percentage holdings, computed on the basis of full dilution.
3. (a) For a period of five years subsequent to the date of the grant this permit, the Group shall not directly or indirectly sell or transfer means of control in the Bank, if as a result thereof it is left with means of control of any type in a percentage lower than the minimum percentage. Any one of the Group's members may sell means of control from the additional percentage exceeding his or her share in the controlling interest, provided that a minimum of six months have elapsed since the last purchase affected by such Group member (in such regard, the exercise of the option from the government shall not be deemed a purchase act).

   (b) Five years from the date of the grant of this permit, the Group may sell or transfer its means of control, provided that it sells or transfers the entire means of control constituting the minimum percentage, to an individual or a Group that has duly received a permit for the control and holding of the aforesaid means of control.

   In the Supervisor of Bank's letter annexed to the permit (hereinafter: "the letter annexed to the permit") it was stated that in the event that after five years from the date of the grant of the permit a decision is made by the Buyers to sell means of control in the Bank from the controlling interest such that after the sale none of the Group's members or the buyers require a permit for the control or holding of the means of control in the Bank, pursuant to the law, the following provisions shall apply:

   - The two Buyers shall approach the Governor of the Bank of Israel, notify him of their decision and detail the manner of the sale planned by them;
   - Before the sale of the means of control, as aforesaid, the Buyers shall make a preliminary with the Governor of the Bank of Israel, regarding the arrangements that shall be 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 Bank's earnings, 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.

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. No dividend shall be distributed from the Bank's profits that accrued prior to September 30, 2004 (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). If losses accrued after this date, no dividend shall be distributed until after these losses have been covered.
   Dividend may be distributed from the sale of the Bank's material assets, subject to the Supervisor's prior written approval
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 Bank's procedures will match and conform with, insofar as required and at any time, with the provision of the permit.

Amendment of the Governor's permit - November 2010. According to information provided to the Bank on November 14, 2010, the permit for the control of and the holding of means of control of the Bank, granted by the Governor of the Bank of Israel on January 29, 2006, to the Bronfman-Schron group, has been amended, permitting the group to reduce its holdings, such that the "minimal rate" will be 25.01% of any class of means of control in the Bank instead of 26%, as was specified in the original permit for a period of three years since completion of the public offering. This, only for the purpose and in connection with the public offering of shares by the Bank to be effected after the Bank's publication of rights issue to its shareholders as well as for the purpose of the dilution stemming from option warrants allotted by the Bank in the past.
It should be noted that in December 2010 the Bank completed a share offer to the public as well as a rights issue.

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, the 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 the 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"). The Bronfman Group is entitled to appoint the first external 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 external director. The identity of the members of the board of directors recommended by each Group is to be determined by the majority of shareholders in the general partner of each of the Buyers. The Buyers would vote by power of their shares in the Bank for the appointment to the board of directors, as aforesaid.

The Cooperation Agreement further stipulates that the Buyers would vote jointly on all issues brought before a General Meeting of the Bank's shareholders. 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 the Bank's shareholders, 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 Bank's Board of Directors.

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 Bank's share capital. 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.

REPAYMENT OF THE STATE'S DEBT WITH RESPECT TO THE AWARD TO EMPLOYEES

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 Bank's Audit Committee and Board of Directors approved the Bank joining the Agreement. On April 5, 2005, the General Meeting of the Bank's Shareholders approved the Bank joining the Employees Agreement. The Finance Committee also approved the Employee Agreement.

The 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 Bank's President & CEO 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 Bank's attachment 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 amounted 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-Schron 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 purchasers do not exercise the option in full, as actually happened, they will have to provide a loan, which will be transferred to the bank, in order 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 the information provided to the Bank, in discussions held at the beginning of 2009 between the State and the Purchasers, the Purchasers asked the State to release them from their commitment to grant a loan to the State on February 1, 2009, as stated, subject to certain conditions to be agreed upon. In this framework, and in order to complete the study of the request of the Purchasers to release them from their commitment to grant the loan, as stated above, The State agreed that the date of granting of the loan and its transfer to the Bank would not fall on February 1, 2009, but at a later date, extended from time to time, recently to September 1, 2011 (or at an earlier date, in respect of which a prior notice of fourteen days will be given).

Since January 2009, the Bank applied, time and again, to the Accountant General requesting the settlement of the debt together with interest and linkage increments.

In December 2012, the Bank and the Accountant General reached a compromise according to which, the calculation of payroll VAT in respect of reimbursements by the Government shall be made on the basis of the tax rates in effect on the contractual payment date to the employees and not on the actual payment date, and accordingly the State shall not bear the interest due in respect of the delay in payment of the debt and shall bear only half of the related linkage increments. The debt was paid accordingly.

CRITICAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

GENERAL

The Bank's financial statements 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.

ALLOWANCES FOR CREDIT LOSSES

Beginning January 1, 2011, the Bank implements the Directive regarding "measurement and disclosure of impaired debts, credit risk and allowance for credit losses".
The allowances for credit losses include a specific allowance - an allowance for credit losses in respect of debts that had been examined on a specific basis and found to be impaired and in respect of restructured troubled debts , and a group allowance - an allowance for credit losses in respect of small and homogeneous debts and in respect of debts examined on a specific basis and not classified as impaired. The said allowances reflect Management's assessment of the loss inherent in the credit portfolio in accordance with rules determined by the Supervisor of Banks and based on evaluations and assessments.
Once in each quarter, the Bank's Management examines the credit portfolio with a view of assessing the possible loss inherent therein. The process of assessing the possible loss related to the credit portfolio includes three stages:

- Identification of customers whose ability to honor their obligations towards the Bank has changed, and their reclassification as a result, into classes determined in the instructions of the Supervisor of Banks and according to criteria determined in these instructions, as "impaired debts", "substandard debts" and "debts under special mention".
- Creation of allowances reflecting the anticipated loss inherent in the credit portfolio. In determining the allowances on a specific basis, the Bank's Management assesses the difference between the recorded amount of the debt and the fair value of the related collateral (as assessed by it), in respect of impaired debts secured by collateral, or of the difference between the recorded amount of the debt and the value of the discounted amount of repayments anticipated to be received on account of the debt, in respect of other debts. In determining the allowance on a group basis, the Bank's Management assesses the amount of unidentified losses inherent in the portfolio, using a "credit loss allowance coefficient" in respect of outstanding credit segmented according to economic sectors and according to the determined classification, determined within the framework of the "range of allowances" computed on the basis of the outstanding balances and allowances in the various economic sectors, as reported by the Bank in recent years (concurrently, Management examines the debts and writes off debt conforming with the rules for accounting write-offs).
- Examination of the overall adequacy of allowance for credit losses.

The process of evaluating the loss inherent in the credit portfolio, as described above, is based on significant assessments involving uncertainty and on subjective evaluations.
Changes in assessments and evaluations as described above, may have a material effect upon the allowance for credit losses reflected in the Bank's financial statements.
It should be further noted that the principles standing at the base of the new Directive comprise a far reaching change in relation to the rules which had been in effect until December 31, 2010, regarding the classification of debts and the measurement of allowances for credit losses in respect of such debts. The said principles required the Bank's Management, among other things, to form a methodology with respect to certain subjects, using assumptions, assessments and discretion. In

future, following study and analysis over a period of time of the information that will be produced, certain changes in the said methodology, assumptions and assessments may have to be made.
For details regarding the accounting policy, see Note 1 D 4 to the financial statements. For details regarding the credit and its quality, see Note 4 to the financial statements. For details regarding the overall credit risk for which the Group is responsible in respect of problematic borrowers, see above under "Developments of assets and liabilities". For details regarding the credit risk management at the Bank, see above under "Exposure to risks and risk management" above.

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 allowance, 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 allowance in respect of the claim and the mode and scope of the disclosure in the financial statements.
The U.S. Standard also rules that if the loss cannot be assessed, no allowance 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, the Bank's Management 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).
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.
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 compared 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 Bank's Management 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 Bank's Management 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.
It has been determined in the public reporting directive in the matter of "The accounting treatment of contingent claims" 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 described in Note 1 D 17 to the financial statements. The financial statements include appropriate provisions for claims in respect of which realization of the related risk exposure is probable.
The financial statements include disclosure of material legal proceedings conducted against the Bank and Group companies, based on the criteria described in Note 1 D 17 to the financial statements. In addition, Note 19 C to the financial statements describes the 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". 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. For additional details, see Note 1 D 17 to the financial statements.

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 loss rate in relation to cost/amortized cost, the period in which the fair value of the security was lower than its cost, the credit rating of the security and changes that had taken place in its rating and attributing impairment to the deterioration in the financial condition of the issuer or to market conditions as a whole, etc. For further details, and including the criteria, the fulfillment of which would require recognition of impairment other than temporary, see Note 1 D 5.7 to the financial statements.
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 a significant effect upon the financial statements.

MEASUREMENT OF FINANCIAL INSTRUMENTS ACCORDING TO THEIR FAIR VALUE

Directives of the Supervisor of Banks. Beginning with January 1, 2011, the Bank implements the directive of the Supervisor of Banks regarding Measurement of fair value based on the U.S. financial accounting standard FAS 157. Fair value is defined as the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between voluntary seller and voluntary purchaser at date of measurement. Among other things, the Standard requires that for the purpose of assessing fair value maximum use should be made, to the extent possible, of observable inputs, while reducing the use of unobservable inputs. Observable inputs reflect information available on the market, received from independent sources, while unobservable inputs reflect the assumptions of the banking corporation.

FAS 157 details the hierarchy of measurement techniques based on the question whether inputs used for the determination of fair value are observable or unobservable.

These types of inputs create a fair value grading according to levels: 1, 2, and 3. For additional details, see Note 1 D 7.

Beginning with January 1, 2012, the Bank implements accounting standard ASU 2011-04, "Measurement of fair value". The update introduces amendments to FAS 157 (ASC 820) required for the uniform definition for the measurement of fair value in generally accepted accounting principles in the U.S. (U.S. GAAP) and in international financial reporting standards (IFRS).

According to the update the basic assumption of "in-use" is not implemented with respect to financial instruments. Nevertheless, financial assets and financial liabilities held and managed within the framework of a portfolio, are measured, under certain circumstances, according to fair value, using a price that would have been received or paid had a net position in groups of financial assets or financial liabilities as above, been sold or transferred.

In addition, according to the update, the measurement of fair value of financial instruments is made without taking into account the blockage factor both as regards financial instruments assessed according to all levels.

Furthermore, consistently with the measurement of fair value of financial liabilities, the fair value of items classified to capital is measured using quoted prices of such items (or of similar instruments) which are traded as assets.

Determination of the fair value of financial instruments of level 2 and level 3, is based upon estimates and assumptions relying, among other things, on subjective considerations. Accordingly, a possible deviation in the said estimates and assumptions may change the fair value of the financial instruments.

For additional details regarding the distribution of the fair value of financial assets and financial liabilities measured at fair value, based on the scale of quality determined in the Standard see Note 21 to the financial statements.

The assumptions, according to which the Bank had classified assets and liabilities to the various quality groups, as detailed above, included:

- In the highest quality group (Level 1) are included financial instruments and derivative financial instruments, traded on an active market (typified by a large number of participants and by a high trading turnover), the prices quoted thereon reflect actual market price;
- In the medium quality group (Level 2) are included financial instruments that are not traded on an active market, the fair value of which is based on quotations received from independent entities (hereinafter: Instruments, the fair value of which is determined by "pricing services"), and assessment models, all significant data used therein are observable in the market and are supported by observable market inputs. The financial instruments (including derivative instruments) the fair value of which is determined using "pricing services" include non-marketable securities denominated in Israeli currency and bonds of foreign financial institutions and governments;
- In the lowest quality group (Level 3) are included derivative financial instruments, the fair value of which is determined based on significant unobservable inputs included in the assessment model.

For details regarding transfers between levels of fair value hierarchies, see Note 21 h to the financial statements.

As seen from the data presented in Note 21 F 1 to the financial statements, the ratio of instruments classified to Level 3, to the total of assets and liabilities in respect of derivative financial instruments, was 11.8% at December 31, 2012, compared with 18.6% at December 31, 2011.

The expense from assets and liabilities, measured recurrently on the basis of fair value, included in level 3 in Note 21 G (1), amounted to NIS 26 million in 2012, compared to an expense of NIS 4 million for 2011.

Estimate of fair value of securities. Securities, excluding bonds held to maturity, are stated in the balance sheet at fair value, except for shares and option warrants 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 financial institutions and governments 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, which comprise an indication of the price for the execution of the transaction. Whenever differences arise between the valuation of the provider and prices quoted by 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 interest rate obtained from a quotation company (elected by the Capital Market, Insurance and Savings Division at the Ministry of Finance). 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. Furthermore, an examination is performed of the reasonableness of changes in fair value, including in relation to quotations of recent known transactions.

Estimate of 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, fair value is assessed by means of accepted models for the pricing and revaluation, 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 Bank's asset and liability management department and through the Bank’s dealing room, as the case may be, 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 (standard deviations) in exchange rates, interest rates and by the indices relevant to the option bought or written by the Bank. The volatility data of the foreign currency to 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 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"). For derivative financial instruments the volume of transactions therein is material, 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 mostly includes the reasonableness tests and the sample computation tests, is performed once in every quarter. In addition to the verification and validation process, control measures are being adopted by the Accounting Group in order to secure the appropriateness and fairness of the fair value of all derivative financial instruments.

An interface exists for the transfer of the results of the validation and verification between the Middle Office and the Liquidity and Market Risks Evaluation Department. In case of disagreements between the said factors, the matter will be brought for discussion in the Control Committee (a committee in the Risk Management Group, in which a representative of the Accounting Group also takes part).

In addition, the Bank performs on a current basis an assessment and examination of the risk pertaining to the process of determining fair value. Within the framework of the same program, the Bank has defined a limitation whereby it would not enter into a transaction involving a new type of financial instrument in a material amount, and would not increase the amount of an existing type of instrument, unless a structured process exists in respect thereof for determining fair value at a reasonable level of assurance (hereinafter: "the exceptional instruments"). It is noted that, in general, the Bank does not engage in transactions involving instruments in respect of which there is insufficient liquidity in the market, except for back-to-back transactions.

Note 20 and 21 to the financial statements includes comprehensive data regarding the Bank's derivative financial instruments activity and information regarding fair value of these instruments, according to the type of instrument.

The credit risk. In measuring the fair value of a debt, including derivative instruments that had been issued by the Bank and are measured at fair value, the Bank reflects credit risk and non-performance risk. For additional details regarding the manner of assessing credit risk, see Note 1D 7 to the financial statements.

Where in respect of the exposure, satisfactory liquid collateral exists that specifically secures the derivative instrument at a high level of legal certainty, the Bank assumes a zero inherent credit risk, and does not make adjustments to fair value in respect of the credit quality of the counterparty.

The Bank conducts reasonableness tests with respect to assessments of credit risk, which include also the testing of exceptional ratios.

The adjustment of credit risk relating to liabilities in respect of derivative instruments led, in 2012, to a profit of NIS 9 million, compared to a profit of NIS 43 million in 2011.

Following are details regarding the adjustment of the assets and liabilities in respect of derivative instruments, as stated above:

	December 31	
	2012	2011
	in NIS millions	
Assets in respect of derivative instruments	3,770	3,271
Adjustment in respect of credit risk regarding assets relating to derivative instruments	(20)	(6)
Liabilities in respect of derivative instruments	4,722	4,580
Adjustment in respect of credit risk regarding liabilities relating to derivative instruments	(29)	(49)

In addition, the Bank performs reasonableness tests of the results obtained from the internal evaluation of changes in market spreads, and perform the necessary adjustments, as the case may be.

EMPLOYEE RIGHTS

Liability for employee severance pay. On March 27, 2011, the Supervisor of Banks issued guidelines in the matter of "guidelines and clarifications regarding the strengthening of internal control over financial reporting of employee rights". The guidelines refer principally to aspects of strengthening the internal control over financial reporting of this subject. However, one aspect comprises an accounting guideline, viz., voluntary retirement plan and non-contractual severance payments. A banking corporation that anticipates the payment to groups of employees of benefits in excess of contractual obligations, has to take into account in its actuarial computations the ratio of employees who are expected to retire (including employees expected to retire under voluntary retirement plan or upon obtaining other beneficial terms) and the benefits to which they will be entitled to upon retirement. The guidelines include quantitative yardsticks, which, where these exist, the banking corporation is required to take into account the additional cost in this respect, based on an actuarial computation. The liability for payment of severance pay to such group of employees shall be presented in the financial statements at the higher of the amount of liability based on an actuarial computation, taking into account the additional cost expected in respect of the said benefits, and the amount of liability computed by multiplying the monthly salary of the employee by the number of years of employment, as required by Opinion No. 20 of the Institute of Certified Public Accountants in Israel.

The computation on an actuarial basis of the provisions with respect to the Bank's liability for severance pay involves the use of statistical tools and evaluations regarding the future, and is based on past experience and on the limitations determined in this respect by the Bank's Management.

The limitations determined by the Management, which have been implemented as from the financial statements as of June 30, 2011,are as follows:

- The retirement of employees under preferred terms will not be allowed during the period of five years following the 2011 retirement plan becoming effective (see under "Human resources" above) excluding exceptional cases (see below);
- The minimum age for retirement under preferred terms is 50;
- The creation of a special fund in the amount of NIS 70 million, for exceptional retirement cases, for that group of employees, who under the determined limitations will not be entitled to retirement under preferred terms, (the computation, initially made with respect to the June 30, 2011 data, related to the special reserve limitation, as stated, in the amount of NIS 50 million; as of December 31, 2011 the balance of the special fund amounted to NIS 100 million).

The actuarial computation is based on several parameters, including: life expectancy, retirement age, the rate of employee retirement prior to the prescribed retirement date, the rate of increase in salary anticipated - 2.5% per year 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. In accordance with the instructions of the Supervisor of Banks, the actuarial computation was based on a discount rate of 4%. The computation is based also on the average retirement rates, according to age groups, in accordance with the actual retirement rates in the years 2004-2010. In view of the scope of natural retirement anticipated in the years 2017-2027, it had been assumed that the rate of voluntary retirement in these years will be 2% per year.

Following is the possible effect of changes in parameters and assumptions standing at the base of the actuarial evaluation, in respect of the liability for payment of severance pay as of December 31, 2012, at the Bank and at MDB:

	Increase in liability
	in NIS millions
Increase of 1% in retirement rate of employees	31
Increase of 10% in paid retirement rate	35
Increase of 0.5% in the real-term annual wage	108
Decrease of 1% in the capitalization rate	219

Presented hereunder is the possible effect of changes in parameters and assumptions on which the actuarial assessment of the liability of the Bank and of Mercantile Discount Bank for employee "Long service (Jubilee) awards and post retirement payments"- as of December 31, 2012, had been based:

	Increase (decrease) in liability
	in NIS millions
Increase of 1% in retirement rate of employees	(9)
Decrease of 1% in retirement rate of employees	9
Increase of 0.5% in the real-term annual wage	15
Decrease of 1% in the capitalization rate	108

Long service (Jubilee) awards and post retirement benefits. Employees of the Bank and of Mercantile Discount Bank Ltd. 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. 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 these liabilities on an actuarial computation and to present it at discounted value. The actuarial computation is based on several parameters mentioned above.

Presenting the actuary's opinion for perusal. The opinion of the Actuary[3] is available for perusal on the MAGNA website of the Israeli Securities Authority and on the MAYA website of the Tel Aviv Stock Exchange Ltd. together with the Bank's 2012 Annual Report (This Report).

The capitalization rate used in actuarial computations. Within the framework of the said actuarial computations, use is made of a 4% discount rate, in accordance with a provisional instruction of the Supervisor of Banks with respect to "The discount rate for computing reserves covering employee rights". In the opinion of the actuary, the actuary noted as follows: "the computation assumes a discount rate of 4% per annum, in accordance with instructions of the Bank of Israel. These instructions remained in effect despite the decline in interest rates around the world and in Israel. A reduction in the discount rate would result in an increase of the reserves".

At the Bank's request, the actuary has assessed the theoretical effect of replacing the above mentioned discount rate by the rate of return on CPI-linked government bonds with a maturity period similar to the average maturity of the liability. According to the said assessment, the liability in respect of employee rights would have increased by an amount of NIS 971 million (pre-tax). The after-tax effect of the said theoretical change is assessed at NIS 630 million.

It should be noted that the change in the estimated amounts, as stated, in comparison with the data published by the Bank in the interim financial statements as of September 30, 2012, (p. 119), stems from the decline in returns of CPI linked government bonds.

Possible change in accounting treatment. On March 12, 2013, the bank was informed that the Supervisor of Banks is examining a change in the accounting treatment of employee benefits. At this stage, it is not yet known which standardization would be adopted, if at all, and what would be the manner and date of its implementation. At present, the discount rate in use, in accordance with the Supervisor's directives, is 4%. This rate reflects the long term average interest rate on government bonds.

DEFERRED TAXES

Deferred taxes are recorded in respect of temporary differences between the value of assets and liabilities in the balance sheet and their value for tax purposes.

[3] The English translation of the Opinion is available for perusal at the Bank's website.

Deferred tax assets in respect of timing differences are recorded only if it is probable that tax savings will accrue upon reversal of the difference and deferred tax assets in respect of carry forward losses for tax purposes are recorded only if the realization of the tax asset in the foreseeable future is more likely than not.
Accordingly, when deferred tax assets are being recorded, the Bank is required to perform assessments and estimates as to the probability and timing of realization of these assets in the future. For further details see Note 1 D 18 and Note 29 to the financial statements.

EXAMINATION OF IMPAIRMENT IN VALUE OF NON-FINANCIAL ASSETS

The Bank's Management examines from time to time whether circumstances exist requiring provisions for impairment of non-financial assets owned by the Bank. The said evaluation, by its nature, involves assumptions and estimates which retroactively might appear biased.
Impairment of costs of internal development of computer software. In addition to the signs for examining the existence of impairment specified in IAS 36, "impairment of assets", examining the existence of impairment with respect to the own development of computer software shall be made also where the signs noted in the generally accepted accounting principles for banks in the United States.
For additional details regarding the said indicators, see Note 1 D 13.
The written down balance of in-house software development costs amounted at December 31, 2012 to NIS 921 million. It should be noted that the major part of the said amount represents investments in the core system ("Ofek") that is anticipated to have a long-term use of several decades.
Investment in affiliated companies treated by the equity method. The investment in an affiliated company is tested for impairment, where objective evidence exists that indicates impairment in accordance with IAS 39 "Financial instruments - recognition and measurement", and in accordance with decision 1-4 of the Securities Authority "Guidelines for examining the need to provide for impairment of fixed investments". Goodwill comprising part of the investment in an affiliated company is not recognized as a separate asset and therefore is not tested separately for impairment. Impairment is tested in respect of the investment as a whole. Where objective evidence exists that indicates a possible impairment of the investment, the Bank assesses the recoverable value amount of the investment, which is the higher of the value in use and the net selling price of the investment.
As detailed in Note 6 E to the financial statements, the equity value of the Bank's investment in FIBI as of December 31, 2012, is NIS 1,624 million. The market value of the Bank's holdings in FIBI totaled on December 31, 2012: NIS 1,446 million. The said equity value is after provision for impairment in the amount of NIS 73 million, recorded by the Bank in the second quarter of 2012 (see Note 6 E (3) to the financial statements).
The Bank received an opinion rendered by Prof, Yoram Eden, CPA (Isr.), who gave his consent to the inclusion thereof in the financial statements, in which he examined the question whether the Bank should be required, in accordance with accepted accounting principles, to include a provision for the impairment in value of its investment in FIBI.
In his evaluation, Prof. Eden noted several limitations affecting the performance of the evaluation, including:

- FIBI did not provide Prof. Eden, in his capacity as valuer on behalf of the Bank, any assistance or information, except for information which is made public anyways and a number of clarifications passed to him. In view of this, Prof. Eden has been requested to assess the value of FIBI based on public information.
- In his opinion, Prof. Eden noted that financial statements issued to the public as well as the accompanying Directors' reports, include information, which in the main is "backward looking". For the preparation of a professional and reliable assessment, additional information is required that may be obtained only from the entity being assessed and from its management.
- The preparation of a valuation based on published information only is therefore problematic and by nature more exposed to error. This is even more so in the case of a valuation of a bank, where it is important to have more detailed information

regarding the Bank's credit portfolio and the evaluations by its management as regards future developments, the anticipated margins, business plans, etc.

- In his valuation, Prof. Eden stated that he also addressed the forward looking statement included in FIBI's Directors' Report. A forward looking statement includes uncertain information regarding the future, which is based upon information existing in FIBI's hands at date of the Report and includes evaluations and objectives of that bank as of that date. If such evaluations of management do not materialize, actual results may differ materially from the results expected or inferred from such data. Prof. Eden further noted that his valuation in itself contains forward looking statements, which reflect his evaluation concerning various parameters and based upon information available to him (public information). Prof. Eden noted that if such evaluations do not materialize, actual results may differ materially from the results estimated by him.

It should be noted that within the framework of the valuation (item 11), Prof. Eden had performed a sensitivity analysis in order to test the possible effect upon the basic result of changes in a number of parameters, including: the financial spread, the rates of the allowance for credit losses and the assumption of the fixed growth rate ad infinitum.

RATING THE LIABILITIES OF THE BANK AND SOME OF ITS SUBSIDIARIES

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
		Discount Bank		
Standard & Poor's, Ma'alot	Issuer rating (including deposits)	il AA-	Stable	January 17, 2013[4]
	Subordinate capital notes[1]	il A+	Stable	January 17, 2013 [4]
	Upper tier II capital (Series 1)	il A-	Stable	January 17, 2013 [4]
	Hybrid tier I capital (Series "A")	il BBB	Stable	January 17, 2013 [4]
Midroog	Long-term deposits	Aa2	Stable	October 18, 2012
	Short-term deposits	P-1	Stable	October 18, 2012
	Subordinate capital notes[1][5]	Aa3	Stable	October 18, 2012
	Subordinate capital notes (tier I capital)	A-2	Stable	October 18, 2012
The international rating agency S&P	Issuer rating Short-term	A-3	Stable	January 15, 2013
	Issuer rating Long-term	BBB-	Stable	January 15, 2013
The international rating agency Moody's[3]	Long-term foreign currency deposits	A-3	Negative	January 31, 2013
	Short-term deposits	P-2	Negative	January 31, 2013
		Mercantile Discount Bank		
Standard & Poor's, Ma'alot	Issuer rating (including deposits)	il AA-	Stable	January 15, 2013 [2]
	Subordinate capital notes	il A+	Stable	January 15, 2013
		Discount Bank Latin America		
The international rating agency S&P	Issuer rating (including deposits)	BB+	Stable	January 15, 2013

Footnotes:

(1) The rating also relates to subordinate capital notes (lower tier II) capital issued by Manpikim.

(2) Within the framework of the updating of the rating, Mercantile Discount Bank has been defined as a "core company" of the Discount Group. This determination creates a unique affinity between the Bank's rating and the rating of Mercantile Discount Bank.

(3) On January 3, 2013, Moody's published a negative outlook on the Israeli banking system for the coming 12-18 months.

(4) Within the framework of the announcement, according to which the Bank's issuer rating and the rating of the Bank's rated liabilities remained unchanged following the consummation of the merger with DMB.

(5) Including Series "A", issued at the time by Discount Mortgage Issues Ltd. (paper No. 1094853), transferred to Discount Manpikim Ltd. (paper No. 7480122), following the merger between them, consummated on November 11, 2012.

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 Bank's Board of Directors 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 total capital adequacy ratio.

For comparison purposes, hereunder are the international rating data for the State of Israel (long-term for bonds issued in foreign currency)*:

Rating given by	Foreign currency - long-term	Rating horizon
The international rating agency Moody's	A-1	Stable
The international rating agency S&P	A+	Stable
The international rating agency Fitch	A	Stable

* The data are taken from the website of the Accountant General at the Ministry of Finance.

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. The Bank's Management 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 claims outstanding against the Bank and its consolidated subsidiaries are described in Note 19 C to the financial statements.

DEBT RECOVERIES PROCEDURES

As part of the Bank's and its consolidated subsidiaries debt collection policy, legal procedures are instituted in the ordinary course of business for the recovery 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

Legal proceedings regarding the Leman Brothers Group. On September 15, 2008, the Lehman Brothers Group (hereinafter: "Lehman Group") collapsed. At that time, the Bank and IDB New York held Lehman Group's holding company's bonds. In addition, the Bank had entered into transactions in financial assets with the Lehman Bros. Group. Furthermore, the Bank managed various accounts of Lehman Group companies, some of which are for their customers.

In March 2012 the Bankruptcy Court in New York approved a creditors' arrangement for the parent company of Lehman Brothers Holdings Inc. and several of its subsidiaries. The Bank has received the first payment under the arrangement, on account of the debentures that it held in the holding company of the Lehman Group. In the Bank's opinion, no further provision is required for the impairment of the aforesaid debentures.

The Bank had reached agreements with most of the companies in the Lehman Bros. Group, which were duly executed, and with one of the companies the parties reached an understanding, that has not yet been refined into a final agreement. Once this agreement and the payment of the balance of the dividend upon liquidation is completed, the accounts between the Bank and any of the companies in the Lehman Bros. Group will be settled.

Legal proceedings against IDB (Swiss) Bank. On November 4, 2011, a former Vice President and Risk manager of IDB (Swiss) Bank, submitted to the Labor Court in Geneva a claim in the amount of SFR 2 million against IDB (Swiss) Bank. The claim raises various arguments against the bank concerning his dismissal from office and his rights in this respect. IDB (Swiss) Bank filed a defense brief as well as a counterclaim. The legal proceedings between the parties are being continued.

As background to the case, it should be noted that in October 2010, the Claimant, while still a Vice President of IDB (Swiss) Bank, submitted a report that included various findings, among which are findings that prima-facie indicate violations of the law and procedures. The said findings have been submitted for an independent examination by KPMG (Swiss), and except for violations of the bank's procedures, no violations of the law, as claimed, have been found. Appropriate reports have been submitted to the Swiss authorities.

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN 2012

1) An action and a motion for the approval of the action as a class action suit that were filed on June 19, 2006, against the State of Israel and 31 other defendants, including the Bank, MDB, Discount Gemel and the Provident funds of MDB.
   The claimants alleged 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 was 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 was NIS 233 million .
   The Court decided on April 22, 2012, to dismiss the claim and the motion for its approval as a class Action suit.
2) An action and a motion for the approval of the action as a class action suit that were 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". The Claimants argued 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 argued 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 the Bank of Israel for charging such a commission. The combined damage to all members of the group was estimated by the Claimants at NIS 672 million. The Court decided on April 19, 2012, to dismiss the

claim and the motion for its approval as a class Action suit.

3) On February 6, 2008, a motion for exemption from Court fees regarding a lawsuit in the amount of NIS 96 million was filed with the Tel Aviv District Court. 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 claimed 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 held the Bank responsible 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.

   The Claimant passed away in April 2010, and with the approval of the Court has been replaced by his heirs. Motions for exemption from court fees and appeals thereon have been dismissed by the Courts. On June 19, 2012, the District Court constructed to strike off the claim.

4) On May 29, 2011, a motion for the admission of a claim as a derivative claim, was served to the Bank. The claim was for an amount of NIS 107 million was served against a third party, companies under his control and against the Bank. The Claimant argued that the Bank was an accessory to collusion to dispose of the assets of the company in whose name the Court petitioned to approve the claim as a derivative claim .

   A verdict dismissing the said motion was given on September 4, 2012.

5) On February 24, 2011, DMB received notice of a motion for approval of a class action in the matter of charging an early repayment commission on commercial loans, filed with the Tel Aviv District Court (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank). The Claimant is a corporation that had received a loan for the purchase of a commercial property, and upon the early repayment of the loan was charged with an early repayment commission. The Claimant argued that DMB calculated incorrectly the early repayment commission in a manner that contradicts the procedures of the Bank of Israel and the provisions of the law.

   On September 20, 2012, the Court approved a compromise arrangement between the parties and determined that the Bank has to act towards the reimbursement of funds within sixty days from the date of publication of the notice in the printed media (the announcement was published on October 16, 2012). Letters were sent to all customers together with checks for the amount of the refund. The total reimbursement of funds amounted to NIS 1 million. About sixteen customers have not been located up till February 14, 2013. In accordance with the Court's ruling, the Bank shall donate an amount of NIS 200 thousand, to a defined association, in respect of unlocated customers.

6) On April 14, 2011, the investigators on behalf of the special manager appointed for a group of companies, filed a motion for approval of the filing of a monetary claim against the Bank and other parties in the amount of NIS 75 million. The investigators argued that the unilateral cancellation by the Bank of the credit facilities granted to the group of companies constituted one of the principal factors causing their collapse. On June 30, 2011, the Court allowed the filing of the claim but stated that the proceedings should not be financed by funds in the hands of the liquidator, which originate in the realization of assets pledged in favor of secured creditors.

   The Court has dismissed the motion for exemption from court fees filed by the petitions.

   On March 12, 2013, the Court dismissed the claim immediately, due to the non-payment of Court fees.

PROCEEDINGS REGARDING AUTHORITIES

1. For details regarding various proceedings conducted by the Antitrust Commissioner and concerning the Group's activities in the credit card field, see Note 33 B 1 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 ("FIBI") regarding the communication of information, see Note 19 C 15 to the financial statements.
3. For details regarding an audit by the Bank of Israel in the matter of "Implementation of the provisions of the Prohibition of Money Laundering Law" at ICC, see above in "Israel Credit Card Company Ltd." under "Main investee companies".
4. For details regarding the terms determined by the Supervisor of Banks and the Antitrust Commissioner in their approval granted to the agreement between the Bank and FIBI Holdings in the matter of the Bank's holdings in FIBI, see Note 6 E (1) to the financial statements.
5. For details regarding the police investigation and the seizure of documents and computer material of ICC, see Note 33 C to the financial statements.
6. For details regarding an audit performed at Mercantile Discount Bank regarding “Compliance with the Prohibition of Money Laundering and Terror Financing Law”, see above “Mercantile Discount Bank Ltd.” under “Main Investee Companies”.

MATERIAL AGREEMENTS

Hereunder is presented a summary description of agreements, entered into outside the ordinary course of business, that might be considered material, to which the Bank is a party, or which according to its best knowledge, the Bank is a beneficiary in terms thereof, including agreements that were valid in the period covered by this annual report, or which affected the Bank’s operations during such period.

AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN THE FIRST INTERNATIONAL BANK ("FIBI")

According to an agreement dated July 31, 1983, between the Bank and FIBI Holdings Ltd. and one of its subsidiaries, in terms thereof the Bank acquired ordinary shares of a par value of NIS 5 each in FIBI, which granted the Bank approx. 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 Bank's recommendation as approved by the Governor of the Bank of Israel. It was further agreed that the Governor would not withhold his approval of the Bank's recommendation as above, unless based on reasonable grounds and considering the possibility that such appointments might create a conflict of interests.

The signing of an agreement with FIBI Holdings - 2010. The Bank and FIBI Holdings signed an agreement on March 28, 2010, which, among other things, limits the period in which Discount Bank shall have the right by which FIBI Holdings shall continue to support the appointment of one quarter of the directors of the First International Bank from among candidates recommended by Discount Bank. For details regarding the highlights of the agreement and regarding the approvals of the Supervisor of Banks and the Antitrust Commissioner with respect to the agreement, including the timetable determined by the Antitrust Commissioner for the reduction in the interest held by Discount Bank in the First International Bank, see Note 6 E (1) 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 Bank's request, 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 Bank's request 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 n to the financial statements.

AGREEMENTS WITH FIBI 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 FIBI 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. Over the years, dozens of collective agreements have been signed, usually to supplement the contents of the Labor Charter. Within this overall context, the “update, stages and determination of salary ceilings for new employees” agreement was signed in 2011. See “Developments in labor relations” under "Human resources” above.

AN AGREEMENT FOR THE GRANTING OF LOANS AND SERVICES TO STATE EMPLOYEES

On May 10, 2007, the Bank signed an agreement for the granting of loans, overdraft and banking services to State employees following its success in the tender issued by the Accountant General. For further details see "Retails banking sector - household segment" in the Chapter "Activity of the Group according to principal segments of operating" and Note 19 C 17 to the financial statements.

ISSUES REGARDING CORPORATE GOVERNANCE

CORPORATE GOVERNANCE CODE FOR THE DISCOUNT GROUP

The corporate governance code approved by the Bank's Board of Directors on October 28, 2009, reflects the implementation of a "best practice" policy in the corporate governance field. The code is based on the provisions of the law and various regulations applying to the Bank in the corporate governance field, including the Basel II guidelines and the recommendations of the Goshen Committee established by the Israel Securities Authority.

Within the framework of the implementation of the corporate governance program, the Bank's Board of Directors approved in January 2012 a work procedure vis-à-vis the subsidiary companies, which is designed to regulate the interfaces between the Bank and its subsidiaries, with a view of preparing an infrastructure for management on a group level, and determine a work format for the supervision and control over the activities of subsidiary companies by the parent company. Within the framework of the work procedure vis-à-vis the subsidiary companies, supervision and control mechanisms have been set, which are designed to assure the proper and effective operation of the Discount group including with respect to the following items: activity and transactions with related parties; supervision by the Bank's Board of Directors over companies in the Group; reorganization and structural changes; the formation of a group risk management policy regarding various areas.

The Bank's 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.

The Bank acts towards completing the formation of corporate governance procedures in the matter of approving transactions with interested parties, in order to establish in such procedures the manner of approval of transactions between the Bank and its controlling shareholders, as well as transactions between the Bank and its senior officers, including engagement and terms of office.

CORPORATE GOVERNANCE QUESTIONNAIRE

As part of the project for the improvement of financial statements, the Israeli Securities Authority published in September 2012, a guideline in terms of Item 36A(b) of the Securities Act, 1968, according to which, public companies are required, as from the periodic report for the year 2012, to submit a "corporate governance questionnaire" in the format stated in the guideline.

The Bank's corporate governance questionnaire is available for perusal at the MAGNA website of the Israeli Securities Authority[4] and at the MAYA website of the Tel Aviv Stock Exchange Ltd., as well as at the Bank's website.

GROUP MANAGEMENT

Proper Banking Management Directives regulate, among other things, the Group conduct of the banking corporation as regards various issues.

Within the framework of an amendment to Proper Banking Management Directive No. 301 (“the New Directive”), which entered

[4] The English translation of the questionnaire is available for perusal at the Bank's website.

into effect on January 1, 2012 (see “Legislation and supervision” below), instructions have been prescribed with regard to group management, according to which the Board of Directors is required to determine the overall strategic goals of a banking corporation and of corporations controlled by it, including its domestic and foreign extensions, including the fundamental operating guidelines and the risk appetite. In addition, it stipulates that the Board of Directors shall determine general guidelines regarding the structure of corporate governance in such controlled corporations, in a manner that would contribute to efficient supervision over the Group.

The new Directive includes reference to the framework of considerations of the controlled corporation, and requires that the Board of Directors of the controlled corporation must take into consideration the overall strategic goals of the Group, the overall risk management policy of the group and the overall guidelines of the group regarding the supervision and control mechanisms over controlled corporations, determined, respectively, by the Board of Directors of the controlling banking corporation, in as much as they agree with the interests of the controlled banking corporation and with the provisions of Section 11 of the Companies Law, regarding the purpose of the company.

Within the Discount Group Strategic plan, approved in July 2011, the Board of Directors formed principles for group management, taking into consideration the circumstances of each subsidiary company, its field of operation and size. Within this framework it was determined, among other things, that in certain of the areas – strategy, accounting group, risk management, internal audit, legal advisory and information systems – the relevant units at the Bank will guide the subsidiaries by way of a "binding professional guideline". In certain matters, particularly with respect to administrative matters, administration will be performed by a "central management" format, with a view of increasing efficiency and utilizing synergic advantages.

In January 2012, the Board of Directors approved the work procedure vis a vis the subsidiary companies, the aim of which is to regularize the interfaces between the Bank and the subsidiary companies, with a view of creating a management infrastructure on a group basis and to enable the Bank to supervise the activities of the subsidiary companies. Among other things, the procedure regularizes the basic principles for group management, and the areas to be managed on a group basis, including: strategy, capital planning and risk management. In addition, the procedure regularizes the supervision and control framework over the subsidiary companies through audit and control functions that are responsible for risk management on a group basis within the area of their responsibility. Furthermore, the procedure framework established reporting mechanisms by the subsidiary companies to the bank, as well as rules regarding transactions requiring the Bank's approval prior to their being approved by the subsidiary companies. The Bank is acting to integrate the procedure, and to form the work interfaces between the subsidiaries and the various parties responsible for the business and supervisory aspects of the subsidiaries’ activities.

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 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" above.

THE INTERNAL AUDIT IN THE GROUP IN 2012

Details of the Internal Auditor. The Bank's Internal Auditor is Mr. Nir Abel, CPA (Isr.), who assumed office on May 18, 2011. The Internal Auditor is not an interested party in the Bank, 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) and the staff of the internal audit department comply with the provisions of Section 8 of the Banking Rules (Internal Audit).

In addition, as from May 18, 2011, Mr. Abel serves also as the Internal Auditor of ICC.

The manner of appointment. The appointment of the Internal Auditor was approved by the audit committee in its meeting on November 29, 2010 and by the Board of Directors in its meeting of December 12, 2010. The appointment of Mr. Abel was approved in light of his qualifications, education and long-term professional experience in the field of internal audit and in the role of chief internal auditor in the banking system. Until his appointment, Mr. Abel, a certified public accountant and economist, served as Head Internal Auditor of the First International Bank Group from August 2006 until March 2011, and as the Chief Internal Auditor of Otzar Hahayal Bank as from November 2000 and until March 2011.

Letter of appointment. The Audit Committee of the Board and the Board of Directors approved in January 2012 the letter of appointment of the Internal Auditor, and in January 2013, they approved an update of the letter of appointment.

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 five years). The annual and multi-annual work plans (hereinafter: "the work plan") are prepared in according to the Internal Audit Law, 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 Proper Banking Management Directive No. 307 regarding the internal audit function).

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 & CEO for lodging comments and elucidations. The Board of Director's Audit Committee discusses the work plan and on the basis of its recommendations the plan is brought before the Board for approval.

A deviation from the work plan is brought for approval of the Audit Committee.

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. The planned work programs for the subsidiaries, at which the Bank's Internal Auditor or his deputy serves also as their Internal Auditor, are combined with the annual work program for the Bank's internal audit, 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.

Where the Bank's Internal Auditor does not perform audits of investee companies, control of such companies is performed as required by Section 1(A)(3) of Banking Rules.

In addition, 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 109.3 positions (including overheads; not including 3 outsourcing positions), of which, 33.7 positions in corporations that engage an independent Internal Auditor (MDB, IDB New York, Discount Bank Latin America and IDB (Swiss)). The number of positions in the Internal Audit Group 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 2012 engaged in internal audit at the Bank and in investee companies in Israel and abroad:

	Group employees	Outsourcing employees
The Bank	60.3	1.5
Investee companies in Israel audited by the Bank's internal auditor(1)	13.3	0.5
In overseas extensions	2.0	
Investee companies in Israel where the audit is performed by an independent internal auditor(2)	18.5	1.0
Investee companies abroad where the audit is performed by an independent internal audito(3)	15.2	
Total	**109.3**	**3.0**

Notes:

(1) Of which, 6.4 positions in ICC.

(2) Of which, the internal auditor and an overhead of 1.9 positions. Not including 2 positions of costumer complaints.

(3) Of which, 10 auditors of IDB New-York,5 auditors of DBLA, 0.2 positions in IDB (Swiss) Bank

Performance of the audit. The internal audit is carried out according to the provisions of the Internal Audit Law, 1992, 1993 and according to the professional standards of the Institute of Internal Auditors in Israel. Until Proper Banking Management Directive No. 307 in the matter of "Internal audit function" (see below) entered into effect on July 1, 2012, The internal audit function operated also in accordance with the Banking Rules (Internal audit), 1992. As from the above date, the internal audit operates also in accordance with Proper Banking Management Directive No. 307.

During the reported period, an audit has been performed in respect of a material transaction (within the meaning of the term in Proper Banking Management Directives) effected in 2012.

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 Bank's information systems and of investee corporations in Israel and abroad, including financial data.

Reports by the Internal Auditor. All audit reports are submitted in writing and presented to the Chairman of the Board, the Chairman of the Audit Committee, the President & CEO, the Chief Risk Manager, the independent auditors and relevant members of the Management. The audit reports are graded on the basis of the audit findings.

A monthly summary report is presented to the Chairman of the Board, the Chairman of the Audit Committee, the independent auditors and the Bank's Management.

The internal auditor submits periodic activity reports, as follows: a quarterly report concerning all the internal audit work performed in Israel and abroad, detailing the material findings reported in the individual reports submitted during the reviewed 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.

The auditor submits also a semi-annual report and an annual report in the format required by Proper Banking Management Instruction No. 307 in the matter of internal audit.

The activity reports are addressed to the Chairman of the Board, the Chairman of the Boards' Audit Committee, the President & CEO, the Chief Risk Manager and to the Independent Auditors. These reports are being discussed with the President & CEO and with the relevant members of Management and thereafter by the Boards' Audit Committee. The annual report is being discussed also by the Board of Directors.

In addition, the audit committee of the board discusses specific audit reports regarding the Bank’s units, and material reports regarding the Bank's subsidiaries, in cases where the chairman of the audit committee or the Internal Auditor consider that the findings in these reports or the significant issues which they raise require special attention.

The periodic reports were submitted and discussed as follows:

- Report on the activities of the internal audit in the fourth quarter of 2011, submitted on February 16, 2012, and discussed by the Audit Committee on March 12, 2012.

- Annual report on the activities of the internal audit in 2011, submitted on April 4, 2012, and discussed by the Audit Committee on May 24, 2012 and by the Board of Directors on June 18, 2012.
- Report on the activities of the internal audit in the first quarter of 2012, submitted on May 6, 2012, and discussed by the Audit Committee on May 24, 2012.
- Report on the activities of the internal audit in the first half of 2012, submitted on July 9, 2012, and discussed by the Audit Committee on August 5, 2012.
- Report on the activities of the internal audit in the third quarter of 2012, submitted on October 23, 2012, and discussed by the Audit Committee on November 25, 2012.
- Report on the activities of the internal audit in the fourth quarter of 2012, submitted on January 29, 2013 and discussed by the Audit Committee on February 17, 2013.

The annual report regarding the activities of Internal Audit in 2012 is being submitted these days.

Valuation by the Board of Directors of the Internal Auditor's performance. In the opinion of the Board of Directors and of the Audit Committee, the scope, nature and continuity of the operations of the Internal Auditor and his work plan are reasonable under the circumstances and attain the goals setout for internal audit at the Bank.

Remuneration. Details of the payments to the Internal Auditor and of the components thereof are given hereunder. In the opinion of the Board of Directors, such payments have no effect upon the Internal Auditor's professional judgment.

Details of the recipient			Remuneration* for services							
year	Extent of position	Rate of holdings in corporation's capital	Salary	Awards	Employer's payments and provisions(1)	Benefits and grossing-up(2)	Total salary, awards, employer's provisions and benefits	Share based payment	Total	Loans granted under regular terms
						in NIS thousands				
2012	100%	-	969	-	273	80	1,322	-	1,322	-
2011	100%	-	594	295	648	51	1,588	-	1,588	-

* The amounts of the remuneration are in cost terms to the Bank and do not include payroll tax.

(1) Includes adaptation award, severance pay, provident pay, further education fund, vacation pay, National Insurance contributions, loss of work ability insurance and adjustment of provisions following changes in salary.

(2) Includes value of use of vehicle and of mobile phone, various benefits and their grossing up.

Mr. Abel 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. Abel is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. Mr. Abels' 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. Abel 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. Abel is entitled to severance payment in accordance with the law and also to a retirement award in an amount equal to six monthly salaries in the first two years, in the event that the termination of employment was initiated by the Bank, and to an amount equal to four monthly salaries in the period following the first two years, or in the event that the termination of employment was initiated by the member of Management. Mr. Abel is entitled to participate in the remuneration plan to members of the Bank's management, as detailed in Note 16 J to the financial statements. Mr. Abel, waived his award in respect of 2012.

Proper Banking Management Directive regarding "Internal audit function". A new Proper Banking Management instruction in the matter of the internal audit function became effective on July 1, 2012. The directive is based on a document of the Basel committee of August 2001, in the matter of "Internal audit at banking corporations and relations between the Supervisor of Banks and the Auditors", on relevant international sources of foreign regulatory authorities, which had been examined and modified to existing reality in Israel and local legislation and regulation. The directive regulates various aspects of the internal audit function. The internal audit acts in accordance with the requirements of this Directive.

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 continued during 2012 - Discount Employees for the Community, in the framework of which, volunteer Bank employees contribute 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, 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 2012 in the culture and arts field, providing sponsorship and donations.

In 2012, the Bank continued the trend of supporting children and youth in various states of distress.

Monetary scope of activity. The total volume of activities of Discount group in 2012, including the Lema'an Project, amounted to NIS 6,353 thousand, compared with NIS 6,403 thousand in 2011. 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 1,523 thousand in 2012, compared to NIS 1,664 thousand in 2011. Furthermore, direct current cost associate with the Visitor Center (tour guide personnel and building maintenance) amounted in 2012 to NIS 4,011 thousand, compared with NIS 3,196 thousand in 2011. Miscellaneous expenses, including expenses for production of the Corporate Social Responsibility Report and participation by Bank Management in financing of the "March for the living" visit to Poland, amounted in 2012 to NIS 297 thousand, compared to NIS 433 thousand in 2011.

The social activity and involvement in the community was carried out by the Bank in the following areas: education, knowledge, having special needs, health, and more.

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 2012, noteworthy are those granted to following associations: Negev Leaf, Association for the Wellbeing of Israel's Soldiers, Association for Advancement of Education in Jaffa, AKIM, Reut Hospital and more.

THE "LEMA'AN" PROJECT - DISCOUNT EMPLOYEES FOR THE COMMUNITY

The varied activity continued in 2012, while focusing on voluntary activities in the framework of various associations acting in aid of youth at risk and in distress and various associations. During 2012, branches and new units joined the Bank's volunteer circle.

The following projects conducted in 2012 deserve special mention:

Adoption of Regiment 405. At the beginning of 2011, DMB committed to adopt Regiment 405 of the Artillery Corp for an additional period of three years. Upon consummation of the merger between DMB and the Bank, the latter has also taken over this commitment.

Adoption of Squadron 916 for an additional period of three years. In June 2012, the President & CEO, the Chairman of the Board and members of the Bank's Management visited the base of Squadron 916 of the Israeli Navy. During the visit, a review had been made of the six year period of adoption of the Squadron by the Bank (within the framework of the "Adopt a combat soldier" project of the Association of Friends of the IDF) and it has been decided to renew the adoption for an additional period of three years.

"Discount Fund" at the "Ezra LeMarpe" Association. The Bank continued its support of the Fund, whose goal is to offer financial assistance, for the fourth 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.

"Our Children's Horizon" Project. During the summer months (July-August) the Bank employed youth with eye defects, who are active at the "Our Children's Horizon" Association. For the sixth year running, the Bank is an active member in the training provided for such youth as preparation for work at the Bank. The participants together with their coordinators from the Association came to the Discount College, where they were given instruction on the subject of work qualification and skills.

Taglit Project. This is a project established by the Israeli Government with the participation of Jewish donors and communities all over the world, designed to create a bond between youth in the Diaspora and the State of Israel. The participation of Israeli youth in the Project, serving as companions for youth from abroad visiting the country, has been expanded in the recent year also to employees of Israeli corporations. Some thirty Bank employees participated in the project in 2012, escorting the young people from abroad for five days.

Bazaar for the sale of products made by persons with special needs. Towards the Passover holiday, the Bank has assisted in setting up a bazaar (on Bank premises) in which Bank employees could buy items made by handicapped individuals. Income from sales was contributed towards the continued activities of associations employing the handicapped. The products were produced by persons having special needs working under the auspices of the following associations: "Beit Miriam" (ILAN), "Sheculo Tov" (emotionally handicapped) and Kfar Idud (slightly retarded). All revenues were dedicated to the activities of members of these centers. An additional bazaar was held at the square of the Discount College at Rishon Le'Zion, where the products of the "Enosh" Association (emotionally handicapped) were sold.

Assistance to needy families towards the Passover holiday. 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 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.

Assistance to Holocaust survivors towards the Jewish New Year. Direct distribution by Bank employees of food cards, of a value of NIS 300, to Holocaust survivors all over the country, in coordination with the welfare departments of local authorities within the Bank's branches.

"Jerusalem Day" and Shavuot Holiday activities at volunteer centers. Volunteer activity at the various centers around the country continued in May. Operations focused on the "Jerusalem day" and Shavuot Holiday celebrations, principally among children, senior citizens and battered women.

Hanukkah and Purim events at volunteering venues. Bank employees conducted Hanukkah and Purim parties at centers in which they work as volunteers; children clubs, senior citizen clubs, schools, a shelter for battered women, drug rehabilitation center, Chimes - Rehabilitation Work Centers (adult population having special needs), children with special needs, hospitals etc.

Adoption of "A Place in the Heart" - children at risk - Jaffa "D". A club for first to sixth grades schoolchildren, operated once weekly by volunteers of Discount Mortgage Bank, with the aim of assisting children at risk with their school homework.

Following the approach of the volunteer work coordinators of the staff of Discount Mortgage Bank staff (which was merged in June with and into the Bank) requesting the continuation of the work with "A Place in the Heart" Association, it has been decided to continue the adoption of the club by the staff of the IT and Planning Division, who will also examine, among other things, activating the computer room in the club (existing but inactive).

The "For the Community" website. The "For the community" website operates on the employee Intranet site. The site includes up-to-date contents regarding the Bank's activities 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.

Sprint for the Future annual event. An event was held at the end of April in honor of the participants in the work of the Sprint for the Future Association, the Bank's flagship project. The event marked twelve years of operation of the Project and noted the cooperation with the Bank.

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.

Five scholarships were donated in 2012 to student graduates of the Association.

CORPORATE RESPONSIBILITY REPORT

On the background of developments regarding the issue of corporate responsibility reporting, and in view of the importance that the Supervisor of Banks attributes to the activity of banking corporations in this respect, the Supervisor of Banks issued on October 3, 2011, a circular, according to which banking corporations heading the banking groups will be required to publish reports for a period of up to two years concerning corporate responsibility, including: ethics in business, corporate governance, commitment to the environment, involvement in the community, etc.

It should be noted that the Bank has already published two Corporate Responsibility Reports.

ENVIRONMENTAL RESPONSIBILITY - FILING DATA TO THE CARBON DISCLOSURE PROJECT (CDP)

In October 2012 the Bank has completed filing its data to the CDP, for the second year running. The CDP is an independent non-for-profit international organization, located in London, which acts towards the reduction in emission of greenhouse gases by corporations, organizations and cities all over the world, through a voluntary reporting and transparency mechanism. The

Organization serves as a source of information for investors, corporations and governments when coming to examine environmental operations of corporations and cities, as well as the future risks to which they might be exposed. The reporting organizations may elect not to reveal to the Organization their full report but only the final grading granted to it, though this lowers the level of transparency presented by the reporting organization.
Among the reporting banks presenting their reports to the public are leading banks around the world, such as: the Royal Bank of Scotland and Bank of America. Discount Bank is the only Bank in Israel that has elected to report to the CDP.

INVOLVEMENT IN AND CONTRIBUTION TO THE COMMUNITY BY THE PRINCIPAL SUBSIDIARIES

Following are descriptions of several prominent projects carried out by the principal subsidiaries:
"Another lesson". ICC takes part in a project of "A Different Lesson" association, which channels the wealth of knowledge found among the public into enriching and enhancing the educational system, by inviting citizens from the business and public sectors, who are professionals in various fields, to come into the schools and give inspiring enrichment courses. Company employees joined this association's voluntary setup within the educational system and invited school children to the Company's offices for an inspirational day to experience the world of finance and credit.
A start-up project in the Arab sector. In 2012, MDB continued the educational project launched in 2008, jointly with "Sprint for the Future" Association, within the framework of which this bank granted this year 72 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 2012.
Participation in an educational project. MDB Bank has been participating also in 2012 in a project conducted by "Yad Eliezer" Association, within the framework of which this bank has granted 160 scholarships to Yeshiva students, at a total cost of NIS 0.2 million, in consideration for their commitment to serve as tutors to children of disadvantaged families in the ultra-orthodox sector.

"THE MARCH OF THE LIVING"

In April 2012, a delegation of Discount Bank employees participated, for the tenth time, in the "March of the Living" from Auschwitz to Birkenau that takes place every year on the memorial day for the Holocaust and Heroism. The delegation numbered 90 of the Bank's staff and ICC'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.

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 Bank's requirements. This offers such persons the opportunity to function as regular citizens who provide for themselves with self respect. In addition, this measure will shape the organizational culture of the Bank, as an organization that is open-minded toward those who are different. In light of the aforesaid, the employment of handicapped personnel has been defined as a primary focal point in the Bank's communal activity.
As of December 31, 2012, 70 handicapped personnel are employed at the Bank. The Bank's management has instructed that the employment of handicapped personnel be expanded during 2013.

"HERZELILINBLUM" - BANKING AND TEL AVIV NOSTALGIA MUSEUM

The Herzelilinblum Museum of Banking and Tel Aviv Nostalgia. The museum provides the possibility of a close study of the history and economics of Israel since the beginning of the last century. The Museum is located in a one hundred and four year old preserved building, one of the first houses of Ahuzat Bait.

Visitors. Since its opening in May 2009, the Museum hosted some 180 thousand visitors of various populations: organized groups, business corporations, young people, servicemen, students and more. In 2012, the Museum hosted some 40 thousand visitors, within the framework of tours, seminars and events of different kinds.

Tours and seminars. During the academic year, some eighty tours per quarter on an average are being conducted for school children of seventh to twelfth grade. Part of the tours, lasts one and a half hours with a focus on economic issues and the other part, designed for the higher grades, comprise seminars of five hours on the subject of the Stock Exchange and the monetary policy of the Bank of Israel.

About three hundred tours for children and their families were conducted during the school vacation: "My money, a seminar for young economists" – economic seminars; "The cup is ours" – tours focused on sports matters.

Conferences and events. The museum hosts conferences and various events initiated by the Bank. In 2012, some 100 events were held for corporations, business forums and organizations, for units of the Bank and their customers.

"Wikipedia likes heritage sites". Entertainment and tours for professional and amateur photographers with a focus on architecture and preservation of the Schiff House, as part of the global project of Wikipedia for photography of locations around the world. This event has produced an impressive series of photographs of the Museum, taken inside and outside the building, which will appear under the item "Herzlilinblum Museum" in Wikipedia.

Changing exhibitions. The Museum presents changing exhibitions, including works from the Bank's art collection. Among the more outstanding exhibitions held in 2012, the following may be mentioned:

- **"Future currency".** Some twenty artists presented their vision as to how money coins will look in twenty years' time.
- **"Compound".** A group photography exhibition of three artists: Yehudit Metzkel, Tali Navon and Adi Brande.

"Records and Goals", 100 Years of Sport. The central exhibition in 2012, that was presented at the Museum for nine months, since the end of February and until the end of November 2012. The exhibition portrayed 100 years of sport in Israel, in a variety of sports branches, such as: ball games, athletics, swimming, women's sports, sports for the handicapped, etc.. The records and achievements of individual sportsmen and women and sports teams, at the Olympics, at the Maccabiyah Games, at Hapoel Sports Conventions and at various other competitions, can be seen interwoven along a time line at the exhibition. A special corner of the exhibition was dedicated to the 11 Israeli athletes and coaches who were murdered at the Munich Olympics, displaying their sporting achievements and personal effects from their estates. About twenty events were held during the exhibition, in which thousands of guests participated, including members of Knesset, the Hon. President of the Israeli Olympic Committee, members of the Israeli Olympic Committee, families of the Munich victims, Olympic record holders, sportsmen from many fields, owners of sport clubs, sport reporters, senior business persons, public figures and many additional guests.

The exhibition enjoyed wide exposure and coverage in the local television networks, the press, the Internet and in the social networks. Furthermore, the commemoration room for the Munich victims enjoyed a wide interest on the part of foreign television and radio networks – particularly in the period prior to the London Olympics.

Cooperation with the Ministry of Education. Since the establishment of the Museum, thousands of students have visited it, pupils from seventh to twelfth grades from all over the country, each age group being allotted a suitable tour plan.

This year, the Museum directed most of its activity in the education field to pupils taking five units in civics, economics and social sciences, within the framework of the following unique study programs:

- The stock exchange, an educated investment;
- Monetary policy in Israel – the Bank of Israel: independence and power;
- Meetings with the social-economic world in Israel: the social-democratic approach as against the neo-liberal approach.

On January 12, 2012, the Minister of Education, Mr. Gideon Sa'ar, visited the Museum and fully approved the said programs. Some twenty-five schools participated this year in the program, which covers a full day of studies.

"MA'ALEH" RATING FOR 2012

In June 2012, "Ma'aleh" published its rating for 2012. A new rating category was added in 2012 – Platinum Plus (awarded to companies with an absolute score of over 90). The Bank has been rated in the Platinum Plus category (the Bank was rated Platinum in previous years). The rating is based on criteria detailed in six central areas of corporate responsibility: environmental protection, business ethics, human rights and work environment, involvement with the community, corporate governance and social environmental reporting. The rating by Ma'aleh covers the largest public and private corporations operating in the market, and allows them to be included in the Ma'aleh rating and in the Ma'aleh Index on the Tel Aviv Stock Exchange.

ARTS

Discount's art collection contains some 1,960 original works and about 4,200 lithographs of the best of Israeli artists, representing a fascinating and varied assortment of making over more than fifty years and includes sculptures, paintings, tapestries, video art and photographs. The Bank's art collection is considered one of the quality collections of Israeli art.

Lending works of art. Cooperation with various museums continued in 2012. Within this framework the Bank lent the following works from its art collection. "Shesh Besh" a work of the artist Zivi Geva, has been loaned to an exhibition of the artist's works named "Seem the Same" held at the Ashdod Museum. A work by the artist Gal Weinstein has been loaned to "Contemporary Israeli Art" Exhibition, held in Paris. A work by the artist Pinchas Cohen Gan was lent to the exhibition "When my redemption comes I shall treasure my tears, works 1970-2012" at the Tel Aviv museum of Art. Three works by the artist Naftali Bezem were lent to the exhibition of the artist "Toing and Froing" opened in December at the Tel-Aviv Museum of Art.

"A Land of Promise" Exhibition. As part of the Art Weekend events opening the Tel Aviv Art Year, twenty-four video art films of Israeli artists were screened continuously at the "A Land of Promise" Exhibition. The Exhibition chose to screen three video art presentations belonging to the art collection of Discount Bank, produced by the artists: Sigalit Landau, Gal Weinstien and Tali Navon.

"Future currency". At the closing of the exhibition held at the Herzelilinblum Museum, in which some twenty artists presented their vision as to how would money coins look in twenty years time, the bank has acquired the works from the designers and they are being permanently exhibited at the Discount Tower.

The bathroom project of Yehezkel Streichman. The Streichman family donated to the Bank’s art collection the 350 bathroom tiles produced by Yehezkel Striechman in the early seventies. The dismantling, cleaning and conservation work of the ceramic tiles and their new presentation on tablets has been effected by professional reconstructors on behalf of the Bank. The Ashdod Art Museum opened in March 2012 an exhibition of bathroom tiles created by the Artist out of the Bank's art collection. Following the closing of the exhibition held at the Ashdod Museum, the tiles are now on a permanent exhibition at the Tel Aviv main Branch of the Bank.

"My Haifa" photographs exhibition at the Haifa region management office. In a convention "Haifa Active and Healthy" organized by the Haifa Region Management in cooperation with the Haifa Municipality and in the presence of the Haifa Mayor Mr. Yona Yahav, an exhibition of photographs from the Bank's collection was presented. The photographs document the beauty and uniqueness of Haifa.

Israeli Art Catalogue. The catalogue that was published in German and in French which tells the story of Israeli art in the years 1906-2012. The catalogue includes, among other things, photographs of works of art from the Bank's collection. The catalogue is intended for art collectors in Germany and France.

Guided public tours. Guided tours of the Bank's art collection, open to the public, are conducted on Friday mornings at the

Discount Tower. Some 60 tours were made during 2012, in which some 2,500 visitors have participated.

The Discount Museum website. 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 Bank's contribution to cultural and community life in Israel.

The address of the site is: http://www.discountbank.co.il/museum.

SPONSORSHIPS

During 2012, the Bank granted sponsorship to entities and activities promoting goals in areas of community, activities in aid of weak populations, health, sporting, cultural, artistic and educational, environmental protection, science, energy and business.

AUDITORS' REMUNERATION[(1)(2)]

Below are particulars of the remuneration that was paid to the auditors (in NIS thousand):

	Consolidated		The Bank	
	For the year ended December 31,			
	2012	2011	2012	2011
For Auditing[(3)]:				
To the joint auditors	19,682	19,812	7,934	8,733
For Other Services:				
Audit related services[(4)]:				
To the joint auditors	3,239	4,365	3,223	4,245
Taxation Services[(5)]:				
To the joint auditors	3,907	3,432	1,815	1,997
Other Services:				
To the joint auditors	3,151	1,975	2,190	1,424
To other auditors	111	-	-	-
Total	**10,408**	**9,772**	**7,228**	**7,666**
Total Auditors' Remuneration	**30,090**	**29,584**	**15,162**	**16,399**

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. 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

Year 2012											
Details of the recipient				Remuneration* for services							
Name	Position	Extent of position	Rate of holdings in corporation's capital	Salary	Awards	Employer's payments and provisions(1)	Benefits and grossing-up(2)	Total salary, awards, employer's provisions and benefits	Share based payment(3)	Total	Loans granted under regular terms
				in NIS thousands							
Dr. Yossi Bachar	Chairman of the Board	100%	(4)-	1,918	(5)-	674	154	2,746	370	3,116	-
Reuven Spiegel	President and CEO of the Bank	100%	-	2,101	(5)-	753	93	2,947	986	3,933	-
Jacob Tennenbaum(6)	President and CEO of Mercantile Discount Bank	100%	-	1,593	418	1,721	158	3,890	-	3,890	71
Ehud Arnon	President and CEO of IDB New York	100%	-	2,305	1,344	148	-	3,797	-	3,797	-
Lissa Baum	Executive Vice President and Chief Lending Officer of IDB New York	100%	-	1,912	390	148	-	2,450	-	2,450	-
Maoz Franko	President and CEO of Israel Discount Capital Market & Investments	100%	-	884	1,190	169	-	2,243	-	2,243	-
Yoval Gavish	Senior Executive Vice President, Head of Banking Division	100%	-	1,072	(7)-	273	102	1,447	-	1,447	-
Shlomo Avidan	Executive Vice President, Head of Operations and Logisitics Division	100%	-	1,063	(7)-	271	107	1,441	-	1,441	5
Yair Avidan	Executive Vice President, Chief Risk Manager and Head of Risk Management groupe	100%	-	1,053	(7)-	301	82	1,436	-	1,436	-
Yigal Ronay	Executive Vice President, Head of the Finance Division	100%	-	978	(7)-	319	104	1,401	-	1,401	-

* The amounts of the remuneration are in cost terms to the Bank and do not include payroll tax.

(1) Includes adaptation award, severance pay, retirement award, provident pay, further education fund, vacation pay, National Insurance contributions, loss of work ability insurance and adjustment of provisions following changes in salary.

(2) Includes value of use of vehicle and of mobile phone, various benefits and their grossing up.

(3) In respect of splitting over future periods the benefits relating to "Phantom" option plans. At each reporting date the benefit is adjusted to fair value.

(4) Mr. Bachar owns shares in the Bank in a negligible par value amount of NIS 29,640.

(5) Waivered an award in respect of 2012 – see Note 22 G.

(6) Mr. Tennenbaum retired from office on August 28, 2012. His retirement will become effective on March 31, 2013.

(7) Waivered an award in respect of 2012 – see Note 16 J 8.

Year 2011											
Details of the recipient				Remuneration* for services							
Name	Position	Extent of position	Rate of holdings in 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							
Dr. Yossi Bachar(4)	Chairman of the Board	100%	(5)-	1,884	1,629	836	40	4,389	(4,315)	74	-
Reuven Spiegel(6)	President and CEO of the Bank	100%	-	2,238	1,889	2,032	317	6,476	1,277	7,753	-
Ehud Arnon	President and CEO of IDB New York	100%	-	2,108	1,376	177	36	3,697	-	3,697	-
Isreal David	President and CEO of ICC	100%	-	1,319	1,538	443	97	3,397	-	3,397	20
Ram Harmelech (7)	Deputy General Manager, Head of Corporate Division of Mercantile Discount Bank	100%	-	1,360	447	1,022	106	2,935	-	2,935	-
Ilyse Baum	Executive Vice President and Chief Lending Officer of IDB New York	100%	-	1,785	463	435	-	2,683	-	2,683	-
Yoval Gavish	Senior Executive Vice President, Head of Banking Division	100%	-	1,030	601	829	81	2,541	-	2,541	-
Noam Hanegbi(8)	Senior Executive Vice President, Head of Strategy, Marketing and Service Division	100%	-	1,127	-	1,163	111	2,401	-	2,401	-
Orit Alster	Vice President, Head of Corportae Banking Division	100%	-	919	552	806	81	2,358	-	2,358	-
Yair Avidan	Executive Vice President, Chief Risk Manager and Head of Risk Management groupe	100%	-	1,061	600	511	1	2,173	-	2,173	134

* The amounts of the remuneration are in cost terms to the Bank and do not include payroll tax.

(1) Includes adaptation award, severance pay, retirement award, provident pay, further education fund, vacation pay, National Insurance contributions, loss of work ability insurance and adjustment of provisions following changes in salary.

(2) Includes value of use of vehicle and of mobile phone, various benefits and their grossing up.

(3) In respect of splitting over future periods the benefits relating to "Phantom" option plans. At each reporting date the benefit is adjusted to fair value.

(4) The remuneration, employment terms and "Phantom" options were approved by Special General meetings of the shareholders held on November 10, 2010 and January 25, 2011. The annual award in respect of 2011 was approved by the Audit Committee on March 21 , 2012 and by the General meeting of the shareholders held on June 12, 2012.

(5) Mr. Bachar owns shares in the Bank in a negligible par value amount of NIS 29,640.

(6) Mr. Spiegel assumed office as President & CEO on January 1, 2011. The amounts presented in the Table also include payments in respect of his office as President & CEO of IDB New York. The amount of benefits and grossing-up includes payments in respect of rent amounting to NIS 164 thousand and amounts of payments and employer provisions including a provision in respect of adaptation award.

(7) On January 29, 2012, Mr. Harmelech gave notice of termination of his employment with Mercantile Discount Bank. His retirement became effective on April 30, 2012.

(8) Mr. Hanegbi retired from office on September 30, 2011. On April 27, 2012, employer/employee relations have been terminated.

Dr. Yossi Bachar - serves as Chairman of the Board of Directors since January 3, 2010. For details regarding the terms of engagement of Dr. Bachar, see Note 22 F and G to the financial statements. For details regarding the phantom option plan granted to Dr. Bachar, see Note 13 D 1 to the financial statements.

Mr. Reuven Spiegel, on January 1, 2011, Mr. Spiegel assumed office as the Bank's President & CEO. For details regarding the terms of engagement of Mr. Spiegel, see Note 22 F and G to the financial statements. For details regarding the phantom option plan granted to Mr. Spiegel, see Note 13 D 1 to the financial statements. Mr. Spiegel served as President & CEO of IDB New York until February 28, 2011.

Mr. Jacob Tennenbaum. The President & CEO of the subsidiary Mercantile Discount Bank (hereinafter: "MDB") is employed by MDB under a personal employment agreement. The period of employment is for an indeterminate period. It should be noted in this context that, on August 28, 2012, Mr. Tennenbaum gave notice of his decision to terminate his duties with MDB. His retirement will take effect on March 31, 2013.

Mr. Tennenbaum's salary was linked to the CPI. Mr. Tennebaum was 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.

According to the employment agreement, Mr. Tennenbaum was entitled upon his retirement to severance pay and a special award, equal to six months' salary, and was prohibited from engaging in a business that would constitute as competition to MDB, for a period of three months from the date of his retirement.

Following the announcement of his retirement, it was decided to add additional retirement arrangements to the employment agreement, including: payment of an additional award in the amount of NIS 1.8 million, which is to be paid to Mr. Tennenbaum upon his retirement, in consideration for his consenting to extend the "Non-competition" period from three months to a year, commencing from April 1, 2013. In addition, upon his retirement Mr. Tennenbaum will be entitled to "pensioner" terms (as defined in MDB's labor agreement) and to redeem his accumulated unutilized vacation days.

In view of his considerable talents and experience in the retail banking sector, MDB has decided to engage with Mr. Tennenbaum for the provision of consulting services in an annual amount of NIS 600 thousand. The agreement will be for a term of one year (which may be extended for a further year, at MDB's discretion).

Despite having given notice on July 22, 2012 of his decision to waive the compensation to which he was entitled with respect to 2012 (by virtue of MDB's senior management compensation plan), Mr. Tennenbaum will be entitled to receive the compensation with respect to 2012 should it ultimately be decided to pay the compensation to the other members of MDB's management.

Mr. Ehud Arnon, President & CEO of IDB New York, is employed by the subsidiary under a personal agreement. The period of employment is until December 31, 2013, 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 four months. In the event that the subsidiary elects to terminate Mr. Arnon's employment prior to December 2013, the subsidiary will have to pay his salary until that date. In any event, upon termination of his employment, Mr. Arnon is entitled to a payment equal to one year salary. Mr. Arnon's monthly salary is reviewed by IDB New York every year. Mr. Arnon is entitled to social benefits (National Insurance contributions and pension within the framework of the pension plans in effect at the subsidiary), as well as to life assurance, medical care and loss of work ability insurance. Mr. Arnon is entitled to an annual award on condition that IDB New York reaches 75% of the forecasted annual earnings in accordance with the annual work plan. IDB New York provides Mr. Arnon with an appropriate motor vehicle and is also entitled to an annual home leave in Israel.

Ms. Ilyse Baum, Executive Vice President and Chief Lending Officer of IDB New York, is employed by the subsidiary as an "employee at will." Ms. Baum's salary is reviewed and approved annually by IDB New York's Compensation Committee of the Board of Directors. Ms. Baum enjoys the customary benefits granted to all members of IDB New York's Senior Management. Ms. Baum participates in IDB New York's Pension Plan, 401(k) Plan, and Deferred Compensation Plan. Under the terms of IDB New York's Severance Plan, Ms. Baum is entitled to a severance payment equal to one year's salary if terminated.

Mr Maoz Franko, the CEO of the subsidiary Discount Israel Capital Markets Ltd. (DCM), is employed under a personal employment agreement for an indeterminate period, which either of the parties could terminate giving a prior notice of three months, which may be extended for an additional period of three months in consideration for an increased salary (150%). The period of prohibition of competition determined in the agreement is twelve months following the termination of his office at DCM, and the period for maintaining confidentiality is unlimited in time, unless otherwise agreed by the parties. Mr. Franco's salary is linked to the CPI, but in case of a decrease in the CPI, the salary will remain unchanged until a rise in the CPI offsets the decrease. Mr. Franco is entitled to vacation pay, sick pay, convalescence pay, an appropriate motor vehicle, social benefits (severance pay, provident fund, further education fund and loss of work ability contributions) as well as other benefits. Upon termination of office, Mr. Franco is entitled to the amounts accumulated in the severance pay and provident funds and also to an adaptation award equal to gross six monthly salaries. (In case of resignation, the said adaptation award will be paid only if the year of resignation is after the end of 2013). Mr. Franco is also entitled to a calculated annual award and to a long-term award according to a scheme approved for the years 2011-2014. Payment of the calculated annual award in respect of a certain year is subject to complying with minimum terms and to attaining a determined target, calculated according to a formula based on the annual yield, as defined in the scheme. The calculated annual award is limited to an amount equal to twelve monthly salaries. In addition, DCM's Board of Directors shall determine, at its exclusive discretion, and on the basis of performance of Mr. Franco in other areas (excluding the return on capital), an additional award equal to two additional salaries, so that the total annual award shall not exceed fourteen monthly salaries. The annual award will be paid in three portions: 60% in the current year, 20% deferred for one year and 20% deferred for two years. Entitlement to the deferred portions is subject to attaining the minimum cumulative average target until the specific target year. In addition to the calculated annual award, Mr. Franco is entitled to a long-term award, which will be calculated depends on attaining cumulative net earning targets of DCM over the period of the scheme, in accordance with the provisions of the scheme. The scheme states that the total awards payable by DCM (not including awards payable by the underwriting company) in respect of any year shall not exceed 10% of the annual earnings according to DCM's financial statements, including the calculation of the awards.

Mr. Yuval Gavish, employed by the Bank as Senior Executive Vice President, Head of the Banking Division. Mr. Gavish 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. Gavish 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. Gavish 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. Gavish is entitled to severance payment in accordance with the law and also to a retirement award in an amount equal to six monthly salaries in the first two years, in the event that the termination of employment was initiated by the Bank, and to an amount equal to four monthly salaries in the period following the first two years, or in the event that the termination of employment was initiated by the member of Management.

Mr. Shlomo Avidan, employed by the Bank as Executive Vice President, Head of the Operations and Logistics Division Mr. Avidan 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. Mr. Avidan is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed. 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. Avidan is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits as well as to a retirement award in an amount equal to 12 to 4 monthly salaries, decreasing in accordance with the length of service in office. Mr. Avidan is entitled to participate in the remuneration plan to members of the Bank's management, as detailed in Note 16 J to the financial statements.

Mr. Yair Avidan, employed by the Bank as Executive Vice President, Chief Risk Officer and head of Risk Management Group. Mr. Avidan 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. Avidan 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. Avidan 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. Avidan is entitled to severance payment in accordance with the law as well as to a retirement award in an amount equal to 12 to 3 monthly salaries, decreasing in accordance with the length of service in office. Mr. Avidan is entitled to participate in the remuneration plan to members of the Bank's management, as detailed in Note 16 J to the financial statements.

Mr. Igal Ronay, employed by the Bank as Executive Vice President, Head of the Finance Division. Mr. Ronay 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. Ronay 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. Ronay 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. Ronay is entitled to severance payment in accordance with the law and also to a retirement award in an amount equal to six monthly salaries in the first two years, in the event that the termination of employment was initiated by the Bank, and to an amount equal to four monthly salaries in the period following the first two years, or in the event that the termination of employment was initiated by the member of Management. Mr. Ronay is entitled to participate in the remuneration plan to members of the Bank's management, as detailed in Note 16 J to the financial statements.

Mr. Israel David, who served as President & CEO of Israel Credit Cards ("ICC") from April 1, 2010 until January 17, 2013, was employed by ICC under a personal employment agreement. Mr. David was entitled to vacation pay, paid sick leave, recreation pay, an appropriate car, social benefits (severance pay under the law, provident contributions, loss of work ability insurance and further education fund contributions) as well as additional benefits. Upon termination of office, Mr. David was entitled according to the agreement to severance pay under the law. In addition, if ICC decided to terminate his employment, Mr. David was entitled to adaptation award equal to six months pay, with the addition of 23.33% in lieu of social benefits contributions, if his employment is terminated after the end of two years since beginning of his employment, and before the end of four years since the beginning of his employment. The non-competition period is three months since the termination of employment, unless otherwise agreed by the parties. Mr. Israel David was also entitled to an award within the framework of the 2011-2013 remuneration plan, that is conditional, among other things, upon the fulfillment of threshold conditions determined in the plan.

In accordance with an agreement dated January 28, 2013, Mr. David has been granted a one-off award in the amount of NIS 2,771 thousand, which takes into consideration any right to remuneration and/or related benefits, direct or indirect, payments and/or rights and/or awards of any kind, to which he was entitled from whatever source, including the redemption of a prior notice and an adaptation award. The amount included in the Table above is net after deduction of amounts provided in the past.

Mr. David is among management members entitled to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 D (2) to the financial statements. The entitlement of Mr. David to the option warrants was not impaired by his termination of office at the Bank, as according to the terms of the plan, changing into an employee of a subsidiary of the Bank in Israel, he was considered for the purpose of the plan, as if his employment by the Bank had not been terminated. The options expired on December 31, 2012.

Mr. Ram Harmelech, acted as Deputy CEO and as Head of the Corporate Division at Mercantile Discount Bank, until April 30, 2013. Mr. Harmelech was employed by Mercantile Discount Bank under a personal employment agreement.

According to the employment agreement, Mr. Harmelech was entitled upon termination of his work to severance pay and to a special award amounting to twelve monthly salaries, while following the termination of his work he may not engage for a period of three months in any occupation that might constitute a competition to Mercantile Discount Bank. In view of the extensive contribution made by Mr. Harmelech to the development of the corporate division and of Mercantile Discount Bank, the board of directors of Mercantile Discount Bank decided on January 29, 2012, to grant to Mr. Harmelech, upon termination of his work, an additional award amounting to six months salary.

According to the employment agreement, the remuneration of Mr. Harmelech was linked to the CPI. In addition, the agreement entitled Mr. Harmelech to vacation pay, paid sick leave, recreation pay, company car, and social benefits (including severance pay, provident contributions, loss of work ability insurance and further education contributions) as well as other benefits.

Mr. Noam Hanegbi, was employed by the Bank as Senior Executive Vice President, Head of the Strategy, Marketing and Service Division until September 30, 2011 (termination of employer/employee relations in April 27, 2012). Up to January 11, 2011, Mr. Hanegbi served as Head of the Retail Banking Division; up to April 26, 2010, as Head of the Operations and Information Systems Division. Mr. Hanegbi was employed under a personal employment agreement for an indeterminate period, which either of the parties were able 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 was linked to the CPI. Mr. Hanegbi was 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 was entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. Hanegbi was among management members entitled to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 D (2) to the financial statements. The options expired on October 24, 2012.

Ms. Orit Alster, employed by the Bank as Executive Vice President, head of Corporate Banking Division. Ms. Alster 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, Ms. Alster is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. Her salary is linked to the CPI, and in the event of the CPI falling, her salary will not change until such time that the rise in the CPI offsets the rate of the fall. Ms. Alster 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, Ms. Alster is entitled to severance payment in accordance with the law and also to a retirement award in an amount equal to six monthly salaries in the first two years, in the event that the termination of employment was initiated by the Bank, and to an amount equal to four monthly salaries in the period following the first two years, or in the event that the termination of employment was initiated by the member of Management. Ms. Alster is entitled to participate in the remuneration plan to members of the Bank's management, as detailed in Note 6 J to the financial statements.

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".

According to the Amendment of the Securities Regulations (Periodic and Immediate Reports), 1970, (hereinafter: "the Amendment"), from 2008, the 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.

In its reply to the Union of Banks, dated August 6, 2008, regarding the fact that the financial statements regulations do not apply to banks, 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 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) The Bank is required to disclose the highest balance during the period of deposits made by controlling shareholders;

(c) 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 of 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 their next of kin living with them 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 annual 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 allowance for impaired debts or the writing off of an amount in respect of the indebtedness of a controlling shareholder or of a corporation related to them 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 their 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 Bank's most recent annual financial statements.
(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 transactions 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 Bank's most recent annual financial statements.

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 compared 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 the Bank's customers 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.
For details regarding transactions with the controlling shareholders or in which the controlling shareholders have an interest, see Note 22 I, J and I and Note 19 C 8 L and M to the financial statements. Also see "Repayment of the State's debt in respect of the award to employees" under "Control of the Bank" above.

Hereunder are summarized data regarding banking transactions considered transactions with controlling shareholders.

December 31, 2012										
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 (1)	
	Balance at end of year	Highest balance during the year	Balance at end of year	Highest balance during the year	Balance at end of year	Highest balance during the year	Balance at end of year	Highest balance during the year	Balance at end of year	Highest balance during the year
	in NIS millions									
The Bronfman group	26	59	2	3	-	-	1	4	-	-
Reporting corporations related to the Bronfman group:										
Isralom properties Ltd	-	-	1	1	-	-	-	-	-	-
Shufersal Ltd	-	1	12	20	19	19	-	-	-	-
Total of reporting corporations	-	1	13	21	19	19	-	-	-	-
Total for the Bronfman group	26	60	15	24	19	19	1	4	-	-
Schron group	6	6	6	6	-	-	-	-	-	-

Deposits	Balance of deposits	
	Balance at end of year	Highest balance during the year
Controlling shareholders, including reporting corporations related to the controlling shareholders	93	160

(1) There was not par value of the said transaction as of December 31,2012, the highest balance during the period amounting to NIS 1 million.

	December 31, 2011									
Credit	Balance of credit		Balance of utilized 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 [(1)]	
	Balance at end of year	A high balance during the year	Balance at end of year	A high balance during the year	Balance at end of year	A high balance during the year	Balance at end of year	A high balance during the year	Balance at end of year	A high balance during the year
	in NIS millions									
The Bronfman group										
Reporting corporations related to the Bronfman group:	8	23	3	12	-	-	6	9		-
Isralom properties Ltd	-	-	-	-	-	-	-	-		-
Shufersal Ltd	-	3	44	44	41	41	-	-		4.1
Total of reporting corporations	-	3	44	44	41	41	-	-		4.1
Total for the Bronfman group	8	26	47	56	41	41	6	9		4.1
Schron group	11	12	-	-	3	3	-	-		-

Deposits	Balance of deposits	
	Balance at end of year	A high balance during the year
Controlling shareholders, including reporting corporations related to the controlling shareholders	10	28

(1) There was not par value of the said transaction as of December 31,2011, the highest balance during the period amounting to NIS 41 million.

TRANSACTIONS WITH CONTROLLING SHAREHOLDERS AND INTERESTED PARTIES

Approving transactions. On March 21, 2012, a special meeting of shareholders of the Bank approved the renewal of the Officers liability insurance, as detailed in the Immediate Report dated March 22, 2012 (Ref. No. 2012-01-075783).

Annual award to the Chairman of the Board (2011). On June 12, 2012, the annual general meeting of shareholders approved the payment of an annual award to the Chairman of the Board in respect of the year 2011, in the amount of NIS 1.6 million, in accordance with the remuneration plan approved by the Bank's General Meeting, as detailed in the Immediate Report dated May 7, 2012 (Ref. No. 2012-01-118704) and June 12, 2012 (Ref. No. 2012-01-154386).

Waiver of the award in respect of 2012. For details regarding the waiver by officers of the Group (including the Chairman of the Board and the President & CEO) of the award in respect of 2012, see "Human Resources" above.

Amendment of the Bank's Articles. On March 21, 2012, a special meeting of shareholders of the Bank approved the amendment of the Bank's Articles regarding items dealing with "exemption, indemnification and insurance", as detailed in the Immediate Report dated March 22, 2012 (Ref. No. 2012-01-075783).

The data detailed in the all the abovementioned reports is presented here by way of reference.

CONTROLS AND PROCEDURES

Disclosure controls and procedures. In the spirit of Section 302 of the Sarbanes-Oxley Act of 2002 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.

In order to establish these declarations, the Bank, engaging outside assistance, has examined the principal processes of production and delivery of information related to the financial statements by the Bank's various units, 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.

Proper Banking Management Directive No. 309. On September 28, 2008, the Bank of Israel issued Proper Banking Management Directive No. 309, in the spirit of Section 404 of the Sarbanes-Oxley Act of 2002, 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.

During 2012, the Bank conducted a process of validation and updating of existing processes and addition of new processes and effectiveness examinations to the internal control layout over financial reporting, by means of the SOX unit established within the Accounting Group.

Based on the findings of the said examination of the effectiveness of internal control, the Bank's Management together with the President & CEO and the Bank's Chief Accountant have assessed the effectiveness of controls in the reported period over the Bank's financial reporting. On the basis of this assessment, the Bank's President & CEO and the Chief Accountant arrived to 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 directives of the Supervisor of Banks and on the date prescribed by these directives.

CHANGES IN INTERNAL CONTROL

During the fourth quarter ended on December 31, 2012, no change has occurred in the Bank's internal control over financial reporting, which materially affected, or is reasonably expected to materially affect, the Bank's internal control over financial reporting, except for the changes made as a result of the merger with DMB, as detailed below.

Changes in internal control following the merger with DMB. As stated, the merger of DMB with and into the Bank was completed on June 28, 2012. The operational merger, including the transfer to the systems of the Bank, is being made in stages and will be completed in the first half of 2013.

Work processes and procedures, including relevant controls, have been updated, where required, in respect of operations the transfer and absorption of which was completed in the third quarter of 2012. As regards operations, the transfer of which, as stated, has not yet been completed, work teams of former DMB employees continued to perform the relevant controls in accordance with work processes and procedures that had been in practice at DMB.

During the said process of transfer and absorption, the Bank has adopted control measures intended to ensure the proper transfer of data.

MISCELLANEOUS

ENVIRONMENTAL QUALITY

The Bank is a financial corporation providing various financial services to its customers, and as such, the direct environmental influences on its existing "production processes" are very limited, if any at all. This differs, for example, from industrial plants that could deal with the problems of gas emissions, sewage, toxic waste removal, etc.
Most of the Bank's environmental effects are indirect effects stemming from the use of "administrative" resources, such as: energy, water, paper and such like. These indirect environmental effects do not expose the Bank to environmental risks (within the meaning of the term in the Securities Regulations), which have or might have a material effect upon the Bank.
One of the Bank's targets as regards the environment is to reduce the indirect effect, as stated.
Details regarding the actions taken by the Bank to reduce the said indirect effect, as stated (including: reduced use of paper, recycling of paper and plastic bottles, reducing the use of water, energy and more) are reported in the social responsibility reports issued by the Bank from time to time.
For details regarding environmental risks within their meaning in Directives of the Supervisor of Banks, see the Chapter on "Exposure to risks and risk management" above.

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[5]

Dr. Yossi 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 Computer Committee, Credit Committee, Manpower committee, Coordination Committee, and a member of the Strategy Committee.
Has accounting and financial expertise as well as professional qualifications.
Dr. Bachar is an Israeli Certified Public Accountant and has an academic education - Ph.D. in Business Administration (specializing in finance) from University of California, Berkley, Master of Business Administration (specializing in finance), University of California, Berkley and Bachelor of Economics and Accounting, Hebrew University, Jerusalem.
Serves as Chairman of the Board of Directors of the Bank and of Israel Credit Cards Ltd. (since March 2012). Also serves as CEO and Chairman of the Board of Amiad Av. Ltd. (since July 2007) and Chairman of the Board of Bachar Yossi Certified Public Accountants (since June 2002).
Served as Chairman of the Board of Directors of Mercantile Discount Bank Ltd. ("MDB") (as Director since January 2010 and as Chairman January 2010 – February 2012), as Director and Deputy Chairman of the Board of Israel Discount Bank of New York

[5]Notes:
- The details given in this Chapter, constitute also a report regarding the Directors who are considered by the Bank as having accounting and financial expertise for the purpose of compliance with the minimum number determined by the Board of Directors, as described in the item "Report on Directors having accounting and financial expertise", and the factual background in respect of which the Bank considers them as having accounting and financial expertise.
- A director having professional qualifications is one who fulfills one of the conditions stated in Regulation No. 2 to the Companies Regulations (Terms and tests for directors having accounting and financial expertise and directors having professional qualifications), 2005.

(since January, 2010 – December 2012) and as Director of Discount Bancorp Inc. (since January, 2010– December 2012), 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 Strategic Advisory Committee of Klirmark Capital Ltd. (April 2009 - November 2009), non-executive Chairman of the Board of Stonehage (Israel) Financial Services Ltd. (October 2007 - December 2009) and as Chairman of the Executive Board of the Haifa University (October 2007 - January 2011) and as partner and manager of Luboshitz Kasierer Accounting Firm (formerly Arthur Andersen and later Ernst and Young) (April 1995 - November 2003).

Ilan Biran - Serves as External director of the Bank since October 29, 2008, appointed for an additional period of office since October 29, 2011. Mr. Biran serves as the chairman of the remuneration committee, a member of the Audit Committee, Credit Committee, Computer Committee, the Risk Management Committee and the Coordination committee.

Acts as an External 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., Controp Precision Technologies Ltd. (from January 2012), Sync-RX Ltd. (since January 2011, director since November 2010) and Centrition Ltd.(since July 2003) and as Chairman of the Management Committee, Kinneret College on the Sea of Galilee (R.A.).

Served as Chairman of the Board of Beit Shemesh Engines Holdings (1997) Ltd. (2006-2007), 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 of Massad Bank Ltd. (2005-2007), as Director and member of the Audit Committee and the Finance Committee of Netafim Ltd. (2004-2007), and as Venture Partner Consultant, The Challenge Fund - Etgar L.P. (until December 2009).

He also served as Director General of the Ministry of Defense (1996-1999), of BEZEQ the Israeli Communication Company Ltd. (1999-2003) and as Chairman of the Board of DBS Satellite Services (1998) Ltd. (2004-2006).

Eli Eliezer Gonen - Acts as Director of the Bank since November 10, 2010. Mr. Gonen is a member of the Manpower committee, the Corporate Governance Committee and the Strategy Committee.

Has accounting and financial expertise as well as professional qualifications.

Mr. Gonen has an academic education - Master of Business Administration from the Hebrew University, Jerusalem, Bachelor of Economics and complementary studies from the Hebrew University, Jerusalem and has completed one year of advanced studies at the University of California, Berkeley, U.S.A.

Serves as Chairman of the Board of Go Alpha Ltd. a company owned by him (since April 2009) and Co-Op Israel – Supermarket Chain Ltd. (as from September 2012); partner, director and joint general manager of Terra Holdings, Management and Investments in Hotels Ltd. (since September 2009), director of Kenes International Organization of Congresses Ltd. (since July 2010) and in the Jerusalem International Convention Center - Binyaney Haooma Ltd. (since 1998).

Served as Chairman of the Board of Ma'ale Hachamisha Hotel (February 2011 – September 2012), and of the Ghetto Fighters House - Itzhak Katzenelson Holocaust and Jewish Resistance Heritage Museum (July 2008-January 2013), as President of the Israel Hotel Association (2000 - December 2010) as Director of Tambour Ltd. (2002 - 2007), as Director of Crystal Machinery and Electrical Appliances Ltd. (2004 - 2006) and in the Hapoel Jerusalem – Management Company Ltd. (up to September 2012), and as General Manager of the Sheraton-Moriah Hotel Chain in Israel (1999-2009).

In addition, served as Director of Yahav Bank for State Employees Ltd. (1989-1992), of Massad Bank Ltd. (1987-1989), of Granite Hacarmel Investments Ltd. (during the eighties); served as General Manager of the Sheraton-Moriah Hotel Chain in Israel (1999-2009), of Koor Tourism Ltd. (1998-1999), of Histour Altiv (1996-1997) and of the Ministry of Tourism (1992-1996); held various executive positions at the Hebrew University, Jerusalem, the last of which was Director General of the University (1975-1992).

Ilan Cohen - Acts as Director of the Bank since November 10, 2010. Mr. Cohen acts as Chairman of the Strategy Committee, the Computer Committee and the Coordination Committee.

Acts as an external director in accordance with Directive No. 301 of Proper Banking Management Directives and has accounting and financial expertise as well as professional qualification.

Mr. Cohen has an academic education - Master of business administration (summa cum laude) from INSEAD, Fontainebleau France and Bachelor of economics and management (summa cum laude) from Tel Aviv University.

Serves as Chairman of the Board of Insuline Medical Ltd. and of Mikveh Israel Alliance Israelite, and as Director of Edmond de Rothschild Investment Services Ltd. ("Edris") (as from June 2012), as Director of Hadaka Hatishim Ltd., of P.O.C. Investment Company (1999) Ltd., of Masa: The Project for the Encouragement of long term Programs in Israel for Jewish Young Adults Ltd. and of P.O.C. Capital Investments Ltd. (since August 1994).

President & CEO of Ilan Cohen Investment and Entrepreneurships Ltd. and of Yield-Investment Advisors Ltd. and a member of the Executive Board (voluntary) of the Lin and Ted Arison Israel Conservatory of Music in Tel Aviv (since October 2011).

Served as Director and Deputy Chairman of the Board of Edmond de Rothschild Private Equity Management Ltd. (September 2009 to March 2012) and as Director of the Alliance Israelite Association (2007 – November 2009) and as Director General of the Prime Minister's Office (2004-2006).

David Levinson – Acts as Director of the Bank since March 21, 2012. Mr. Levinson is a member of the Credit Committee and the Risk management committee.

Acts as an external director in accordance with Directive No.301 of Proper Banking Management Directives and has accounting and financial expertise as well as professional qualification.

Mr. Levinson has an academic education – Master of business administration from the Tel Aviv University and Bachelor of economics and statistics from the Hebrew University, Jerusalem.

Acts as external director in Gav-Yam Ltd. (since 2006).

Served as Director of Otzar Hachayal Bank Ltd. (2006-March 2012), as external director of Direct Investments House (Mutual Trust Funds) (2006-2010), and in Excellence-Nessuah Brokerage Services Ltd. (2010 to February 2013), and as financial and business consultant to corporations and Private Equity funds (2006-August 2011) and as consultant to the "Hamashbir Latzarchan" Group (2006-October 2011).

Acted as General Manager of FIBI Bank (UK) plc. (2002-2006), of Maritime Bank of Israel Ltd. (1996-2002) and of Granit Hacarmel Holdings Ltd. (1994-1996).

Has fulfilled different roles at Bank Hapoalim and/or on its behalf (1974-1994), including Senior Assistant to the CEO in charge of the overseas operations of Bank Hapoalim, CEO of Israel Continental Bank, in charge of all credit departments at Head Office, manager of the Head Office foreign currency department and manager of the London City Branch.

Served as a banker at the Corporate Finance department of Japhet Charterhouse (a London investment bank) (1972-1974) and as an economist at the Industrialization of Development Areas Company (1970-1972).

Edith Lusky - Serves as External director of the Bank since March 25, 2009, appointed for an additional period of office as from March 25, 2012. Ms. Lusky acts as Chairperson of the Audit Committee and as member of the manpower committee, the Remuneration Committee, the Risk Management Committee, the Corporate Governance Committee and the Coordination Committee.

Acts as an External director in accordance with the Companies Law, 1999. Has financial and accounting expertise and professional qualifications.

Ms. Lusky has an academic education - Master of Economics and Bachelor of Economics and Statistics from Tel Aviv University.

Acts as director of Cellcom Israel Ltd. (as from March, 2011).

Served as senior executive vice president and member of management of Union Bank of Israel Ltd. (February 2004 - December 2008) which areas of responsibility were: Head of the retail, customer assets and advisory services department, Head of the retails banking and risk management department and in addition in charge of marketing, advertising and mortgages and as a Director of Netvision Ltd. (July 2011-December 2011) and in 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 Livluv Insurance Agency (1993) Ltd. (February 2004 - December 2008).

Served as President & CEO of Mishcan Bank, a subsidiary of Bank Hapoalim Ltd. (2001-2004) and as 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.

Jorge Zafran - Serves as Director of the Bank since January 31, 2006. Mr. Zafran acts as Chairman of the Corporate Governance Committee, a member of the Audit Committee, the Risk Management Committee and the Coordination committee.

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.

Ilan (Eilon) Aish - Serves as Director of the Bank since November 1, 2008. Mr. Aish Acts as Chairman of the Risk management Committee, as member of the Audit Committee, the Credit committee, Manpower committee, the Corporate Governance Committee, the Strategy Committee and the Coordination Committee.

Serves as an External director according to Directive No. 301 of the Proper Banking Management Directives and has accounting and financial expertise as well as professional qualifications.

Mr. Aish is a Certified Public Accountant and has academic education - Bachelor of Economics and Accounting from Tel Aviv University.

Serves as Joint Director and CEO Harvest Capital Markets Ltd.

Served as a Director of Harisha Tuff Lanka Private (Limited) (April 2007 - December 2009), Chairman of the Board of Tuff Merom Golan (2000) Ltd. (April 2002 - December 2008), Chairman General Partner of Tuff L.P. (April 2002 - December 2008), as External director and Chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd. (December 2003 - September 2007) and as External director and Chairman of the Risk Management Committee of MDB (November 2000 - October 2006).

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).

Joseph Ciechanover-Itzhar - Serves as Director of the Bank since June 3, 2009. Mr. Ciechanover-Itzhar acts as member of the Manpower committee, of the Risk Management Committee and the Strategy Committee.

Has financial and accounting expertise as well as professional qualifications.

Mr. Ciechanover-Itzhar has an academic education - Ph.D. in Philosophy and Jewish Studies, Boston University; studies at the Jewish Theological Seminary, Boston University; has an LL.M. from the Faculty of Law, University of California, Berkley; 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.

Serves as Director of the Azrieli Group Ltd. (since May, 2010),as president of I.Y.Z. Investments Ltd. and of Atidim-Etgar Nihul Kranot Ltd., as Director of Harel Insurance Investments and Financial Services Ltd., as Director and Chairman of the Board of G.Y.N Financial Consulting and Management Ltd. (as from June 2012) and as a Director of the Israel Museum. Member and Treasurer of the Elie Wiesel - Foundation of Humanity, Chairman of the Board of Trustees of the Moshe Dayan Center at the Faculty of Humanities, Tel Aviv University (as from April 2012), Chairman of the Dr. Jacob Isler Association for Assisting the Handicapped and Bereaved Families and member of The Advisory Public Committee of Mifal Ha'payis (Israel's National Lottery) (since February 2013), the Rashi Foundation, a Registered Association and in the K.M.R Association – Advancement of Medical Centers Ltd.

Served as Director of Nova Measuring Instruments Ltd. (until May 2007) and as Deputy Chairman of HILLEL: the Center for Jewish Campus Life in Israel Ltd. (Public benefit company) (until April 2012).

In addition, 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).

Richard Morris Roberts - Acts as Director of the Bank since November 10, 2010. Mr. Roberts acts as member of the Audit Committee.

Has professional qualification.

Mr. Roberts is a lawyer, member of the Israeli Bar Association since 1968. Has an academic education - Bachelor of Law from the Hebrew University, Jerusalem.

Founding partner of Shibolet & Co. (in 1973) and since then serves as managing partner of the Firm. His areas of expertise are: commercial law, mergers, acquisition and corporate law.

Serves as Director of Shibolet & Co. trust companies: Sharo Trustees Ltd. (since 1973), Sharo Services Ltd. (since 1973) and Shyryz Trust Company Ltd. (since 1993).Owner and director of Richard Roberts Law Company (1997) Ltd. (since 1997). Serves as Director of the Interdisciplinary Center Herzliya Projects Ltd. (since 1998), and of Ed Value Ltd. (since 2001), and of Elevator Venture Capital Investments Ltd. (since September 2011), and of Hillel - The Israel Center for Jewish Campus Life (PBC). Chairman of the executive board of A Different Lesson Association (RA) (since 2006) and member of the executive board of Docuaviv - Promotion of Documentary Films Association (RA) (since 2008). Acted as Director of Simda Ltd. (1990-2010) and of Apolonia Towers (1994) Ltd. (2005-2007).

Aliza Rotbard – acts as Director of the Bank since November 28, 2012. Ms. Rotbard is a member of the computer committee.

Has accounting and financial expertise as well as professional qualifications.

Ms. Rotbard has an academic education – Bachelor of mathematics and physics (B.Sc.) from the Hebrew University, Jerusalem.

Ms. Rotbard acts as external director of Redhill Biopharma Ltd. (since 2011), A.I.G Israel Insurance Company Ltd. (since 2011), Hadera Paper Ltd. (since 2011), QueenCo Leisure International Ltd. (since 2010), R.V.B. Holdings Ltd. (since 2008), Proseed Venture Capital Fund Ltd. (since 2006), Kamada Ltd. (since 2005), and Director of Pointer Telocation Ltd. (since 2010) and of Mobile Max Technologies Ltd. (since 2007).

Ms. Rotbard acted as external Director of Kamor Motors Ltd. (2010-2012), Orad Ltd. (2007-2012), Prizma Capital Markets Ltd. (2007-2009), Widemed Ltd. (2006-2011), Clal Industries and Investments Ltd. (2003-2009), Pilat Technologies International Ltd. (2001-2007), and as Director of B.G.I. Investments (1961) Ltd. (2007-August 2012), Hilan Tech Ltd. (2001-2012) and Gilat Satcom Ltd. (2005-2006).

Furthermore, founded and served as General Manager of DOORS Information Systems Inc. USA (1990-2002) (inactive); Deputy Director General of the Tel Aviv Stock Exchange (1980-1985); in the years 1970-1977 served in several roles at the Bank of Israel including management of the computer department.

Yali Sheffi - Acts as Director of the Bank since November 10, 2010. Mr. Sheffi acts as member of the Audit Committee, the Credit Committee, Manpower committee, Remuneration committee, the Strategy Committee and the Computer Committee.

Acts as an external director in accordance with Directive No. 301 of Proper Banking Management Directives and has accounting and financial expertise as well as professional qualification.

Mr. Shefi is a certified public accountant since 1982 and has an academic education - Bachelor of economics and complementary studies in statistics and mathematics (summa cum laude) from the Hebrew University, Jerusalem, has a Diploma in Accounting for degree holders from Tel Aviv University (outstanding seminary work), and direct PhD. Studies in mathematical economics, the Hebrew University, Jerusalem (not completed).

Acts as CEO and director of a private company owned by him, engaged in business consulting (Yaheli Shefi, company with unlimited liability) (since June 2009), as owner and director of Yaheli Properties Ltd. (since 2003) as director of Mysupermarket Israel (MSI) Ltd. (since 2011) and as consultant for Bylinks International Relations Ltd. (since 2010).

Served as Chairman of the Board of the Association of Life Assurance Companies of Israel Ltd. (2008-2009). Served as President & CEO of Phoenix Insurance Company Ltd. (2005-2009) and Phoenix Holdings Ltd. (2005-2009), acted as member of the Barnea Committee (2000-2001), served in several roles with Almagor & Co. CPA's (partner 1983-1987, managing partner 1987-1999) thereafter served as managing partner of Delloite - Briteman Almagor & Co. CPA's (1999-2004). Acted as member of the accounting principles committee of the Institute of Certified Public Accountants in Israel (1995-1998) and of the Israeli Accounting Standards Institute founded by the Institute of Certified Public Accountants in Israel and the Israeli Securities Authority (1998-2001).

DETAILS REGARDING MEMBERS OF MANAGEMENT

Reuven Spiegl - acts as the Bank's President & CEO since January 1, 2011.

Mr. Spiegl has an academic education – Bachelor and Master of business administration from the New York Institute of technology.

Acts as Chairman of the Board of Mercantile Discount Bank Ltd. (since March 2012), Discount Bancorp Inc. (as from January 2011 and Director as from January 2006) and of IDB (Swiss) Bank Ltd. (as from March 2012, Director since March 2011) and as Director of Israel Discount Bank of New York.

Served as President of Discount Bank of New York (February 2006 - December 2010) and of Discount Bancorp Inc. (April 2006 - December 2010), as Director and Chairman of the Board (President) of IDBNY Realty (Delaware), Inc. (December 2006 - December 2010), as Chairman of the Board of Israel Credit Cards Ltd. (January 2011 – February 2012), Diners Club Israel Ltd. (July 2011 – December 2011), Diners (Finance) Ltd. (August 2011 – December 2011), B.L.D. Ltd. (March 2011 – August 2011), as Director and Chairman of the Board of Directors of IDB Latin America (November 2006 – February 2012) as Director of IDB Capital Corp. (November 2006 - December 2010, as President & CEO of Discount Bank of New York (February 2006 - February 2011).

Joseph Beressi - member of management since April 1, 2000, Senior Executive Vice President, Comptroller - Chief Accounting Officer and Head of the Bank's Accounting Group.

Mr. Beressi is a Certified Public Accountant and has an academic education - Bachelor of Accounting and Economics from Tel Aviv University.

Acts as Director of Badal Computer and Management Services Ltd. (since February 2002), Nidbach Real Estate and Investments Ltd. and Discount Reinsurance International Limited, Guernsey (since March 2008), Diners Club Israel Ltd. (since July 2011) and in Mercantile Discount Bank Ltd. (since July 2012).

Served as Chairman of the Board of Discount Gemel Ltd. (until December 2008), as Director of Israel Credit Cards Ltd. (June 2010 – June 2011) and of Israel Discount Capital Markets and Investments Ltd. (DCMI) (September 1999 – June 2012).

Yuval Gavish - member of management since January 11, 2011, Senior Executive Vice President, Head of the Banking Division.

Mr. Gavish has an academic education - Bachelor of Humanities and Social Sciences from the Open University.

Mr. Gavish acts as chairman of Diners Club Israel (since January 2012).

Served as chairman of the board of Discount Mortgage Bank Ltd. ("DMB") (March 2011 – June 2012), Chairman of the Board of Ace Auto Depot (September 2009 - December 2010) and of Maalot Insurance Agency (2006 -2008), as General Manager of Prisma Capital Markets Ltd. (April 2008 - August 2009) and of Leumi Mortgage Bank Ltd. (2006- 2008).

Esther Deutsch - member of management since June 1, 2006, Senior Executive Vice President, Chief Legal Adviser and Head of the Bank's Legal Advisory Group.

Ms. Deutsch is a lawyer with an LL.B. Degree from the Hebrew University, Jerusalem.

Served as Chairperson of the Board of Discount Trust Ltd. (Chairperson February 2008 – October 2011 and Director January 2008 – October 2011). Served as Director of the Tel Aviv Stock Exchange Ltd. (July 2007 - June 2009).

Yair Avidan - member of management since June 9, 2010, Executive Vice President, the Bank's Chief Risk Manager and Head of the Risk Management Group.

Mr. Avidan has an academic education -Master of Business Administration and Master of Administration and Leadership in Education from Tel Aviv University, and Bachelor of Economics and Statistics from Tel Aviv University.

Served as Director of DMB (1998 - August, 2010), as deputy head of the Corporate Division at Israel Discount Bank Ltd. (January, 2008-2010), as Manager of the Foreign Extensions and Management Information Department at Israel Discount Bank Ltd. (August, 2006 - January, 2010). In addition, he acted as an external member of the investments committee of the Provident Fund of IBM, Israel Employees Ltd. (2004-2008).

Shlomo Avidan - member of management since April 26, 2010, Executive Vice President, Head of Operations and Logistics Division.

Mr. Avidan has an academic education - Master of Business Administration from Tel Aviv University and Bachelor of Economics and Business Administration from Bar-Ilan University.

Acts as Chairman of the Board of Discount Provident Ltd. (since May, 2010), of Nidbach Real Estate and Investment Ltd. (since May, 2010), Tzir Trading Company Ltd. (as from May 2010) and Har Levi Properties Ltd. (as from May 2010) and as Director of Badal Computer and Management Services Ltd. (since June, 2006), and of MDB (since June, 2010).

Served as Chairman of the Board of Bank Clearing Center Ltd. (April, 2009-May, 2010) and of Automatic Bank Services Ltd. (April, 2009 - May, 2010), as deputy head of the Operations and Information Systems Division in charge of business continuity at Israel Discount Bank Ltd. (2006 - April, 2010).

Orit Alster - Member of Management since March 21, 2011, Vice President, Head of the Corporate Division. Ms. Alster has an academic education - Master of business administration from the Tel Aviv University and a Bachelor of economics and law from the Tel Aviv University.

Acts as Director of Discount Bancorp Inc. (since December 2012) and of Israel Discount Bank of New York (since February 2013). Acted as manager of the large corporations department at Israel Discount Bank Ltd. (January 2007 to March 2011) and as Director of MDB (July 2006 to October 2008).

Shai Vardi - member of management since April 26, 2010, Executive Vice President Head of Technologies & Planning Division.

Mr. Vardi has an academic education - Master of Business Administration and Bachelor of Industrial Engineering and Management from Tel Aviv University.

Acts as Chairman of the Board & CEO of Badal Computer and Management Services Ltd. (since May 2010, Director since August 2004), and director at Discount Provident Ltd. (since 2008) and in Israel Credit Cards Ltd. (since June 2011). Member of the computer committee of the Tel Aviv Stock Exchange (since May 2010).

Served as Director of DMB (2006 – June 28, 2012), as deputy head of the Operations and Information Systems Division and as Manager of the computer system of Israel Discount Bank Ltd. (2004 - April 2010).

Avraham (Avi) Levi - Member of Management since August 28, 2011, Executive Vice President, Head of the Customer Asset Division.

Mr. Levi has an academic education - Master of business administration from the Bar-Ilan University and Bachelor of economics from the The Aviv University. Also, graduate of professional courses at Bank Hapoalim for the training of senior managers and for derivative products consultation.

Acts as Chairman of the Board of Discount Trust Ltd. (Chairman since February 2012 and Director since October 2011) and as Director in IDB (Swiss) Bank Ltd. And of IDB Registration Company Ltd. (since March 2012).

Served as manager of the London Branch of Bank Hapoalim (2007 to June 2011), as sector manager at the corporate division of Bank Hapoalim (2003 to 2007), as director and member of the investment committee of Yahav Bank Ltd. (2004 to 2007), as director of BHI Jersey (2007 to June 2011), of Hapoalim International N.V. (2007 to June 2011) and of the British-Israel Chamber of Commerce (2009 to June 2011).

Gilad Sokolov - Member of Management since October 1, 2011, Executive Vice President, Head of the Strategy, Marketing and Service Division.

Mr. Sokolov has an academic education - Master of business administration from Northwestern University, Chicago, U.S.A, and Bachelor of law from the Hebrew University, Jerusalem.

Served as EVP Business Development at HCL Cleantech (2010 - August 2011), as an independent consultant for strategy and business development (2008-2010) and as Head of the Business and Global Strategy Staff at Bank Leumi LeIsrael BM (2005-2007).

Joseph Perets – Member of Management since August 12, 2011, Executive Vice President, Head of the Human Resources Group.

Mr. Perets has an academic education - Master of business administration from the T.V.U. University extension, and Master of public policy and administration from the Haifa University and Bachelor of social sciences from the Tel Aviv University. Also, a graduate of professional courses in mediation, Neve-Zedek mediation and in financial management at the Israel Management Center (IMC).

Served as Director in DMB (3/2012 - 28/6/2012). Served as Head of the Human Resources group at the Prime Minister's Office (2005 - August 2011).

Yigal Ronay – Member of Management as from July 3, 2011, Executive Vice President, Head of the Finance Division.

Mr. Ronay has an academic education – Master of business administration (specializing in finance) from the Bar-Ilan University and Bachelor of economics from the Hebrew University, Jerusalem.

Acts as Chairman of the Board of Discount Manpikim Ltd. (since July 2011) and at BLD, Ltd. (since August 2011), as Director of Israel Discount Capital Markets and Investments Ltd. (DCMI) (since October 2012) and as lecturer in securities and finance at the College of Management (since 1994).

Served as chairman of the board of REIT 1 (May 2008 - June 2011), as external director, Chairman of the investment committee and member of the audit and financial statements committees, of DS Provident Funds Management Ltd. (2008 - June 2011) and General Manager of Gmulot – Provident Funds Asset management Unit of Bank Hapoalim (2005 - 2008).

Nir Abel – Internal Auditor of the Bank and of certain of the Bank's subsidiaries since May 18, 2011, Executive Vice president.

Mr. Abel is a CPA and has an academic education - Bachelor of economics and accounting from the Hebrew University, Jerusalem.

Mr. Abel served as Chief Internal Auditor of the First International Bank (August 2006 - March 2011).

REPORT ON DIRECTORS HAVING ACCOUNTING AND FINANCIAL EXPERTISE

In accordance with the amendment to Directive 301, which became effective on January 1, 2012, at least one-fifth of the total number of Directors and at least two Directors out of the members of the Audit Committee should have accounting and financial expertise.

At date of reporting, the number of Directors having accounting and financial expertise is ten and the number of Directors having accounting and financial expertise who are members of the audit committee of the Board is four.

Details of Directors having accounting and financial expertise and the factual background on the basis of which they may be considered as having such expertise, are included above under "Details regarding members of the Board of Directors".

AMENDMENT OF THE BANK'S ARTICLES

A special general meeting of the shareholders held on November 28, 2012, resolved to approve an amendment of the Bank's articles, in accordance with a marked draft appended as Annex No.1 to the immediate report filed by the Bank on October 23, 2012, with respect to the convening of the meeting (Ref. No. 2012-01-262488) and this as detailed in an immediate report regarding the change in the Memorandum and/or Bylaws published by the Bank on November 28, 2012 (Ref. No. 2012-01-293355). The data detailed in the abovementioned reports is presented here by way of reference.

The background for the amendment is the entry into effect, in March 2012, of the Banking Act (Legislation amendments), 2012 ("the Amendment"), which, among other things, included directives regarding the appointment, office and termination of office of directors of a banking corporation, which is a public corporation, as well as instructions regarding the proposal of candidates for the office of director, appointment, office and termination of office of director of a banking corporation that has no core controlling interest, as defined in Section 11B(c) of the Banking Ordinance, 1941. (It should be noted that as of date of this report, the Bank is not considered a "banking corporation having no core controlling interest").

In view of the Amendment and following guidelines of the Supervisor of Banks, the Bank is required to examine the Articles of the Bank and, if necessary, modify them in accordance with the Amendment, and so it was done. Most of the changes approved and effected in the articles stemmed from the said amendment are those stemming from the said Amendment and also from the enactment of the Capital Market Enforcement Intensification Act (Legislation amendments), 2011, and the Antitrust Act (Amendment No. 13), 2012, which added administrative enforcement proceedings.

CHANGES IN THE BOARD OF DIRECTORS

RATIFICATION OF APPOINTMENT OF AN EXTERNAL DIRECTOR OF THE BANK

On February 7, 2013, the Bank published a preliminary notice of intention to convene a general meeting of the Bank's shareholders. The agenda of the meeting will, among other things, include the ratification of the appointment of Mr. Ilan Biran as external director at the Bank until the end of the period of appointment on October 29, 2014, as detailed in the immediate report filed by the Bank on February 7, 2013, (Ref. No. 2013-01-033465). The data detailed in the abovementioned report is presented here by way of reference.

The Bank's general meeting of shareholders held on October 29, 2008, appointed Mr. Biran as external director for a period of three years, and on October 26, 2011, the general meeting approved Mr. Biran's appointment for an additional period of three years, namely, until October 29, 2014.

Mr. Biran acts as an active Chairman of the Board of Rafael Advanced Defense Systems Ltd. (hereinafter – "Rafael"), with effect from June 2007. Rafael is a Government corporation, fully controlled by the State of Israel. Rafael generally maintains business relations with the Bank.

Due to doubt whether the acting of Mr. Biran as an active Chairman of the Board of Rafael, simultaneously with existing business relations between the Bank and Rafael as stated above, does not create affinity relations, as defined in Section 240(b) of the Companies Act, the Bank's Audit Committee examined (in November 2012) the nature of the relations between the Bank and Rafael. Following this examination, the Audit Committee reached the conclusion, that to the extent that the relations between the Bank and Rafael create a connection between Mr. Biran and the Bank, such connection is negligible as regards Rafael and as regards the Bank. Accordingly, the appointment of Mr. Biran will be tabled for ratification in accordance with the procedure stated in the Companies Regulations (matters that do not constitute connection), 2006.

The Bank intends to convene a general meeting of shareholders in the matter at a near date. The report to be published with respect to the convening of the meeting will include additional details in the matter, including the arguments of the Audit Committee on the question of negligibility.

CHANGES IN THE BOARD OF DIRECTORS

On June 12, 2012, the annual general meeting of shareholders approved the reappointment of the following Board members, who do not serve as external directors: Dr. Yossi Bachar, Chairman of the Board, Mr. Eli Eliezer Gonen, Mr. Jorge Zafran, Mr. Joseph Ciechanover-Itzhar, Mr. Richard Morris Roberts.
The external directors continue in office until the end of their tenure according to the law.
A special meeting of the Bank's shareholders, dated November 28, 2012, resolved to appoint Ms. Aliza Rotbard as Director of the Bank, in effect from date of the meeting, in addition to the acting Directors.

MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

In 2012, the Board of Directors held 30 meetings. In addition, 88 meetings of committees of the Board of Directors were held.
The Board of Directors wishes to thank the President & CEO, the members of Management, the Bank's employees and employees of the Group's companies and their management for their work towards the advancement of the Bank and the Group.

March 20, 2013	Dr. Yossi Bachar Chairman of the Board of Directors	Reuven Spiegel President & Chief Executive Officer

ANNEX TO THE REPORT OF THE BOARD OF DIRECTORS

PART "A": ADDITIONAL DETAILS - SECURITIES PORTFOLIO

1. 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:

			Cumulative other comprehensive income	
	Net adjusted cost	Fair value	profits	losses
	In NIS millions			
	December 31, 2012			
Non governmental bonds and bills				
Various sectors*	678	702	27	3
Public and community services[1]	9,041	9,100	123	64
Financial services[2]	4,143	4,027	64	180
Total non governmental bonds and bills	**13,862**	**13,829**	**214**	**247**
Government bonds and bills				
US government	336	336	-	-
Israel Government	20,027	20,610	591	8
Other Governments	575	581	6	-
Total government bonds and bills	**20,938**	**21,527**	**597**	**8**
Total available-for-sale bonds	**34,800**	**35,356**	**811**	**255**
	December 31, 2011			
Total non governmental bonds and bills**	**15,329**	**15,148**	**191**	**372**
Total government bonds and bills**	**17,677**	**17,828**	**222**	**71**
Total available-for-sale bonds	**33,006**	**32,976**	**413**	**443**

*There is no segment in the said group the fair value of investments in its related bonds exceeds NIS 382 million.

** Reclassified – U.S. Government agencies, which were presented separately in the past, in an amount of NIS 8,471 million (fair value), and Ginnie Mae bonds, which were presented in the past as "U.S. government", in an amount of NIS 3,538 million (fair value), have been reclassified to "Public and community services" under "Non-government bonds".

1. AVAILABLE FOR SALE BONDS - DATA ACCORDING TO ECONOMIC SECTORS (CONTINUED)

(1) Following are details regarding available-for-sale securities in public and community services sector:

			Cumulative other comprehensive income	
	Net adjusted cost	Fair value	profits	losses
	In NIS millions			
	December 31, 2012			
Ginnie Mae	3,137	3,151	35	21
Other	66	64	-	2
Freddie Mac	1,927	1,928	17	16
Fannie Mae	3,911	3,957	71	25
Total public and community services	**9,041**	**9,100**	**123**	**64**

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

Banks and banking holding companies(3)	3,249	3,124	53	178
Insurance and provident funds	65	67	2	-
Other*	829	836	9	2
Total financial services	**4,143**	**4,027**	**64**	**180**

*Fair value amounts lower than NIS 56 million.

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

North America(4)	1,499	1,356	24	167
West Europe(5)	866	868	12	10
Israel	599	611	12	-
Australia	178	182	5	1
Other	107	107	-	-
Total bank and other banking holding companies	**3,249**	**3,124**	**53**	**178**

(4) 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:

Rating				
AA	34	35	1	-
AA-	4	4	-	-
A+ to A-	324	311	2	15
BBB+ to BBB-	842	758	4	88
BB+ to B-	252	197	-	55
Not rated	43	51	17	9
Total	**1,499**	**1,356**	**24**	**167**

1. AVAILABLE FOR SALE BONDS - DATA ACCORDING TO ECONOMIC SECTORS (CONTINUED)

(5) 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	483	484	9	8
Switzerland	142	141	-	1
Other*	241	243	3	1
Total	**866**	**868**	**12**	**10**

* Fair value amounts lower than NIS 100 million per country

2. HELD-TO-MATURITY SECURITIES - DATA ACCORDING TO ECONOMIC SECTORS

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

	Amortized cost	Fair value	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value
	In NIS millions			
	December 31, 2012			
Non governmental bonds and bills				
Various sectors	11	11	-	-
Public and community services (1)	3,488	3,659	175	4
Financial services	209	224	17	2
Total non governmental bonds and bills	**3,708**	**3,894**	**192**	**6**
Total Government bonds and bills	**3,280**	**3,542**	**262**	**-**
Total held-to-maturity bonds	**6,988**	**7,436**	**454**	**6**
	December 31, 2011			
Total non governmental bonds and bills*	**3,256**	**3,391**	**136**	**1**
Total government bonds and bills*	**2,639**	**2,724**	**85**	**-**
Total held-to-maturity bonds	**5,895**	**6,115**	**221**	**1**

** Reclassified – U.S. Government agencies, which were presented separately in the past, in an amount of NIS 728 million (amortized cost), and Ginnie Mae bonds, which were presented in the past as "U.S. government", in an amount of NIS 2,394 million (amortized cost), have been reclassified to "Public and community services" under "Non-government bonds".

(1) Following are details of Held-to-maturity bonds of the public and community services sector:

Ginnie Mae	756	781	25	-
Municipal bonds and U.S. Government bond	1,732	1,872	142	2
Freddie Mac	490	495	6	1
Fannie Mae	415	416	2	1
Other Government Agencies	95	95	-	-
Total public and community services	**3,488**	**3,659**	**175**	**4**

3. TRADING BONDS - DATA ACCORDING TO ECONOMIC SECTORS

Following are details regarding the distribution of bonds in the trading securities portfolio according to economic sectors:

	Amortized cost	Fair value	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value
	In NIS millions			
	December 31, 2012			
Non governmental bonds and bills				
Various sectors(1)	76	73	-	3
Financial services	67	52	1	16
Total non governmental bonds and bills	**143**	**125**	**1**	**19**
Total government bonds and bills	**2,820**	**2,826**	**6**	**-**
Total trading bonds	**2,963**	**2,951**	**7**	**19**
	December 31, 2011			
Total non governmental bonds and bills	**(2)162**	**(2)140**	**-**	**22**
Total government bonds and bills	**(2)3,216**	**(2)3,224**	**9**	**1**
Total trading bonds	**3,378**	**3,364**	**9**	**23**

Footnotes:

(1) There is no sector in the said group the fair value of investments in its related bonds exceeds NIS 54 million.

(2) Reclassified – U.S. Government agencies, which were presented separately in the past, in an amount of NIS 37 million (fair value), and Ginnie Mae bonds and bonds of states and political units in the U.S., which were presented in the past as "U.S. government", in an amount of NIS 17 million (fair value), have been reclassified to "Public and community services" under "Non-government bonds".

4. EXPOSURE TO COMMERCIAL MORTGAGE BACKED SECURITIES (CMBS)

IDB New York holds commercial mortgage backed securities (CMBS) with a total balance sheet exposure of NIS 69 million as of December 31, 2012, compared with NIS 57 million as of December 31, 2011, an increase of 21%. The said increase stems mainly from the purchase of an additional bond in the first quarter of 2012, which was classified to the "available for sale" portfolio. The remaining bonds are classified to the "held to maturity" portfolio. These securities are classified to the financial services economic sector. The collateral pertaining to these securities is all located in the United States.

As of December 31, 2012, there is no provision for impairment of value due to the said securities.

The securitization exposure included in the following table does not include mortgage backed securities of the U.S. government agencies GNMA, FNMA and FHLMC, due to the fact that all layers of the said securities reflect identical credit risk.

Following are details regarding CMBS Exposure:

	As at December 31,2012			As at December 31,2011		
Maturity Date	Adjusted cost	Fair Value	Book Value	Adjusted cost	Fair Value	Book Value
	in NIS millions					
2039-2040	9	11	9	17	17	17
2045-2047	5	6	5	5	5	5
2049-2051	55	64	55	35	38	35
Total	**69**	**81**	**69**	**57**	**61**	**57**

5. UNREALIZED LOSSES - SHARES AVAILABLE FOR SALE

On December 31, 2012, and December 31, 2011, there were no unrealized accumulated losses in respect of availble-for sale shares.

6. UNREALIZED LOSSES - MORTAGAGE BACKED SECURITIES AVAILABLE FOR SALE

Following are details regarding the distribution of unrealized accumulated losses on mortgage 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:

	Period of decline in fair value below amortized cost				
Ratio of unrealized loss to amortized cost	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	Total
	In NIS millions				
	December 31, 2012				
Up to 20%	28	19	4	13	64
Total	**28**	**19**	**4**	**13**	**64**
	December 31, 2011				
Up to 20%	18	1	-	9	28
Total	**18**	**1**	**-**	**9**	**28**

7. DETAILS REGARDING CERTAIN BONDS HELD BY IDB NEW YORK IN THEIR AVAILABLE FOR SALE PORTFOLIO

Presented below are details as of December 31, 2012 and December 31, 2011, of certain bonds 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%, during a period which exceeds 12 months:

	December 31 2012						
					Securities Ratings		
	Net adjusted Cost	Fair Value	Unrealized Loss	Final Maturity	Moody's	S&P	Fitch
Issuer's / Group's Name	in NIS thousands						
Securities with ratio of unrealized loss from 20% to 40%							
Bank of America	147,659	113,942	(33,717)	2028	Ba2	BB+	BB
Suntrust	76,989	60,609	(16,380)	2028	Baa3	BB+	BB
J.P Morgan Chase	56,148	43,112	(13,036)	2027	Baa2	BBB	BBB
Huntington Bank	18,665	13,360	(5,305)	2027	Baa3	BB+	BB
United Bancshares Inc	17,064	12,132	(4,932)	2037	NR	NR	NR
International Bancshares Corp	17,396	12,506	(4,890)	2037	NR	NR	NR
Keycorp	3,707	2,949	(758)	2028	Baa3	BBB-	BB+
Total securities with ratio of unrealized loss from 20% to 40%	**337,628**	**258,610**	**(79,018)**				

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

7. DETAILS REGARDING CERTAIN BONDS HELD BY IDB NEW YORK IN THEIR AVAILABLE FOR SALE PORTFOLIO (CONTINUED)

Presented below are details as of December 31, 2012 and December 31, 2011, of certain bonds 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%, during a period which exceeds 12 months (continued):

	December 31 2011						
					Securities Ratings		
	Net adjusted Cost	Fair Value	Unrealized Loss	Final Maturity	Moody's	S&P	Fitch
Issuer's / Group's Name	in NIS thousands						
Securities with ratio of unrealized loss over 40%							
United Bancshares Inc	17,401	9,553	(7,848)	2037	NR	NR	NR
Barclays Bank	19,105	11,392	(7,713)	2026	Aa3	NR	A
International Bancshares Corp	17,752	10,126	(7,626)	2037	NR	NR	NR
Total securities with ratio of unrealized loss over 40%	**54,258**	**31,071**	**(23,187)**				
Securities with ratio of unrealized loss from 20% to 40%							
J.P Morgan Chase	246,619	177,126	(69,493)	2027	A2	BBB	A
Wells Fargo	212,100	157,265	(54,835)	2027	Baa1	BBB+	A
Bank of America	198,241	145,618	(52,623)	2028	Ba1	BB+	BBB-
Suntrust	78,770	55,469	(23,301)	2028	NR	BB+	BBB-
Huntington Bank	19,105	14,093	(5,012)	2027	Baa1	BB+	BBB-
First Maryland	18,547	14,206	(4,341)	2027	Baa2	BBB-	NR
Keycorp	3,794	2,828	(966)	2028	Baa3	BBB-	BBB
Total securities with ratio of unrealized loss from 20% to 40%	**777,176**	**566,605**	**(210,571)**				

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

As of December 31, 2012, all of the unrealized loss detailed in the above table relate to Trust Preferred Securities (hereinafter: "TRUPS"), issued by financial institutions. Unrealized loss in the amount of NIS 56 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 statement and 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. 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 specific criteria.

IDB New York reviews its Available for sale and Held to maturity investment securities quarterly to determine whether an impairment that is considered to be other than temporary (OTTI) has occurred. If a decline in fair value is judged by the Company to be other than temporary, and if there are significant credit concerns regarding a particular security and it is expected that the Company will not recover its amortized cost, the security is written down from its original cost basis to reflect the adjusted fair value and a new cost basis is established. IDB New York's assessment also addresses the impact of the length of time an investment has been in an unrealized loss position. In general, the longer the length of time that a security has been in an unrealized loss position and the greater the magnitude of the unrealized loss, the more likely it is that the security is OTTI. Factors that management considers in its reviews for OTTI are the financial condition and near-term prospects of the issuer, recent events specific to the issuer or the issuer's industry, adverse or positive changes in fair value and ratings announced by one or more rating agencies, trends and volatility in earnings, whether the issuer of the debt security has remained current on principal and interest payments, whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market conditions, and current analyst evaluations and other key measures, and if relevant, cash flow models based on the specific structure of the security to determine if there are adverse changes in cash flows.

IDB New York has the ability and intent to hold securities with unrealized losses until a market price recovery (which for debt securities may not be until maturity) and currently intends to hold all temporarily impaired securities to full recovery. Future reviews for OTTI will consider the particular facts and circumstances during the respective reporting period. There remain significant market and economic uncertainties that could result in further declines in the fair value of securities in our portfolio in the future. There continues to be considerable challenges facing the U.S. and global economies and a prolonged economic downturn could have implications and impact any recovery in security valuations. In spite of numerous market interventions and programs implemented by U.S. and global governments and regulators there continues to be a lack of liquidity and capital market flows to facilitate an improvement in many securities markets. Therefore, there is still a risk that there may be additional other than temporary impairment writedowns in the future.

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 of their value over their book value.

As of December 31, 2012, IDB New York did not hold in its available-for-sale portfolio any debentures having an unrealized loss of a temporary nature amounting to 40% or more, compared to their amortized cost.

In the end of 2011, in light of the Bank of Israel's guideline, a provision for impairment was recorded in the consolidated financial statements, in respect of securities of two issuers which incurred unrealized losses of more than 40%, over a period of several consecutive quarters.

A study of the volatility in prices of the securities presented above subsequent to balance sheet date (and up to February 28, 2013), indicates no significant changes compared to market prices at December 31, 2012.

Presented below are further details relating to particular groups presented in the table above, with regard to which there is an unrealized loss of NIS 10 million or more, as of December 31, 2012.

Bank of America (BOA). BOA reported a net profit of US$732 million for the fourth quarter 2012, compared with US$340 million in the third quarter 2012 and US$1.9 billion in the corresponding quarter last year. The said results were affected, among other things, from expenses for credit losses, which in the fourth quarter of 2012 amounted to US$2.2 billion, compared to US$1.8

billion in the previous quarter and by expenses related to claims and settlements in the mortgage loan field. On the other hand, results were affected by tax benefits. Earnings per share stood at US$0.03, compared to negligible earnings per share in the previous quarter. Total assets amounted to US$2.3 trillion, compared to US$2.1 trillion in the previous quarter.

Non-performing loans at the fourth quarter 2012 were 7.16% of gross loans, compared to 7.91% in the previous quarter. The ratio of the allowance for credit losses to total non-performing loans at the end of the fourth quarter of 2012 was 34.86%, compared to 35.1% at the end of the previous quarter.

BOA is a well-capitalized institution, with a Total Capital ratio of 16.31% at December 31, 2012, compared with 17.16% at September 30, 2012.

On April 25, 2012, BOA published an offer for the early redemption of certain of the TRUPS series that had been issued in the past. The Management of IDB New York has decided not to accept the offer.

The rating of the said securities was lowered in June 2012 by the international rating agency, Moody's, from "Ba1" to "Ba2".

Sun Trust Banks (STI). STI reported a net profit of US$356 million for the fourth quarter 2012, compared with US$1 billion in the third quarter 2012 and US$74.6 million in the corresponding quarter last year. The profit in the third quarter was mostly affected by the realization of Coca-Cola Company shares. Expenses for credit losses amounted in the fourth quarter to US$333 million compared to US$450 million in the previous quarter. Earnings per share amounted to US$0.66, compared with US$1.98 per share in the previous quarter. Total assets amounted to US$173.5 billion, compared to US$173.2 billion in the previous quarter.

Non-performing loans at the fourth quarter 2012 were 1.89% of gross loans, a decrease compared to 3.15% in the previous quarter. The ratio of the allowance for credit losses to total non-performing loans at the end of the fourth quarter of 2012 was 92%, compared to 56% at the end of the previous quarter.

STI is a well-capitalized institution, with a Total Capital ratio of 13.48% at December 31, 2012, compared to 12.95% as of September 31, 2012.

JP Morgan Chase (JPM). JPM reported a net profit of US$5.6 billion for the fourth quarter 2012, compared with US$5.7 billion in the third quarter 2012 and US$3.7 billion in the corresponding quarter last year. Expenses for credit losses in the fourth quarter of 2012, amounted to US$740 million compared to US$1.8 billion in the previous quarter and US$2.1 billion in the corresponding quarter last year. Earnings per share amounted to US$1.39 compared with US$1.40 per share in the previous quarter. Total assets amounted to US$2.35 trillion, compared to US$2.32 trillion in the previous quarter. Non-performing loans at the fourth quarter 2012 were 4.5% of gross loans, compared to 4.8% in the previous quarter. The ratio of the allowance for credit losses to total non-performing loans was 63.6% at the end of the fourth quarter of 2012, compared to 63.2% at the end of the previous quarter.

JPM is a well-capitalized institution, with a Total Capital ratio of 15.27% at December 31, 2012, compared to 14.69% at September 30, 2012.

The rating of the said securities was lowered in June 2012 by the international rating agency, Moody's, from "A2" to "Baa2", but remained within the investment rating.

PART "B": ADDITIONAL DETAILS - THIRD PILLAR OF BASEL II

General note - the tables in Part "B" are numbered in accordance with the definitions in the directives of the Supervisor of Banks.

1. TABLE 4 D - COUNTERPARTY TYPE DISTRIBUTION OF EXPOSURES

	Credit	Bonds	Other(1)	Guarantees and other liabilities on account of clients(2)	Transactions in derivative financial instruments(3)	Total
			in NIS millions			
			December 31 2012			
Sovereigns	19,851	27,926	-	551	27	48,355
Public sector entities	1,218	3,357	-	309	120	5,004
Banks	10,867	2,043	-	101	747	13,758
Corporates	67,819	1,798	-	34,504	603	104,724
Secured by commercial real estate	2,381	-	-	-	-	2,381
Single retailer exposures	19,686	-	-	19,124	58	38,868
Small business loans	11,029	-	-	4,186	5	15,220
Mortgage	17,867	-	-	1,116	7	18,990
Securitization	-	750	-	-	-	750
Other assets	-	-	7,450	-	-	7,450
Total	**150,718**	**35,874**	**7,450**	**59,891**	**1,567**	**255,500**
			December 31 2011			
Sovereigns	26,390	24,061	-	1	33	50,485
Public sector entities	637	4,109	-	624	41	5,411
Banks	12,351	1,520	-	64	793	14,728
Corporates	69,023	1,623	-	35,874	841	107,361
Secured by commercial real estate	2,149	-	-	-	-	2,149
Single retailer exposures	17,523	-	-	18,034	16	35,573
Small business loans	9,872	-	-	4,021	3	13,896
Mortgage	19,587	-	-	1,447	42	21,076
Securitization	-	30	-	-	-	30
Other assets	-	-	7,715	-	-	7,715
Total	**157,532**	**31,343**	**7,715**	**60,065**	**1,769**	**258,424**

Footnotes:

(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).

2. TABLE 4 E - DIVISION OF THE FILE ACCORDING TO REMAINING CONTRACTUAL MATURITY PERIODS(1)

	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				
	December 31 2012				
Credit	85,891	42,142	25,751	3,145	156,929
Bonds	9,889	15,208	31,458	-	56,555
Others(3)	2,368	213	663	4,270	7,514
Guarantees and other liabilities on account of clients(4)	40,398	13,115	4,881	1,318	59,712
Transactions in derivative financial instruments(5)	2,094	1,405	1,416	-	4,915
Total	**140,640**	**72,083**	**64,169**	**8,733**	**285,625**
	December 31 2011				
Credit	90,100	43,487	25,205	2,916	161,708
Bonds	10,105	15,592	26,463	-	52,160
Others(3)	2,214	394	622	4,575	7,805
Guarantees and other liabilities on account of clients(4)	40,175	13,711	4,499	1,509	59,894
Transactions in derivative financial instruments(5)	*2,460	*955	*1,304	*-	4,719
Total	**145,054**	**74,139**	**58,093**	**9,000**	**286,286**

*Reclassified between the different periods.

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 respect of which they were made.

(2) Includes past due receivables totaling NIS 1,628 million (31.12.2011: NIS 1,461 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 borrowers indebtedness.

3. TABLE 5 - EXPOSURE AMOUNTS ACCORDING TO RISK WEIGHTS[2][1]

Amount of exposure after allowance for credit losses and after credit risk mitigation.

	0%	20%	35%	50%	75%	100%	150%	Total
				in NIS millions				
				December 31 2012				
Sovereigns	46,358	1,003	-	995	-	-	-	48,356
Public sector entities	-	2,925	-	2,063	-	12	-	5,000
Banks	-	11,514	-	1,426	-	816	-	13,756
Corporates	-	523	-	666	-	99,515	2,771	103,475
Secured by commercial real estate	-	-	-	-	-	2,372	6	2,378
Single retailer exposures	-	-	-	-	38,021	72	395	38,488
Small business loans	-	-	-	-	14,296	437	304	15,037
Mortgage	-	-	15,318	-	3,028	327	136	18,809
Securitization	-	733	-	17	-	-	-	750
Other assets	2,050	65	-	-	-	4,746	588	7,449
Total	**48,408**	**16,763**	**15,318**	**5,167**	**55,345**	**108,297**	**4,200**	**253,498**
				December 31 2011				
Sovereigns	49,156	565	-	36	-	727	-	50,484
Public sector entities	-	4,043	-	1,357	-	11	-	5,411
Banks	-	12,477	-	1,650	-	596	-	14,723
Corporates	-	633	-	849	-	102,277	2,536	106,295
Secured by commercial real estate	-	-	-	-	-	2,140	2	2,142
Single retailer exposures	-	-	-	-	34,832	300	69	35,201
Small business loans	-	-	-	-	13,502	27	146	13,675
Mortgage	-	-	17,203	-	2,934	626	88	20,851
Securitization	-	-	-	30	-	-	-	30
Other assets	1,883	25	-	-	-	5,278	529	7,715
Total	**51,039**	**17,743**	**17,203**	**3,922**	**51,268**	**111,982**	**3,370**	**256,527**

3. TABLE 5 - EXPOSURE AMOUNTS ACCORDING TO RISK WEIGHTS (CONTINUED)

	0%	20%	35%	50%	75%	100%	150%	Total
	in NIS millions							
	December 31 2012							
Sovereigns	47,386	1,003	-	995	-	-		49,384
Public sector entities	-	2,925	-	1,208	-	12		4,145
Banks	-	7,385	-	6,810	-	816	-	15,011
Corporates	-	523	-	666	-	93,986	2,158	97,333
Secured by commercial real estate	-	-	-	-	-	2,361	6	2,367
Single retailer exposures	-	-	-	-	29,911	66	366	30,343
Small business loans	-	-	-	-	11,532	425	277	12,234
Mortgage	-	-	15,311	-	3,028	327	136	18,802
Securitization	-	733	-	17	-	-	-	750
Other assets	2,050	65	-	-	-	4,746	588	7,449
Total	**49,436**	**12,634**	**15,311**	**9,696**	**44,471**	**102,739**	**3,531**	**237,818**
	December 31 2011							
Sovereigns	49,279	565	-	36	-	727	-	50,607
Public sector entities	-	4,043	-	1,233	-	11	-	5,287
Banks	-	6,863	-	7,516	-	596	-	14,975
Corporates	-	633	-	849	-	96,798	2,378	100,658
Secured by commercial real estate	-	-	-	-	-	1,988	2	1,990
Single retailer exposures	-	-	-	-	26,352	267	64	26,683
Small business loans	-	-	-	-	10,835	14	132	10,981
Mortgage	-	-	17,178	-	2,931	626	88	20,823
Securitization	-	-	-	30	-	-	-	30
Other assets	1,883	25	-	-	-	5,278	529	7,715
Total	**51,162**	**12,129**	**17,178**	**9,664**	**40,118**	**106,305**	**3,193**	**239,749**

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).

4. TABLE 7 - REDUCTION OF CREDIT RISK

	Gross credit risk exposure before provision for credit losses(1)(2)	Gross credit risk exposure after provision for credit losses(1)(2)	Credit exposure covered by eligible financial collateral(3)(4)	Total outflows(5)	Total Inflows (5)	Net credit exposure
	in NIS millions					
	December 31 2012					
Sovereigns debts	48,355	48,356	-	-	1,028	49,384
Public sector entities debts	5,004	5,000	-	(854)	-	4,146
Banks debts	13,758	13,756	(5,599)	-	6,854	15,011
Corporates debts	104,724	103,475	(5,404)	(738)	-	97,333
Secured by commercial real estate	2,381	2,378	(11)	-	-	2,367
Single retailer exposures	38,868	38,488	(1,870)	(6,275)	-	30,343
Small business loans	15,220	15,037	(2,788)	(15)	-	12,234
Mortgage	18,990	18,809	(8)	-	-	18,801
Securitization	750	750	-	-	-	750
Other assets	7,450	7,449	-	-	-	7,449
Total	**255,500**	**253,498**	**(15,680)**	**(7,882)**	**7,882**	**237,818**
	December 31 2011					
Sovereigns debts	50,485	50,484	-	-	123	50,607
Public sector entities debts	5,411	5,411	(1)	(123)	-	5,287
Banks debts	14,728	14,723	(6,818)	-	7,070	14,975
Corporates debts	107,361	106,295	(5,211)	(426)	-	100,658
Secured by commercial real estate	2,149	2,142	(152)	-	-	1,990
Single retailer exposures	35,573	35,201	(1,893)	(6,625)	-	26,683
Small business loans	13,896	13,675	(2,675)	(19)	-	10,981
Mortgage	21,076	20,851	(28)	-	-	20,823
Securitization	30	30	-	-	-	30
Other assets	7,715	7,715	-	-	-	7,715
Total	**258,424**	**256,527**	**(16,778)**	**(7,193)**	**7,193**	**239,749**

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, including positive adjustments added to the exposure.

(4) Including gold.

(5) The amount of exposure covered by guaranties is presented as part of the obligations of the counterparty providing the guarantees.

5. TABLE 8 - DISCLOSURE REGARDING OVER THE COUNTER DERIVATIVES

	December 31	
	2012	2011
	in NIS millions	
Gross positive fair value of contracts[1]:		
Interest rate contracts:		
Shekel/CPI	12	2
Other	2,486	1,972
Foreign currency contracts	1,158	1,093
Contracts on shares	111	177
Commodities and other contracts	3	27
Total Gross positive fair value of contracts	3,770	3,271
Potential off balance sheet exposure[2]	1,589	1,550
Netting benefits	(3,792)	(3,052)
Current credit exposure after netting[2]	1,567	1,769
Held collateral	(65)	(30)
Net derivatives credit exposure	**1,502**	**1,739**

Footnotes:

(1) Including embedded derivatives in the amount of NIS 43 million (31.12.2011: NIS 31 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.

6. TABLE 9 - SECURITIZATION EXPOSURE

The securitization exposure included in the following table does not include mortgage backed securities issued by GNMA, FNMA and FHLMC. This, due to the fact that all layers of the said securities reflect identical credit risk

	Total exposure	
	December 31	
	2012	2011
	in NIS millions	
Mortgage-backed securities (MBS):		
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS)	54	30
Total mortgage-backed securities	**54**	**30**
Asset-backed securities (ABS):		
Collaterized bonds CLO	696	-
Total asset-backed securities	**696**	**-**
Total mortgage and asset-backed securities	**750**	**30**

	December 31			
	2012		2011	
	Exposure	Capital requirements	Exposure	Capital requirements
		9.00%		9.00%
	in NIS millions			
Risk weights:				
20%	733	13	-	-
50%	17	1	30	1
Total	**750**	**14**	**30**	**1**

7. TABLE 13 - 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

	December 31			
	2012		2011	
	Cost	Book value	Cost	Book value
	In NIS millions			
Investments in shares of affiliated companies[1][2]:				
Non marketable shares	100	100	53	53
Shares in the available-for-sale portfolio:				
Marketable shares	62	63	28	33
Non marketable shares	641	641	625	625
Total shares in the available for sale portfolio	703	704	653	658
Total investment in shares	**803**	**804**	**706**	**711**

Footnotes:

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

(2) For details regarding an investment in the First International Bank, not included in the table, see Note 6 E to the financial statements and "First International Bank of Israel Ltd". Under "Main investee companies" below.

Capital requirement regarding share position[1]

	December 31	
	2012	2011
	In NIS millions	
In respect of investments in venture capital funds, in private equity funds and in fund of hedge funds[2]	79	71
In respect of investments in other shares[3]	12	12
With respect to owner's loans[3]	1	1
Total capital requirement regarding share position	**92**	**84**
Investments deducted from capital[4]	1,687	[5][6]1,556

Footnotes:

(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 risk weight of 150%.

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

(4) Including investment in FIBI.

(5) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statement.

(6) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statement.

8. 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.

Table No.	Topic	Location*	Page No. in this Report
Table 1	Scope of implementation	Basel II - The implementation in Israel of the Basel committee recommendations	127-130
Table 2a	Capital structure - qualitative disclosure	Note 14 to the financial statements	420-430
Table 2b,c,e	Capital structure - quantitative disclosure	Capital resources - The Bank's capital adequacy Note 14(1),14(4) to the financial statements	420-422
Table 3a	Capital adequacy - qualitative disclosure	Capital resources - The Bank's capital adequacy	35-38
Table 3b,d,e,f,g	Capital adequacy - quantitative disclosure	Capital resources - The Bank's capital adequacy Note 14(3) to the financial statements	421
Section 824	General qualitative disclosure	Risk management policy and objectives, The structure and organization of the risk management function - factors involved in risk management	121-127
Table 4a	Credit risk - qualitative disclosure	Credit risk management	133-149
Table 4b	Credit risk - segmentation of credit risk according to the main credit exposure types	Credit risk management - Quantitative disclosure regarding credit risk	141
Table 4c	Credit risk - main geographic distribution of exposures	Management review - Schedule "F"	316-319
Table 4d	Credit risk - Counterparty type distribution of exposures	Credit risk management - Quantitative disclosure regarding credit risk Annex to the Report of the Board of Directors – Part "B"	286
Table 4e	Credit risk - Residual contractual maturity breakdown of the whole portfolio	Credit risk management - Quantitative disclosure regarding credit risk Annex to the Report of the Board of Directors – Part "B"	287
Table 4f	Credit risk - problematic debts	Management review - Schedule "E"	314-315
Table 4g	Credit risk - problematic debts classified according to main geographical areas	Management review - Schedule "F"	316-319
Table 4h	Credit risk - movement in the balance of allowance for credit losses	Note 4a to the financial statements	384-387
Table 5	Credit risk - disclosure as to credit files managed according to the standard approach	Credit risk management - Disclosure as to credit files managed according to the standard approach Annex to the Report of the Board of Directors – Part "B"	288-289
Table 7	Credit risk mitigation	Credit risk management - Reduction of credit risk Annex to the Report of the Board of Directors – Part "B"	290
Table 8	General disclosure for exposure related to counterparty credit risk	Credit risk management - General disclosure regarding exposure related to credit risk of a counterparty Annex to the Report of the Board of Directors – Part "B"	141-143 291
Table 9	Securitization exposure	Credit risk management – Securitization Annex to the Report of the Board of Directors – Part "B"	143 291

8. TABLE RELATING THE DISCLOSURE REQUIREMENTS ACCORDING TO THE THIRD PILLAR TO THE DATA PRESENTED IN THE REPORT (CONTINUED)

Table No.	Topic	Location*	Page No. in this Report
Table 10	Market risk	Management of market and liquidity risks	149-162
Table 12	Operational risks	Operational risks	164-168
Table 13	Share positions in the bank's portfolio	Annex to the Report of the Board of Directors – Part "B"	292
Table 14	Interest rate risk in the banking book	Management of market and liquidity risks	149-162

* Unless stated otherwise, the location is under "Exposure to Risks and Risks management" or as a Note to the Financial Statements.

PART "C": ADDITIONAL DETAILS

1. ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

Credit risk involved in financial instruments. The Bank's activity in derivative financial instruments involves special risk factors including credit risks. The uniqueness of the credit risk in such transactions stems from the fact that the stated amount of the transaction does not necessarily reflect its entailed credit risk. For further details see "General disclosure regarding exposure related to credit risk of a counterparty" under "Credit risk management".

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	
	2012	2011
	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	-	208
With an AA rating	-	126
With an AA- rating	346	502
With an A+ rating	59	443
With an A rating	876	158
With an A- rating	550	-
With a BBB+ rating	2	29
With a BBB rating	34	-
Not rated	14	36
Total against foreign financial institutions	**1,882**	**1,502**
Total against Israeli financial institutions	**1,226**	**1,054**
Total balances of assets deriving from transactions in derivative instruments	**3,108**	**2,556**

1. ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

(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	
	2012	2011
	In NIS million	
Off 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	-	16
With an AA rating	-	41
With an AA- rating	56	145
With an A+ rating	6	11
With an A rating	120	20
With an A- rating	57	-
With an BBB+ rating	9	-
With an BBB rating	1	-
Not rated	1	1
Total against foreign financial institutions	**251**	**234**
Total against Israeli financial institutions	**29**	**17**
Total Off balances of assets deriving from transactions in derivative instruments	**280**	**251**

1. ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

(3) Following are details of the column "Other" in Note 20 B to the financial statements according to the overall credit to the public risk per economic sectors:

	On December 31, 2012		On December 31, 2011	
	in NIS million			
Agriculture		3		2
Industry:				
Machines, electrical and electronic equipment	41		139	
Mining, chemical industry and oil products	122		292	
Other	37		36	
Total industry		200		467
Construction and real estate:				
Construction and real estate acquisition	72		-	
Real estate holdings	92		287	
Other	16		47	
Total Construction and real estate		180		334
Electricity and water		211		29
Commerce		71		44
Hotels, hotel services and food		-		4
Transportation and storage		39		30
Communications and computer services		7		3
Financial services:				
Financial institution (excluding banks)	172		74	
Private customers active on the capital market	132		116	
Financial holding institutions	50		47	
Insurance and provident fund services	61		205	
Total financial services		415		442
Other business services		96		19
Public and community services		10		143
Private individuals - housing loans		-		13
Private individuals - other		125		87
Total		**1,357**		**1,617**

2. 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 50 million.

The Bank's exposure to leveraged finance according to economic sector of the acquired corporation:

	Balance sheet credit as of	
	December 31, 2012	December 31, 2011
Sector	in NIS millions	
Industry	545	*700
Construction and real estate	838	962
Electricity and water	130	134
Commerce	386	*404
Communications and computer services	94	108
Financial services	421	352
Other business services	177	203
Total	**2,591**	**2,863**

* Reclassified in respect of a reclassification of exposure from the industry sector to the commercial sector.

Exposure to leveraged finance (as defined above) as of December 31, 2012 amounted to NIS 2,591 million, compared to NIS 2,863 million at the end of 2011, a decrease of 9.5%. The balance of exposure presented in the table above, is net of accounting write-offs in accordance with the directive regarding impaired debts.

3. CREDIT LEVELS IN EXCESS OF NIS 800 MILLION - ADDITIONAL DETAILS

Note 4 C presents details regarding composition of credit to the public and off-balance-sheet credit risk, by size of credit to individual borrower, in accordance with public reporting instructions published by the Supervisor of Banks.

Following are general details regarding the largest borrowers included in the upper levels (over NIS 800 million) of the said Note(1) (Consolidated):

	As at December 31	
	2012	2011
	in NIS thousands	
Field of activity:		
Financial services(2)	580,611	1,146,172
Electricity and water(2)	1,311,935	1,031,775
Real estate(2)	1,072,586	1,097,532
Machinery, electric and electronic equipment(2)	721,552	917,987
Communications and computer services(2)	822,653	888,841
Transportation and storage(2)	606,059	871,759
Public and Community Services(2)	3,922,000	(3)3,253,000
Public and Community Services(2)	2,425,000	(3)4,295,000
Public and Community Services(2)	4,403,000	(3)5,544,000

Footnotes:
(1) The above data represent "indebtedness" data (also including unutilized credit facilities) and before provision for credit losses.
(2) One of- 9 borrowers in the two upper levels in 2011
(3) Reclassified, in order to include U.S. Government Agencies, municipal bonds and bonds of States in the U.S.A.

4. 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 Banking Division's data at the Bank level, up to the "earnings before tax" line. The Banking Division's data include the household segment customers, the small business segment and the middle market banking segment. The data for the Corporate Division include the corporate banking segment and the data for the Customer Assets Division include the private 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 Bank's "Nostro" management and risk management, which is subject to the responsibility of the Finance 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 31,2012						
Reported net income (loss)	224	263	245	173	24	(127)	802
Net income (loss) for Management reports	170	244	214	159	21	(6)	802
Difference	**54**	**19**	**31**	**14**	**4**	**(121)**	**-**
Following is the composition of the differences:							
Income (loss) from Interest income, net before credit loss expenses	9	10	24	12	1	(57)	-
Profit from severance pay funds	74	19	24	8	5	(130)	-
Total income that was transferred	83	29	48	21	6	(186)	-
Provision for taxes (tax savings)	29	10	17	7	2	(65)	-
Difference	**54**	**19**	**31**	**14**	**4**	**(121)**	**-**

4. THE MAIN DIFFERENCES BETWEEN THE MANAGERIAL REPORTING FORMAT AND THE PUBLIC REPORTING FORMAT (CONTINUED)

	For the year ended December 31,2011[(1)(3)]						
Reported net income (loss)	219	174	353	150	(4)	[(2)(4)](45)	847
Net income (loss) for Management reports	203	163	338	141	(5)	7	847
Difference	**16**	**11**	**15**	**9**	**1**	**(52)**	**-**
Following is the composition of the differences:							
Income (loss) from Interest income, net before credit loss expenses	8	12	18	12	1	(52)	-
Profit from severance pay funds	15	5	5	2	1	(27)	-
Total Income that was transferred	23	17	23	14	2	(79)	-
Provision for taxes (tax savings)	7	6	8	5	1	(27)	-
Difference	**16**	**11**	**15**	**9**	**1**	**(52)**	**-**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) Reclassified, See "General" at the beginning of "Activity of the Group according to principal segments of operations"

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

5.DETAILS OF THE INVESTMENT IN GOVERNMENT BONDS

Note 3 to the financial statements includes, among other things, details regarding investments in government bonds included in the "held to maturity" portfolio, the "available-for-sale" portfolio and the "trading" portfolio, divided into bonds and loans of the Government of Israel and bonds and loans of foreign governments.

Following are details divided by governments with respect to the total securities portfolio:

	December 31,2012		December 31,2011	
	Book value	Fair value[1]	Book value	Fair value[1]
	In NIS millions			
Of the Israeli Government	26,682	26,941	22,814	22,895
US governments	336	336	[3]394	[3]394
Other governments	615	[2]618	[3]483	[2][3]487
Total	**27,633**	**27,895**	**23,691**	**23,776**

Footnotes:

(1) Fair value data based on market prices, does not necessarily reflect the price that may be obtained on the sale of securities in large volumes.

(2) Among the other governments, there is not one government the investment in bonds and loans and thereof exceeds NIS 374 million as December 31, 2012 (NIS 315 as of December 31,2011).

(3) Reclassified – Ginnie Mae bonds, which were presented in the past as “U.S. government”, in an amount of NIS 2,316 million (book value), have been reclassified from “Of foreign governments” to “Of others abroad” (which is not presented above).

MANAGEMENT REVIEW

SCHEDULE "A" – CONSOLIDATED BALANCE SHEET – MULTI-PERIOD DATA

	As at December 31				
	2012	2011	2010	2009	2008
	In NIS millions				
Assets					
Cash and deposits with banks	24,100	30,329	18,187	24,583	21,554
Securities	46,001	42,898	37,176	36,338	31,535
Securities borrowed or purchased under resale agreements	387	145	45	336	25
Credit granted to the public(1)	119,696	118,358	124,902	120,820	122,511
Provision for credit loss(1)	(2,085)	(1,975)	(6,236)	(6,394)	(6,055)
Credit granted to the public, net	117,611	116,383	118,666	114,426	116,456
Credit granted to the Governments	1,696	1,640	1,556	1,820	1,491
Investments in affiliated companies	1,724	(1)(2)1,591	(1)(2)1,660	1,785	1,817
Buildings and equipment	2,962	3,080	3,125	3,178	3,039
Intangible assets and goodwill	142	152	(3)163	(3)211	(3)264
Assets in respect of derivative instruments	3,595	3,114	2,039	1,836	3,407
Other assets	2,662	(4)3,132	(4)(3)2,937	(3)3,042	(3)2,201
Noncurrent assets held for sale	-	8	13	-	-
Total Assets	**200,880**	**202,472**	**185,567**	**187,555**	**181,789**
Liabilities and Equity					
Deposits from the public	151,935	153,368	138,011	141,825	139,232
Deposits from banks	3,720	4,249	3,387	3,724	4,555
Deposits from the Government	1,005	925	461	284	206
Securities loaned or sold under buy-back arrangements	5,452	6,700	7,227	7,651	7,194
Subordinated capital notes	12,284	12,239	12,294	11,529	9,373
Liabilities in respect of derivative instruments	4,576	4,432	3,215	2,489	4,222
Other liabilities	9,774	(2)9,538	9,829	10,158	8,376
Total liabilities	188,746	191,451	174,424	177,660	173,158
Equity capital attributed to the Bank's shareholders	11,838	(1)(2)(4)10,702	(1)(2)(4)10,815	9,597	8,405
Non-controlling rights in consolidated companies	296	(2)319	328	298	226
Total equity	12,134	11,021	11,143	9,895	8,631
Total Liabilities and Equity	**200,880**	**202,472**	**185,567**	**187,555**	**181,789**

:Footnotes

(1) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) Reclassified, see Note 1 C 7 to the financial statements.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

SCHEDULE "B" - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

	As at December 31				
	2012	(1)2011	(1)2010	(1)2009	(1)2008
	in NIS millions				
Interest income	7,843	8,413	7,400	7,699	9,637
Interest expenses	3,384	(2)3,796	2,849	3,248	5,320
Interest income, net	4,459	4,617	4,551	4,451	4,317
Credit loss expenses	726	778	821	998	780
Net interest income after credit loss expenses	**3,733**	**3,839**	**3,730**	**3,453**	**3,537**
Non-interest Income					
Non-interest financing income	352	98	172	215	(283)
Commissions	2,685	2,670	2,725	2,895	2,644
Other income	220	(4)169	99	266	12
Total non-interest income	**3,257**	**2,937**	**2,996**	**3,376**	**2,373**
Operating and other Expenses					
Salaries and related expenses	3,444	(4)3,466	3,218	3,130	3,132
Maintenance and depreciation of buildings and equipment	1,203	1,159	1,148	1,032	951
Amortization and impairment of intangible assets and goodwill (2)	10	(5)11	(5)48	(5)50	(5)48
Other expenses	1,169	(5)1,209	(5)1,245	(5)1,229	(5)1,243
Total operating and other expenses	**5,826**	**5,845**	**5,659**	**5,441**	**5,374**
Income before taxes	1,164	931	1,067	1,388	536
Provision for taxes on income	407	114	479	556	160
Income after taxes	757	817	588	832	376
Bank's share in income (loss) of affiliated companies, net of tax effect	(3)104	(2)(6)101	(2)(6)172	158	(70)
Net income:					
Before attribution to non-controlling rights holders	861	918	760	990	306
Attributed to the non-controlling rights holders	(59)	(2)(71)	(70)	(72)	(78)
Net income attributed to bank's shareholders	**802**	**847**	**690**	**918**	**228**
Earnings per share of NIS 0.1 (in NIS):					
Total earnings per share attributed to Bank's shareholders	**0.76**	**(2)(6)0.80**	**(2)(6)0.69**	**0.92**	**0.23**
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	**1,053,869**	**1,053,869**	**997,578**	**993,979**	**993,979**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(4) Reclassified, see Note 1 C 5.3 to the financial statements.

(5) Reclassified, see Note 1 C 7 to the financial statements.

(6) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

SCHEDULE "C" – RATES OF FINANCIAL INCOME AND EXPENSES – CONSOLIDATED[1]

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]
	In NIS millions		In %		In NIS millions		In %	
Non-linked Israeli Currency:								
Assets[4][5]	107,448	4,815	4.48		98,072	[9]4,917	5.01	
Effect of derivatives:[3]								
Hedging derivatives	42	12			-	-		
Embedded and ALM derivatives	84,211	1,875			77,212	3,266		
Total assets	**191,701**	**6,702**		**3.50**	**175,284**	**8,183**		**4.67**
Liabilities[5]	(96,329)	(1,727)	(1.79)		(88,610)	[10](1,847)	(2.08)	
Effect of derivatives:[3]								
Hedging derivatives	(42)	(15)			-	-		
Embedded and ALM derivatives	(94,577)	(2,196)			(79,338)	(3,305)		
Total liabilities	**(190,948)**	**(3,938)**		**(2.06)**	**(167,948)**	**(5,152)**		**(3.07)**
Interest margin			2.69	1.44			2.93	1.60
Israeli Currency Linked to the CPI :								
Assets[4][5]	25,956	1,212	4.67		27,041	[9]1,625	6.01	
Effect of derivatives:[3]								
Embedded and ALM derivatives	2,831	109			1,908	62		
Total assets	**28,787**	**1,321**		**4.59**	**28,949**	**1,687**		**5.83**
Liabilities[5]	(20,562)	(987)	(4.80)		(21,103)	[9](1,299)	(6.16)	
Effect of derivatives:[3]								
Embedded and ALM derivatives	(4,829)	(90)			(4,746)	(570)		
Total liabilities	**(25,391)**	**(1,077)**		**(4.24)**	**(25,849)**	**(1,869)**		**(7.23)**
Interest margin			(0.13)	0.35			(0.15)	(1.40)

For footnotes see page 308.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED[1] (CONTINUED)

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]
	In NIS millions		In %		In NIS millions		In %	
Foreign Currency:[6]								
Assets[4][5]	60,350	1,524	2.53		[9]58,324	[9]6,279	10.77	
Effect of derivatives:[3]								
Hedging derivatives	1,235	35			398	54		
Embedded and ALM derivatives	69,479	(623)			50,651	5,328		
Total assets	**131,064**	**936**		**0.71**	**109,373**	**11,661**		**10.66**
Liabilities[5]	(66,676)	(159)	(0.24)		(63,461)	(5,272)	(8.31)	
Effect of derivatives:[3]								
Hedging derivatives	(1,287)	(60)			(408)	(77)		
Embedded and ALM derivatives	(58,466)	551			(47,229)	(4,932)		
Total liabilities	**(126,429)**	**332**		**0.26**	**(111,098)**	**(10,281)**		**(9.25)**
Interest margin			2.29	0.97			2.46	1.41

For footnotes see page 308.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED[1] (CONTINUED)

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]
	In NIS millions		In %		in NIS millions		In %	
Total:								
Monetary assets which generated financing income [4][5]	193,754	7,551	3.90		183,437	12,821	6.99	
Effect of derivatives:[3]								
Hedging derivatives	1,277	47			398	54		
Embedded and ALM derivatives	156,521	1,361			129,771	8,656		
Total assets	**351,552**	**8,959**		**2.55**	**313,606**	**21,531**		**6.87**
Monetary liabilities which generated financing expenses[5]	(183,567)	(2,873)	(1.57)		(173,174)	(8,418)	(4.86)	
Effect of derivatives:[3]								
Hedging derivatives	(1,329)	(75)			(408)	(77)		
Embedded and ALM derivatives	(157,872)	(1,735)			(131,313)	(8,807)		
Total liabilities	**(342,768)**	**(4,683)**		**(1.37)**	**(304,895)**	**(17,302)**		**(5.67)**
Interest margin			2.33	1.18			2.13	1.20
In respect of options		15				[9]-		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives)[3]		26				[9](5)		
Other financing income[7]		415				[9]351		
Other financing expenses		(1)				[9](1)		
Income from financing activities before credit loss expenses[11]		4,731				4,574		
Credit loss expenses		(726)				(778)		
Income from financing activities after credit loss expenses		4,005				3,796		

For footnotes see next page.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED[1] (CONTINUED)

	2012	2011
	Average balance[2]	Average balance[2]
	In NIS millions	
Total:		
Monetary assets which generated financing income [4][5]	193,754	183,437
Assets related to derivative instruments[8]	3,068	2,275
Other monetary assets[5]	2,518	[9]2,009
Provisions for credit losses	(1,852)	(1,903)
Total monetary assets	**197,488**	**185,818**
Total:		
Monetary liabilities which generated financing expenses [5]	(183,567)	(173,174)
Liabilities related to derivative instruments[8]	(4,125)	(3,380)
Other monetary liabilities[5]	(3,682)	(3,741)
Total monetary liabilities	**(191,374)**	**(180,295)**
Surplus of monetary assets over monetary liabilities	6,114	5,523
Non-monetary assets	5,646	6,076
Non-monetary liabilities	(279)	(803)
Total capital resources	**11,481**	**10,796**

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.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the Bank's asset and liability management system.

(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 the equity under other cumulative comprehensive income, in the item "Adjustments for the presentation of available-for-sale securities at fair value" : 2012 – NIS 234 million in the unlinked segment, NIS 91 million in the CPI linked segment and NIS (214) million in the foreign currency segment; 2011 – NIS 6 million in the unlinked segment, NIS 10 million in the CPI linked segment and NIS (131) 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) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(10) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(11) Net interest income together with non-interest financing income and excluding gains from investment in shares, comprise the profit from financing operations before expenses in respect of credit losses.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED[1] (CONTINUED)

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding effect of derivatives	Including effect of derivatives[3]
	In US$ millions*		In %		In US$ millions*		In %	
Foreign Currency – Nominal in US$:[6]*								
Assets[4][5]	16,113	475	2.95		16,081	535	3.33	
Effect of derivatives:[3]								
Hedging derivatives	331	16			116	-		
Embedded and ALM derivatives	18,169	234			14,536	329		
Total Assets	**34,613**	**725**		**2.09**	**30,733**	**864**		**2.81**
Liabilities[5]	(17,917)	(166)	(0.93)		(17,806)	(195)	(1.10)	
Effect of derivatives:[3]								
Hedging derivatives	(345)	(22)			(119)	(6)		
Embedded and ALM derivatives	(15,251)	(193)			(13,470)	(249)		
Total liabilities	**(33,513)**	**(381)**		**(1.14)**	**(31,395)**	**(450)**		**(1.43)**
Interest margin		344	2.02	0.95		414	2.23	1.38

* 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.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the Bank's asset and liability management system.

(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: 2012 - in amount of US$ (49) million; 2011 - in the amount of US$ (36) million.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

SCHEDULE "D" – EXPOSURE TO CHANGES IN INTEREST RATES – CONSOLIDATED

	As at December 31, 2012				
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years
	in NIS millions				
Non linked Israeli currency					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets[(1)]	71,297	13,453	8,519	4,531	3,560
Derivative financial instruments (except for options)	16,466	29,160	12,837	6,856	7,454
Options (in terms of base assets)	532	574	978	185	83
Total fair value	**88,295**	**43,187**	**22,334**	**11,572**	**11,097**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities[(1)]	71,233	6,866	11,247	4,836	1,098
Derivative financial instruments (except for options)	20,281	30,140	15,624	7,265	9,316
Options (in terms of base assets)	438	725	849	20	9
Off-balance sheet financial instruments	1	2	6	1	-
Total fair value	**91,953**	**37,733**	**27,726**	**12,122**	**10,423**
Financial instruments, net					
Exposure to changes in interest rates in the segment	(3,658)	5,454	(5,392)	(550)	674
Cumulative exposure in the segment	**(3,658)**	**1,796**	**(3,596)**	**(4,146)**	**(3,472)**
CPI linked Israeli currency					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets[(1)]	556	993	3,648	8,395	4,775
Derivative financial instruments (except for options)	11	513	686	407	923
Options (in terms of base assets)	9	3	11	19	9
Total fair value	**576**	**1,509**	**4,345**	**8,821**	**5,707**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities[(1)]	534	687	3,167	6,390	3,804
Derivative financial instruments (except for options)	11	104	1,567	1,516	200
Options (in terms of base assets)	3	14	75	108	31
Off-balance sheet financial instruments	1	1	6	1	-
Total fair value	**549**	**806**	**4,815**	**8,015**	**4,035**
Financial instruments, net					
Exposure to changes in interest rates in the segment	27	703	(470)	806	1,672
Cumulative exposure in the segment	**27**	**730**	**260**	**1,066**	**2,738**

Notes:

(1) Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

(2) Weighted average by fair value of average effective duration.

(3) Including shares listed under "No fixed maturity".

(4) Including Israeli currency linked to foreign currency.

As at December 31, 2012							As at December 31, 2011		
Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average duration In years	Total fair value	Internal rate of return In %	Effective average duration In years
in NIS millions									
4,208	436	18	700	106,722	4.21%	0.69	106,363	5.08%	0.81
6,336	57	-	-	79,166		1.36	76,040		1.21
52	4	-	-	2,408		0.01	2,804		0.01
10,596	**497**	**18**	**700**	**188,296**		**(2)0.96**	**185,207**		**(2)0.96**
774	36	-	-	96,090	1.51%	0.29	96,630	2.26%	0.29
6,340	39	-	-	89,005		1.30	82,990		1.21
3	-	-	-	2,044		0.01	2,490		0.01
-	-	-	-	10		0.01	10		0.01
7,117	**75**	**-**	**-**	**187,149**		**(2)0.76**	**182,120**		**(2)0.70**
3,479	422	18	700	1,147			3,087		
7	**429**	**447**	**1,147**						
5,986	1,131	15	31	25,530	2.08%	3.78	26,692	2.65%	3.55
566	3	-	-	3,109		3.09	2,342		2.25
3	-	-	-	54		0.01	56		0.01
6,555	**1,134**	**15**	**31**	**28,693**		**(2)3.70**	**29,090**		**(2)3.44**
6,598	870	-	-	22,050	1.14%	4.04	21,789	2.20%	3.98
1,043	-	-	-	4,441		2.78	4,841		3.23
8	-	-	-	239		0.01	277		0.01
-	-	-	-	9		0.64	11		0.82
7,649	**870**	**-**	**-**	**26,739**		**(2)3.79**	**26,918**		**(2)3.81**
(1,094)	264	15	31	1,954			2,172		
1,644	**1,908**	**1,923**	**1,954**						

General notes:

(a) 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 regarding the assumptions used in calculating the fair value of financial instruments, see "Management and measurement of market risks" under "Exposure to risks and risk management".

(b) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(c) 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.

SCHEDULE "D" - EXPOSURE TO CHANGES IN INTEREST RATES - CONSOLIDATED (CONTINUED)

	As at December 31, 2012				
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years
	in NIS millions				
Foreign currency[4]					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets[1]	26,501	12,685	7,100	4,456	2,730
Derivative financial instruments (except for options)	23,705	18,529	13,231	3,390	2,552
Options (in terms of base assets)	1,355	1,389	1,350	274	-
Total fair value	**51,561**	**32,603**	**21,681**	**8,120**	**5,282**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities[1]	38,186	8,574	11,615	4,437	2,162
Derivative financial instruments (except for options)	18,242	17,546	7,955	3,614	2,800
Options (in terms of base assets)	1,439	1,236	1,413	339	42
Off-balance sheet financial instruments	-	-	1	-	-
Total fair value	**57,867**	**27,356**	**20,984**	**8,390**	**5,004**
Financial instruments, net					
Exposure to changes in interest rates in the segment	(6,306)	5,247	697	(270)	278
Cumulative exposure in the segment	**(6,306)**	**(1,059)**	**(362)**	**(632)**	**(354)**
Total exposure to changes in interest rates					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets[1],[3]	98,354	27,131	19,267	17,382	11,065
Derivative financial instruments (except for options)	40,182	48,202	26,754	10,653	10,929
Options (in terms of base assets)	1,896	1,966	2,339	478	92
Total fair value	**140,432**	**77,299**	**48,360**	**28,513**	**22,086**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities[1]	109,953	16,127	26,029	15,663	7,064
Derivative financial instruments (except for options)	38,534	47,790	25,146	12,395	12,316
Options (in terms of base assets)	1,880	1,975	2,337	467	82
Off-balance sheet financial instruments	2	3	71	2	-
Total fair value	**150,369**	**65,895**	**53,583**	**28,527**	**19,462**
Financial instruments, net					
Exposure to changes in interest rates in the segment	(9,937)	11,404	(5,223)	(14)	2,624
Cumulative exposure in the segment	**(9,937)**	**1,467**	**(3,756)**	**(3,770)**	**(1,146)**

Notes:

(1) Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

(2) Weighted average by fair value of average effective duration.

(3) Including shares listed under "No fixed maturity".

(4) Including Israeli currency linked to foreign currency.

	As at December 31, 2012							As at December 31, 2011		
	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average duration In years	Total fair value	Internal rate of return In %	Effective average duration In years
	in NIS millions									
	3,046	1,244	-	1,052	58,814	2.53%	1.16	59,108	3.50%	1.12
	3,894	-	-	-	65,301		0.60	58,270		0.67
	-	-	-	-	4,368		0.01	8,090		0.01
	6,940	**1,244**	**-**	**1,052**	**128,483**		**(2)0.84**	**125,468**		**(2)0.84**
	1,729	12	-	-	66,715	0.65%	0.58	68,170	1.57%	0.74
	4,961	3	-	-	55,121		0.81	50,139		0.82
	37	4	-	-	4,510		0.01	8,170		0.01
	-	-	-	-	1		0.67	2		0.70
	6,727	**19**	**-**	**-**	**126,347**		**(2)0.66**	**126,481**		**(2)0.72**
	213	1,225	-	1,052	2,136			(1,013)		
	(141)	**1,084**	**1,084**	**2,136**						
	13,240	2,811	33	2,489	191,772	3.41%	1.25	192,826	4.26%	1.29
	10,796	60	-	-	147,576		1.06	136,652		1.00
	55	4	-	-	6,830		0.01	10,950		0.01
	24,091	**2,875**	**33**	**2,489**	**346,178**		**(2)1.14**	**340,428**		**(2)1.13**
	9,101	918	-	-	184,855	1.16%	0.84	186,589	2.00%	0.88
	12,344	42	-	-	148,567		1.16	137,970		1.14
	48	4	-	-	6,793		0.01	10,937		0.01
	-	-	-	-	78		0.08	26		0.41
	21,493	**964**	**-**	**-**	**340,293**		**(2)0.96**	**335,522**		**(2)0.96**
	2,598	1,911	33	2,489	5,885			4,906		
	1,452	**3,363**	**3,396**	**5,885**						

General notes:

(a) 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 regarding the assumptions used in calculating the fair value of financial instruments, see “Management and measurement of market risks" under "Exposure to risks and risk management".

(b) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(c) 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.

SCHEDULE "E" - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS

	December 31, 2012								
	Total Credit Risk[1]		Debts[2] and off-balance sheet Credit Risk (excluding Derivatives)[3]						
							Credit Losses[4]		
	Total	Problematic[5]	Total	of which: Debts[2]	Problematic[5]	Impaired	Periodic Credit Loss Expenses	Net Accounting Write-Offs Recognized during the Period	Balance of Allowance for Credit Losses
	in NIS millions								
Lending Activity in Israel									
Agriculture	1,145	91	1,142	919	91	28	9	5	25
Industry	16,187	811	15,913	11,236	790	583	192	154	244
Construction and Real Estate - Construction	[7]14,510	1,010	14,461	5,740	1,008	657	(29)	13	183
Construction and Real Estate - Real Estate Activity	9,487	570	9,418	8,106	541	496	2	46	103
Electricity and Water	2,981	17	2,401	1,598	17	-	5	-	6
Commerce	13,034	671	12,918	10,402	671	214	77	27	161
Hotels, Hotel Services and Food	2,077	318	2,077	1,808	317	301	1	4	18
Transportation and Storage	3,954	83	3,898	3,203	74	49	7	(1)	25
Communication and Computer Services	2,438	166	2,318	1,975	166	25	(3)	(3)	36
Financial Services	11,442	758	10,098	8,347	671	422	244	130	159
Other Business Services	7,109	189	7,014	5,200	190	127	(4)	38	76
Public and Community Services	2,167	162	2,157	1,517	161	153	(1)	2	13
Commercial Total	**86,531**	**4,846**	**83,815**	**60,051**	**4,697**	**3,055**	**500**	**415**	**1,049**
Private Individuals - Housing Loans	20,672	1,071	20,671	19,613	1,071	-	-	5	225
Private Individuals - Other	35,508	284	35,484	16,823	284	148	21	65	380
Total Public	**142,711**	**6,201**	**139,970**	**96,487**	**6,052**	**3,203**	**521**	**485**	**1,654**
Banking Corporations in Israel	3,109	-	1,577	1,267	-	-	-	-	-
Israeli Government	28,925	-	2,164	1,614	-	-	-	-	-
Total Lending Activity in Israel	**174,745**	**6,201**	**143,711**	**99,368**	**6,052**	**3,203**	**521**	**485**	**1,654**
Lending Activity Outside of Israel									
Agriculture	340	-	340	191	-	-	(2)	-	3
Industry	7,566	352	7,530	4,110	351	289	48	(1)	102
Construction and Real Estate - Construction	1,344	578	1,344	1,292	578	577	42	4	146
Construction and Real Estate - Real Estate Activity	7,669	1,179	7,517	6,160	1,172	936	18	52	86
Electricity and Water	469	-	469	306	-	-	3	-	3
Commerce	6,657	355	6,649	4,344	355	267	46	17	110
Hotels, Hotel Services and Food	849	140	849	822	140	140	10	-	13
Transportation and Storage	998	51	998	722	51	51	2	-	22
Communication and Computer Services	179	-	178	108	-	-	1	-	2
Financial Services	5,070	[6]358	3,042	1,846	50	29	12	24	44
Other Business Services	2,454	204	2,452	1,769	204	85	24	29	54
Public and Community Services	12,908		267	260		-	1	-	2
Commercial Total	**46,503**	**3,217**	**31,635**	**21,930**	**2,901**	**2,374**	**205**	**125**	**587**
Private Individuals - Housing Loans	53	1	53	53	1	-	-	-	-
Private Individuals - Other	1,805	15	1,789	1,226	15	7	(1)	-	15
Total Public	**48,361**	**3,233**	**33,477**	**23,209**	**2,917**	**2,381**	**204**	**125**	**602**
Banking Corporations Outside of Israel	10,177	85	6,879	6,711	-	-	1	-	5
Governments Outside of Israel	1,421	-	82	82	-	-	-	-	-
Total Lending Activity Outside of Israel	**59,959**	**3,318**	**40,438**	**30,002**	**2,917**	**2,381**	**205**	**125**	**607**
TOTAL	**[1]234,704**	**9,519**	**184,149**	**129,370**	**8,969**	**5,584**	**726**	**610**	**2,261**

Footnotes:

(1) Balance Sheet and Off-Balance Sheet Credit Risk, including in respect of derivative instruments. Including: Debts[2], investments in bonds, securities borrowed or purchased under resale agreements, assets in respect of derivative instruments, and credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, of NIS 129,370, 45,294, 387, 3,596, 56,057 million, respectively.

(2) Credit to the Public, Credit to Governments, deposits with banks and other debts, excluding investments in bonds and securities borrowed or purchased under resale agreements.

(3) Credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, excluding in respect of derivative instruments.

(4) Including in respect of off-balance sheet credit instruments (stated in the balance sheet under "Other liabilities").

(5) Balance sheet and off-balance sheet credit risk in respect of the public, which is impaired, substandard or under special mention, including in respect of housing loans, in respect of which a allowance is made according to the period in arrears, and housing loans in respect of which no allowance is made according to the period in arrears, and are in arrears of 90 days or more.

(6) Includes problematic credit risk due to certain bonds issued by banking holding corporations, held by a subsidiary in an amount of NIS 271 million.

(7) Including acquisition groups in an amount of NIS 812 million.

SCHEDULE "E" - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS (CONTINUED)

	December 31, 2011								
	Total Credit Risk[1]		Debts[2] and off-balance sheet Credit Risk (excluding Derivatives)[3]						
							Credit Losses[4]		
	Total	Problematic[5]	Total	of which: Debts[2]	Problematic[5]	Impaired	Periodic Credit Loss Expenses	Net Accounting Write-Offs Recognized during the Period	Balance of Allowance for Credit Losses
	in NIS millions								
Lending Activity in Israel									
Agriculture	1,111	42	1,109	902	42	30	5	8	20
Industry	(9)16,798	(8)944	16,387	11,003	937	679	97	142	208
Construction and Real Estate - Construction	(10)14,264	1,102	14,237	5,918	1,102	774	(8)	34	227
Construction and Real Estate - Real Estate Activity	(9)10,233	673	10,106	8,342	623	578	56	4	177
Electricity and Water	2,158	7	2,048	980	7	-	1	1	1
Commerce	12,019	(8)330	11,975	9,038	321	269	(11)	-	107
Hotels, Hotel Services and Food	2,060	367	2,057	1,827	367	359	(11)	(9)	20
Transportation and Storage	3,046	58	3,009	2,606	52	27	4	6	16
Communication and Computer Services	2,691	227	2,687	2,245	227	25	8	(4)	36
Financial Services	(9)10,564	(8)340	9,224	7,919	300	276	42	78	35
Other Business Services	7,442	206	7,417	5,486	206	139	48	56	128
Public and Community Services	2,327	291	2,185	1,547	291	164	3	6	16
Commercial Total	**84,713**	**4,587**	**82,441**	**57,813**	**4,475**	**3,320**	**234**	**322**	**991**
Private Individuals - Housing Loans	21,172	469	21,158	19,659	469	-	(4)	7	230
Private Individuals - Other	35,030	338	35,003	17,040	338	197	150	184	423
Total Public	**140,915**	**5,394**	**138,602**	**94,512**	**5,282**	**3,517**	**380**	**513**	**1,644**
Banking Corporations in Israel	3,111	-	239	239	-	-	1	-	-
Israeli Government	24,675	-	1,617	1,617	-	-	-	-	-
Total Lending Activity in Israel	**168,701**	**5,394**	**140,458**	**96,368**	**5,282**	**3,517**	**381**	**513**	**1,644**
Lending Activity Outside of Israel									
Agriculture	290	17	290	199	17	17	4	-	5
Industry	8,263	25	8,095	4,460	25	3	5	12	54
Construction and Real Estate - Construction	1,417	529	1,416	1,337	517	504	165	148	98
Construction and Real Estate - Real Estate Activity	7,732	(8)1,334	7,449	6,381	1,334	1,159	84	59	89
Electricity and Water	266	-	264	148	-	-	-	18	-
Commerce	7,221	466	7,206	4,686	466	31	36	31	81
Hotels, Hotel Services and Food	925	229	924	918	229	229	9	7	13
Transportation and Storage	1,079	52	1,080	610	52	52	8	-	19
Communication and Computer Services	60	3	59	32	3	2	-	1	-
Financial Services	4,493	(7)958	3,279	1,819	316	76	26	19	68
Other Business Services	2,751	279	2,737	1,948	279	132	69	36	59
Public and Community Services	(6)15,219	-	43	27	-	-	-	-	-
Commercial Total	**49,716**	**3,892**	**32,842**	**22,565**	**3,238**	**2,205**	**406**	**331**	**486**
Private Individuals - Housing Loans	16	-	16	16	-	-	-	-	-
Private Individuals - Other	1,823	5	1,764	1,265	5	3	(12)	6	17
Total Public	**51,555**	**3,897**	**34,622**	**23,846**	**3,243**	**2,208**	**394**	**337**	**503**
Banking Corporations Outside of Israel	5,818	250	4,921	4,813	-	-	3	-	4
Governments Outside of Israel	909	-	23	23	-	-	-	-	-
Total Lending Activity Outside of Israel	**58,282**	**4,147**	**39,566**	**28,682**	**3,243**	**2,208**	**397**	**337**	**507**
TOTAL	**(1)226,983**	**9,541**	**180,024**	**125,050**	**8,525**	**5,725**	**778**	**850**	**2,151**

Footnotes:

(1) Balance Sheet and Off-Balance Sheet Credit Risk, including in respect of derivative instruments. Including: Debts[2], investments in bonds, securities borrowed or purchased under resale agreements, assets in respect of derivative instruments, and credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, of NIS 125,050, 42,235, 145, 3,197, 56,356 million, respectively.

(2) Credit to the Public, Credit to Governments, deposits with banks and other debts, excluding investments in bonds and securities borrowed or purchased under resale agreements.

(3) Credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, excluding in respect of derivative instruments.

(4) Including in respect of off-balance sheet credit instruments (stated in the balance sheet under "Other liabilities").

(5) Balance sheet and off-balance sheet credit risk in respect of the public, which is impaired, substandard or under special mention, including in respect of housing loans, in respect of which a allowance is made according to the period in arrears, and housing loans in respect of which no allowance is made according to the period in arrears, and are in arrears of 90 days or more.

(6) Reclassified – US Government agencies, Ginnie Mae bonds, municipal bonds and bonds issued by US States, in the stated value of NIS 15,176 million, were reclassified to "Public and community services".

(7) Reclassified, in order to include troubled credit risk in respect of certain bonds of bank holding corporations (TRUPS), held by a subsidiary in the amount of NIS 608 million.

(8) Reclassified, in order to include troubled credit risk in respect of transactions in derivatives.

(9) Reclassified, in order to include in "comprehensive credit risk", guarantees and other liabilities on account of customers, as well as certain transactions involving derivatives and bonds in a total amount of NIS1,181 million.

(10) Includes acquisition groups in the amount of NIS1,145 million

SCHEDULE "F" – EXPOSURE TO FOREIGN COUNTRIES – CONSOLIDATED[1]

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 - 2012

	December 31 2012 Balance sheet exposure[2]		
	Across the border balance sheet exposure		
The Country	To governments[4]	To banks	to Others
	In NIS millions		
United States	1,482	2,108	1,243
United Kingdom	93	2,059	135
PIIGS[5]	-	4	16
Other	274	3,588	3,818
Total exposure to foreign countries	**1,849**	**7,759**	**5,212**
Includes - Total exposure to LDC countries	**78**	**899**	**795**

Notes:

(1) Based on the final risk, net of the effect of guarantees, liquid collateral and credit derivatives.

(2) Balance and off-balance credit risk, Problematic criticized exposure and impaired debts are presented before the impact of the provision for credit loss and before the impact of collateral that are deductible for the purpose of a borrower or a group of borrowers liability.

(3) Credit risk of off-balance sheet financial instruments as computed for the purpose of borrower indebtedness limitations.

(4) Governments, official institutions and central banks.

(5) Portugal, Ireland, Italy, Greece and Spain.

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, 2012 and 2011, the Bank had no such exposure.

C. Information regarding exposure to foreign countries having liquidity problems, for the year ending December 31, 2012:

	Outstanding balances
	Ireland
	In NIS millions
Amount of exposure at the beginning of year	29
Changes in remaining exposure:	-
Amounts collected	(20)
Amount of exposure at period end	**9**

December 31 2012									
Balance sheet exposure[2]						Off-balance sheet exposure[2][3]			
Balance sheet exposure to local resident customers of extensions of a banking corporation in a foreign country								Across the border balance sheet exposure[2]	
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	Problematic criticized exposure	impaired debts	Total off-balance sheet exposure	Of which problematic criticized exposure	Due up to one year	Due over one year
In NIS millions									
29,543	18,992	10,551	15,384	887	191	8,341	6	4,162	671
1,123	157	966	3,253	688	663	77	-	1,551	736
-	-	-	20	1	1	12	-	9	11
2,129	1,919	210	7,890	642	620	1,118	2	4,302	3,378
32,795	**21,068**	**11,727**	**26,547**	**2,218**	**1,475**	**9,548**	**8**	**10,024**	**4,796**
1,654	**1,654**	**-**	**1,772**	**33**	**31**	**251**	**-**	**1,087**	**685**

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 extensions liabilities (the deduction is performed up to the exposure amount).

SCHEDULE "F" - EXPOSURE TO FOREIGN COUNTRIES - CONSOLIDATED[1] (CONTINUED)

D. 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 the Bank's equity, the lower of the two - 2011

	December 31, 2011		
	Balance sheet exposure[2]		
	Across the border balance sheet exposure		
The Country	To governments[4]	To banks	to Others
	In NIS millions		
United States	1,452	1,940	1,764
United Kingdom	-	1,659	119
PIIGS[5]	-	28	18
Other	227	2,762	4,342
Total exposure to foreign countries	**1,679**	**6,389**	**6,243**
Of which: Total exposure to LDC countries	**57**	**607**	**664**

Notes:

(1) Based on the final risk, net of the effect of guarantees, liquid collateral and credit derivatives.

(2) Balance and off-balance credit risk, commercial criticized exposure and impaired debts are presented before the impact of the provision for credit loss and before the impact of collateral that are deductible for the purpose of a borrower or a group of borrowers liability.

(3) Credit risk of off-balance sheet financial instruments as computed for the purpose of borrower indebtedness limitations.

(4) Governments, official institutions and central banks.

(5) Portugal, Ireland, Italy, Greece and Spain.

December 31, 2011									
Balance sheet exposure[(2)]						Off-balance sheet exposure[(2)(3)]			
Balance sheet exposure to local resident customers of extensions of a banking corporation in a foreign country								Across the border balance sheet exposure[(2)]	
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	Problematic commercial criticized exposure	impaired debts	Total off-balance sheet exposure	Of which problematic criticized exposure	Due up to one year	Due over one year
In NIS millions									
28,742	18,643	10,099	15,255	751	291	7,982	-	3,424	1,732
1,330	259	1,071	2,849	636	553	162	-	1,143	635
-	-	-	46	26	25	14	1	34	12
1,770	1,619	151	7,482	776	760	1,898	2	4,366	2,965
31,842	**20,521**	**11,321**	**25,632**	**2,189**	**1,629**	**10,056**	**3**	**8,967**	**5,344**
1,368	**1,368**	**-**	**1,328**	**-**	**8**	**646**	**-**	**876**	**452**

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 extensions liabilities (the deduction is performed up to the exposure amount)

E. Information regarding the balance-sheet exposure to foreign countries having liquidity troubles for the year ended December 31, 2011

	Outstanding balances		
	Greece	Ireland	Portugal
	In NIS millions		
Amount of exposure at the beginning of year	2	97	24
Changes in remaining exposure:			
Amounts collected	-	(45)	(24)
Other changes (including provisions and write-offs)	(2)	(23)	-
Amount of exposure at period end	**-**	**29**	**-**

SCHEDULE "G" - CONDENSED CONSOLIDATED BALANCE SHEET - MULTI QUARTER DATA

	2012				2011			
Quarter	4	3	2	1	4	3	2	1
	In NIS millions							
Assets								
Cash and deposits with banks	24,100	27,544	22,454	27,077	30,329	29,316	23,703	20,781
Securities	46,001	45,334	45,455	45,240	42,898	37,774	33,102	34,257
Securities borrowed or purchased under resale agreements	387	678	423	224	145	157	82	204
Credit granted to the public	119,696	121,042	121,333	117,034	118,358	120,480	119,132	118,586
Provision for credit loss[1]	(2,085)	(2,002)	(1,921)	(1,954)	(1,975)	(1,964)	(1,843)	(1,916)
Credit granted to the public, net	117,611	119,040	119,412	115,080	116,383	118,516	117,289	116,670
Credit granted to the Government	1,696	1,734	1,703	1,651	1,640	1,641	1,608	1,570
Investments in affiliated companies	1,724	1,621	1,565	1,648	(3)(2)1,591	(3)(2)1,555	(3)(2)1,554	(3)(2)1,538
Buildings and equipment	2,962	2,970	3,022	3,029	3,080	3,057	3,086	3,128
Intangible assets and goodwill	142	145	148	149	152	(1)149	165	167
Assets in respect of derivative instruments	3,595	3,254	3,403	2,348	3,114	3,560	1,908	2,111
Other assets	2,662	2,913	3,045	2,857	(4)3,132	(1)3,246	3,498	3,285
Noncurrent assets held for sale	-	6	11	11	8	5	6	50
Total Assets	**200,880**	**205,239**	**200,641**	**199,314**	**202,472**	**198,976**	**186,001**	**183,761**

For footnotes, see next page.

SCHEDULE "G" – CONDENSED CONSOLIDATED BALANCE SHEET – MULTI QUARTER DATA

	2012				2011			
Quarter	4	3	2	1	4	3	2	1
	In NIS millions							
Liabilities and Equity								
Deposits from the public	151,935	154,688	150,862	149,811	153,368	149,197	139,296	136,088
Deposits from banks	3,720	5,412	4,352	4,866	4,249	4,362	4,151	4,533
Deposits from the Government	1,005	1,059	1,030	951	925	881	780	707
Securities loaned or sold under buy-back arrangements	5,452	5,752	5,867	7,020	6,700	6,523	6,002	6,621
Subordinated capital notes	12,284	12,422	12,434	12,346	12,239	12,426	12,255	12,174
Liabilities in respect of derivative instruments	4,576	4,005	4,373	3,687	4,432	4,797	2,965	3,046
Other liabilities	9,774	9,959	10,091	9,390	(2)9,538	(2)10,038	9,900	10,212
Total liabilities	188,746	193,297	189,009	188,071	191,451	188,224	175,349	173,381
Equity capital attributed to the Bank's shareholders	11,838	11,612	11,306	10,919	(4)(3)(2)10,702	(3)(2)10,448	(3)(2)10,333	(3)(2)10,058
Non-controlling rights in consolidated companies	296	330	326	324	(2)319	(2)304	319	322
Total equity	12,134	11,942	11,632	11,243	11,021	10,752	10,652	10,380
Total Liabilities and Equity	**200,880**	**205,239**	**200,641**	**199,314**	**202,472**	**198,976**	**186,001**	**183,761**

Footnotes:

(1) Reclassified, see Note 1 C 7 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA

	2012			
Quarter	4	3	2	1
	In NIS millions			
Interest income	1,630	2,076	2,213	1,924
Interest expenses	564	934	1,060	826
Interest income, net	1,066	1,142	1,153	1,098
Credit loss expenses	252	233	118	123
Net interest income after credit loss expenses	**814**	**909**	**1,035**	**975**
Non-interest Income				
Non-interest financing income	59	94	37	162
Commissions	660	693	673	659
Other income	65	(2)73	(2)34	(2)48
Total non-interest income	**784**	**860**	**744**	**869**
Operating and other Expenses				
Salaries and related expenses	785	(2)882	(2)877	(2)900
Maintenance and depreciation of buildings and equipment	309	297	299	298
Amortization and impairment of intangible assets	2	3	2	3
Other expenses	283	312	275	299
Total operating and other expenses	**1,379**	**1,494**	**1,453**	**1,500**
Income before taxes	219	275	326	344
Provision for taxes (tax savings) on income	107	78	107	115
Income after taxes	112	197	219	229
Bank’s share in income (loss) of affiliated companies, net of tax effect	71	39	(1)(38)	32
Net income:				
Before attribution to non-controlling rights holders	183	236	181	261
Attributed to the non-controlling rights holders	(14)	(15)	(16)	(14)
Net income attributed to bank's shareholders	**169**	**221**	**165**	**247**
Earnings (losses) per share of NIS 0.1 (in NIS):				
Total earnings per share attributed to Bank's shareholders	**0.16**	**0.21**	**0.16**	**0.23**
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	**1,053,869**	**1,053,869**	**1,053,869**	**1,053,869**

Footnotes:

(1) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(2) Reclassified, see Note 1 C 5.3 to the financial statements.

SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA (CONTINUED)

	(1)2011			
Quarter	4	3	2	1
	In NIS millions			
Interest income	1,954	2,105	2,294	2,060
Interest expenses	846	(2)954	1,069	927
Interest income, net	1,108	1,151	1,225	1,133
Credit loss expenses	252	226	188	112
Net interest income after credit loss expenses	**856**	**925**	**1,037**	**1,021**
Non-interest Income				
Non-interest financing income	(7)	(109)	46	168
Commissions	658	662	668	682
Other income	(3)37	(3)78	(3)37	(3)17
Total non-interest income	**688**	**631**	**751**	**867**
Operating and other Expenses				
Salaries and related expenses	(3)831	(3)875	(3)856	(3)904
Maintenance and depreciation of buildings and equipment	310	283	287	279
Amortization and impairment of intangible assets	2	(4)5	2	2
Other expenses	321	(4)317	296	275
Total operating and other expenses	**1,464**	**1,480**	**1,441**	**1,460**
Income before taxes	80	76	347	428
Provision for taxes (tax savings) on income	(132)	(52)	127	171
Income after taxes	212	128	220	257
Bank's share in income of affiliated companies, net of tax effect	(2)(5)20	(2)10	(2)28	43
Net income:				
Before attribution to non-controlling rights holders	232	138	248	300
Attributed to the non-controlling rights holders	(13)	(2)(17)	(19)	(22)
Net income attributed to bank's shareholders	**219**	**121**	**229**	**278**
Earnings per share of NIS 0.1 (in NIS):				
Total earnings per share attributed to Bank's shareholders	**0.21**	**0.11**	**0.22**	**0.26**
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	**1,053,869**	**1,053,869**	**1,053,869**	**1,053,869**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) Reclassified, see Note 1 C 5.3 to the financial statements.

(4) Reclassified, see Note 1 C 7 to the financial statements.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

CERTIFICATION

I, Reuven Spiegel, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 2012 (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.

Reuven Spiegel,
President & Chief Executive Officer

March 20, 2013

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, 2012 (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 20, 2013

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 Bank's internal control system 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, 2012, 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, 2012, 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, 2012 has been audited by the Bank's independent auditors, Messrs. Somekh Chaikin and Ziv Haft, Certified Public Accountants, as stated in their report presented on page 329, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as of December 31, 2012.

	Dr. Yossi Bachar	Reuven Spiegel	Joseph Beressi
	Chairman of the	President &	Senior Executive Vice President
March 20, 2013	Board of Directors	Chief Executive Officer	Chief Accountant

FINANCIAL STATEMENTS

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD. - IN ACCORDANCE WITH THE PUBLIC REPORTING DIRECTIVE OF THE SUPERVISOR OF BANKS REGARDING 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, 2012, 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 the attached financial reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the United States Public Company Accounting Oversight Board (PCAOB), regarding audit of internal control over financial reporting as adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

The internal control of a bank over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with 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 Bank's assets (including disposal thereof); (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 the Bank's receipts and expenditures are being made only in accordance with authorizations of the Bank's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition (including disposal) of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective material control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by COSO.

We also have audited, in accordance with accepted auditing standards in Israel and certain auditing standards applied in the audit of banking corporations as determined by directives and guidelines of the Supervisor of Banks, the Bank's accompanying financial statements and consolidated financial statements as of December 31, 2012 and 2011 and for each of the years in the three-year period ended on December 31, 2012, and our report dated March 20, 2013, expressed an unqualified opinion on these financial statements as well as calling attention to Note 19C items 12.5, 13 and 14 concerning motions for the approval of certain lawsuits as class action suits and regarding other claims against the Bank and investee companies, and item 15 regarding a decision of the Antitrust Commissioner.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 20, 2013

Ziv Haft
Certified Public Accountants (Isr.)

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, 2012 and December 31, 2011, 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, 2012. 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 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 audit provides a reasonable basis for our opinion.

In our opinion, based on our audits, the financial statements referred to above present fairly, in all material respects, the financial position - of the Bank and consolidated - as at December 31, 2012 and 2011, 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, 2012, 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 12.5, 13 and 14 concerning motions for the approval of certain lawsuits as class action suits and item 15 regarding a decision of the Antitrust Commissioner.

We have also audited in accordance with standards prescribed by the United States Public Company Accounting Oversight Board (PCAOB) regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel, the internal control of the Bank over financial reporting as of December 31, 2012, 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 20, 2013, included an unqualified opinion on the effectiveness of internal control over financial reporting of the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 20, 2013

Ziv Haft
Certified Public Accountants (Isr.)

BALANCE SHEET AS AT DECEMBER 31

		Consolidated		[1]The Bank	
	Notes	2012	2011	2012	2011
			in NIS millions		
Assets					
Cash and deposits with banks	2,15	24,100	30,329	17,545	26,284
Securities (of which 6,043, 5,877, 4,613, 4,387 respectively, pledged to lenders)	3,15	46,001	42,898	23,624	18,960
Securities borrowed or purchased under resale agreements		387	145	387	145
Credit granted to the public[1]	4	119,696	118,358	82,404	82,532
Provision for credit loss[1]	4	(2,085)	(1,975)	(1,375)	(1,281)
Credit granted to the public, net		117,611	116,383	81,029	81,251
Credit granted to Governments	5	1,696	1,640	1,614	1,616
(Investment in investee companies (consolidated – affiliated companies	6	1,724	[3][2]1,591	9,176	[3][2]9,078
Buildings and equipment	7	2,962	3,080	2,161	2,292
Intangible assets and goodwill	7a	142	152	-	-
Assets in respect of derivative instruments		3,595	3,114	3,521	3,042
Other assets	8	2,662	[5]3,132	1,168	[5]1,604
Noncurrent assets held for sale		-	8	-	3
Total Assets		**200,880**	**202,472**	**140,225**	**144,275**
Liabilities and Equity					
Deposits from the public	9	151,935	153,368	111,810	116,065
Deposits from banks	10	3,720	4,249	3,118	4,391
Deposits from the Government		1,005	925	223	221
Securities loaned or sold under buy-back arrangements		5,452	6,700	-	-
Subordinated capital notes	11	12,284	12,239	3,955	3,805
Liabilities in respect of derivative instruments		4,576	4,432	4,253	4,174
Other liabilities[4]	12	9,774	[2]9,538	5,028	4,917
Total liabilities		188,746	191,451	128,387	133,573
Equity capital attributed to the Bank's shareholders	13	11,838	[5][3][2]10,702	11,838	[5][3][2]10,702
Non-controlling rights in consolidated companies		296	[2]319	-	-
Total equity		12,134	11,021	11,838	10,702
Total Liabilities and Equity		**200,880**	**202,472**	**140,225**	**144,275**

:Footnotes

(1) For details regarding the restatement of the data for the Bank (unconsolidated), in order to retroactively reflect the merger between the Bank and DMB, see Note 1 C 7.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(4) Of which NIS 171 million and NIS 172 million in the consolidated, and NIS 134 million and NIS 135 million in the bank, as of December 31, 2012, and December 31, 2011, provision for credit loss in respect of off-balance sheet credit instruments.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

The notes to the financial statements are an integral part thereof.

March 20, 2013

Dr. Yossi Bachar Chairman of the Board of Directors	Reuven Spiegel President & Chief Executive Officer	Joseph Beressi Senior Executive Vice President, Chief Accountant

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31

		Consolidated		
	Notes	2012	[1]2011	[1]2010
		in NIS millions		
Interest income		7,843	8,413	7,400
Interest expenses		3,384	[2]3,796	2,849
Interest income, net	23	4,459	4,617	4,551
Credit loss expenses	4a	726	778	821
Net interest income after credit loss expenses		**3,733**	**3,839**	**3,730**
Non-interest Income				
Non-interest financing income	24	352	98	172
Commissions	25	2,685	2,670	2,725
Other income	26	220	[4]169	99
Total non-interest income		**3,257**	**2,937**	**2,996**
Operating and other Expenses				
Salaries and related expenses	27	3,444	[4]3,466	3,218
Maintenance and depreciation of buildings and equipment		1,203	1,159	1,148
Amortization and impairment of intangible assets and goodwill		10	[5]11	[5]48
Other expenses	28	1,169	[5]1,209	[5]1,245
Total operating and other expenses		**5,826**	**5,845**	**5,659**
Income before taxes		1,164	931	1,067
Provision for taxes on income	29	407	114	479
Income after taxes		757	817	588
Bank's share in income of affiliated companies, net of tax effect	6b	[3]104	[2][6]101	[2][6]172
Net income:				
Before attribution to non-controlling rights holders in consolidated companies		861	918	760
Attributed to the non-controlling rights holders in consolidated companies		(59)	[2](71)	(70)
Net income attributed to Bank's shareholders		**802**	**847**	**690**
Earnings per share of NIS 0.1 (in NIS)	13, 35			
Total earnings per share attributed to Bank's shareholders		**0.76**	**[2][6]0.80**	**[2][6]0.69**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(4) Reclassified, see Note 1 C 5.3 to the financial statements.

(5) Reclassified, see Note 1 C 7 to the financial statements.

(6) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

The notes to the financial statements form an integral part thereof.

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

		[4]The Bank		
	Notes	2012	[1]2011	[1]2010
		in NIS millions		
Interest income		5,282	5,755	4,874
Interest expenses		2,487	2,831	2,049
Interest income, net	23	2,795	2,924	2,825
Credit loss expenses	4a	589	574	527
Net interest income after credit loss expenses		**2,206**	**2,350**	**2,298**
Non-interest Income				
Non-interest financing income	24	138	(368)	232
Commissions	25	1,268	1,260	1,295
Other income	26	233	170	133
Total non-interest income		**1,639**	**1,062**	**1,660**
Operating and other Expenses				
Salaries and related expenses	27	2,219	2,248	2,126
Maintenance and depreciation of buildings and equipment		858	832	833
Other expenses	28	472	474	547
Total operating and other expenses		**3,549**	**3,554**	**3,506**
Income (loss) before taxes		296	(142)	452
Provision for taxes (tax savings) on income	29	121	(113)	192
Income (loss) after taxes		175	(29)	260
Bank's share in income of affiliated companies, net of tax effect	6b	[3]627	[2][5]876	[2][5]430
Net income attributed to bank's shareholders		**802**	**847**	**690**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(3) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(4) For details regarding the restatement of the data for the Bank (unconsolidated), in order to retroactively reflect the merger between the Bank and DMB, see Note 1C(7) to the financial statements.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Balance at December 31, 2009
Changes in 2010 :
Net Income for the year
Non-controlling interests, acquired by an affiliated company
Issue of Shares
Benefit in respect of equity based compensation transactions
Option expiration(3)
Exercise of options(4)
Provision for tax on an investment in an affiliated company in respect of items recorded in the equity
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
Dividend to non-controlling rights holders in consolidated subsidiaries
Balance at December 31, 2010
Cumulative effect, net of tax, of the initial implementation on Jan 1, 2011, of the Directive regarding the measurement of impaired debts and provision for credit losses
Cumulative effect, net of tax, of the initial application on Jan 1, 2011, of IFRS
Balance as of January 1, 2011, after adjustments stemming from the implementation of new standards and directives
Changes in 2011 :
Net Income for the year
Sale of shares in subsidiary companies to non-controlling rights holders
Option expiration(3)
Provision for tax on an investment in an affiliated company in respect of items recorded in the equity
Net adjustments for the presentation of available-for- sale securities at fair value
Net adjustments for the presentation of available-for-sale securities reclassified to the income statement
Related tax effect
Financial statements translation adjustments
Net loss on the hedging of cash flows
Effect of related taxes
Dividend to non-controlling rights holders in consolidated subsidiaries
Balance at December 31, 2011
Changes in 2012:
Net Income for the year
Option expiration(3)
Provision for tax on an investment in an affiliated company in respect of items recorded in the equity
Dividend to non-controlling rights holders in consolidated subsidiaries
Net adjustments for the presentation of available-for- sale securities at fair value
Net adjustments for the presentation of available-for-sale securities reclassified to the income statement
Related tax effect
Financial statements translation adjustments
Net loss on the hedging of cash flows
Effect of related taxes
Balance at December 31, 2012

* An amount lower than NIS 1 million.

Footnotes:

(1) Translation adjustments of foreign operations, primarily from a consolidated subsidiary IDB 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. Following the adoption of IAS21, the said balance was classified to retained earnings. Translation adjustments, as from January 1, 2012, relating to a consolidated subsidiary - Discount Bancorp Inc., the functional currency of which is different from that of the Bank.

(2) Including an amount of NIS 2,704 million that is not available for distribution see Note 13 f 2.

(3) In respect of 1,438,272 expired option warrants in 2012 (8,433,498 in 2011, 6,472,220 in 2010).

(4) In respect of 2,876,540 option warrants exercised into 348,994 ordinary "A" shares of NIS 0.1 par value each.

(5) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(6) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(7) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

The notes to the financial statements are an integral part thereof.

	Capital reserves				Other cumulative comprehensive income (loss)						
Share capital	Share premium	Benefit in respect of equity-based compensation transactions	Other	Total share capital and reserves	Adjustment for presentation of available for sale securities at fair value	Translation adjustments[1]	Net losses on cash flow hedging	Retained earnings[2]	Equity attributed to the Bank's shareholders	Non-controlling rights holders in consolidated subsidiaries	Total equity
					in NIS millions						
658	2,942	49	212	3,861	56	(236)	-	5,916	9,597	298	9,895
-	-	-	-	-	-	-	-	[5][7]690	690	70	760
-	-	-	-	-	-	-	-	[5](3)	(3)	-	(3)
7	443	-	-	450	-	-	-	-	450	-	450
-	-	* -	-	* -	-	-	-	-	* –	-	* –
-	13	(13)	-	-	-	-	-	-	-	-	-
* –	12	(12)	-	-	-	-	-	-	-	-	-
-	-	-	-	-	[5](3)	-	-	-	(3)	-	(3)
-	-	-	-	-	[5][7]462	-	-	-	462	9	471
-	-	-	-	-	[5](340)	-	-	-	(340)	(6)	(346)
-	-	-	-	-	[5][7](38)	-	-	-	(38)	(1)	(39)
-	-	-	-	-	-	-	-	-	-	(42)	(42)
665	3,410	24	212	4,311	137	(236)	-	6,603	10,815	328	11,143
-	-	-	-	-	-	-	-	(830)	(830)	(5)	(835)
-	-	-	-	-	-	231	-	(231)	-	-	-
665	3,410	24	212	4,311	137	(5)	-	5,542	9,985	323	10,308
-	-	-	-	-	-	-	-	[5][7]847	847	[5]71	918
-	-	-	-	-	-	-	-	[5](11)	(11)	[5](18)	(29)
-	18	(18)	-	-	-	-	-	-	-	-	-
-	-	-	-	-	10	-	-	23	33	-	33
-	-	-	-	-	[5][7](94)	-	-	-	(94)	-	(94)
-	-	-	-	-	[5](134)	-	-	-	(134)	(3)	(137)
-	-	-	-	-	[5][7]83	-	-	-	83	1	84
-	-	-	-	-	-	1	-	-	1	-	1
-	-	-	-	-	-	-	(15)	-	(15)	-	(15)
-	-	-	-	-	-	-	7	-	7	-	7
-	-	-	-	-	-	-	-	-	-	(55)	(55)
665	3,428	6	212	4,311	2	(4)	(8)	6,401	10,702	319	11,021
-	-	-	-	-	-	-	-	802	802	59	861
-	6	(6)	-	-	-	-	-	-	-	-	-
-	-	-	-	-	(17)	-	-	-	(17)	-	(17)
-	-	-	-	-	-	-	-	-	-	(82)	(82)
-	-	-	-	-	1,040	-	-	-	1,040	-	1,040
-	-	-	-	-	(367)	-	-	-	(367)	-	(367)
-	-	-	-	-	(243)	-	-	-	(243)	-	(243)
-	-	-	-	-	-	(77)	-	-	(77)	-	(77)
-	-	-	-	-	-	-	(3)	-	(3)	-	(3)
-	-	-	-	-	-	-	1	-	1	-	1
665	3,434	-	212	4,311	415	(81)	(10)	7,203	11,838	296	12,134

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31

	Consolidated			The Bank(6)		
	2012	2011	2010	2012	2011	2010
	in NIS millions					
Cash Flows from Operating Activities						
Net profit before attribution to non-controlling rights holders in consolidated companies	861	(1)(2)(7)918	(7)760	802	(2)(7)847	(7)690
Adjustments necessary to present cash flows from current operations:						
Bank's share in undistributed income of affiliated companies	(202)	(1)(127)	(133)	(758)	(1)(925)	(1)(427)
Depreciation of buildings and equipment (including impairment in value)	593	591	567	452	448	430
Amortization of goodwill and intangible assets	10	(6)11	(6)48	-	-	-
Provision for impairment of securities held for investment	28	(5)42	(5)82	-	(5)14	29
Credit loss expenses	1,167	1,178	1,114	883	813	712
Gain on sale of available-for-sale securities	(399)	(258)	(324)	(219)	(91)	(187)
Realized and non realized gain (loss) from adjustment to fair value of trading securities	(32)	(19)	(9)	(27)	(23)	(11)
Provision for impairment of affiliated company(4)	113	-	-	113	-	-
Loss on realization of investment in affiliated company	-	(26)	(34)	-	-	-
Provision for impairment in value of buildings	(3)	(11)	4	(3)	(11)	4
Gain on sale of buildings and equipment	(27)	(35)	(9)	(7)	-	(3)
Net deferred taxes	44	(131)	(86)	(21)	(42)	(67)
Severance pay – decrease in excess of deposits over the provision	7	140	58	20	26	(1)
Net change in current assets:						
Deposits with banks,net(3)	587	(274)	(1,014)	841	(310)	468
Credit granted to the public,net(3)	(1,988)	(456)	(4,643)	(357)	1,759	(2,467)
Credit granted to the Government,net(3)	(56)	(84)	264	2	(65)	267
Net on securities borrowed or purchased under resale agreements(3)	(242)	(100)	291	(242)	(100)	291
Assets in respect of derivative instruments	(481)	(1,075)	(203)	(479)	(1,085)	(233)
Trading securities(3)	(300)	(1,158)	(28)	(687)	(809)	10
Other assets	202	567	176	298	586	52
Effect of changes in exchange rate on cash and cash equivalent balances(3)	(44)	219	(137)	(57)	33	(24)
Accrual differences included in investment and financing activities	517	(5)(903)	(5)2,156	(14)	(5)41	463
Net change in current liabilities:						
Deposits from banks,net(3)	(529)	862	(337)	(1,273)	848	(438)
Deposits from the public,net(3)	(1,528)	15,556	(4,001)	(4,352)	11,130	(2,160)
Deposits from the Government,net(3)	80	464	177	2	19	14
Net on securities borrowed or purchased under resale agreements(3)	(1,248)	(527)	(424)	-	-	-
Liabilities in respect of derivative instruments	140	1,217	726	79	1,202	680
Other liabilities	223	(1)(505)	(468)	89	(535)	471
Adjustments in respect of exchange rate differences on current assets and liabilities, net	10	-	-	-	-	-
Net Cash Flows from Operating Activities	**(2,497)**	**16,076**	**(5,427)**	**(4,915)**	**13,770**	**(1,437)**

Footnotes:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

(3) Reclassified following the initial implementation of IAS 7 regarding "Cash Flow Statements", see Note 1 D 20 to the financial statements.

(4) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3) to the financial statements.

(5) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1 to the financial statements.

(6) For details regarding the restatement of the data for the Bank (unconsolidated), in order to retroactively reflect the merger between the Bank and DMB, see Note 1 C (7) to the financial statements.

(7) Amended following an immaterial adjustment of the comparative figures at FIBI - see Note 1 c 8 to the financial statements.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

	Consolidated			The Bank[3]		
	2012	2011	2010	2012	2011	2010
	in NIS millions					
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(1,788)	(645)	(2,319)	(407)	(359)	-
Proceeds from redemption of held-to-maturity bonds	976	1,506	1,661	-	-	-
Proceeds from held-to-maturity bonds in a consolidated company	-	166	-	-	-	-
Acquisition of available-for-sale securities	(23,826)	(21,168)	(24,116)	(10,551)	(7,049)	(10,958)
Proceeds from sale of available-for-sale securities	15,157	11,093	14,058	5,881	4,736	8,230
Proceeds from redemption of available-for-sale securities	7,107	5,706	7,956	1,707	254	281
Reduction of (additional) investment in investee companies	1	(5)	1	(86)	(89)	(22)
Proceeds of the sale of investments in investee companies and dividend	-	165	277	712	[1]202	[1]340
Proceeds of the sale of activity in an investee company	-	-	6	-	-	-
Acquisition of buildings and equipment	(498)	(520)	(509)	(332)	(364)	(351)
Proceeds from sale of buildings and equipment	54	49	7	16	-	7
Net Cash Flows from Asset Transactions	**(2,817)**	**(3,653)**	**(2,978)**	**(3,060)**	**(2,669)**	**(2,473)**
Cash Flows From Liability and Capital Transactions:						
Issuance of subordinated capital notes	440	344	1,237	290	79	687
Redemption of subordinated capital notes	(647)	(677)	(809)	(274)	(498)	(521)
Issuance of share capital	-	-	450	-	-	450
Sale of shares in a subsidiary to no -controlling right holders	-	34	-	-	-	-
Dividend to non-controlling rights holders	(82)	(55)	(42)	-	-	-
Net cash flows from liability and capital transactions	**(289)**	**(354)**	**836**	**16**	**(419)**	**616**
Increase (decrease) in cash	(5,603)	12,069	(7,569)	(7,959)	10,682	(3,294)
Cash balance at beginning of year	27,909	16,042	23,452	24,732	14,080	17,334
Effect of changes in exchange rate on cash and cash equivalent balances[1]	(41)	(219)	137	57	(33)	24
Cash balance at end of year	**22,265**	**27,892**	**16,020**	**16,830**	**24,729**	**14,064**
Interest and taxes paid and/or received						
Interest received	7,449	[2]8,048	7,572	4,703	5,587	4,617
Interest paid	(3,554)	(2,913)	(3,135)	(2,715)	(1,912)	(1,911)
Dividends received	1	[4]1	212	365	195	334
Taxes on income paid	(519)	(429)	(585)	(245)	(228)	(314)

Footnotes:

(1) Reclassified following the initial implementation of IAS 7 regarding "Cash Flow Statements", see Note 1 D 20.

(2) Reclassified - deduction of interest not recognized.

(3) For details regarding the restatement of the data for the Bank (unconsolidated), in order to retroactively reflect the merger between the Bank and DMB, see Note 1 C (7).

(4) Reclassified - setoff of intercompany balances

The notes to the financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

ANNEX - Non-cash asset and liability activity during the reported year:

	2012	2011	2010
	in NIS millions		
The Bank[(1)]:			
Purchase of fixed assets	-	10	20
Consolidated:			
Purchase of fixed assets	6	25	28

Footnote:

(1) For details regarding the restatement of the data for the Bank (unconsolidated), in order to retroactively reflect the merger between the Bank and DMB, see Note 1 C (7) to the financial statements.

The notes to the financial statements are an integral part thereof.

NOTES TO THE FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

A. GENERAL

1) Israel Discount Bank Ltd. (hereinafter: "the Bank") is a banking corporation incorporated in Israel.
2) The financial statements are prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and in accordance with directives and guidelines of the Supervisor of Banks regarding the preparation of a banking corporation's annual financial statements.
3) 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.
4) The financial statements were approved for publication by the Bank's Board of Directors on March 20, 2013.

B. DEFINITIONS

In these financial statements –

International Financial Reporting Standards (hereinafter: "IFRS") – standards and interpretations adopted by the International Accounting Standards Board (IASB) that include International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS), including interpretations of such standards determined by the International Financial Reporting Interpretation Committee (IFRIC), or interpretations determined by the Standing Interpretation Committee (SIC), respectively.

Generally Accepted Accounting Principles by banks in the U.S. – Accounting principles which U.S. banks traded in the U.S. are required to adopt. These principles have been determined by the bank supervisory authorities in the U.S., the U.S. Securities and Exchange Commission, the U.S. Financial Accounting Standards Board and additional factor in the U.S., and which are being implemented according to a hierarchy determined by the U.S. Financial Accounting Standard FAS 168 (ASC 105-10), the codification of accounting standards by the U.S. Financial Accounting Standards Board and the hierarchy of Generally Accepted Accounting Principles. In addition, the Supervisor of Banks has clarified that despite the hierarchy determined by FAS 168, any position announced publicly by the bank supervisory authorities in the U.S., or by a team of the bank supervisory authorities in the U.S., regarding the manner of implementation of generally accepted accounting principles in the U.S., shall be deemed a Generally Accepted Accounting Principle by banks in the U.S..

"Interested party" - as defined in Section 1 of the Securities Law, 1968.

"Related party" – As defined in IAS-24 regarding "Related party disclosures", excluding an interested party.

"Consolidated subsidiaries" - Companies the financial statements of which are fully consolidated, directly or indirectly, with those of the Bank.

"Affiliated companies" - companies, other than consolidated subsidiaries and including partnerships, the investment in which is included in the financial statements, either directly or indirectly, on the equity basis.

"Investee companies" - consolidated subsidiaries and affiliated companies.

"CPI" - the Consumer Price Index in Israel published by the Central Bureau of Statistics.

"Adjusted amounts" - Amounts in nominal historical terms adjusted to the CPI of December 2003, in accordance with the provisions of Opinions Nos. 23 and 36 of the Institute of Certified Public Accountants in Israel;

"Adjusted financial reporting" - Financial reporting in adjusted values based on changes in the general purchasing power of the Israeli currency, in accordance with the provisions of Opinions of the Institute of Certified Public Accountants in Israel.

"Reported amounts" - Adjusted amounts to date of transition (December 31, 2003), 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.

"Overseas extensions " - consolidated subsidiaries and branches abroad.

1. ACCOUNTING POLICIES (CONTINUED)

"Functional currency" - the currency of the principal business environment in which the Bank operates: generally, it is the currency of the environment in which the corporation generates and spends most of the cash.

"Presentation currency" - the currency in which the financial statements are presented.

C. BASIS FOR THE PREPARATION OF THE FINANCIAL STATEMENTS

1. Principles of financial reporting

The financial statements have been prepared according to the following principles:

- Issues within the core banking business - in accordance with the directives and guidelines of the Supervisor of Banks and in accordance with generally accepted accounting principles applying to banks in the United States that had been adopted within the framework of the public reporting directives of the Supervisor of Banks.
- Issues outside the core banking business - in accordance with generally accepted accounting principles in Israel and in accordance with certain International Financial Reporting Standards (IFRS), all according to the directives and guidelines of the Supervisor of Banks on such matters.

The international standards are being applied in accordance with 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, the Bank will act according to specific implementation guidelines determined by the Supervisor of Banks;
- In cases where a material issue is not addressed in the international standards or in the implementation directives of the Supervisor, the Bank will 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 reporting instructions, the Bank will 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 Bank will 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.

2. Basis of measurement

The financial statements have been prepared on the basis of historical cost except for the following assets and liabilities:

- Derivative financial instruments and other financial instruments measured at fair value through profit and loss (such as: investment in securities included in the trading portfolio);
- Financial instruments classified as available for sale;
- Liabilities in respect of share based payments to be settled in cash;
- Non-current assets held for sale and a group of assets held for sale;
- Deferred tax assets and liabilities;
- Provisions;
- Assets and liabilities in respect of employee benefits;
- Investments in affiliated companies and in entities under joint control treated on the equity basis of accounting.

The value of non-monetary assets and capital items measured by the historical cost basis, has been adjusted to changes in the CPI until December 31, 2003, since until that date the Israeli economy had been considered a hyper-inflationary economy. Beginning with January 1, 2004, the Bank prepares its financial statements in reported amounts.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3. Use of estimates and discretion

In preparing the financial statements in accordance Israeli GAAP and with directives and guidelines of the Supervisor of Banks, the Management of the Bank and of the investee companies are required to use discretion and apply estimates, evaluations and assumptions that affect the implementation of the accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from such estimates.

Upon the formation of accounting estimates applied in the preparation of financial statements, the Bank's Management is required to make assumptions with respect to circumstances and events involving significant uncertainty. When considering such estimates, the Bank's Management bases itself upon past experience, various facts, external factors and reasonable assumptions according to the circumstances applying to each estimate.

The estimates as well as the underlying assumptions are being reviewed on a current basis. Changes in accounting estimates are recognized in the period in which the estimates were changed and in each affected future period.

4. Change in estimates - update of the mortality tables in Israel

The Commissioner of the Capital Market, Insurance and savings issued in July 2012, a draft statement of position document, which includes a possible update of the mortality tables, in view of a new research indicating a rise in life expectancy. In accordance with guidelines of the Supervisor of Banks, on the actuarial computations used in computing the provisions in respect of benefits to employees following their retirement, the Bank used the draft mortality tables, as stated, in examining the best estimate. The effect of the change is not material. A final circular on the subject was issued on March 6, 2013. The circular did not include changes in respect of data included in the said draft, therefore the publication of the circular had no effect on the actuarial evaluations.

5. Reclassification

Following the initial implementation of certain accounting standards and directives of the Supervisor of Banks, certain items have been reclassified in order to adjust the comparative data to the headings of the items and to reporting requirements in the current period. In particular, the following have been reclassified:

5.1 New format for the statement of income. Following the initial implementation of the directives of the Supervisor of Banks in the matter of a new format for the statement of income (see subsection 6 (1) below), certain reclassifications have been made in the financial statements for the years ended December 31, 2010 and 2011, as follows:

- The following items, which in the past were included in the item "Profit from financing activities" have been reclassified and are included in the item "Non-interest financing income" as part of operations that are not for trading purposes:
  - Financing income (expenses) in respect of foreign currency exchange rate differences accrued on the principal sum of financial assets or financial liabilities not measured according to fair value through the statements of income (such as: credit to the public or to governments, deposits with banks, securities borrowed or purchased under resale agreements, available-for-sale bonds and bonds held to maturity, deposits of banks or deposits of the public, bonds and securities loaned or sold under repurchase agreements);
  - Income (expenses) in respect of derivative instruments used for ALM operations;
  - Gains (losses) from the sale of available-for-sale bonds and/or bonds held to maturity; and
  - Gains (losses) on the sale of loans;
- The items detailed below, which in the past had been included in the item "Profit from financing activities" have been reclassified and are included in the item "Non-interest financing income" as part of operations for trading purposes:
  - Realized and unrealized gains (losses) on adjustment to fair value of trading bonds;
  - Income (expenses) from other derivative instruments (not used for accounting hedge or ALM operations purposes);
- Commission income from financing operations that had been included in the past in the item "Profit from financing activities", have been reclassified and are included in the Item "Commissions" (formerly "Operating commissions");

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Gains (losses), which in the past had been included in the item "Net gains (losses) on investment in shares ", have been reclassified and are included in the item "Non-interest financing income" as part of operations for trading purposes, or as part of operations not for trading purposes, in accordance with the classification of the shares to the trading portfolio or to the available-for-sale portfolio;
- Gains (losses) that had been included in the past in the item "Profit (loss) from extraordinary operations, net of tax" have been reclassified, as follows:
  - Gains (losses) on sale of shares in affiliated companies and from the sale of the basket certificates operations, have been classified to the item "Non-interest financing income" as part of operations not for trading purposes;
  - Gains (losses) on sale of property and equipment have been classified to the item "Other income".

Concurrently, an appropriate amount has been recognized the "Provision for taxes on income" item.

Following are details of additions (deductions) in the statement of income items stemming from the said changes in classification (continued):

	For The Year Ended December 31, 2011			For The Year Ended December 31, 2010		
	Classification of financing items	Classification of gains from shares	Classification of income from extraordinary operations	Classification of financing items	Classification of gains from shares	Classification of income from extraordinary operations
	In NIS millions					
Income from financing activities before credit loss expenses[1]	(4,785)	-	-	(4,830)	-	-
Interest income, net	4,630	-	-	4,551	-	-
Non-interest financing income	(44)	92	44	136	31	-
Operating commissions[1]	(2,489)	-	-	(2,547)	-	-
Commissions	2,676	-	-	2,729	-	-
Net income on investment in shares[1]	-	(92)	-	-	(31)	-
Other income	12	-	41	17	-	-
Provision for taxes (tax savings) on profit	-	-	27	-	-	20
Bank's share in income of affiliated companies, net of tax effect	-	-	3	-	-	-
Net income (loss) from extraordinary operations, net of taxes, before attribution to non-controlling rights holders[1]	-	-	(61)	-	-	(36)

Footnote:
(1) Item that appeared in the old format.

5.2 Statement of cash flows. Following the initial implementation of IAS 7 regarding "Cash flow statements" (see subsection 6(2) below) the following reclassification has been made:

- Net changes in the flow of cash in respect of current assets (such as: deposits with banks, credit to the public, credit to the government, securities borrowed or purchased under resale agreements), and trading securities, previously included as part of investment activity (formerly activity in assets), in the amount of NIS 2,077 million (in the Bank: NIS 253 million), in the year ended December 31, 2011, and in the amount of NIS 5,130 million, in the year ended December 31, 2010 (in the Bank: NIS 1,388 million), have been reclassified to operating activity.
- Net changes in the flow of cash in respect of current liabilities (such as: deposits from banks, deposits from the public, government deposits and securities loaned or sold under repurchase agreements, previously included as part of financing activity (formerly activity in liabilities and capital), in the amount of NIS 16,355 million, in the year ended December 31, 2011 (the Bank: NIS 12,069 million), and in the amount of NIS 4,585 million, in the year ended December 31, 2010 (the Bank: NIS 2,561 million)have been reclassified to operating activity.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- The effect of changes in exchange rate on cash balances, which in the past were reflected as part of cash balances, in the amount of NIS 219 million for the year ended December 31, 2011 (the Bank: NIS 33 million), and in the amount of NIS 137 million for the year ended December 31, 2010 (the Bank: NIS 24 million), have been reclassified to "Effect of changes in exchange rate on cash and cash equivalent balances";
  - Separate presentation of the items of “Interest and taxes paid and/or received”.

5.3 Reclassified items in notes to the financial statements. Following the initial implementation of accounting standards, the updating of accounting standards and the directives of the Supervisor of Banks, as detailed in item 6 and item "D" below, data presented in certain notes to the financial statements have been reclassified in order to comply with new definitions, headings and manner of presentation in the current reporting period.

As well as modifying the accounting treatment by a subsidiary of gains on deposits with a severance pay fund to that of the Bank. An amount of NIS 7 million was added to payroll and related expenses and was added to other income.

6. Initial implementation of accounting standards, updates of accounting standards and Directives of the Supervisor of Banks

As from January 1, 2012, the Bank implements accounting standards and directives as detailed in items (1) to (7) hereunder. The instruction mentioned in Item 7 hereunder, is partially implemented, in accordance with the application instructions included therein, starting with the present financial statements.

(1) Instructions regarding the format of the statement of income determined in a circular letter of the Supervisor of Banks in the matter of "Format of the statement of income of a banking corporation and adoption of generally accepted accounting principles by banks in the U.S. in the matter of the measurement of interest income" (see item D 24 hereunder);

(2) Certain international financial reporting standards (IFRS) and interpretations of the International Financial Reporting Interpretation Committee (IFRIC) relating to the implementation of such standards, as detailed below:
- IAS 7, regarding "Cash flow statements";
- IAS 12, regarding "Income taxes";
- IAS 23, regarding "Borrowing costs";
- IAS 24, regarding "Related party disclosures";

(3) Clarifications by the Supervisor of Banks with respect to the manner of implementation of certain international financial reporting standards (IFRS):
   (a) Functional currency of overseas banking extensions;
   (b) Put options granted to non-controlling rights shareholders;

(4) Directives of the Supervisor of Banks regarding "Accounting treatment of transactions between a banking corporation and its controlling shareholder and between a company controlled by the banking corporation";

(5) Update of accounting standard ASU 2011-03 regarding "The re-examination of effective control in repurchase transactions";

(6) Instructions of the Supervisor of Banks in the matter of "measurement of fair value";

(7) Instructions of the Supervisor of Banks in the matter of "updating the disclosure regarding the credit quality of debts and the allowance for credit losses".

The Bank's accounting policy, as detailed in Item D below, combines the new accounting policy in respect of the implementation of the said standards and directives, and presents the manner and effect of their initial implementation, if at all.

7. Merger between the Bank and Discount Mortgage Bank Ltd. (“DMB”). On June 28, 2012, DMB was merged with and into the Bank. Upon the completion of the merger, DMB ceased to exist without being liquidated, and for all intents and purposes, the Bank is deemed to be DMB. (For details regarding the tax implications of the merger, see Note 29 L, below).

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On August 1, 2012, the Governor of the Bank of Israel, under the powers vested in him in terms of Section 8(1) of the Banking Law (Licensing), 1981, signed the order of cancellation of a mortgage bank license that had been granted to DMB in 1981.

As DMB was a wholly owned and controlled subsidiary of the Bank, the merger, as such, had no effect upon the consolidated financial statements at date of the merger.

The comparative figures for the Bank's data (not consolidated) in these financial statements and in the notes thereto, have been restated unanimously in order to reflect the merger retroactively as ever existing.

8. **An immaterial adjustment of the comparative figures of FIBI.** Following an approach by the Bank of Israel, a consolidated subsidiary of FIBI re-examined its compliance with accounting hedge rules, as determined in the public reporting instructions, and found that the documentation in its hand regarding hedge transactions made in the years 2007-2009, does not comply with a part of the requirements in the instructions. Accordingly, the said consolidated subsidiary decided to untie the hedge relations of the said transactions and restate them.

   Following an approach by the Bank of Israel, FIBI examined compliance with the terms detailed in the letter of the Bank of Israel dated March 1, 2009, in the matter of recognition of impairment of securities sold during the first quarter of 2011, prior to the signing of the financial statements for the year 2010. This examination showed that FIBI did not comply with one of the terms detailed in the said letter, according to which, impairment of securities sold prior to the publication of the financial statements for a given reporting period, should be recognized in that reporting period. Accordingly, FIBI decided to recognize in the statement of income losses from adjustment to fair value of available for sale securities, included in the equity as of December 31, 2010, and which were sold at a loss prior to the publication of the financial statements for 2010.

   FIBI had examined the materiality of the said corrections in relation to the relevant reporting periods and reached the conclusion, after studying the quantitative and qualitative parameters, that there is nothing in the said corrections that might affect the manner of making economic decisions and/or affect the analysis of the said financial statements by users thereof. Therefore, the mistake in question is not considered material and accordingly FIBI corrected the comparative figures by way of an immaterial adjustment.

9. **Restatement in respect of the retroactive implementation of IAS 12 and of the clarification by the Supervisor of Banks with respect to put options to non-controlling interest**

Presented below is the effect of the retroactive implementation on each of the previous periods included in this report:

A. Data regarding Balance Sheet items - Consolidated

	As previously reported	The effect of restatement	As reported after restatement
	December 31, 2011		
Investments in affiliated companies	1,611	(20)	1,591
Other liabilities	9,463	75	9,538
Equity capital attributed to the shareholders of the bank	10,745	(43)	10,702
Non-controlling rights in consolidated companies	370	(51)	319
Total equity	11,115	(94)	11,021
	December 31, 2010		
Total equity	11,152	(9)	11,143

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Presented below is the effect of the retroactive implementation on each of the previous periods included in this report:

B. Data regarding Statement of income items - Consolidated

	For the year ended December 31, 2011			For the year ended December 31, 2011		
	As previously reported	The effect of restatement	As reported after restatement	As previously reported	The effect of restatement	As reported after restatement
Consolidated Statement of Income						
Interest expenses	3,783	13	3,796	-	-	-
The bank's share in the profits of affiliated companies after tax effect	106	(5)	101	186	(14)	172
Net income Before attribution to non-controlling rights holders in consolidated companies	84	(13)	71	-	-	-
Net income attributed to bank's shareholders	852	(5)	847	704	(14)	690

D. ACCOUNTING POLICY APPLIED IN THE PREPARATION OF THE FINANCIAL STATEMENTS

1. FOREIGN CURRENCY AND LINKAGE

1.1 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.

1.2 IAS 21, the effects of changes in foreign exchange rates:

Foreign currency transactions. Transactions in foreign currency are translated into the Bank's relevant functional currencies and its extensions on the basis of the exchange rates ruling at dates of the transactions. Financial assets and liabilities denominated in foreign currency at the reporting date are translated into the functional currency in accordance with the exchange rate ruling on that date. The exchange rate difference in respect of financial items is the difference between the amortized cost stated in the functional currency at the beginning of the year, adjusted to the effective interest and payments during the year, and the amortized cost stated in foreign currency and translated using the year-end exchange rate.

Non-financial assets and liabilities denominated in foreign currency and measured according to fair value are translated into the functional currency according to the exchange rate ruling on the date on which fair value has been determined. Non-financial items stated in foreign currency and measured according to historical cost are translated according to the exchange rate ruling at the date of the transaction.

Exchange rate differences stemming from translation to the functional currency are recognized in the statement of income, except for the following differences which are recognized in other comprehensive income, stemming from the translation of: capital financial instruments classified as available for sale (except in cases of impairment when translation differences that had been recognized in other comprehensive income are reclassified to the statement of income); hedging of cash flow, in respect of the effective part of the hedge.

Foreign activity. Assets and liabilities of foreign activities, including goodwill and adjustments to fair value made upon acquisition, are translated into NIS on the basis of the exchange rates ruling at the reporting date. Income and expenses of foreign activities are translated into NIS on the basis of exchange rates ruling at dates of the transactions.

Foreign banking extensions. Until 1994, certain foreign banking extensions had been classified as autonomous units and exchange differences on translation of their operations had been reflected directly in the equity as part of the translation adjustments reserve. Starting with 1995, in accordance with guidelines of the Supervisor of Banks, foreign banking extensions have been classified as "long-arm operations" (foreign operations the functional currency of which is identical to the bank's functional currency).

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Classification of the Bank's foreign extensions. According to IAS21, in order to determine the functional currency, the banking corporation has to consider, among other things, the following factors:

- The currency that mainly affects the selling price of goods and services (as a general rule, it will be the currency in which the sale prices of goods and services are denominated and settled) and the currency of the country the competitive powers and regulation of which determine mainly the sale prices of goods and services;
- The currency that principally affect payroll costs, materials and other costs required for the supply of goods or services (as a general rule, this will be the currency in which such costs are denominated and settled);
- Other factors which may provide evidence for the functional currency of the entity, such as: the currency in which funds from financing operations are produced and the currency in which generally the proceeds from current operations are being maintained;
- Relations of the extension with the banking corporation - whether the overseas operation has a significant degree of independence, whether transactions of the extension with the banking corporation comprise a high or low rate of the overseas operations, whether the cash flows from the overseas operations have a direct effect upon the cash flows of the banking corporation and are available for transfer and whether the cash flows of the overseas operations are adequate to finance existing and anticipated liabilities of the overseas extension without additional finance being provided by the banking corporation.

Based on the examination of the said criteria, it has been determined that the functional currency of certain of the overseas extensions is not identical to the Shekel. Notwithstanding, changing the classification of an overseas banking extension into an extension in which functional currency is different than the Shekel, was conditioned in a pre-ruling by the Supervisor of Banks. Until such pre-ruling is obtained, the Bank continued to treat its overseas extensions as an overseas operation which functional currency is identical to the Shekel.

On February 14, 2012, the Supervisor of Banks published a circular letter in the matter of "The functional currency of extensions operating overseas", which included criteria determined by the Supervisor of Banks designed to determine the functional currency of a bank overseas extension. In determining the functional currency that is not NIS, a banking corporation is required to verify the existence/absence of each one of the criteria detailed below and document the results:

- The principal environment in which the extension produces and expends cash is a foreign currency environment, while the shekel operations of the extension are marginal;
- Autonomous attraction of customers by the extension – business transacted by the extension with banking corporation customers and/or parties related to them and/or parties referred to the extension by the banking corporation, is insignificant;
- The activity of the extension with the banking corporation and/or with parties related to the banking corporation is insignificant. Furthermore, there is no significant dependence of the extension on financing sources provided by the banking corporation or by parties related to the banking corporation;
- In essence, the activity of the extension is independent and is self sufficient and does not expand or complement the domestic activity of the group. Furthermore, the extension transacts its business and operations having a significant level of autonomy.

Where one of the said criteria does not significantly exist (example: business of the extension transacted with the Bank's customers is significant to the extent that it constitutes the major part of the extension's business), this would indicate that the extension should be treated as a foreign operation the functional currency of which is the shekel. In other situations, the decision will have to be made based on an examination of all the criteria.

The Bank has re-examined the classification of its overseas banking extensions based on the new criteria. In light of the new examination, the banking extension Bancorp was classified as from January 1, 2012, as foreign operations the functional currency of which is different from the shekel. The change in classification was treated by way of from now onwards as a change in the functional currency of such extension, so that currency translation differences were recognized as from January 1, 2012, in other comprehensive income and presented as part of "adjustments from translation".

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.3 The following are the representative rates of exchange and the CPI and their annual rates of change:

				Annual rate of change		
	2012	2011	2010	2012	2011	2010
CPI (in points):						
Known at balance sheet month (November index)	111.9	110.3	107.6	1.5	2.6	2.3
Representative exchange rate (in NIS) at the balance sheet date of the:						
U.S. Dollar	3.733	3.821	3.549	(2.3)	7.7	(6.0)
Euro	4.921	4.938	4.738	(0.4)	4.2	(12.9)

2. PRINCIPLES OF CONSOLIDATION AND THE IMPLEMENTATION OF THE EQUITY METHOD

2.1 Business combinations. A business combination is a transaction or another event in which the purchaser acquires control of another business or over a number of businesses. The Bank applies the "acquisition method" in respect of all business combinations.

Date of acquisition is the date on which the purchaser acquires control over the purchased entity. Control is the power to determine the financial and operational policies of a corporation in order to gain benefits from its operations. In examining the existence of control, potential voting rights that may be exercised immediately are taken into consideration. The Bank uses discretion in determining the acquisition date and whether control has indeed been obtained.

Business combinations that have occurred prior to January 1, 2011. In accordance with guidelines of the Supervisor of Banks, the Bank has adopted the relief determined in items C4 and C5 of IFRS 1, "Initial adoption of international financial reporting standards".

Accordingly, the Bank did not apply IFRS 3 (2008) retroactively in respect of business combinations, acquisition of affiliated companies and acquisition of minority interests that had occurred prior to January 1, 2011. Therefore, with respect to acquisitions made prior to January 1, 2011, recognized goodwill and excess of cost created represent the amounts recognized in accordance with generally accepted accounting principles in Israel.

Goodwill. In accordance with IFRS 3 (2008), goodwill acquired in a business combination is to be measured at its cost, less impairment losses. Accordingly, the Bank discontinued amortizing goodwill acquired prior to January 1, 2011 (the transition date).

Subsidiary companies. These are entities controlled by the Bank, the financial statements of which are consolidated with those of the Bank from date of obtaining control until control is discontinued.

The accounting policies of the subsidiaries were changed, where necessary, in order to adjust them to the accounting policies adopted by the Bank.

Non-controlling rights in consolidated subsidiaries. These are rights representing the equity of a subsidiary company which may not be attributed, directly or indirectly, to the parent company and which include therein additional components, to the extent existing, as follows: the capital component in convertible bonds of the subsidiary companies, share based payments to be settled by capital instruments of the subsidiary companies and stock options to shares of the subsidiary companies.

Non-controlling rights comprising instruments conferring ownership rights in the present and granting the owners thereof a share in the net assets in case of a liquidation (example: ordinary shares), are measured at fair value at date of the business combination. Other instruments matching the definition of non-controlling rights in consolidated subsidiaries (such as: options for ordinary shares) are measured at fair value or in accordance with other relevant IFRS rules.

Allocation of income and other comprehensive income items to shareholders. Income or losses and any component of other comprehensive income are allocated to the owners of a subsidiary company and to the non-controlling right holders in consolidated subsidiaries therein. Total income and other comprehensive income are allocated to the owners of a subsidiary company and to the non-controlling right holders in consolidated subsidiaries therein even if, as a result, the outstanding balance of the non-controlling rights in consolidated subsidiaries will be negative.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Transactions with non-controlling right holders in consolidated subsidiaries while maintaining control. Transactions with non-controlling right holders in consolidated subsidiaries while maintaining control are being treated as capital transactions. Any difference between the consideration received or paid and the change in the non-controlling rights is reflected directly in the equity.

Furthermore, upon a change in the ratio of holdings in a subsidiary company with no loss of control, the Bank reallocates the cumulative amounts recognized in other comprehensive income between the Bank's owners and the non-controlling interests holders.

2.2 Put options granted to non-controlling rights shareholders

In accordance with a letter of the Supervisor of Banks of March 18, 2012, regarding "The treatment of put options granted to non-controlling rights shareholders", the Bank implements the guidelines of international financial reporting standards (IFRS) in the matter.

Accordingly, put options issued to non-controlling rights shareholders settled in cash or in another financial instrument (including options issued prior to January 1, 2012) have been recognized as a liability in the amount of the present value of the exercise price. In following periods, changes in the value of the option have been recognized in the statement of income by the effective interest method. Furthermore, the share of the Group in the profits of the investee company includes the share of the non-controlling rights shareholders, to whom the Group had issued the put option.

The Supervisor’s letter contained a relief, whereby, for the purpose of calculating the ratio of capital to risk components, a banking corporation will include in its capital base the change in the shareholders’ equity stemming from the initial implementation of the guidelines included in the letter, not later than the termination date of its existing commitments.

The initial implementation and its effect. The guidelines have been implemented as from January 1, 2012, by way of retroactive implementation.

The effect of the retroactive implementation on previous reporting period included in this report, is presented in item C 9 above.

2.3 Investments in affiliated companies. Affiliated companies are entities in which the Bank has a material influence over their financial and operational policies, though not control.

Investments in affiliated companies are treated by the equity method and are initially recognized at cost. The cost of investment includes transaction costs. The consolidated financial statements include the share of the Group in income and expenses, in the income or loss and in other comprehensive income of investee entities treated by the equity method, after adjustments required to modify the accounting policy to that of the Group from date on which material influence has been obtained and until the date on which material influence no longer exist. It is clarified that the Bank does not make adjustments to accounting policies relating to core banking business issues (issues in respect of which the IFRS rules have not yet been adopted by the public reporting directives) implemented by a non-financial affiliated company, and to the accounting policy as a whole applied by an affiliated company constituting a banking corporation.

Where the share of the Group in losses exceed the value of the rights in a company treated by the equity method, the stated value of the said rights (including any long-term investment) is written-down to zero and the Bank does not recognize further losses, unless there are commitments for the support of the investee company or where amounts were paid in respect thereof.

Loss of material influence. The bank discontinues the use of the equity method as from the date on which material influence no longer exists and treats the investment as a financial asset.

On such date, the Bank measures at fair value any investment remaining in the former affiliated company and recognizes in the item "Non-interest financing income – gains or losses on investment in shares", as part of operations that are not for trading purposes, any income or loss resulting from the difference between the fair value of any remaining investment together with any consideration received for the realization of the part of the investment in the affiliated company and the stated value of the investment at that date.

Amounts that had been recognized as capital reserves within the framework of other comprehensive income, pertaining to that affiliated company are reclassified to the Statement of income or to retained earnings, in the same manner that would have been required had the affiliated company itself realized the related assets and liabilities.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Changes in rates of holdings in affiliated companies while maintaining material influence. Upon the increase in the rate of holdings in an affiliated company treated by the equity method, while maintaining the material influence, the Bank applies the acquisition method only in respect of the additional holdings percentage, the existing holdings remaining unchanged. Upon a reduction in the rate of holdings in an affiliated company treated by the equity method, while maintaining the material influence, the Bank deducts the proportionate share of its investment and recognizes an income or loss on the sale in the item "Non-interest financing income – gains or losses on investment in shares", as part of operations that are not for trading purposes. The cost of the sold rights for the purpose of computing the income or loss on the sale is based on a weighted average.

Furthermore, at that date, a proportionate part of the amounts that had been recognized as capital reserves within the framework of other comprehensive income, pertaining to that former affiliated company, are reclassified to the Statement of income or to retained earnings, in the same manner that would have been required had the former affiliate itself realized the related assets and liabilities.

2.4 Intercompany transactions. Intercompany balances within the Group and unrealized income and expenses stemming from intercompany transactions, were eliminated upon consolidation of the financial statements. Unrealized profits derived from transactions with affiliated companies were eliminated against the investment according to the rights of the Group in the affiliated companies. Unrealized losses were eliminated in the same manner in which profits have been eliminated, so long as no evidence of impairment exists.

2.5 The treatment in the Bank's stand alone financial statements. The Bank implements IAS27, excluding the treatment of investment in investee companies in the stand alone financial statements of the Bank. Accordingly, in preparing the standalone financial statements, the Bank is treating investee companies by the equity method of accounting. This, in accordance with directives and guidelines of the Supervisor of Banks.

3. The basis of recognition of income and expenses.

3.1 Financing income and expenses are included on an accrual basis, except for:

- Interest accrued on problematic debts classified as not occurring interest income debts is recognized on cash basis, when there is no doubt that the remaining recorded amount of the impaired debt will be collected. In cases where such doubt exists, all amounts collected serve to reduce the outstanding balance of the loan. Furthermore, interest on amounts in arrear in respect of housing loans is recognized on the basis of actual collection.
- Income from commission on early loan repayments, net of a proportionate part attributed to the financial capital, is included in the statement of income in equal annual installments over the remaining period of the loan or over three years from the date of early repayment, the shorter of the two periods.

  Cost of allocation of credit facilities, as well as commission on financing transactions, are recognized pro-rata to the period of the transactions.

3.2 Operating commissions in respect of services granted are recognized when the right to receive the commission materializes. Commissions on financing transactions are recognized relatively to the period of the transactions.

3.3 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.

3.4 With respect to securities – see sub-section 5 below; with respect to derivative financial instruments - see sub-section 6 below.

3.5 In periods following an impairment of an other than temporary nature, interest income on investments in debt instruments shall be recognized in a reported period based upon the anticipated surplus cash flows of the debt instrument (the base amount of a debt instrument at date of impairment of an other than temporary nature, is its fair value).

3.6 Other income and expenses are recognized on an accrual basis.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.7 Sale and leaseback transactions are presented in the financial statements in accordance with IAS-17.

3.8 **Initial implementation of the directives regarding the format of the statement of income.** A circular of the Supervisor of Banks dated December 29, 2011 in the matter of "the format of the statement of income of a banking corporation and adoption of generally accepted accounting principles by banks in the U.S. in the matter of the measurement of interest income", updated the definition of "interest", so as to include CPI linkage increments on interest, exchange rates differences on interest and CPI linkage increments on principal sums (a component formerly not regarded as part of interest). The instructions regarding the change in the definition of interest were implemented retroactively as from January 1, 2012 onwards. Notwithstanding, the instructions regarding the change in definition of "interest" in respect of impaired debts, were implemented in respect of debts classified as impaired as from January 1, 2012 and thereafter.

For details regarding instructions relating to the manner of presentation of the statement of income and reclassifications made accordingly, see item 1C 5.1 above.

4. IMPAIRED DEBTS, CREDIT RISK AND ALLOWANCE FOR CREDIT LOSS

4.1 The policy implemented as from January 1, 2011

In accordance with a Directive of the Supervisor of Banks regarding "Measurement and disclosure of impaired debts, credit risk and allowance for credit losses", the Bank applies, as from January 1, 2011, the U.S. accounting standards in this matter (ASC 310) and the positions of the bank’s supervisory authorities in the U.S. as well as of the SEC, in statements of position and guidelines of the Supervisor of Banks. Furthermore, since that date, the Bank is implementing the guidelines of the Supervisor of Banks in the matter of "Dealing with problem debts". Also, since January 1, 2012, the Bank implements the instructions of the Supervisor of Banks in the matter of "Update of the disclosure regarding the credit quality of debts and the allowance for credit losses".

Credit to the public and other debt balances

The Directive is being implemented with respect to all debt balances, such as: deposits with banks, bonds, securities borrowed or purchased under resale agreements, credit to the public, credit to governments, etc. Credit to the public and other debt balances, in respect of which the public reporting instructions do not include specific rules as regards the measurement of the allowance for credit losses (such as: credit to the government, deposits with banks, etc.) are stated in the Bank's books at their recorded amount. The recorded amount of a debt is defined as the debt balance, net of accounting write-offs, but before deduction of an allowance for credit losses in respect of the said debt. The recorded amount of a debt does not include unrecognized accrued interest or accrued interest recognized in the past but reversed at a later date. It should be clarified that prior to January 1, 2011, the Bank had applied different rules, according to which the balance of a debt stated in the Bank's books included the interest component accrued prior to the classification of the debt as a non-performing problematic debt. Accordingly, credit balances presented in periods prior to the period in which the Directive was initially implemented, are not comparable with credit balances reported after the initial implementation of the Directive. As to other debt balances, to which specific rules apply regarding the measurement and recognition of the provision for impairment (such as: bonds) the Bank continues to apply the same measurement rules (see item 5.7 below).

Identification and classification of impaired debts

The Bank has established procedures for the identification of problematic credit and the classification of debts as impaired. According to these procedures the Bank classifies problematic debts and off-balance sheet credit items under the following classifications: special mention, substandard or impaired. A debt is classified as impaired when based on information and updated events, the Bank does not expect to collect all amounts due to it under the contractual terms of the debt agreement. The decision regarding the classification of a debt is based, among other things, on the arrears situation of the debt, evaluation of the financial position and repayment ability of the borrower, the existence of collateral and the state thereof, the financial position of guarantors, where applicable, and their undertaking to support the debt and the ability of the borrower to obtain finance from a third party.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A debt examined on a specific basis, is classified as impaired when the principal amounts or interest in its respect are in arrears for 90 days or over, except where the debt is well secured and is in the process of collection. For this purpose, the Bank monitors the number of days in arrears in relation to the contractual repayment terms of the debt. Debts (including bonds and other assets) are in arrears when the principal amount or the interest thereon has not been paid upon their due date. In addition, current loan accounts or current accounts are reported as debts in arrears for 30 days or over, when the account exceeds the approved credit facility for a consecutive period of 30 days or over, or if during a period of 180 days, no amounts covering the debt within the framework of the credit facility, have been credited to the account. Starting with the date on which a debt is classified as impaired, it is treated as a debt that does not accrue interest income (hereinafter: "non-performing debt").

Furthermore, any debt, the terms of which had been changed within the framework of a reconstruction of a troubled debt, shall be classified as an impaired debt, unless prior to the reconstruction and thereafter, a minimum allowance for credit losses according to the extent of arrears method has been made in accordance with the Appendix to Proper Banking Management Directive No. 314 regarding "Problematic debts in housing loans granted by mortgage banks".

Reinstatement of an impaired debt as an unimpaired debt

An impaired debt returns to be classified as an unimpaired debt if one of the two situations exists:

- There are no principal or interest components which remain unpaid on their due date and the Bank expects the repayment in full of the remaining principal balance and of the interest due according to the terms of the agreement (including amounts which had been written off accounting wise or an allowance was made in their respect).
- The debt becomes well secured and is in the process of collection.

Reinstatement of an impaired debt as an impaired debt accruing interest

A debt, which has been formally reconstructed, so that after the reconstruction reasonable assurance exists that the debt would be repaid and would perform according to its new terms, is being treated again as a debt accruing interest income, on condition that the reconstruction and any accounting write-off made in relation to the debt are supported by an updated and well documented credit assessment with respect to the financial position of the borrower and a repayment forecast according to the new terms. The assessment is based on the cash and cash equivalent consecutive historical repayment performance of the borrower during a reasonable period of at least six months, and only after amounts which have materially reduced the recorded amount of the debt determined following the reconstruction, have been received.

A troubled debt under reconstruction

A debt that has undergone a formal troubled debt restructurings, is defined as a debt in respect of which, due to economic or legal circumstances related to financial difficulties of the borrower, the Bank has granted a waiver by way of changing the terms of the debt, so as to alleviate the burden of cash repayments in the short-term (a reduction in or deferment of cash payments due from the borrower), or by way of accepting other assets of the borrower in full or part as settlement of the debt.

Debts, the terms of which have been changed under a reconstruction of a troubled debt, including those debts which prior to the reconstruction had been examined on a group basis, will be classified as troubled debts and will be assessed on a specific basis for the purpose of performing the allowance for credit losses or of an accounting write-off. In view of the fact that the debt that had been reconstructed as a troubled debt, would not be paid in accordance with its original contractual terms, the debt continues to be classified as an impaired debt even after the borrower returns to a repayment schedule according to the new terms.

Allowance for credit losses

The Bank has determined procedures for the classification of credit and for the measurement of the allowance for credit losses in order to maintain an allowance at a level adequate to cover anticipated credit losses in relation to its credit portfolio. In addition, the Bank has determined procedures required to maintain an allowance at a level adequate to cover anticipated losses relating to off-balance sheet credit instruments as a separate liability account (such as: commitments to grant credit, unutilized credit facilities and guarantees).

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The allowance covering credit losses anticipated in relation to the credit portfolio is assessed in one of two ways: "specific allowance" or "group allowance".

Specific allowance for credit losses – The Bank has elected to identify for the purpose of a specific examination debts the total of their contractual amount, grouped at the borrower level, is over NIS 1 million (in one consolidated company – in respect of debts exceeding NIS 50 thousand, and in a consolidated credit card company – debts in respect of credit cards exceeding NIS 500 thousand, and in respect of debts of trading houses – of any amount). A specific allowance for credit losses is recognized in respect of any debt examined on a specific basis and which is classified as impaired. Furthermore, any debt, the terms of which had been changed under a reconstruction of a troubled debt shall be classified as an impaired debt, unless prior to the reconstruction and thereafter, a minimum allowance for credit losses according to the extent of arrears method has been made in accordance with the Appendix to Proper Banking Management Directive No. 314 regarding "Problematic debts in housing loans granted by mortgage banks".

The specific allowance for credit losses is assessed on the basis of anticipated future cash flows, capitalized using the original effective interest rate pertaining to the debt. Where the debt is collateral dependent or when foreclosure of property is expected by the Bank, the specific allowance is assessed on the basis of the fair value of the collateral pledged to secure the debt in question, after taking into account conservative and consistent coefficients reflecting, among other things the volatility of the fair value of the collateral, the time period until its actual realization and expected costs involved in the selling of the collateral.

In this respect, the Bank defines a debt as collateral dependent when repayment of the debt is anticipated to be made exclusively from the collateral pledged in favor of the Bank, or where the Bank is expected to be repaid from the asset held by the borrower, even though no specific pledge is registered on the asset, and everything in a situation where the borrower has no other significant, reliable and available resources for repayment of the debt.

Group allowance for credit losses. Computed in order to reflect allowances for impairment in respect of credit losses, that are not specifically identified inherent in large groups of small debts having similar risk characteristics, as well as in respect of debts examined on a specific basis and found unimpaired. The allowance for credit losses in respect of debts assessed on a group basis, excluding housing loans in respect of which a minimum allowance has been computed according to the extent of arrears, is computed in accordance with the rules established in ASC 450 (FAS 5) "Accounting for contingencies", based on a formula detailed in the provisional instruction published by the Supervisor of Banks, which is in effect up to and including December 31, 2012.The formula is based on historical loss ratios in various economic sectors, divided between problematic credit and non-problematic credit in the years 2008, 2009 and 2010, as well as on actual ratios of net accounting write-offs recorded as from January 1, 2011. In addition to the calculation of the range of historical loss rates in various economic sectors, as stated, for the purpose of determining the fair rate of allowance, the Bank takes into account additional factors, including trends in the total volume of credit and in the volume of open credit in each sector, sectorial conditions, macro-economic data, the level of risk and its trend and the effect of changes in the concentration of credit.

In accordance with guidelines specified in the provisional directive, as from January 1, 2011, the Bank does not maintain general and supplemental allowances, however it continues to compute the supplemental allowance and checks that in any event the amount of the group allowance at the end of each reporting period is not below the general and supplemental allowances that would have been computed as of that date, before the tax effect.

The required allowance in respect of off-balance sheet credit instruments is assessed according to the rules determined by ASC 450 (FAS 5). The group allowance in respect of off-balance sheet credit instruments is based on the rates of allowance determined for balance sheet credit (as detailed above), taking into consideration the anticipated rate of realization to credit of the off-balance sheet credit risk. The rate of realization to credit is computed by the Bank based on Credit Conversion Factors (CCF), as detailed in Proper Banking Management directive No. 203 "Measurement and capital adequacy – credit risk – the standard approach", with certain adjustments in cases where past experience is available at the Bank indicating realization to credit rates.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Minimum allowance in respect of housing loans – is computed according to a formula determined by the Supervisor of Banks, considering the extent of arrears, in a way in which the rates of the allowance increase in proportion to the extent of arrears. At date of the initial implementation of the new instruction, an amendment to the Appendix to Proper Banking Management directive No. 314 "Problematic debts in housing loans at mortgage banks" entered into effect, which extends the application of calculating the allowance according to the extent of arrears, to all housing loans, with the exception of loans not repayable by periodic installments and loans financing business characteristics operations.

In addition, the Bank studies the overall fairness of the allowance for credit losses. This fairness evaluation is based on the Management's discretion, which takes into account the risks inherent in the credit portfolio and evaluation methods implemented by the Bank in determining the allowance.

Accounting write-off

The Bank writes-off accounting wise each debt or part thereof examined on a specific basis and considered a debt that is uncollectible and of a low value so that leaving it as an asset is not justified, or a debt in respect thereof the Bank is conducting long-term collection efforts (in most cases defined as a period exceeding two years). With respect to debts assessed on a group basis, the write-off rules were determined based on their period of arrears (in most cases, over 150 consecutive days in arrear) and on other problem parameters. It should be clarified that accounting write-offs do not involve a legal waiver and they reduce the reported balance of debt for accounting purposes only, while creating a new cost base for the debt in the Bank's books.

Income recognition

On date of classification of a debt as impaired, the Bank defines the debt as not accruing interest income and discontinues the accrual of interest income in respect of the debt, with the exception of that mentioned below regarding certain reconstructed debts. Furthermore, at date of classification of a debt as impaired, the Bank cancels all interest income accrued and recognized as income in the statement of income but not yet collected. The debt continues to be classified as a debt that does not accrue interest so long as its classification as impaired has not been cancelled. A debt which had formally undergone troubled debt reconstructing – see "Restatement of an impaired debt as an impaired debt accurring interest" above. For details regarding the recognition of income on a cash basis in respect of debts classified as impaired, see item 3.1 above.

The Bank does not discontinue the accrual of interest income in respect of debts examined and provided for on a group basis, which are in arrears for 90 days or over.

4.2 The policy that had been implemented until December 31, 2010

1) The allowance for doubtful debts included a specific allowance, a general allowance and a supplemental allowance. The allowance for doubtful debts of the Bank and the consolidated subsidiaries in Israel was made according to the directives of the Supervisor of Banks. The allowances for doubtful debts in the consolidated banking subsidiaries abroad, were determined according to generally accepted principles in those countries.
2) The specific allowance 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 (or a part thereof) classified as non-performing, were not recognized as from the beginning of the quarter in which such debt have been declared as non-performing. These interest income were recognized upon collection of the interest.
4) The specific allowances 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 allowance for doubtful debts was 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

6) The directives of the Supervisor of Banks stipulate that the balance of the general allowance 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 allowance was discontinued on January 1, 2005, according to directives of the Supervisor of Banks. The balance of the general allowance on December 31, 2010, amounted to NIS 424 million.

7) The supplemental allowance and the general allowance were 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 created a general allowance 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 were written off when the Bank reached 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.

4.3 Instructions of the Supervisor of Banks in the matter of " Update of the disclosure regarding the credit quality of debts and the allowance for credit losses, adoption of accounting standards update ASU 2010-20"

On March 25 2012, the Supervisor of Banks issued a circular which expands the disclosure regarding balances of debt, movement in the balance of allowance for credit losses, any material purchases and sales of debts during the reported period and disclosures regarding the quality of credit.

Among other things, a quantitative indication of the quality of credit is required, at least with respect to troubled debts in each debt group and disclosure as to the credit quality of housing loans. The new disclosure is required for each of the credit segments (commercial credit, private individuals – housing loans, private individuals - others, banks and governments) as well as for each of the principal groups of debt, as defined in the instruction, while differentiating between borrower activity in Israel and borrower activity abroad, if material.

No new disclosures are required in the financial statements for 2012, with regards to the restructuring of troubled debts. All remaining disclosures required under this instruction will be implemented as from the interim financial statements for March 31, 2013.

Effect of initial implementation. The Bank implements the instructions as from January 1, 2012, by way of from now onwards in respect of balance sheet data required for the first time under this instruction, with a reclassification, to the extent possible, of the comparative data. The initial implementation of the instruction had no effect on the financial statements except for a change in presentation.

5. SECURITIES

5.1 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.

The transfer or sale of bonds classified to the held-to-maturity portfolio, is permitted in case of certain changes in circumstances, in which the sale or transfer will not be considered as contradicting the initial classification of the bonds, including evidence of material deterioration in the repayment ability of the bond issuer.

(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 trading securities are presented in the balance sheet 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 the equity within the framework of accumulated other comprehensive income, and forwarded to statement of income upon sale or redemption of the securities.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

5.2 The cost of realized securities is recognized in the statement of income on a "moving average" basis.

5.3 Dividend income, accrued interest, 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.

5.4 Interest income in respect of acquired beneficiary rights (such as: asset backed financial instruments of the MBS, CDO, CLO, 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".

5.5 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.

5.6 For the treatment of transactions involving the transfer of financial assets (such as: repurchase agreements, lending of securities, etc.), see subsection 9 below. In the matter of computing fair value, see subsection 7 below.

5.7 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 (while examining developments subsequent to balance sheet date);
- 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 - Events of default in the payment of periodic interest in accordance with the terms of the bond, forecast of changes in the expected cash flow from the bond.
- 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.
- Relevant information regarding the financial condition of the issuer and changes therein, analysis of specific events that might affect the activities of the issuer and his profitability and an analysis of the economic sector and of the country in which the issuer operates. or until redemption thereof.

The Bank recognizes impairment of a nature other than temporary, at least in each of the following cases:

- 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 bank 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.

  Significantly lower –

  In the case of bonds – where their fair value is lower than the written down cost by 40% and over and the rate of return to redemption is 20% and over, unless special circumstances exist;

  In the case of shares - when their fair value is lower than cost by 20% and over and the shares are in a loss position for a period of six months and over, unless special circumstances exist;

  Special circumstances – circumstances that have been explained and documented, including, among other things; changes in market value that mostly might be attributed to a change in market interest rate, a security issued by a government (Government of Israel or government of an OECD country) in local currency, nationalization.
- A security that had been sold prior to the date of publication of the financial report for the period;

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- A security, which near the date of publication of the financial report for the 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 the period has been significantly reduced compared to its rating on date of purchase by the bank (a significant downgrading – where the rating is lower than the investment rating, and is at least four notches lower than the rating at date of acquisition);
- A bond which following its purchase has been classified by the bank as problematic;
- A bond in respect of which there has been a payment default subsequent to its purchase;

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).

6. 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. Changes in the fair value of a derivative instrument shall be reflected in the statement of income, or shall be included in the 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 or a liability, is recognized in the statement of income on a current basis, as well as the change in value of the hedged item, which may be related to the hedged risk.

The accounting treatment of changes in the fair value of derivatives that hedge exposure to changes in the cash flow generated by an asset or a liability.

The effective part of the change in the fair value of a derivative designated to hedge a cash flow risk, is initially reported in the 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.

For further details see Note 20 hereunder.

7. DETERMINATION OF FAIR VALUE OF FINANCIAL INSTRUMENTS

As from January 1, 2011, the Bank applies the principles determined in FAS 157 (ASC 820-10), which 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, as from January 1, 2012, the Bank implements the directive of the Supervisor of Banks in the matter of "fair value measurement", which combines in the Public Reporting Instructions the rules determined in accounting standard update ASU 2011-04 in the matter of "fair value measurement (ASU 820): amendments to achieve common fair value measurement and uniform disclosure requirements in U.S. GAAP and IFRS".

Fair value is defined as the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between voluntary seller and voluntary purchaser at date of measurement. Among other things, the Standard requires that for the purpose of assessing fair value maximum use should be made, to the extent possible, of observable inputs, while reducing the use of unobservable inputs. Observable inputs reflect information available on the market, received from independent sources, while unobservable inputs reflect the assumptions of the banking corporation.

FAS 157 details the hierarchy of measurement techniques based on the question whether inputs used for the determination of fair value are observable or unobservable. These classes of inputs create a fair value grading as detailed below:

- Level 1 inputs: quoted prices (non-adjusted) on active markets for identical assets or liabilities, which are accessible to the Bank at measurement date;
- Level 2 inputs: Inputs observable, directly or indirectly, for the asset or liability and which are not quoted prices that are included in Level 1;
- Level 3 inputs: unobservable inputs for assets or liabilities.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Such hierarchy requires the use of observable inputs, where this information is available. Where possible, the Bank, when making its assessments, considers observable and relevant market inputs. The volume and frequency of the transactions the size of the bid/ask spread and the extent of the adjustment required when comparing similar transactions, are all factors being considered when determining liquidity of the markets and the relevancy of observable prices in these markets.

Securities. The fair value of trading securities and of available-for-sale securities is determined on the basis of quoted market prices on the principal market, where several markets on which the security is traded exist, the assessment is made according to the quoted price on the most active market. In such cases, the Bank's fair value of the investment in securities is the multiplication of the number of units by that quoted market price. Where no quoted market price is available, the assessment of fair value is based on the best available information while making maximum use of observable inputs, taking into consideration the risk inherent in the financial instrument (market risk, credit risk and such like).

Derivative financial instruments. Derivative financial instruments that have an active market are assessed at market value determined on the principal market, and in the absence of a principal market, according to the price quoted on the most efficient market. Derivative financial instruments that are not marketable are assessed on the basis of models that take into account the risks inherent in the derivative instrument (market risk, credit risk and such like). For further details, see below for assessment methodologies for credit risk and non-performance risk.

Additional non-derivative financial instruments. No "market price" is available in respect of most of the financial instruments in this category (such as: credit to the public, credit to the government, deposits from the public, deposits with banks, subordinate capital notes and non-marketable loans) because these are not traded on any active market. Accordingly, fair value is assessed using accepted pricing models, such as the present value of future cash flows discounted at a discount rate reflecting the risk level inherent in the financial instrument. For this purpose, future cash flows in respect of impaired debts and other debts have been computed after eliminating the effect of accounting write-offs and allowances for credit losses in respect of the debts.

Items classified to equity. Consistently with the fair value measurement of financial liabilities, the fair value of items classified to equity is measured using quoted prices of such items (or of similar instruments) that are being traded as assets.

Evaluation of credit risk and nonperformance risk. The Standard requires a banking corporation to reflect credit risk and nonperformance risk in measuring the fair value of a debt, including derivative instruments that were issued by it and measured according to fair value. Nonperformance risk includes the credit risk of the banking corporation but is not limited to that risk only. The Bank assesses the credit risk involved in derivative instruments in accordance with the prices of the debt instruments of the counterparty traded on an active market and with the prices of credit derivatives the basis of which is the credit quality of the counterparty, for banks and customers in respect of which credit quality indications exist through transactions on an active market, and in accordance with internal models for the forecast of the rate of credit losses in case of credit default for the rest of the population.

For further details regarding the methods and principle assumptions used for assessment of fair value of financial instruments, see note 21 below regarding balances and fair value assessments of financial instruments.

Amendment of the Public Reporting Directives in the matter of "measurement of fair value". The Supervisor of Banks issued on November 20, 2012, a circular for the amendment of the Public Reporting Directives regarding the issue of "measurement of fair value". The circular is intended to modify the Public Reporting Directives in this respect to the updated version of the accounting principles accepted by banks in the United States. In particular, the amendment integrates into the Public Reporting Directives the fair value measurement rules, as determined in ASU 2011-04. The circular determines a new uniform disclosure format with respect to certain disclosure requirements regarding fair value, included in ASU 2011-04.

The initial implementation and its effect. The amendments determined in ASU 2011-04 and in the Supervisor's circular, were implemented as from January 1, 2012, by way of from now onwards. No comparative data has been included in these financial statements with respect to the new disclosures, as implementation of the new disclosure requirements is not mandatory for financial statements in respect of periods presented prior to the initial implementation. The initial implementation of the updated standard and Supervisor's circular had no material effect on the financial statements, except for presentation changes due to the new disclosure requirements.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

8. Offsetting assets and liabilities

8.1 The Bank offsets assets and liabilities, including in respect of derivative instruments, deriving from the same counterparty and presents their net balance in the balance sheet, when the following cumulative conditions exist:

- A legally enforceable right for the offsetting of liabilities against assets exists in respect of the liabilities in question;
- There is an intention to settle the liabilities and realize the assets on a net basis or simultaneously.

8.2 The Bank offsets assets and liabilities with two different counterparties and presents a net amount in the balance sheet when the above two cumulative conditions exist, on condition that an agreement between the three parties exists clearly establishing the Bank's right of setoff in respect of the said liabilities.

8.3 The Bank offsets deposits, the repayment of which to the depositor is conditional upon the collection of the credit and the credit granted out of such deposits, where no credit loss risk to the Bank is involved.

9. TRANSFERS AND SERVICES RELATING TO FINANCIAL ASSETS AND SETTLEMENT OF LIABILITIES.

The Bank applies the measurement and disclosure rules determined in the U.S. Financial Accounting Standard FAS 140 (ASC 860-10) "Transfers and servicing of financial assets and extinguishments of liabilities" as amended by FAS 166 "Transfers of financial assets" (ASC 860-10), for the accounting treatment of financial asset transfers and extinguishments of liabilities.

According to the said rules, the transfer of a financial asset shall be treated as a sale accounting wise, if and only if all the following conditions exist: (1) the transferred financial asset had been isolated from the transferor, also in the case of bankruptcy or other type of receivership; (2) any transferee of the asset (or if the transferee is an entity, the only purpose of which is to engage in securitization or in asset backed financial activity, and which is prevented from pledging or exchanging the transferred financial asset - any third party holding beneficiary rights) may pledge or exchange the transferred asset (or the beneficiary rights), and no conditions exist which also restrict the transferee (or a third party who holds the beneficiary rights) from using his right to pledge or exchange the asset and which grants the transferor a larger than just a trivial benefit; (3) the transferor, or subsidiary companies included in its financial statements, or its agents, do not retain effective control over the financial assets or over the beneficiary rights relating to such transferred assets.

In addition, in order for the transfer of a part of a financial asset to be considered a sale, the transferred part must fall within the definition of participating rights. Participating rights have to meet the following criteria: the right has to represent proportionate rights in relation to the total financial asset; all cash flows receivable from the asset are distributed among the participating rights proportionally to their interest in the asset; the rights are not subordinated to other rights in the asset; no right of return of the asset to the transferor or to other participating right holders exists (except in cases of misrepresentation or violation of commitments, ongoing contractual obligations for the service of the financial asset as a whole and the management of the transfer agreement, and contractual obligations to share in the setoff of any benefits received by any holder of participating rights); the transferor and also the holder of participating rights have no right to pledge or exchange the financial asset in entirety, except where all the holders of the participating rights agree to pledge or exchange the financial asset in its entirety.

In the event that the transaction meets the terms for treatment thereof as a sale transaction, the transferred financial assets are removed from the Bank's balance sheet. Where sale conditions do not exist, the transfer is treated as a collateralized debt. A sale of a part of a financial asset, which is not considered a participating right, is treated as a collateralized debt, namely, the transferred asset continue to be stated in the Bank's balance sheet and the proceeds of sale are recognized as a liability of the Bank.

In view of the above, securities sold under repurchase terms or purchased under resale terms, securities loaned or borrowed, as well as other financial instruments transferred or received by the Bank, in which the Bank retained control over the transferred asset or did not acquire control over the asset received, are treated as a collateralized debt. Financial instruments transferred under such transactions are measured according to the same measurement rules applying prior to their transfer. Namely, such securities are not removed from the balance sheet, against which a deposit is recognized secured by a pledge on the said securities, which are stated in the item "Securities loaned or sold under repurchase agreements". Securities received under such transactions, are stated according to the cash amount paid by the Bank in the item "Securities borrowed or purchased under resale agreements".

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Bank monitors the fair value of securities borrowed or loaned and of securities transferred under repurchase and resale agreements, and where necessary additional collateral is sought. Interest paid or received in respect of securities as above, is reported as financing income or expenses, respectively.

In accordance with the public reporting instructions, transactions involving the lending or borrowing of securities, in which the lending is made in consideration of the credit quality and general collateral of the borrower, the lending or borrowing is treated as credit or as a deposit, which are measured at the fair value of the related securities.

The Bank removes a liability if and only if it had been extinguished, namely, if one of the following terms exists: (a) the Bank had paid the lender and was released from its obligations regarding this liability; or (b) the Bank, under a legal process, had been legally released from liability or, with the consent of the lender, had been released from being the principal debtor in respect of this liability.

An overseas subsidiary conducts transactions for the sale of securities under repurchase agreements terms and for the purchase of securities under resale agreements terms. Securities sold under repurchase agreements terms, according to which control over the sold asset has not been lost, are treated as acceptance of a secured liability, so that the sold securities are not eliminated from the balance sheet, being reflected in the item "Securities", against which a deposit, the repayment of which is secured by a pledge of the said securities, is reflected in the item "Securities loaned or sold under repurchase agreements". Securities purchased under resale agreement terms, are treated as the granting of a secured loan, so that the securities so purchased serve as collateral for the loan and are not reflected in the Balance sheet. The loan granted is reflected in the item "Securities borrowed or purchased under resale agreements".

Update of accounting standard ASU 2011-03 regarding "The re-examination of effective control in repurchase transactions" comprises an update of the rules stated in FAS 166 (ASC 860).

Evaluation of the existence of effective control is focused on the contractual rights and the contractual liabilities of the transferor, therefore the following are not taken into consideration: (1) criterion requiring that the transferor will have the ability to purchase the transferred securities also in the case of default of the transferee, and (2) guidelines regarding the requirement of collateral with respect to the said criterion.

In transactions involving the transfer of financial assets, the Bank determines that effective control over the assets remains with the transferor (and therefore the transfer of assets shall be treated as a secured debt) if all the following conditions are fulfilled:

- The assets to be repurchased or redeemed are identical or identical in substance to the transferred assets;
- The agreement provides for the repurchase of the assets or for their redemption prior to the date of repayment, at a determined price or at a determinable price; and
- The agreement was signed simultaneously with the transfer.

The initial implementation and its effect. The rules determined in ASU 2011-03 were implemented as from January 1, 2012, by way of from now onwards, with respect to new transactions and existing transactions that had been changed after the date on which the update became effective. At the transition date, the implementation of the update had no effect upon the financial statements. However, as from date of implementation of the update, a larger number of repurchase transactions will be treated accounting wise as a secured debt and not as a sale.

10. FIXED ASSETS (BUILDINGS AND EQUIPMENT)

Recognition and measurement. Fixed asset items are measured at cost less depreciation and losses on impairment. Cost includes expenditure that may be directly attributed to the acquisition of the asset. The cost of self constructed assets includes the cost of materials, direct payroll and any additional costs which may be attributable directly to the bringing of the asset to the location and condition in which it could function in the manner intended by Management.

The cost of acquired software being an integral part of the operation of the related equipment is recognized as part of the cost of such equipment. Furthermore, in accordance with the public reporting directives, the Bank classifies to the buildings and equipment item the cost of purchased software assets or capitalized costs of software developed internally for own use. Regarding the accounting treatment of software costs, see item 11 hereunder.

Where substantial parts of fixed asset items have different life spans, they are treated as separate items of the fixed assets.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Profits or losses on the disposal of a fixed asset item are determined by comparing the proceeds from disposal of the asset to its stated value, and are recognized, net, in the item "Other income" in the statement of income.

Subsequent costs. The cost of replacement of a part of a fixed asset item is recognized as part of the book value of that item if it is anticipated that the future economic benefits inherent in the replaced part will flow to the Bank and if its cost is reliably measurable. The stated value of the replaced part is deducted. Current maintenance costs of fixed asset items are charged to the Statement of income as incurred.

Depreciation. Depreciation is a methodical allocation of the depreciable amount of an asset over its useful life span. The depreciable amount is the cost of the asset, or another amount replacing cost, less the residual value of the asset.

Depreciation is charged to the Statement of income by the straight-line method over the assessed useful life span of each part of the fixed asset items, as this method reflects in the best manner, the anticipated consumption format of the future economic benefits inherent in the asset. Leased assets are amortized over the shorter of the period of the lease or the period of use of the asset

Assessments regarding the depreciation method, the useful life span of assets and their residual values are being re-examined at the end of each financial year and adjusted where required.

Land is not depreciated.

11. LEASES

Leases, including the lease of land from the Israel Land Administration or from other third parties in respect of which the Group essentially bears all risk and yield pertaining to the asset, are classified as financial leases. Upon initial recognition, the leased assets are measured at an amount equal to the lower of its fair value or the present value of the future minimum lease fees. Future payments to the Israel Land Administration in respect of the exercise of an option for extension of the lease period are not recognized as part of the asset and the related liability, since they constitute conditional lease fees derived from the fair value of the land at date of the future renewal of the lease agreement. Following the initial recognition, the asset is treated in accordance with the accepted accounting policy in respect of such an asset.

All other leases are classified as operational leases, and the leased assets are not recognized in the balance sheet of the Group.

12. INTANGIBLE ASSETS

Goodwill. For information regarding the measurement of goodwill upon initial recognition thereof, see item D 2.1 above. In following periods, goodwill is measured at cost less accumulated impairment losses.

Software costs. Software purchased by the Bank is measured at cost less accumulated depreciation and impairment losses.

Costs related to the development of software or its modification for own use are capitalized only if: it is reliably possible to measure the development costs; the software is technologically and commercially feasible, future economic benefits are anticipated; the Bank has the intention and adequate resources to complete the development and to use the software. Costs recognized as an intangible asset include the direct cost of materials and payroll. These costs are measured at cost less accumulated depreciation and impairment losses. Overhead costs that cannot be directly attributed to the development of the software and research costs are recognized as an expense as incurred.

Depreciation. Depreciation is charged to the Statement of income by the straight-line method over the useful life span of intangible assets, including software assets, beginning with the date on which the assets are ready for use.

Goodwill and intangible assets of indeterminate life span are not depreciated systematically but are examined yearly for examining impairment.

Intangible assets created within the Bank (such as: software in the course of development) are not depreciated systematically so long as they are not ready for use. Accordingly, impairment of such intangible assets is reviewed once a year, until they become available for use.

The development costs of the core computer system (Ofek Project) are being depreciated over seven years.

Subsequent costs. Subsequent costs are recognized as an intangible asset only when they enhance the future economic benefits inherent in the asset in respect of which they had been incurred. Other costs, including goodwill related costs or costs related to independently developed brands are charged to the Statement of income as incurred.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

13. IMPAIRMENT OF NON-FINANCIAL ASSETS

The stated value of the Bank's non-financial assets, excluding deferred tax assets and including investments treated by the equity method, is examined in order to determine whether signs of impairment exist. If such signs do exist, an assessment is made of the recoverable value amount of the asset. In periods following the initial recognition date, an assessment is made once a year, at a determined date for each asset, of the recoverable value amount of intangible assets having an indeterminate lifespan or which are not available for use or at more frequent dates if signs of impairment exist. The recoverable value amount of an asset or of a cash generating unit is the higher of its value in use or the net selling price (fair value, less selling expenses).

Loss on impairment of goodwill may not be reversed. As regards other assets, impairment losses recognized in prior periods are re-examined at each reporting date in order to determine whether there are signs for the reduction in the loss or for its nonexistence. A loss on impairment may be reversed in case of changes in the assessment used to determine the recoverable value amount, on condition that the stated value of the asset after reversal of the impairment loss does not exceed the stated value, less depreciation or amortization, that would have been determined had an impairment loss not been recognized.

Impairment of costs of internal development of computer software. In addition to the signs for examining the existence of impairment specified in IAS 36, "impairment of assets", examining the existence of impairment with respect to the own development of computer software shall be made also where the signs noted in the generally accepted accounting principles for banks in the United States exist, SOP 98-1: "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (ASC 350-40):

(1) It is not expected that the software will provide significant potential services;

(2) A material change occurred in the manner or scope of use of the software or in the anticipated use of the software;

(3) A material change in the software was made or will be made in the future;

(4) The costs of development or of modifying the software intended for internal use deviate materially from forecasted amounts;

(5) It is no longer expected that the development of the software will be completed and use made of it.

If one or more of the above signs appear, it is required to examine impairment in accordance with the rules of IAS 36, "Impairment of assets".

Investment in affiliated companies treated by the equity method. The investment in an affiliated company is tested for impairment, where objective evidence exists that indicates impairment in accordance with IAS 39 "Financial instruments - recognition and measurement", and in accordance with decision 1-4 of the Securities Authority "Guidelines for examining the need to provide for impairment of fixed investments". Goodwill comprising part of the investment in an affiliated company is not recognized as a separate asset and therefore is not tested separately for impairment. Impairment is tested in respect of the investment as a whole. Where objective evidence exists that indicates a possible impairment of the investment, the Bank assesses the recoverable value amount of the investment, which is the higher of the value in use and the net selling price of the investment.

In determining the value in use of the investment in an affiliated company, the Bank assesses its share in the present value of the future cash flows anticipated to be produced by the affiliated company, including cash flows from the operations of the affiliated company and the proceeds of final realization of the investment, or the present value of futures cash flows anticipated to be derived from dividends to be received and from the final realization.

Loss on impairment is recognized when the stated value of the investment, after applying the equity method, exceeds the recoverable value amount, and is recognized in the item "Bank's share in income (loss) of affiliated companies" in the statement of income. The loss on impairment is not allocated to any particular asset, including goodwill comprising a part of the investment account in the affiliated company. Loss on impairment may be reversed if and only if changes have occurred in the assessments used to determine the recoverable value amount of the investment since the date on which a loss on impairment had been recognized. The stated value of the investment, after reversal of the impairment loss, shall not exceed the stated value of the investment that would have been determined by the equity method had no impairment loss been recognized. The reversal of an impairment loss is recognized in the item "Bank's share in income (loss) of affiliated companies".

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

14. NON-CURRENT ASSETS HELD FOR SALE. Non-current assets (or realization groups comprising assets and liabilities) expected to be realized through a sale or distribution and not by way of continued use (excluding assets foreclosed in respect of impaired debts), are classified as assets held for sale or distribution. This applies also where the Bank is committed to the planning of a sale involving the loss of control over a subsidiary company, irrespective of whether the Bank remains with non-controlling rights in consolidated subsidiaries in the former subsidiary subsequent to the sale.

Immediately prior to the classification of the assets as held for sale or distribution, the assets (or the components of the groups intended for disposal) are measured according to the Bank's accounting policy. Subsequently, the assets (or the group intended for disposal) are measured according to the lower of the stated value or the fair value, net of selling expenses.

Any loss on impairment of a group intended for disposal, is primarily attributed to goodwill, and thereafter, on a proportional basis, to the remaining assets and liabilities, though no loss is attributed to assets to which the standard does not apply, such as: financial assets and deferred tax assets which continue to be measured according to the Bank's accounting policy. Impairment losses upon the initial classification of an asset as held for sale, as well as subsequent income or losses derived from remeasurement, are reflected in the Statement of income. Income is recognized up to the cumulative amount of impairment losses recognized in the past.

In following periods, depreciable assets classified as held for sale or distribution are no longer depreciated periodically, and investments in affiliated companies held for sale are no longer treated by the equity method.

15. EMPLOYEE RIGHTS

15.1 Liabilities in respect of employee rights are covered by appropriate provisions. For further details see Note 16 hereunder.

15.2 The subsidiary IDB New York adopted EITF Issue No. 06-04, "Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements", as of January 1, 2008. The Task Force reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with 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.

15.3 Guidelines and clarifications regarding "strengthening of internal control over financial reporting of employee rights". The guidelines from March 2011 refer principally to aspects of strengthening the internal control over financial reporting of this subject. However, one aspect comprises an accounting guideline, viz., voluntary retirement plan and non-contractual severance payments. A banking corporation that anticipates the payment to groups of employees of benefits in excess of contractual obligations, has to take into account in its actuarial computations the ratio of employees who are expected to retire (including employees expected to retire under voluntary retirement plan or upon obtaining other beneficial terms) and the benefits to which they will be entitled to upon retirement. The guidelines include quantitative yardsticks, which, where these exist, the banking corporation is required to take into account the additional cost in this respect, based on an actuarial computation. The liability for payment of severance pay to such group of employees shall be presented in the financial statements at the higher of the amount of liability based on an actuarial computation, taking into account the additional cost expected in respect of the said benefits, and the amount of liability computed by multiplying the monthly salary of the employee by the number of years of employment, as required by Opinion No. 20 of the Institute of Certified Public Accountants in Israel.

The computation on an actuarial basis of the provisions with respect to the Bank's liability for severance pay involves the use of statistical tools and evaluations regarding the future, and is based on past experience and on the limitations determined in this respect by the Bank's Management (see hereunder).

The computation is based also on the average retirement rates, according to age groups, in accordance with the actual retirement rates in the years 2004-2010. In view of the scope of natural retirement anticipated in the years 2017-2027, it had been assumed that the rate of voluntary retirement in these years will be 2% per year. The computation based on retirement rates has been applied retroactively.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The limitations determined by the Management, which have been implemented as from the financial statements as of June 30, 2011, are as follows:

- The retirement of employees under preferred terms will not be allowed during the period of five years following the 2011 retirement plan becoming effective (see Note 16 below) except for exceptional cases (see below);
- The minimum age for retirement under preferred terms is 50;
- The creation of a special fund in the amount of NIS 100 million, for exceptional retirement cases, for that group of employees, who under the determined limitations will not be entitle to retirement under preferred terms (as of December 31, 2012, the balance of the special fund amounted to NIS 70 million).

16. SHARE BASED PAYMENT

The fair value at date of granting the share based payments to officers is charged as a payroll expense concurrently with the increase in the share capital over the period in which unconditional entitlement to the awards is obtained. The amount charged as an expense in respect of share based payments conditional upon vesting terms being service terms or performance terms that differ from market terms, is adjusted to reflect the number of awards expected to be vested. For share based payments that are conditional upon terms that are not vesting terms, or upon vesting terms comprising performance terms representing market terms, the Bank takes into consideration these terms in assessing the fair value of the capital instruments granted. Therefore, the Bank recognizes an expense in respect of such awards irrespective of the existence of these terms.

The fair value of the amount due to officers in respect of rights to appreciation in value of shares settled in cash ("phantom options") is charged as an expense against a parallel increase in liabilities over the period in which entitlement to the payment is obtained. The liability is remeasured at each reporting date until final settlement. Any change in fair value of the liability is charged as a payroll expense in the Statement of income.

17. 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 a lawsuit together with a petition to have it approved as a class action suit, such period is not to include a period in which the Court has decided to stay the proceedings. Note 19 states separately the outstanding claims, in respect of which a reasonable assessment of the exposure to risk is not possible.

The Bank has described material legal proceedings being conducted against the Bank and Group companies. In this respect, the Bank has determined that as a general rule, a legal proceeding shall be disclosed where the amount claimed exceeds 0.5% of the equity capital of the Bank if it is not possible to assess the prospects of the risk exposure materializing and exceeds 1% of the equity capital where the reasonability prospects of the risk exposure materializing is possible or 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 or 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.

18. TAXES ON INCOME

18.1 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.

18.2 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.

18.3 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.

18.4 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.

18.5 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.

18.6 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.

18.7 IAS 12 regarding "Income taxes"

Income taxes include current and deferred taxes. Current and deferred taxes are recognized in the statement of income, unless the taxes stem from business combinations, or are recognized directly in shareholders' equity to the extent that they stem from items recognized directly in equity.

Uncertain tax positions. The Bank recognizes the effect of tax positions only if it is more likely than not that these positions would be accepted by the Tax Authorities or by the Courts. Recognized tax positions are measured according to the highest amount the probability of its realization exceeds 50%. Changes in recognition or in measurement are reflected in the period in which changes in circumstances leading to a change in considerations have occurred.

Setoff of deferred tax assets and liabilities. The Bank offsets deferred tax assets against deferred tax liabilities where a legal and enforceable right exists for the setoff of current tax assets and liabilities that relate to the same taxable income, which is taxed by the same tax authority in respect of that assessed entity.

Intercompany transactions. Deferred tax in respect of intercompany transactions in the consolidated financial statements is recognized according to the tax rate applying to the purchasing company.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Additional taxes in respect of the distribution of dividends. The Bank may be liable for additional taxes in the case of a distribution of dividend by consolidated subsidiaries. This additional tax is not included in the financial statements in cases where the investee company adopts a policy of non-distribution of dividends involving additional taxes. In cases where an investee company is expected to distribute dividends out of earnings involving additional taxes, the provision for taxes is increased in respect of the additional tax that might apply in respect of such distribution of dividend.

Principal changes. Implementation of the Standard led, among other things, to the cancellation of the relief in effect until now, according to which a deferred tax liability was not created in respect of linkage increments on depreciable fixed assets, that had accumulated until January 1, 1982.

Implementation of the standard led also to a relief as regards the recording of differed taxes in respect of deductible temporary differences. In accordance with the standard, a probability of "more likely than not" is sufficient so a tax savings would be created in respect of the said differences, while in the past the probability level had to be "beyond any reasonable doubt".

Initial implementation and its effect. The rules of this standard were implemented as from January 1, 2012, by way of retroactive implementation.

The initial implementation of the Standard had no material effect.

The effect of the retroactive implementation on prior reported periods included in these financial statements is presented in subsection 1 c 9.

19. EARNINGS PER SHARE

The Bank presents basic and fully diluted earnings per share with respect to its ordinary share capital. The basic earnings per share is computed by dividing the earnings or loss attributed to the holders of the Bank's ordinary shares by the weighted average number of ordinary shares outstanding during the period. The fully diluted earnings per share is determined by adjusting the earnings or loss attributed to the holders of the ordinary shares and by adjusting the weighted average number of ordinary shares outstanding in respect of the effect of all potentially diluting ordinary shares, which include share option warrants granted to employees.

20. STATEMENT OF CASH FLOWS

The statement of cash flow is presented being classified to cash flows from operating activities, from investing activities (formerly, asset transactions) and from financing activities (formerly, liability and capital transactions).

Cash flows produced by the Bank's principal activities are classified to operating activities.

The cash and cash equivalent item includes cash, marketable deposit certificates and deposits with banks for an original period of up to three months.

Initial implementation and its effect. The rules of IAS-7 were implemented as from January 1, 2012, by way of retroactive implementation. The initial implementation of the standard had no effect, except for a change in presentation. For details as to the reclassification resulting from the implementation of the directives, see subsection C 5.2 above.

21. 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.

22. AMORTIZATION OF DEFERRED EXPENSES

Bond and subordinated capital notes issue costs are amortized proportionally to the outstanding principal amount of the bonds.

23. DEBTORS AND CREDITORS REGARDING CREDIT CARD ACTIVITY

At date of the transaction, the credit card company clearing the transaction acquires an asset in respect of the debt of the issuer of the card or the holder of the card and concurrently assumes a liability towards the trading house. Furthermore, a credit card

Company as an issuer, acquires an asset in respect of a debt of a holder of the card or of the issuing bank, and concurrently, a liability towards the clearing credit card company.

Debtor and creditor balances in respect of credit card transactions represent entries processed until the business day preceding the day of the report.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

24. Instructions regarding the format of the statement of income determined in a circular letter of the Supervisor of Banks in the matter of "Format of the statement of income of a banking corporation and adoption of generally accepted accounting principles by banks in the U.S. in the matter of the measurement of interest income".

The Bank implements the directives regarding the manner of presentation of the statement of income, in accordance with the circular letter of the Supervisor of Banks dated December 29, 2011, on this subject. In accordance with the directives, the Bank modified the manner of presentation of the profit components in the statement of income and in the notes thereto, as follows:

- The item "profit from financing activities before credit loss expenses" has been split into three separate items "interest income", interest expenses" and "non-interest financing income", all three items presented in separate lines;
- Components of profit from financing activities that do not comprise interest and components of gains (losses) from investment in shares, have been classified to the item "non-interest financing income" differentiating between trading operations and non-trading operations;
- The definition of "interest" has been updated to include exchange rates increments on the interest, CPI linkage increments on the interest and CPI linkage increments on principal sums (a component formerly not regarded as part of interest);
- The differentiation between financing commission, formerly included as part of profit from financing activities, and operating commission has been cancelled. In view of this, all commission income, except for credit allocation commission and early repayment commission, is now included in the item "Commissions" in the statement of income (formerly, the item "operating commissions");
- The item "profit from extraordinary operations" has been cancelled and the approach in practice in the U.S. has been adopted, according to which special items are defined as "unusual" and "infrequent" items. In view of this, the classification in the statement of income of a certain event as a special item (unusual) shall be made only with a prior approval of the Supervisor of Banks.

25. "Related party disclosures"

IAS 24 regarding "Related party disclosures" determines the disclosure requirements with respect to relations with a related party as well as to transactions and outstanding balances with related parties.

In addition, disclosure is required regarding the compensation paid to key management personnel. These are defined as persons having authority and responsibility for the planning of the entity's operations, for the direct or indirect direction and control thereof, including any Director (whether active or inactive) of the entity.

Within the framework of adoption of the standard, the Supervisor of Banks has modified the disclosure format required in the financial statements in order to provide a response both as to the disclosure requirements of IAS 24 and as to additional disclosure required according to the Securities Regulations, 2010 (which until now had not applied to the banking corporations).

Initial implementation and its effect. As from January 1, 2012, the Bank implements the new directives of the Supervisor of Banks in the matter. IAS 24 is implemented by way of retroactive implementation. The initial implementation had no effect upon the financial statements, except for a presentation change.

26. In accordance with the directives of the Supervisor of Banks, the Bank implements generally accepted accounting principles in the U.S. as regards the accounting treatment of transactions between a banking corporation and its controlling shareholder and between a company controlled by the banking corporation. As regards situations where the said principles do not address a method of treatment, the Bank implements, in accordance with the instructions, the principles determined in Standard No. 23 of the Israeli Accounting Standards Board as regards "the accounting treatment of transactions between an entity and the controlling shareholder therein", this consistently with the adoption principles of the international financial reporting standards as regards subjects that are not part of the core banking business.

Assets and liabilities involved in the transaction with the controlling shareholder are measured at fair value at date of the transaction. Due to the fact that the transaction is of a capital nature, the difference between the fair value and the consideration for the transaction is recognized in shareholders' equity.

Accepting a liability or a waiver. The difference between the fair value of the liability and its book value at date of settlement is recorded as a profit or loss. The difference between the fair value of the liability at date of settlement and the determined consideration is recorded in the equity. In the case of a waiver, the fair value of the waived liability is recorded in the equity.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Indemnification. The amount of the indemnification is recognized in a capital reserve.

Loans, including deposits. At date of initial recognition, the loan granted to a controlling shareholder or a deposit received from a controlling shareholder, are presented in the financial statements at their fair value as an asset or liability, as the case may be. The difference between the amount of the loan granted or of the deposit received and their fair value at date of initial recognition is recognized in shareholders' equity.

In periods following the initial recognition date, the said loan or deposit are stated in the financial statements at their written down cost, using the effective interest method, except for cases where according to generally accepted accounting principles they are stated at fair value.

The initial implementation and its effect. The Bank implemented the guidelines specified in the directives by way of from now onwards in respect of all transactions between the Bank and its controlling shareholder performed subsequent to January 1, 2012, as well as in respect of a loans granted to or deposits received from the controlling shareholder prior to the implementation date of the directives, beginning with their effective date. The initial implementation of the directives had no material effect.

27. Capitalization of credit costs

IAS 23 regarding "Borrowing costs" states that an entity has to capitalize credit costs relating directly to the acquisition, construction or production of a qualified asset. A qualified asset is an asset requiring a significant length of time to prepare it for its future use or sale, and, among other things, it includes fixed assets, software assets and other assets requiring a lengthy period of time in order to bring them to the condition of their intended use or sale. Notwithstanding, the instructions of the Supervisor of Banks clarify that a banking corporation shall not capitalize credit costs without having first determined clear policy, procedures and controls as regards the criteria for recognizing qualified assets and for capitalized credit costs. Accordingly, the Bank does not capitalize credit costs to a qualified asset.

Initial implementation and its effect. The initial implementation of the standard had no effect on the financial statements.

E. NEW ACCOUNTING STANDARDS AND NEW DIRECTIVES OF THE SUPERVISOR OF BANKS IN THE PERIOD PRIOR TO THEIR IMPLEMENTATION

1. **Instructions regarding the format of the statement of income of a banking corporation and the adoption of accounting principles accepted by U.S. banks in the matter of the measurement of interest income.** Instructions were issued on December 29, 2011, intended to modify the public reporting instructions for the purpose of adoption of the rules determined within the framework of generally accepted accounting principles in the U.S. regarding "non-refundable commissions and other costs". The instruction determines rules for the treatment of commissions earned on the setting-up of loans and of direct costs incurred in the setting-up of loans. The qualified commissions and costs in accordance with criteria determined in the instruction shall not be immediately recognized in the statement of income but will be taken into account in computing the effective interest rate on the loan. In addition, the instruction changes the treatment of commissions and costs related to commitments to grant credit, including credit card transactions. Furthermore, the instruction determines rules for the treatment of changes in the terms of debts that do not constitute troubled debt restructurings, for the treatment of early repayment of debts as well as the treatment of other transactions for the granting of credit, such as syndication transactions.

   A circular letter dated July 25, 2012, stated that the instructions in this respect shall be implemented as from January 1, 2014, and thereafter.

   The Bank is examining the anticipated effect of its initial implementation of the directive.

2. **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"). The Standard 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 form part of the core banking business - as from January 1, 2013. 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 U.S. accounting standards boards.
- As regards issues which are not part of the core banking business - as from January 1, 2011. This, except for several standards implemented as from January 1, 2012 (see above) and except for IAS 19 regarding "Employee benefits", which has not yet become effective and which will be adopted in accordance with guidelines of the Supervisor of Banks, when published, with respect to the timing and manner of initial implementation.

3. New financial reporting standards regarding consolidation of financial statements and related matters. The IASB published in May 2011 a series of new standards being part of joint union of the FASB and the IASB project, which is intended to replace the existing standards regarding the consolidation of financial statements and joint ventures, and includes also certain changes regarding affiliated companies. In accordance with guidelines of the Supervisor of Banks, a banking corporation shall update on a current basis the accounting treatment of subjects adopted by the public reporting directives. The said update is required in accordance with the effective date and in accordance with the transitional provisions to be determined by new international financial reporting standards that will be issued regarding these subjects, and in accordance with the adoption principles and clarifications by the Supervisor of Banks. In view of this, the implementation of rules determined by the new set of standards in the matter of consolidation of financial statements and related matters shall be effected subject to guidelines setout in the public reporting directives, among other things, with regard to the implementation of the standard in respect of matters where the public reporting directive had already adopted or determined specific rules that differ from those determined by the standard and/or guidelines relating thereto.

A circular of the Supervisor of Banks dated December 12, 2012, in the matter of "Adoption of certain international reporting standards (IFRS) in the public reporting instructions", stated the manner in which banking corporations are to apply the standards included in the new system.

Following is a description of the principal issues of the rules included in the new system:

3.1 **International financial reporting standard IFRS 10 in the matter of "consolidated financial statements".** The Standard presents a new control model to be used in determining whether an investee entity has to be consolidated. In accordance with the Standard, "de facto" circumstances have to be taken into account in evaluating the existence of control, so that the existence of effective control over the investee will require consolidation of the financial statements. Furthermore, in evaluating the existence of control, all significant potential voting rights shall be taken into account and not only potential voting rights that may be exercised immediately.

The guidelines of IAS 27 will continue to apply only with respect to standalone financial statements.

In accordance with the guidelines of the Supervisor of Banks, as stated, banking corporations shall apply IFRS 10, except for the rules relating to the treatment of entities having variable interests (VIE's), which will continue to be treated according to the provisions of FAS 167. It has also been clarified that at this stage, IAS 27 (as amended) shall not be adopted in the public reporting instructions.

3.2 **International financial reporting standard IFRS 11 in the matter of "Joint arrangements" and amendment to IAS 28 in the matter of "Investments in associates companies and in joint ventures".** The Standard classifies "joint arrangements" as "joint operations" or "joint ventures" based on the rights and liabilities of the parties to the arrangement. Joint ventures, which constitute all joint arrangements incorporated as a separate entity, in which the parties having the joint control enjoy the rights in the net assets of the joint arrangement, shall be treated by the equity method of accounting only (the option of applying proportionate consolidation has been abolished).

In addition, the Standard amends IAS 28 so that the valuation at fair value of existing or remaining rights in the investment shall be cancelled upon transition from significant influence to joint control and vice versa. It has also been determined that IFRS 5 shall apply to an investment or part thereof that corresponds with the criteria for the classification as an investment held for sale.

In accordance with the guidelines of the Supervisor of Banks, as stated, banking corporations shall implement the provisions of IFRS 11 and IAS 28 (as amended).

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3 **International financial reporting standard IFRS 12 in the matter of "Disclosure of interests in other entities".** The Standard includes comprehensive disclosure requirements with respect to interests in subsidiary companies, joint arrangements, associates and structured entities which are not consolidated.

In accordance with the guidelines of the Supervisor of Banks, as stated, banking corporations shall implement the provisions of IFRS 12, except for the disclosure requirements included therein with respect to structured entities that are not consolidated. The disclosure requirements stated in FAS 167 shall continue to apply to the said entities, as incorporated in item 22 to the Public Reporting Instructions regarding disclosure of entities having variable interests.

The Bank believes that the implementation of the set of rules is not expected to have a material effect upon the financial statements.

4. Draft amendment of the Public Reporting Directives in the matter of "statement of comprehensive income". The Supervisor of Banks issued on December 9, 2012, a circular for the amendment of the Public Reporting Directives regarding the issue of "Statement of comprehensive income". The circular is intended to modify the presentation of the statement of comprehensive income to the requirements of the updated U.S. GAAP (ASU 2011-05 and ASU 2011-12) and to the presentation format of the comprehensive income statement as accepted in financial statements of U.S. banks. According to the circular, the changes in other comprehensive income shall be presented in a separate statement named "statement of comprehensive income", which shall be presented immediately after the statement of income. Furthermore, the movement in the statement of changes in shareholders' equity in respect of items included in "cumulative other comprehensive income" shall be presented in one amount, while the details and composition of the movement in " cumulative other comprehensive income" shall be presented in a new note on cumulative other comprehensive income.

According to the circular, the changes included therein shall apply to the financial statements for the first quarter of 2013 and thereafter, and shall be implemented by way of retroactive implementation. The initial implementation of these changes is not expected to have a material effect upon the financial statements, except for presentation changes.

5. Amendment of the Public Reporting Directives in the matter of "offsetting of assets and liabilities". The Supervisor of Banks issued on December 12, 2012, a circular for the amendment of the Public Reporting Directives regarding the issue of "offsetting of assets and liabilities". The circular is intended to modify the Public Reporting Directives in this respect to the U.S. GAAP.

According to the circular regarding the offsetting of derivative instruments, a banking corporation shall offset assets and liabilities deriving from the same counterparty and shall present in the balance sheet their net balance, where the following cumulative conditions exist: (1) in respect of the said liabilities, the bank has a legally enforceable right of setoff of the liabilities against assets; (2) it is its intention to settle the liabilities and realize the assets on a net basis or simultaneously; (3) Both the banking corporation and the counterparty owe to one another determinable amounts.

Furthermore, under certain conditions, the banking corporation may be entitled to offset fair value amounts recognized in respect of derivative instruments and fair value amounts recognized in respect of the right to reclaim cash collateral (receivables) or in respect of the obligation to return cash collateral (payables) arising from derivative instruments executed with the same counterparty in accordance with a master netting arrangement, even where the condition regarding the intention to settle on a net basis or simultaneously does not exist. A banking corporation is required to adopt an accounting policy to be applied consistently with respect to the setoff of fair value amounts, as above.

With respect to repurchase transactions, a banking corporation is entitled to offset "securities purchased under repurchase agreements" against "securities sold under repurchase agreements" if certain conditions set out in this respect in U.S. GAAP, exist.

The circular clarifies certain considerations that banking corporations are required to consider when determining whether there is doubt concerning the existence of conditions permitting setoff. Among other things with respect to the right of setoff, the independent auditor of the banking corporation would be required to examine whether a legally enforceable contractual right of setoff exists (for setoff purposes), mutatis mutandis, in the same manner in which he examines at present whether the transferred financial assets had been removed from the control of the transferor and of his creditors (for the purpose of deletion of financial assets).

The circular includes extensive disclosure requirements, including disclosure of the policy of the banking corporation debating whether the said derivative instruments should be setoff or not setoff.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

According to the circular, the changes included therein will apply to financial statements for reporting periods beginning January 1, 2013, and shall be presented through retrospective implementation. The Bank is studying the implications of the said circular.

6. **Directive regarding disclosure of deposits.** A circular was published on January 13, 2013, amending the Public Reporting Instructions of the Supervisor of Banks in the matter of disclosure of deposits. The circular is intended to match the disclosure requirements regarding deposits to the disclosure requirements which are in practice in financial statements of U.S. banking corporations.

The circular includes more extensive disclosure requirements with respect to deposits from the public, deposits from banks and deposits of the government, such as: requirement to disclose deposits raised in Israel separately from deposits raised abroad, subject to materiality.

Furthermore, additional disclosure requirements are to be included in the Note regarding deposits from the public, including:

- Disclosure regarding the balance of interest bearing deposits separately from the balance of non-interest bearing deposits;
- The disclosure requirement regarding savings deposits and other deposits has been cancelled;
- The disclosure regarding deposits from the public should include disclosure regarding time deposits and demand deposits;
- There is an additional requirement for disclosure according to size of deposits; and
- Additional disclosure regarding the identity of depositors in Israel according to private individuals, institutional bodies, corporations and others.

The amendments included in the directive are to be applied retroactively as from the financial statements for 2013 and thereafter, except for the requirement for disclosure of the balance of deposits from institutional bodies that had been included in deposits from the public raised in Israel, which will apply as from the financial statements for the first quarter of 2013 onwards. The initial implementation of the said changes is not expected to affect the financial statements, save for a presentation change.

2. CASH AND DEPOSITS WITH BANKS[1]

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Cash and deposits with central banks	19,589	26,156	13,490	23,025
Deposits with commercial banks	4,492	4,020	4,041	3,138
Deposits with specialized banking institutions	19	153	14	121
Total cash and deposits with banks	**24,100**	**30,329**	**17,545**	**26,284**
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	22,265	27,892	16,830	24,729

Footnote:
(1) See Note 15 D, F, I, L for pledges.

3. SECURITIES[1]

A. Composition of this item - consolidated

	December 31,2012				
	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:					
Of the Israeli Government	3,250	3,250	259	-	3,509
Of foreign governments	30	30	3	-	33
Of Israeli financial institutions	87	87	4	-	91
Of foreign financial institutions	75	75	1	2	74
Mortgage-backed-securities and Assets - backed-securities	1,520	1,520	44	2	1,562
Of others abroad[7]	2,026	2,026	143	2	2,167
Total held-to-maturity bonds and bills	**6,988**	**6,988**	**454**	**6**	**[3]7,436**

For footnotes see next page.

3. SECURITIES[1] (CONTINUED)

A. Composition of this item - consolidated (continued)

	December 31,2012				
			Cumulative other comprehensive income		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value(2)
	In NIS millions				
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	20,610	20,027	591	8	20,610
Of foreign governments	917	911	6	-	917
Of Israeli financial institutions	729	709	20	-	729
Of foreign financial institutions	2,567	2,705	40	178	2,567
Mortgage-backed-securities and Assets - backed-securities	9,754	9,691	127	64	9,754
Of others in Israel	705	681	27	3	705
Of others abroad(8)	74	76	-	2	74
Total bonds and bills	**35,356**	**34,800**	**811**	**255**	**(3)35,356**
Shares	704	703	1	-	(5)704
Total available-for-sale securities	**36,060**	**35,503**	**(4)812**	**(4)255**	**36,060**

	December 31,2012				
	Book value	Amortized cost (for shares - 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:					
Of the Israeli Government	2,822	2,816	6	-	2,822
Of foreign governments	4	4	-	-	4
Of Israeli financial institutions	19	19	-	-	19
Of foreign financial institutions	33	48	1	16	33
Mortgage-backed-securities and Assets - backed-securities	53	53	-	-	53
Of others in Israel	18	20	-	2	18
Of others abroad	2	3	-	1	2
Total bonds and bills	**2,951**	**2,963**	**7**	**19**	**2,951**
Shares	2	5	-	3	2
Total trading securities	**2,953**	**2,968**	**(6)7**	**(6)22**	**2,953**
Total securities	**46,001**	**45,459**	**1,273**	**283**	**46,449**

Footnotes:

(1) Pledges, see Note 15.

(2) Fair value data based on market prices, does not necessarily reflect the price that may be obtained on the sale of securities in large volumes.

(3) Including securities sold by an overseas consolidated subsidiary under buy-back terms from the held to maturity portfolio at a reduced cost of NIS 1,250 million (approx. US$335 million) and from the available for sale portfolio with a market value of NIS 5,238 million (approx. US$1,403 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 641 million.

(6) Recorded in the statement of income.

(7) Reclassified – U.S. Government agencies and municipal bonds of states in the U.S.A, in an amount of NIS 2,016 million (book value), have been reclassified from "Of foreign governments" to "Of others abroad".

(8) Reclassified – U.S. Government agencies, in the amount of NIS 64 million (book value), have been reclassified from "Of foreign governments" to "Of others abroad".

3. SECURITIES[1] (CONTINUED)

A. Composition of this item - consolidated (continued)

	December 31,2011				
	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:					
Of the Israeli Government	2,605	2,605	81	-	2,686
Of foreign governments[7]	34	34	4	-	38
Of foreign financial institutions	58	58	1	-	59
Mortgage-backed-securities and Assets - backed-securities `	1,028	1,028	38	-	1,066
Of others abroad[7]	2,170	2,170	97	1	2,266
Total held-to-maturity bonds and bills	**5,895**	**5,895**	**221**	**1**	**[3]6,115**

	December 31,2011				
			Cumulative other comprehensive income		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value[2]
	In NIS millions				
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	16,991	16,844	217	70	16,991
Of foreign governments[8]	837	833	5	1	837
Of Israeli financial institutions	762	759	11	8	762
Of foreign financial institutions	2,067	2,369	11	313	2,067
Mortgage-backed-securities and Assets - backed-securities `	11,842	11,709	161	28	11,842
Of others in Israel	278	293	8	23	278
Of others abroad[8]	199	199	-	-	199
Total bonds and bills	**32,976**	**33,006**	**413**	**443**	**[3]32,976**
Shares	658	653	5	-	[5]658
Total available-for-sale securities	**33,634**	**33,659**	**[4]418**	**[4]443**	**33,634**

For footnotes see next page.

3. SECURITIES[1] (CONTINUED)

A. Composition of this item - consolidated (continued)

	December 31,2011				
	Book value	Amortized cost (for shares - 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:					
Of the Israeli Government	3,218	3,210	9	1	3,218
Of foreign governments	6	6	-	-	6
Of Israeli financial institutions	4	4	-	-	4
Of foreign financial institutions	45	61	-	16	45
Mortgage-backed-securities and Assets - backed-securities	54	54	-	-	54
Of others in Israel	27	32	-	5	27
Of others abroad	10	11	-	1	10
Total bonds and bills	**3,364**	**3,378**	**9**	**23**	**3,364**
Shares	5	8	-	3	5
Total trading securities	**3,369**	**3,386**	**(6)9**	**(6)26**	**3,369**
Total securities	**42,898**	**42,940**	**648**	**470**	**43,118**

Footnotes:

(1) Pledges, see Note 15.

(2) Fair value data based on market prices, does not necessarily reflect the price that may be obtained on the sale of securities in large volumes.

(3) Including securities sold by an overseas consolidated subsidiary under buy-back terms from the held to maturity portfolio at a reduced cost of NIS 1,039 million (approx. US$272 million) and from the available for sale portfolio with a market value of NIS 6,860 million (approx. US$1,795 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 625 million.

(6) Recorded in the statement of income.

(7) Reclassified – U.S. Government agencies and municipal bonds of states in the U.S.A., in an amount of NIS 2,150 million (book value), have been reclassified from "Of foreign governments" to "Of others abroad".

(8) Reclassified – U.S. Government agencies, in the amount of NIS 167 million (book value), have been reclassified from "Of foreign governments" to "Of others abroad".

B. Composition of this item

	December 31,2012				
	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:					
Of the Israeli Government	3,038	3,038	248	-	3,286
Total held-to-maturity bonds and bills	**3,038**	**3,038**	**248**	**-**	**3,286**

For footnotes see next page.

3. SECURITIES[1] (CONTINUED)

B. Composition of this item – consolidated (continued)

	December 31,2012				
			Cumulative other comprehensive income		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value[2]
	In NIS millions				
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	16,513	16,049	472	8	16,513
Of foreign governments	240	234	6	-	240
Of Israeli financial institutions	103	97	6	-	103
Of foreign financial institutions	702	672	30	-	702
Of others in Israel	243	231	13	1	243
Total bonds and bills	**17,801**	**17,283**	**527**	**9**	**17,801**
Shares	4	4	-	-	4
Total available-for-sale securities	**17,805**	**17,287**	(3)**527**	(3)**9**	**17,805**

	December 31,2012				
	Book value	Amortized cost (for shares - 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:					
Of the Israeli Government	2,759	2,753	6	-	2,759
Of Israeli financial institutions	6	6	-	-	6
Of foreign financial institutions	15	31	-	16	15
Total bonds and bills	**2,780**	**2,790**	**6**	**16**	**2,780**
Shares	1	3	-	2	1
Total trading securities	**2,781**	**2,793**	(4)**6**	(4)**18**	**2,781**
Total securities	**23,624**	**23,118**	**781**	**27**	**23,872**

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data based on market prices, does not necessarily reflect the price that may be obtained on the sale of securities in large volumes.

(3) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(5) Recorded in the statement of income.

3. SECURITIES[1] (CONTINUED)

B. Composition of this item – the Bank

	December 31,2011				
	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:					
Of the Israeli Government	2,605	2,605	81	-	2,686
Total held-to-maturity bonds and bills	**2,605**	**2,605**	**81**	**-**	**2,686**

	December 31,2011				
			Cumulative other comprehensive income		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value[2]
	In NIS millions				
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	12,947	12,820	193	66	12,947
Of foreign governments	145	143	3	1	145
Of Israeli financial institutions	4	4	-	-	4
Of foreign financial institutions	350	360	10	20	350
Of others in Israel	84	90	2	8	84
Total bonds and bills	**13,530**	**13,417**	**208**	**95**	**13,530**
Shares	12	7	5	-	[4]12
Total available-for-sale securities	**13,542**	**13,424**	**[3]213**	**[3]95**	**13,542**

.For footnotes see next page

3. SECURITIES[1] (CONTINUED)

B. Composition of this item - the Bank (continued)

	December 31,2011				
	Book value	Amortized cost (for shares - 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:					
Of the Israeli Government	2,800	2,793	8	1	2,800
Of foreign financial institutions	12	26	-	14	12
Total bonds and bills	**2,812**	**2,819**	**8**	**15**	**2,812**
Shares	1	4	-	3	1
Total trading securities	**2,813**	**2,823**	**(5)8**	**(5)18**	**2,813**
Total securities	**18,960**	**18,852**	**302**	**113**	**19,041**

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data based on market prices, does not necessarily reflect the price that may be obtained on the sale of securities in large volumes.

(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 1 million.

(5) Recorded in the statement of income.

C. **Sale of securities out of the "held to maturity" portfolio (2011).** In the first quarter of 2011, IDB New York, sold, out of the "held to maturity" portfolio, securities the amount of which at December 31, 2010 was US$42 million (NIS 149 million).The said securities were of the non-U.S. Government agencies RMBS type, which upon purchase thereof had been classified to the "held to maturity" portfolio, the quality of credit in respect of which has significantly declined. The loss on the sale was recognized in the financial statements for 2010.

On July 13, 2011, IDB New York sold two CMBS securities, the stated amount of which as of June 30, 2011, was NIS 14.3 million. These securities were classified during the first quarter of 2010, as held to maturity, and since then significant impairment of the credit quality in their respect has taken place and in particular, impairment of the quality of the loans backing these securities (an increase in the rate of loans in arrears and in the period in arrears).

D. **Further details regarding mortgage and asset backed securities, on a consolidated basis.** The Bank's securities portfolio as of December 31, 2012, 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 pool of mortgages, in respect of which periodic payments of principal and interest are paid. These securities are also referred to as mortgage related or mortgage pass-through securities.

In accordance with the IDBNY Treasury Management and Asset-Liability Policy, investments in MBSs, excluding GNMAs, are limited to 75% of the total investment portfolio. The market risk of these securities is evaluated prior to purchase to determine their suitability for inclusion in the portfolio. Moreover, certain high risk tranches, are not allowable.

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, a U.S. Government guarantee is in effect. When the issue is performed by Fannie Mae or Freddie Mac, Government Sponsored Enterprises (hereinafter: "GSE"), 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 GSE's who have a high credit rating. The GSE's are sponsored 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 GSE's.

3. SECURITIES[1] (CONTINUED)

Mortgage loans, grant the private borrower the right of early repayment at any given time.

As a result, the investor's have interest exposure (early repayment), as well as exposure to the condition in the real estate market and the economy in general.

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 GNMA or GSE's, 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 high rated in respect of payments of principal and interest over the other tranches given a lower rating.

CLO (Collateralized Loan Obligation): A bond backed up by a loan portfolio.

FNMA (Fannie Mae): a public corporation under the sponsorship of the U.S. Government that purchases mortgages, securitizes them and sells them on the open market (the corporation does not carry a U.S. Government guarantee).

FHLMC (Freddie Mac): an agency branched to the U.S. Government that purchases mortgages, securitizes them and sells them to the public (the agency does not carry a U.S. Government guarantee).

GNMA (Ginnie Mae): a federal mortgage corporation. Bonds issued by it are secured by guarantees of the Government National Mortgage Association.

3. SECURITIES[(1)] (CONTINUED)

E. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES

	December 31,2012			
	Amortized cost	Unrecognized gains from adjustment to fair value(1)	Unrecognized losses from adjustment to fair value(1)	Fair value
	In NIS millions			
1.Mortgage-backed securities (MBS):				
Available-for-sale trading securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	186	3	*-	189
Securities issued by FHLMC and FNMA	2,434	70	*-	2,504
Total mortgage-backed pass-through securities	**2,620**	**73**	***-**	**2,693**
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	6,355	50	62	6,343
Other mortgage-backed securities	21	1	-	22
Total mortgage-backed other MBS securities	**6,376**	**51**	**62**	**6,365**
Total available-for-sale MBS securities	**8,996**	**124**	**62**	**9,058**
Held-to-maturity securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	79	4	-	83
Securities issued by FHLMC and FNMA	67	4	-	71
Total mortgage-backed pass-through securities	**146**	**8**	**-**	**154**
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	1,326	24	2	1,348
Other mortgage-backed securities	48	12	-	60
Total mortgage-backed other MBS securities	**1,374**	**36**	**2**	**1,408**
Total held-to-maturity MBS securities	**1,520**	**44**	**2**	**1,562**
:Securities for sale				
A. Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	2	-	-	2
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	51	-	*-	51
Total securities for sale MBS securities	**53**	**-**	***-**	**53**
Total mortgage-backed securities (MBS)	**10,569**	**168**	**64**	**10,673**
2. Asset-backed available-for-sale securities (ABS)				
Collaterized bonds CLO	695	3	2	696
Total asset-backed available-for-sale securities (ABS)	**695**	**3**	**2**	**696**
Total mortgage and asset-backed securities	**11,264**	**171**	**66**	**11,369**

*Loss amount lower then NIS 1 million.

Footnote:

(1) For available sale securities-Total other cumulative income.

3. SECURITIES (CONTINUED)

E. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES (CONTINUED)

	December 31,2011			
	Amortized cost	Unrecognized gains from adjustment to fair value(1)	Unrecognized losses from adjustment to fair value(1)	Fair value
	In NIS millions			
1. Mortgage-backed securities (MBS):				
Available-for-sale trading securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	225	8	-	233
Securities issued by FHLMC and FNMA	3,268	76	1	3,343
Total mortgage-backed pass-through securities	**3,493**	**84**	**1**	**3,576**
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	8,216	77	27	8,266
Total mortgage-backed other MBS securities	**8,216**	**77**	**27**	**8,266**
Total available-for-sale MBS securities	**11,709**	**161**	**28**	**11,842**
Held-to-maturity securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	100	6	-	106
Securities issued by FHLMC and FNMA	102	5	-	107
Total mortgage-backed pass-through securities	**202**	**11**	**-**	**213**
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	770	22	-	792
Other mortgage-backed securities	56	5	-	61
Total mortgage-backed other MBS securities	**826**	**27**	**-**	**853**
Total held-to-maturity MBS securities	**1,028**	**38**	**-**	**1,066**
Securities for sale				
A. Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	3	-	-	3
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	51	-	*-	51
Total securities for sale MBS securities	**54**	**-**	***-**	**54**
Total mortgage-backed securities (MBS)	**12,791**	**199**	**28**	**12,962**

*Loss amount lower then NIS 1 million.

Footnote:

(1) For available sale securities-Total other cumulative income.

3. SECURITIES (CONTINUED)

F. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE AND ASSET BACKED SECURITIES

Additional details regarding mortgage and asset backed securities in unrealized loss position:

	December 31, 2012			
	Less than 12 months		12 months and over	
	Fair value	Unrealized losses	Fair value	Unrealized losses
	In NIS millions			
1.Mortgage-backed securities (MBS):				
Available-for-sale trading securities:				
A. Mortgage pass-through securities				
Securities guaranteed by GNMA	68	*-	-	-
Securities issued by FHLMC and FNMA	98	*-	-	-
Total mortgage-backed pass-through securities	**166**	***-**	**-**	**-**
Other mortgage-backed securities (including CMO,REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	3,349	50	437	12
Total other mortgage-backed securities	**3,349**	**50**	**437**	**12**
Total available-for-sale MBS securities	**3,515**	**50**	**437**	**12**
Held-to-maturity securities				
Other mortgage-backed securities (including CMO,REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	228	2	-	-
Total other mortgage-backed securities	**228**	**2**	**-**	**-**
Total held-to-maturity MBS securities	**228**	**2**	**-**	**-**
securities for sale				
Other mortgage-backed securities (including CMO,REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	27	*-	14	*-
Total bonds for sale MBS securities	**27**	***-**	**14**	*-
Total mortgage-backed securities (MBS)	**3,770**	**52**	**451**	**12**
2. Asset-backed available-for-sale securities (ABS)				
Collaterized bonds CLO	395	2	-	-
Total asset-backed available-for-sale securities (ABS)	**395**	**2**	**-**	**-**
Total mortgage and asset-backed securities	**4,165**	**54**	**451**	**12**

*Loss amount lower then NIS 1 million.

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, 2011			
	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 issued by FHLMC and FNMA	130	1	-	-
Total mortgage-backed pass through securities	**130**	**1**	**-**	**-**
B. Other mortgage-backed securities (including CMO,REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	2,622	18	387	9
Total other mortgage-backed securities	**2,622**	**18**	**387**	**9**
Total available-for-sale MBS securities	**2,752**	**19**	**387**	**9**
Securities for sale				
Other mortgage-backed securities (including CMO,REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	23	*-	-	-
Total bonds for sale MBS securities	**23**	***-**	**-**	**-**
Total mortgage-backed securities (MBS)	**2,775**	**19**	**387**	**9**

*Loss amount lower then NIS 1 million.

G. The available-for-sale securities portfolio includes corporate bonds, including bonds of banks, in a total amount of NIS 4,075 million (December 31, 2011: NIS 3,306 million). The balance of the said bonds included as of December 31, 2012, unrealized losses in the amount of NIS 183 million (December 31, 2011: NIS 344 million).

H. Most of the unrealized losses as at December 31, 2012 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 it relevant consolidated companies estimates that it is not probable that they will be able to collect all the amounts owed to them pursuant to the investment contracts.

In 2012, an other than temporary in nature write down was recorded on several securities, in the amount of US$8 million (NIS 28 million) [2011: US$11 million (NIS 42 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, 2012 except for certain securities, in respect of which a provision for impairment in value has been included.

I. The securities portfolio of the Discount Group as at December 31, 2012, 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$76 million, (NIS 284 million), compared to US$171 million on December 31, 2011 (NIS 653 million).

J. **Fair value presentation.** The balances of securities as of December 31, 2012, and December 31, 2011, include securities amounting to NIS 38,372 million and NIS 36,378 million, respectively, that are presented at fair value.

3. SECURITIES (CONTINUED)

K. Data regarding impaired bonds - consolidated

	December 31, 2012	December 31, 2011
	In NIS millions	
Recorded amount of Non performing impaired bonds	82	69

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES

General. In the annual report for 2012, the Bank implements for the first time the instructions of the Supervisor of Banks regarding "Update of the disclosure as to the quality of credit of debts and the allowance for credit losses". The comparative figures for 2011 have been reclassified, to the extent possible, in order to modify them to the required format in accordance with the said instructions. For details, see Note 1D 4.3 above.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A. Debts[1] and off-balance sheet credit instruments

1. Change in the balance of the allowance for credit losses - Consolidated

	Credit to the public					
	Commercial	Private Individuals - Housing Loans	Private Individuals - Other Loans	TOTAL	Banks and Governments	TOTAL
	In NIS millions					
	2012					
Balance of allowance for credit losses, as at December 31, 2011	1,477	230	440	2,147	4	2,151
Credit loss expenses	705	-	20	725	1	726
Accounting write-offs	(781)	(7)	(263)	(1,051)	-	(1,051)
Collection of debts written-off in previous years	241	2	198	441	-	441
Net accounting write-offs	(540)	(5)	(65)	(610)	-	(610)
Financial statements translation adjustments	(6)	-	-	(6)	-	(6)
Balance of allowance for credit losses, as at December 31, 2012	**1,636**	**225**	**395**	**2,256**	**5**	**2,261**
Of which: In respect of off-balance sheet credit instruments	132		39	171		171
	2011					
	In NIS millions					
Balance of allowance for credit losses at the beginning of the year	--	--	--	6,384	--	6,384
Net accounting write-offs recognized as at January 1, 2011	--	--	--	(5,543)	--	(5,543)
Other changes in the allowance for credit losses as at January 1, 2011 (reflected in the equity)	--	--	--	1,382	--	1,382
Allowance for credit losses as at January 1,2011	1,490	241	492	2,223	[2]-	2,223
Credit loss expenses	640	(4)	138	774	4	778
Accounting write-offs	(962)	(7)	(281)	(1,250)	-	(1,250)
Collection of debts written-off in previous years	309	-	91	400	-	400
Net accounting write-offs	(653)	(7)	(190)	(850)	-	(850)
Balance of allowance for credit losses, as at December 31, 2011	**1,477**	**230**	**440**	**2,147**	**4**	**2,151**
Of which: In respect of off-balance sheet credit instruments	134		38	172		172

Notes:
(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.
(2) An amount lower than NIS 1 million.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A. Debts[1] and off-balance sheet credit instruments (continued)

2. Additional information regarding the mode of computing the allowance for credit losses in respect of debts[1] and regarding the debts[1] for which the allowance is computed – consolidated

	December 31,2012						December 31,2011		
	Credit to the public								
	Commercial	Private Individuals - Housing Loans	Private Individuals - Other Loans	TOTAL	Banks and Governments	TOTAL	Credit to the Public	Banks and Governments	TOTAL
	In NIS millions								
Recorded amount of debts[1]:									
Examined on a specific basis	62,145	35	6,702	68,882	4,577	73,459	63,035	4,009	67,044
Examined on a group basis:									
The allowance in respect thereof is computed by the extent of arrears	246	19,544	-	19,790	-	19,790	19,868	-	19,868
Other	19,590	86	11,348	31,024	5,097	36,121	35,455	2,683	38,138
Total debts[1]	81,981	19,665	18,050	119,696	9,674	129,370	118,358	6,692	125,050
Allowance for Credit Losses in respect of debts[1]:									
Examined on a specific basis	1,257	-	109	1,366	-	1,366	1,185	-	1,185
Examined on a group basis:									
The allowance in respect thereof is computed by the extent of arrears	2	[2]224	-	226	-	226	[2]230	-	230
Other	245	1	247	493	5	498	560	4	564
Total allowance for Credit Losses	1,504	225	356	2,085	5	2,090	1,975	4	1,979

:Footnotes

(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding investments in bonds and securities borrowed or purchased under resale agreements

(2) Includes the balance of allowance in excess of that required by the extent of arrears method, computed on a specific basis in amount of NIS 15 million (31.12.2011- NIS 19 million), computed on a group basis in amount of NIS 42 million (31.12.2011- NIS 32 million).

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A. Debts[1] and off-balance sheet credit instruments (continued)

3. Change in the balance of the allowance for credit losses – The Bank

	Provision for credit losses					
	Credit to the public					
	Commercial	Private Individuals - Housing Loans	Private Individuals - Other Loans	TOTAL	Banks and Governments	TOTAL
	In NIS millions					
	2012					
Balance of allowance for credit losses, as at December 31, 2011 (audited)	982	222	212	1,416	1	1,417
Credit loss expenses	569	(1)	22	590	(1)	589
Accounting write-offs	(627)	(7)	(157)	(791)	-	(791)
Collection of debts written-off in previous years	185	2	107	294	-	294
Net accounting write-offs	(442)	(5)	(50)	(497)	-	(497)
Balance of allowance for credit losses, as at December 31, 2012	**1,109**	**216**	**184**	**1,509**	**-**	**1,509**
Of which: In respect of off-balance sheet credit instruments	117	-	17	134	-	134
	2011					
Balance of allowance for credit losses at the beginning of the year	-	-	-	5,290	-	5,290
Net accounting write-offs recognized as at January 1, 2011	-	-	-	(4,860)	-	(4,860)
Other changes in the allowance for credit losses as at January 1, 2011 (reflected in the equity)	-	-	-	1,062	-	1,062
Allowance for credit losses as at January 1,2011	1,024	233	235	1,492	[2]-	1,492
Credit loss expenses	450	(4)	127	573	1	574
Accounting write-offs	(641)	(7)	(241)	(889)	-	(889)
Collection of debts written-off in previous years	149	-	91	240	-	240
Net accounting write-offs	(492)	(7)	(150)	(649)	-	(649)
Balance of allowance for credit losses, as at December 31, 2011	**982**	**222**	**212**	**1,416**	**1**	**1,417**
Of which: In respect of off-balance sheet credit instruments	116	-	19	135	-	135

Note:
(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.
(2) An amount lower than NIS 1 million

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A. Debts[1] and off-balance sheet credit instruments (continued)

4. Additional information regarding the mode of computing the allowance for credit losses in respect of debts[1] and regarding the debts[1] for which the allowance is computed – The Bank

	December 31,2012						December 31,2011		
	Credit to the public								
	Commercial	Private Individuals - Housing Loans	Private Individuals - Other Loans	TOTAL	Banks and Governments	TOTAL	Credit to the Public	Banks and Governments	TOTAL
	In NIS millions								
Recorded amount of debts[1]:									
Examined on a specific basis	49,774	35	4,190	53,999	5,670	59,669	51,664	2,468	54,132
Examined on a group basis:									
The allowance in respect thereof is computed by the extent of arrears	246	17,143	-	17,389	-	17,389	17,781	-	17,781
Other	5,251	64	5,701	11,016	-	11,016	13,087	-	13,087
Total debts[1]	**55,271**	**17,242**	**9,891**	**82,404**	**5,670**	**88,074**	**82,532**	**2,468**	**85,000**
Allowance for Credit Losses in respect of debts[1]:									
Examined on a specific basis	917	-	56	973	-	973	816	-	816
Examined on a group basis:									
Of which: the allowance in respect thereof is computed by the extent of arrears	2	[2]215	-	217	-	217	[2]222	-	222
Other	73	1	111	185	-	185	244	1	245
Total allowance for Credit Losses	**992**	**216**	**167**	**1,375**	**-**	**1,375**	**1,282**	**1**	**1,283**

:Footnotes

(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding investments in bonds and securities borrowed or purchased under resale agreements

(2) Includes the balance of allowance in excess of that required by the extent of arrears method, computed on a specific basis in amount of NIS 14 million (31.12.2011- NIS 18 million), computed on a group basis in amount of NIS 37 million (31.12.2011- NIS 28 million).

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1]

1. Credit quality and arrears - consolidated

	December 31,2012					
		Criticized[2]			Unimpaired debts – additional information	
	Uncriticized	Unimpaired	Impaired[3]	TOTAL	In Arrears of 90 Days or More[4]	In Arrears of 30 to 89 Days[5]
	In NIS millions					
Lending Activity in Israel						
Public - Commercial						
Construction and Real Estate - Construction	5,024	84	632	5,740	3	11
Construction and Real Estate - Real Estate Activity	7,610	7	489	8,106	1	3
Financial Services	7,680	247	420	8,347	1	-
Commercial - Other	35,519	869	1,470	37,858	25	56
Total Commercial	**55,833**	**1,207**	**3,011**	**60,051**	**30**	**70**
Private Individuals - Housing Loans	18,542	[6]1,071	-	19,613	592	92
Private Individuals - Other Loans	16,545	131	147	16,823	48	53
Total Public - Lending Activity in Israel	**90,920**	**2,409**	**3,158**	**96,487**	**670**	**215**
Banks in Israel	1,267	-	-	1,267	-	-
Government of Israel	1,614	-	-	1,614	-	-
Total Lending Activity in Israel	**93,801**	**2,409**	**3,158**	**99,368**	**670**	**215**
Lending Activity Outside of Israel						
Public - Commercial						
Construction and Real Estate	5,740	201	1,511	7,452	-	
Commercial - Other	13,423	286	769	14,478	-	5
Total Commercial	**19,163**	**487**	**2,280**	**21,930**	**-**	**5**
Private Individuals	1,263	9	7	1,279	1	8
Total Public - Lending Activity Outside of Israel	**20,426**	**496**	**2,287**	**23,209**	**1**	**13**
Foreign banks	6,711	-	-	6,711	-	-
Foreign governments	82	-	-	82	-	-
Total Lending Activity Outside of Israel	**27,219**	**496**	**2,287**	**30,002**	**1**	**13**
Total public	**111,346**	**2,905**	**5,445**	**119,696**	**671**	**228**
Total banks	**7,978**	**-**	**-**	**7,978**	**-**	**-**
Total governments	**1,696**	**-**	**-**	**1,696**	**-**	**-**
Total	**121,020**	**2,905**	**5,445**	**129,370**	**671**	**228**

For footnotes see next page.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

1. Credit quality and arrears – consolidated (continued)

	December 31,2011				
				Unimpaired debts – additional information	
	Non Impaired	Impaired[3]	Total	In arrears for 90 days or more[4]	In arrears for 30 to 89 days
	In NIS millions				
Credit to the Public					
Examined on a specific basis	57,465	5,570	63,035	-	118
Housing loans according to the extent of period in arrears	19,868	-	19,868	447	236
Examined on other group basis	35,414	41	35,455	110	98
Total Public	**112,747**	**5,611**	**118,358**	**557**	**452**
Total Banks	**5,052**	**-**	**5,052**	**-**	**-**
Total Governments	**1,640**	**-**	**1,640**	**-**	**-**
Total	**119,439**	**5,611**	**125,050**	**557**	**452**

:Footnotes

(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.

(2) Impaired, substandard or under special mention credit risk, including housing loans for which a allowance according to the extent of arrears exists, housing loans in arrears for ninety days or over for which a allowance according to the extent of arrears does not exist.

(3) As a general rule, interest income is not accrued in respect of impaired debts. For information regarding impaired debt restructured under troubled debt restructuring, see Note 4.B.2.c. below.

(4) Classified as unimpaired criticized debts. Accruing interest income.

(5) Accruing interest income. Debts in arrears for between 30 and 89 days in amount of NIS 196 million are classified as unimpaired criticized debts.

(6) Including housing loans in amount of NIS 49 million with a allowance according to the extent of arrears, for which an arrangement was made for the repayment of overdue amounts, which included a change in the repayment schedule for the balance of the loan not yet due.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

2. Additional information regarding impaired debts – consolidated

A. Impaired debts and specific allowance

	Balance[2] of impaired debts in respect of which specific allowance exist[3]	Balance of specific allowance[3]	Balance[2] of impaired debts for which specific allowance do not exist[3]	Total balance[2] of Impaired Debts	Contractual principal amount of impaired debts
			In NIS millions		
			December 31,2012		
Lending Activity in Israel					
Public - Commercial					
Construction and Real Estate - Construction	116	36	516	632	4,822
Construction and Real Estate - Real Estate Activity	50	13	439	489	2,047
Financial Services	371	67	49	420	827
Commercial - Other	486	96	984	1,470	7,460
Total Commercial	**1,023**	**212**	**1,988**	**3,011**	**15,156**
Private Individuals - Housing Loans	-	-	-	-	-
Private Individuals - Other Loans	75	22	72	147	595
Total Public - Lending Activity in Israel	**1,098**	**234**	**2,060**	**3,158**	**15,751**
Banks in Israel	-	-	-	-	-
Government of Israel	-	-	-	-	-
Total Lending Activity in Israel	**1,098**	**234**	**2,060**	**3,158**	**15,751**
Lending Activity Outside of Israel					
Public - Commercial					
Construction and Real Estate	647	160	864	1,511	1,960
Commercial - Other	753	150	16	769	1,003
Total Commercial	**1,400**	**310**	**880**	**2,280**	**2,963**
Private Individuals	7	6		7	7
Total Public - Lending Activity Outside of Israel	**1,407**	**316**	**880**	**2,287**	**2,970**
Foreign banks	-	-	-	-	-
Foreign governments	-	-	-	-	-
Total Lending Activity Outside of Israel	**1,407**	**316**	**880**	**2,287**	**2,970**

For footnotes see next page.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

2. Additional information regarding impaired debts – consolidated (continued)

A. Impaired debts and specific allowance (continued)

	Balance[2] of impaired debts in respect of which specific allowance exist[3]	Balance of specific allowance[3]	Balance[2] of impaired debts for which specific allowance do not exist[3]	Total balance[2] of Impaired Debts	Contractual principal amount of impaired debts
	In NIS millions				
	December 31,2012				
Total public	**2,505**	**550**	**2,940**	**5,445**	**18,721**
Total banks	**-**	**-**	**-**	**-**	**-**
Total governments	**-**	**-**	**-**	**-**	**-**
Total [4]	**2,505**	**550**	**2,940**	**5,445**	**18,721**
[4]Of which:					
Measured According to Present Value of Cash Flows	1,118	285	1,137	2,255	
Debts under troubled debt restructurings	799	91	1,591	2,390	
	December 31,2011				
Total public [5]	2,136	435	3,434	5,570	
[5]Of which:					
Measured According to Present Value of Cash Flows	-	-	-	3,049	-
Debts under troubled debt restructurings	-	-	-	3,045	-

Footnotes:
(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.
(2) Recorded amount
(3) Specific allowance for credit losses

B. Average balance and interest income

	2012	2011
	in NIS millions	
The average recorded amount of impaired debts	6,852	5,515
Total interest income recognized in respect of such debts during the period of time in which it had been classified as impaired	121	160
Of which: interest income recorded by the cash basis accounting method.	59	65
Total interest income that would have been recognized had such debts accrued interest according to its original terms.	468	356

:Footnotes
(1) Credit to the public, credit to Governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

2. Additional information regarding impaired debts – consolidated (continued)

C. Restructured troubled debts - consolidated

	Non Performing				
	Non Performing	Performing Debts[2],in arrears for 90 days or more	Performing Debts[2], in Arrears for 30 to 89 Days	Performing Debts[2] not in Arrears	TOTAL[3]
	In NIS millions				
	December 31,2012				
Lending Activity in Israel					
Public - Commercial					
Construction and Real Estate - Construction	44	-	3	59	106
Construction and Real Estate - Real Estate Activity	216	-	-	99	315
Financial Services	139	-	-	107	246
Commercial - Other	363	-	7	292	662
Total Commercial	**762**	**-**	**10**	**557**	**1,329**
Private Individuals - Housing Loans	-	-	-	-	-
Private Individuals - Other Loans	5	-	14	78	97
Total Public - Lending Activity in Israel	**767**	**-**	**24**	**635**	**1,426**
Banks in Israel	-	-	-	-	-
Government of Israel	-	-	-	-	-
Total Lending Activity in Israel	**767**	**-**	**24**	**635**	**1,426**
Lending Activity Outside of Israel					
Public - Commercial					
Construction and Real Estate	711	-	-	108	819
Commercial - Other	79	-		66	145
Total Commercial	**790**	**-**		**174**	**964**
Private Individuals					
Total Public - Lending Activity Outside of Israel	**790**	**-**		**174**	**964**
Foreign banks	-	-	-	-	-
Foreign governments	-	-	-	-	-
Total Lending Activity Outside of Israel	**790**	**-**		**174**	**964**
Total	**1,557**	**-**	**24**	**809**	**2,390**
	December 31,2011				
Total Public	**547**	**-**	**11**	**2,487**	**3,045**

:Footnotes

(1) Credit to the public, credit to governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under resale agreements.

(2) Accruing interest income.

(3) Included in impaired debts.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

3. Additional disclosure regarding the quality of credit

(A) Risk characteristics according to credit segments

(1) Business credit

- Sensitivity to the domestic economic cycle in Israel. In addition, in view of material overseas investments by large Israeli corporations, the level of exposure to global crises increased;
- Sensitivity to private consumption;
- Exposure to foreign competition;
- In view of the high concentration of the ownership and control structure of corporations in the Israeli market – credit is typified by high concentration at the large borrower groups' level. Furthermore, the structure of the holding groups and their indebtedness at several levels within the holding corporations, increase the credit risk and the vulnerability of these corporations. Several debt arrangements were particularly noticeable in the recent period, and uncertainty exists as to the ability of corporations, which had raised debt with no matching cash flow, to recycle such debts.

(2) Credit to private individuals – housing loans

- Loans involving a high finance ratio carry risk in the event of impairment in the value of collateral below the balance of the loan. The Bank's underwriting policy limits the ratio of finance when granting a loan;
- Future regulation might restrict the ability to realize the assets/collaterals and reduce the possibility of reliance thereon.

(3) Credit to private individuals – other

- Exposure to retail credit is affected by macro-economic factors.
- Intensification of competition in the banking system in recent years may lead to erosion in margins, decline in quality of borrowers with a resultant increase in credit risk. The credit policy does not allow at the present time the granting of credit to customers having a low internal credit rating, thus moderating such risks.

(B) Indication of credit quality

	December 31,2012				December 31,2011
	Commercial	Private Individuals - Housing Loans	Private Individuals - Other Loans	TOTAL	TOTAL
Ratio of the balance of non-problematic credit to the public to the balance of credit to the public	91.5%	94.5%	98.4%	93.0%	93.3%
Ratio of the balance of problematic unimpaired credit to the public to the balance of credit to the public	2.1%	5.5%	0.8%	2.4%	2.0%
Ratio of the balance of impaired credit to the public to the balance of credit to the public	6.5%	-	0.9%	4.5%	4.7%
Ratio of the balance of allowance to credit loss in respect of credit to the public to the balance of credit to the public	1.8%	1.1%	2.0%	1.7%	1.7%
Ratio of the balance of allowance to credit loss in respect of credit to the public to the balance of problematic credit (excluding derivatives and bonds)	19.8%	21.0%	119.0%	23.2%	23.2%

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

3. Additional disclosure regarding the quality of credit (continued)

The ratio of non-problematic credit to the public declined during 2012 to 93.0% in contrast to 93.3% in 2011. Impaired credit as a ratio of total credit to the public declined during 2012. The impaired credit belongs mostly to the commercial segment.

The total problematic credit to the public (impaired and unimpaired) increased during 2012, comprising approx. 7% of total credit to the public, as compared with 6.7% at the end of 2011. The ratio of non-performing credit to the public was approx. 8.6% in the commercial segment (mostly impaired) in contrast to approx. 7.6% relating to private individuals (excluding housing loans), and 5.5% as regards housing loans.

(C) Policy and procedures for determining the allowance for credit losses

The Bank has determined a specific policy and procedures for detection, classification and treatment, designed to ensure the adequacy of the allowance. The processes defined in the Bank's policy are consistently applied by all risk accepting functionaries at the Bank and at the control circles. The policy and procedures were drafted in accordance with and on the basis of the regulatory requirements included in the directives and guidelines of the Supervisor of Banks. Procedures are updated in accordance with changes in regulatory directives.

Processes and tools for detecting and identifying problematic debts. The Bank has defined processes for locating weaknesses in borrower portfolios. The processes include the use of mechanized models for the early detection of negative symptoms, including: A "credit securing" model, "debt rating" model, "red lights" system, exceptions reports, etc. In addition, processes were defined for current surveys of borrower portfolios by the responsible business functionary, current discussions by the credit committees and scanning by the various control units.

Debt test routes. For details regarding the adopted accounting policy, see Note 1 above.

Criteria for the classification of debts as problematic debts. The process of classification of debts at the Bank is performed while combining qualitative criteria with quantitative criteria.

In deciding whether a debt should be classified as problematic, all factors relevant to the collection prospects of the debt are taken into consideration, including economic, environmental and industry factors. Furthermore, defined in the policy are terms for the reclassification of a debt from the status of "impaired" and the terms for defining an impaired debt under restructuring as accruing interest.

In 2012, the Bank made changes to its policy and procedures for the treatment of problematic debts. These changes stem from guidelines and "questions and answers" published by the Supervisor of Banks. The changes include extending the processes for detecting and identifying problematic debts, integration of additional criteria for the classification of debts, characterization of the types of impaired debts, updating the methodology for accounting write-offs and updating the methodology for determining the fair value of collateral for the purpose of determination of the amount of allowance and write-off. Controls for the documentation of classification, allowance and write-off processes have also been extended.

Also adjusted and updated was the model for determining the group allowance for performing debts and problematic debts, which are not impaired.

For a wider discussion of the accounting policy, see Note 1.

(C) Credit quality disclosure

The Bank is following on a current basis the quality of the credit portfolio by means of methodical processes for the scanning and detection of problematic debts and of debts showing preliminary symptoms which might turn in the future into problematic debts. The processes include models and information system for detecting negative symptoms, the current scanning of borrowers, current discussions at credit committees and monitoring activities by the various control units.

The Bank's credit policy addresses, among other things, the monitoring of credit quality. In addition, the Bank has work processes regarding the manner of credit treatment, which are being updated when required.

(1) Business credit processes

A current follow-up and a systematic quarterly monitoring for the detection of negative symptoms are being conducted as well as tests on the background of negative indications. In addition, borrower portfolios are being discussed from time to time, and the need to add a borrower to the follow-up list or reclassify his debt is being examined.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

B. Debts[1] (continued)

3. Additional disclosure regarding the quality of credit (continued)

Follow-up lists comprise a supporting process within the overall framework of detecting and classifying problematic debts at a preliminary stage of identifying negative symptoms in borrower portfolios.

Furthermore, periodic exceptions reports are being produced and a follow-up of findings is performed. These reports are used as an auxiliary tool for detecting borrowers having negative symptoms.

A periodic risk evaluation using the computer system is performed and the risk rating is being updated in accordance with stated circumstances. The rating is determined by the business factor, is being used for customer credit risk evaluation and provides a comparative index between all borrowers. The rating mark determines the quality of indebtedness of borrowers on the basis of industry and activity risks, structural-organizational risks, borrower compliance with loan terms, scope and quality of collateral and various financial indices. Its reasonableness is tested by factors at the Bank who are not involved with the granting and management of credit, and as such are considered independent.

In addition, small businesses have a separate system, which is in the development stage and is based on the platform of the "credit securing" system for private individuals.

Furthermore, an additional control circle exists – credit control and internal audit. This process is conducted at all credit layers.

(2) Credit processes for private individuals

- Credit scoring – A model used by the branches for rating determination and providing recommendations for the granting of credit, designed to foresee the prospect of "failure" of a private customer on the basis of a diversity of explanatory variables. The results of the model are used as a parameter in the red lights system;
- Red lights – A computer system for the identification of various symptoms in customer accounts, indicating the possibility of deterioration in his situation. The system produces control and management reports for the purpose of follow-up. Specific accounts are transferred for treatment by a designated unit for the purpose of reinstatement of regular activity in the account or passing-on the treatment to collection and classification of the debt;
- In-depth control – sample control tests at all branches of the Bank;
- Control factors take samples and examine accounts (having negative symptoms or in which negative indications have not been found) and provide comments regarding the quality and reasonableness of the credit granted;
- Exceptions reports, borrower reports under different distributions, problematic symptoms reports, etc.;
- A model for the rating of applications for mortgage loans – the model rates new transactions on the basis of failure prospects considering the characteristics of the borrower, the transaction and the property in question;
- Studies of failure event conclusions – studying the processes and their results, analysis and integration of conclusions and lessons that might be drawn from them. This process is conducted at all credit layers.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A. Debts[(1)]

3. Additional disclosure regarding the quality of credit (continued)

		Balance of housing loans			
		Total[(1)]	Of which: Bullet and Baloon debts[(1)]	Of which: variable interest[(1)]	Total Off-Balance Sheet Credit Risk
		In NIS millions			
		December 31,2012			
First degree pledge: financing ratio	Up to 60%	10,866	224	5,846	275
	Over 60%	8,879	122	4,876	71
Second degree pledge or without pledge		347	303	309	1,204
Total		**20,092**	**649**	**11,031**	**1,550**
		December 31,2011			
Total		**20,075**	**871**	**12,307**	**2,359**

Footnote:
(1) The ratio between the authorized credit line at the time the credit line was granted and the value of the asset, as confirmed by the bank at the time the credit line was granted

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

C. Composition of credit to the public[(1)] and off-balance-sheet credit risk[(3)], by size of credit to individual burrowers

1. Consolidated

				December 31					
				2012			2011		
				Number of borrowers[(2)]	Credit[(1)]	Off-balance Credit risk[(3)]	Number of borrowers[(2)]	Credit[(1)]	Off-balance Credit risk[(3)]
				in NIS millions					
Credit limit (in NIS thousand):									
		Up to	10	1,163,830	3,264	1,549	808,642	1,730	1,425
Over	10	Up to	20	384,585	2,490	3,934	338,635	2,151	2,896
Over	20	Up to	40	249,476	3,602	4,288	250,017	3,460	3,752
Over	40	Up to	80	133,303	4,142	3,438	147,780	4,580	3,430
Over	80	Up to	150	48,126	3,684	1,676	59,239	4,520	2,047
Over	150	Up to	300	27,078	4,752	1,026	31,012	5,413	1,607
Over	300	Up to	600	22,687	8,534	1,292	22,390	8,677	1,863
Over	600	Up to	1,200	15,905	10,953	1,811	13,594	9,878	1,486
Over	1,200	Up to	2,000	3,749	4,567	936	3,319	4,209	935
Over	2,000	Up to	(4)4,000	2,519	5,372	1,334	2,350	5,329	1,311
Over	4,000	Up to	(4)8,000	1,181	5,074	1,729	1,182	5,158	1,642
Over	8,000	Up to	(4)20,000	1,009	9,550	2,931	948	9,435	2,633
Over	20,000	Up to	(4)40,000	574	11,258	4,024	515	10,786	3,801
Over	40,000	Up to	(4)200,000	632	30,912	13,660	595	29,631	13,898
Over	200,000	Up to	(4)400,000	41	8,567	2,901	46	8,186	4,157
Over	400,000	Up to	(4)800,000	18	6,682	2,758	16	6,357	2,145
Over	800,000	Up to	(4)1,200,000	2	1,311	585	6	3,620	2,335
Over	1,200,000	Up to	(4)1,600,000	1	939	373	-	-	-
Over	1,600,000	Up to	(4)2,400,000	-	-	-	-	-	-
Over	2,400,000	Up to	(4)2,800,000	1	2,424	-	-	-	-
Over	2,800,000	Up to	(4)3,200,000	-	-	-	-	-	-
Over	3,200,000			2	8,326	-	3	13,156	-
Total				**2,054,719**	**136,403**	**50,245**	**1,680,289**	**136,276**	**51,363**

Footnotes:

(1) The credit and off-balance credit risk presented before the impact of the provision for credit loss and collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability.

(2) Number of borrowers based on total credit and Off-balance credit risk.

(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.(not including credit facilities under banks guarantees as of December 31,2012 - NIS 4,424 million, as of December 31,2011 - NIS 4,831 million).

(4) Consolidated - by combining specific balances.

(5) The credit limit in the top level: NIS 4,403 million (2011: NIS 5,544 million).

(6) Reclassified, in order to include US Government agencies, municipal bonds and bonds issued by US States.

(7) Reclassified, in order to include in "comprehensive credit risk", guarantees and other liabilities on account of customers, as well as certain transactions involving derivatives and bonds in a total amount of NIS1,181 million.

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

C. Composition of credit to the public[(1)] and off-balance-sheet credit risk[(3)], by size of credit to individual burrowers (continued)

2. The Bank

				December 31					
				2012			2011		
				Number of borrowers[(2)]	Credit[(1)]	Off-balance Credit risk[(3)]	Number of borrowers[(2)]	Credit[(1)]	Off-balance Credit risk[(3)]
				in NIS millions					
Credit limit (in NIS thousand):									
		Up to	10	279,660	1,776	526	177,268	325	467
Over	10	Up to	20	119,910	919	1,395	114,941	666	1,012
Over	20	Up to	40	109,115	1,638	2,090	124,131	1,612	1,864
Over	40	Up to	80	77,323	2,501	2,148	96,205	3,085	2,231
Over	80	Up to	150	35,810	2,648	1,401	48,304	3,550	1,777
Over	150	Up to	300	20,120	3,487	827	24,586	4,228	1,403
Over	300	Up to	600	18,169	6,831	1,080	18,320	7,143	1,670
Over	600	Up to	1,200	13,365	9,102	1,569	11,333	8,209	1,278
Over	1,200	Up to	2,000	2,747	3,249	740	2,432	3,030	754
Over	2,000	Up to	4,000	1,668	3,362	1,073	1,585	3,437	1,064
Over	4,000	Up to	8,000	887	3,312	1,563	873	3,445	1,466
Over	8,000	Up to	20,000	645	5,857	2,246	586	5,501	1,924
Over	20,000	Up to	40,000	301	5,783	2,695	303	6,109	2,564
Over	40,000	Up to	200,000	309	17,022	6,870	303	17,114	6,643
Over	200,000	Up to	400,000	34	6,947	2,665	44	8,130	3,936
Over	400,000	Up to	800,000	17	6,600	2,567	11	3,915	1,849
Over	800,000	Up to	1,200,000	2	1,311	498	6	3,619	2,249
Total				**680,082**	**82,345**	**31,953**	**621,231**	**83,118**	**34,151**

Footnotes:
(1) The credit and off-balance credit risk presented before the impact of the provision for credit loss and collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability.
(2) Number of borrowers based on total credit and Off-balance credit risk.
(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.
(4) The credit limit un the top level: NIS 1,312 million (2011:NIS 1,146 million).

D. Information regarding the purchase and sale of debts

Following are details regarding the consideration paid or received for the purchase or sale of loans:

	2012							
	Commercial	Housing	Other	Total	Commercial	Housing	Other	Total
	in NIS millions				in NIS millions			
Loans acquired	–	–	–	–	–	–	–	–
Loans sold	–	–	–	–	1,895	–	–	1,895

4. CREDIT RISK, CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

ADDITIONAL DETAILS:

In 2011. In respect of a sale of a certain credit portfolio of the Bank, amounting in total to NIS 910 million, the Bank recognized gains in an amount of NIS 53 million, stated as profit from financing operations before expenses in respect of credit losses. The outstanding balance of credit stated in the financial statements as of December 31, 2011, in respect of the credit portfolios sold in that year, amounts to NIS 547 million.

In 2012. No credit portfolios of the Bank were sold in 2012.

5. CREDIT GRANTED TO GOVERNMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Deposit of the Accountant General - tender for teaching employees	1,614	1,591	1,614	1,591
Other credit[(1)]	82	49	-	25
Total credit granted to Governments	**1,696**	**1,640**	**1,614**	**1,616**

Footnote:

(1) Including credit to foreign governments: Consolidated - NIS 82 million (2011: NIS 23 million), the Bank - no balance.

6. INVESTMENT IN INVESTEE COMPANIES

A. Consolidated

	December 31, 2012			December 31, 2011		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	In NIS millions					
Investments						
Shares stated on equity basis (including goodwill)[(1)]	1,720	-	1,720	[(3)(4)(5)]1,586	-	1,586
Other investments:						
Shareholders' loans	4	-	4	5	-	5
Total other investments	4	-	4	5	-	5
Total investments	**1,724**	**-**	**1,724**	**1,591**	**-**	**1,591**
Includes:						
Earnings accumulated since January 1, 1992	1,097	-	1,097	[(3)(4)(5)]1,007	-	1,007
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	21	-	21	[(3)(5)](25)	-	(25)
Details Regarding Goodwill:						
Original amount	3	283	286	3	283	286
Stated value[(2)]	-	142	142	-	142	142
Book and Market Values of Marketable Investments:						
Book value	1,624	-	1,624	[(3)(4)(5)]1,538	-	1,538
Market value	1,446	-	1,446	900	-	900

Footnotes:

(1) Includes earnings and translation adjustments in units having a functional currency that differs from the reporting currency accumulated from the acquisition date up to December 31, 1991.

(2) Balances of goodwill in respect of consolidated subsidiaries are presented in the item "Intangible assets and goodwill".

(3) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(4) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 d 18.7 to the financial statements.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

B. The Bank

	December 31, 2012			December 31, 2011		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	in NIS millions					
Investments:						
Shares stated on equity basis (including goodwill)[(1)]	1,706	6,447	8,153	[(2)(3)(4)]1,574	[(2)]6,219	7,793
Other investments:						
Subordinated debt notes and Capital notes	-	1,021	1,021	-	1,283	1,283
Shareholders' loans	2	-	2	2	-	2
Total other investments	2	1,021	1,023	2	1,283	1,285
Total investments	**1,708**	**7,468**	**9,176**	**1,576**	**7,502**	**9,078**
Includes:						
Retained earnings since January 1, 1992	1,135	3,592	4,727	[(2)(3)(4)]1,049	[(2)]3,518	4,567
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	21	38	59	[(2)(4)](25)	(75)	(100)
Adjustment for translation of foreign currency financial statements	-	(81)	(81)	-	(4)	(4)
The State's bonus to the employees (privatization)	-	32	32	-	32	32
Net adjustments on the hedging of cash flows	-	(10)	(10)	-	(8)	(8)
Details Regarding Goodwill:						
Original amount	3	282	285	3	282	285
Stated value	-	142	142	-	142	142
Book and Market Values of Marketable Investments:						
Book value	1,624	-	1,624	[(2)(3)(4)]1,538	-	1,538
Market value	1,446	-	1,446	900	-	900

Footnotes:

(1) Includes earnings and translation adjustments in units having a functional currency that differs from the reporting currency accumulated from the acquisition date up to December 31, 1991.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 d 18.7 to the financial statements.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

The Bank's share of income or loss of investee companies

	Consolidated			The Bank		
	2012	2011	2010	2012	2011	2010
	In NIS millions					
Bank's share in income of investee companies (consolidated - affiliated companies)(3)	201	(4)(6)130	(4)(6)114	759	(4)(6)937	(4)(6)423
Provision for impairment in value of investee companies	(5)(113)	-	(3)	(5)(113)	(3)	(17)
	88	130	111	646	934	406
Provision for taxes:						
Current taxes(1)	-	-	-	23	26	37
Deferred taxes(2)	(16)	(4)29	(4)(61)	(4)	(4)32	(4)(61)
Total provision for taxes (tax saving)	(16)	29	(61)	19	58	(24)
Bank's share in income net of tax effect of investee companies (consolidated - affiliated companies)(3)	**104**	**(4)(6)101**	**(4)(6)172**	**627**	**(4)(6)876**	**(4)(6)430**

Footnotes:

(1) Current taxes in respect of IDB New York, in accordance with an agreement with the Tax Authorities – see Note 29 m hereunder.

(2) Including the increase (decrease) in the provision for taxes in respect of the Bank's share in the results of the First International Bank: 2012 - NIS (16) Million, 2011 - NIS 29 million and 2010 - NIS (61) million. Includes also a provision for taxes in respect of the possibility of sale of holdings: 2012 – NIS 14 million.

(3) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 1.5 to the financial statements.

(4) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.

(5) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 F (3) to the financial statements.

(6) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

C. Information on principal investee companies

Name of Company	Details of company	Share in capital conferring rights to profits		Share in voting rights		Value of investment in shares on equity: Equity basis[1]		Market value	
		2012	2011	2012	2011	2012	2011	2012	2011
		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	24	-	-
Israel Discount Bank of New York [3]	Commercial bank, U.S.A	100.00	100.00	100.00	100.00	3,101	2,994	-	-
Mercantile Discount Bank Ltd.	Commercial bank	100.00	100.00	100.00	100.00	1,889	1,764	-	-
Israel Credit Cards Ltd.[4]	Credit card service	71.83	71.83	79.00	79.00	635	[15]774	-	-
Discount Leasing Ltd.	Equipment leasing	100.00	100.00	100.00	100.00	110	109	-	-
Discount Israel Capital Markets and Investments Ltd.	Underwriting and investments	100.00	100.00	100.00	100.00	(53)	(37)	-	-
Discount Manpikim Ltd.[14]	Securities issue	100.00	100.00	100.00	100.00	61	59	-	-
IDB (Swiss) Bank Ltd.	Commercial bank, Switzerland	100.00	100.00	100.00	100.00	215	211	-	-
Companies held by Israel Discount Bank of New York:									
(America Latin) Bank Discount [5]	Commercial bank, Uruguay	100.00	100.00	100.00	100.00	289	270	-	-
Inc, (Delaware) Realty IDBNY [5]	Holding company, USA	100.00	100.00	100.00	100.00	1,794	1,837	-	-
LLC Realty IDB [6]	Investment company, USA	100.00	100.00	100.00	100.00	6,644	6,729	-	-
Company held by Discount Israel Capital Markets and Investments Ltd.:									
Freenet A.K. Communications Ltd.[17]	Holding company	100.00	100.00	100.00	100.00	145	74	-	-
Companies held by Israel Credit Cards Ltd.:									
Diners (Club) Israel Ltd.[15]	Credit card service	51.00	51.00	51.00	51.00	145	115	-	-
Cal Mimun Ltd.	Credit facilitate	100.00	100.00	100.00	100.00	114	63	-	-
2.Affiliated Companies:									
First International Bank of Israel Ltd.[7]	Commercial bank	26.45	26.45	26.45	26.45	[13]1,624	[12][16][20]1,538	1,446	900

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) Included in the financial statements of Israel Discount Bank of New York. The investment in these companies and their contribution to the net income are not deducted from the investment and contribution to profit of Israel Discount Bank of New York

(6) Included in the financial statements of IDBNY Realty (Delaware), Inc. The investment in these companies and their contribution to the net income are not deducted from the investment and contribution to profit of IDBNY Realty (Delaware), Inc

Of which: excess of cost balance		Other investments		Contribution to net income attributed to bank's shareholders[18]		Of which: loss on impairment		Dividend		Other items recorded in shareholders' equity[8]		Guarantees issued for consolidated subsidiaries in favor of entities outside the group	
2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
In NIS millions													
-	-	-	-	1	1	-	-	-	-	-	3	-	-
-	-	-	288	122	326	-	-	-	-	(144)	(96)	-	-
-	-	83	82	191	162	-	-	150	-	123	38	-	-
[9]142	[9]142	36	17	106	100	-	-	209	140	-	-	15	42
-	-	-	-	1	1	-	-	-	-	-	-	-	-
-	-	190	190	(19)	6	-	-	-	-	()	-	-	-
-	-	84	-	2	3	-	-	-	3	-	-	-	-
-	[11]10	-	-	(7)	5	-	(3)	-	-	-	-	-	-
-	-	-	-	[19]21	48	-	-	-	-	[19](6)	(4)	-	-
-	-	-	-	[19](5)	162	-	-	-	-	[19](45)	(2)	-	-
-	-	-	-	[19]48	544	-	-	-	-	[19](212)	(71)	-	-
-	-	531	531	75	69	-	-	-	-	(4)	(4)	-	-
-	-	-	-	29	28	-	-	-	-	-	-	-	-
-	-	90	28	17	35	-	-	-	-	-	-	-	-
-	-	-	-	[10][13]56	[10][16][20]99	[13](113)	-	-	-	11	[16][20](19)	-	-

(7) For details regarding the agreement with FIBI Holdings Ltd. regarding the continued interest of the Bank in the First International Bank, regarding the outline for the reduction in such interest and regarding the deposit of a part of the shares in the hands of a Trustee, see Section E below.
(8) Including adjustments from translation of financial statements of units having a functional currency that differs from the reporting currency and adjustments concerning the presentation of certain securities of investee companies at fair value.
(9) Goodwill.
(10) Including the increase (decrease) in the provision for taxes in respect of the Bank's share in the results of the First International Bank: 2012 - NIS (16) Million, 2011 - NIS 29 million.
(11) Including in the Intangible assets and goodwill, see Note 7 A.
(12) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1D18.7.
(13) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3).
(14) Following the merger between MDB and the Bank, Discount Mortgage Issues Ltd. was merged on November 11, 2012 with and into Discount Manpikim Ltd.
(15) For details regarding the holding of a controlling interest in Diners and as regards the put option written to the other interest holders, see Note 33A below.
(16) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.
(17) For details regarding the agreement for the merger of Freenet A.K. Communications Ltd. with and into Israel Discount Capital Markets & Investments Ltd., see Note 6 F.
(18) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.
(19) The steep decline in the contribution to the profit in 2012, compared to 2011, is due to the presentation of the exchange differences in the translation adjustments capital reserve, with effect from January 1, 2012; see Note 1 D 1.2.
(20) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

D. Summary information regarding affiliated companies

1. Summary information regarding the financial condition

	Rate of ownership	Total assets	Total liabilities	Capital attributed to company owners	Capital attributed to non-controlling right holders
	As a percentage		In NIS millions		
31.12.2012	26.45	105,387	98,615	6,563	209
31.12.2011	26.45	(1)(2)101,113	(1)(2)95,118	(1)(2)5,810	(1)(2)185

2. Summary information regarding results of operation

	Rate of ownership	Net income	Net income attributed to company shareholders	Net income attributed to non-controlling rights holders
	As a percentage		In NIS millions	
2012	26.45	599	577	22
2011	26.45	(1)499	(1)480	(1)19
2010	26.45	(1)458	(1)438	(1)20

Footnotes:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1D 7.18.

E. THE INVESTMENT IN THE FIRST INTERNATIONAL BANK ("FIBI")

(1) Signing an agreement with FIBI holdings. On March 28, 2010, an agreement was signed between the Bank and FIBI Holdings Ltd. (hereinafter: "FIBI Holdings") regarding the Bank's holdings in FIBI.

Following are the principal terms of the agreement:

- The agreement contains conditions precedent to its validity (hereinafter: "the conditions precedent"), which are: obtaining the approval of the Supervisor of Banks and the approval of the Antitrust Commissioner to the agreement ("the regulatory approvals"), this until the end of 150 days from the date of signing of the agreement; as well as the distribution of a cash dividend of NIS 800 million by FIBI to its shareholders, out of its retained earnings as of December 31, 2005, as per its financial statements (hereinafter: "the distribution");
- It has been agreed that FIBI Holdings will act to the best of its ability towards the unification of the share capital of FIBI, following which, all shares making up the share capital of FIBI shall be of one class and shall confer equal voting rights;
- Israel Discount Bank shall vote in favor of completing the process of unification of the share capital in the general meetings of shareholders of FIBI, subject to obtaining the regulatory approvals to the agreement as well as to the realization of the terms specified in the agreements, inter-alia, completion of actual distribution or obtaining confirmation according to which all required proceedings for the distribution have been realized and all approvals for the distribution have been obtained;

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

- Soon after completion of the unification of capital, Israel Discount Bank shall deposit with a trustee a number of shares of FIBI, the voting rights attached therein (out of the total voting rights in FIBI) exceeding the rate of voting rights in FIBI held by Israel Discount Bank at date of signing the agreement (hereinafter: "the deposited shares"), this in accordance with a trusteeship agreement to be approved by the Supervisor of Banks. Israel Discount Bank or the trustee shall refrain from acting upon the voting rights attached to the deposited shares. The trustee shall pass on to Israel Discount Bank any dividend or any other benefit of any kind that will be received by him by virtue of the deposited shares, immediately upon their receipt (excluding bonus shares or shares stemming from the unification of the capital, or a split of the deposited shares, or shares deriving from securities convertible into shares, which FIBI may issue in respect of the deposited shares. These shares shall remain in the hands of the trustee and shall become an integral part of the deposited shares for all intents and purposes). The trustee shall release the deposited shares in the event that the ratio of voting rights held by Israel Discount Bank in FIBI shall fall below the ratio that existed at date of signing the agreement (11.09%) in order to restore the ratio of voting rights to the ratio that existed at date of signing the agreement, or for the purpose of transferring the deposited shares, or part thereof, to a third party;
- Until the end of six months from the date of completion of the unification of capital, and subject to the fulfillment of the conditions precedent and subject to the completion of the unification of the capital, Israel Discount Bank shall act towards the sale of 6% of its holdings in the equity and voting rights in FIBI to third parties, provided that market conditions allow this sale at a price that is not lower than the stated value of the investment in such shares in the financial statements of Israel Discount Bank;
- It has been agreed that until the determining date, as signified below, Israel Discount Bank shall be entitled to purchase additional securities within the framework of any rights offer by FIBI to its shareholders, on condition that the additional shares purchased by Israel Discount Bank, if at all, shall be deposited with the trustee and all the provisions applying to the deposited shares shall also apply to them;
- Starting with the date on which all conditions precedent to the agreement are fulfilled, the arrangement existing between Israel Discount Bank and FIBI Holdings regarding the right of first refusal for the purchase of shares in FIBI, shall be abolished, and any transfer or sale of shares in FIBI by FIBI Holdings or by Israel Discount Bank, shall not be subject to the said right;
- Starting with the date on which all conditions precedent to the agreement are fulfilled and 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), regardless of the number of shares held by Israel Discount Bank. Subsequent to the determining date, the arrangement existing between Israel Discount Bank and FIBI Holdings, including the arrangement regarding appointment of directors recommended by Israel Discount Bank, shall become null and void. Certain terms had been included in the agreement, where upon the realization of which, the determined date would be deferred. Accordingly the determined date was deferred to March 13, 2014.

For details regarding the approvals of the Supervisor of Banks and the Antitrust Commissioner, see hereunder.

Distribution of Dividend. On September 6, 2010, the Bank received a cash dividend of NIS 212 million in the framework of a cash dividend to shareholders of FIBI in a total amount of NIS 800 million.

Unifications of share capital. The determining date for the unification of FIBI's share capital was on September 19, 2010, and as from September 20, 2010 only shares of a par value of NIS 0.05 of FIBI are being traded on the Tel Aviv Stock Exchange. Upon completion of the process for the unification of the share capital of FIBI, the rate of the Bank's holdings in FIBI increased to 26.4% in the voting rights. In accordance with the provisions of the agreement, the Bank deposited with a Trustee shares which grant it voting rights in excess of 11.09%.

It should be mentioned that at this stage the Bank has not yet sold 6% of the shares in FIBI, due to the fact that conditions enabling a sale at a price which is not below the stated value of the shares in the Bank's books have not yet arisen.

Approvals of the Supervisor of Banks and the Antitrust Commissioner. The approval of the Supervisor of Banks for the agreement and the approval of the Antitrust Commissioner (hereinafter: "the Commissioner) for "merger of companies" under the Restrictive Trade Practices Law, 1988, were received on August 17, 2010, with respect to the process of unification of the share capital to be executed by FIBI. The parties to the agreement confirmed that the conditions precedent determined in the agreement for this purpose have been fulfilled with the receipt of the above mentioned two approvals.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

The agreement, approved by the Supervisor of Banks, specified that the Supervisor of Banks would consider the Bank's request in the event that FIBI would offer rights to all its shareholders and the Bank would seek to participate in such offer.

Among other things, the approval by the Commissioner specified that the Bank must reduce its holdings in FIBI to a rate below 10% of the issued share capital of FIBI by December 31, 2015, or until the end of five years from date of the unification of the share capital of FIBI, the earlier of the two, and in addition reduce its holdings in FIBI to a rate below 5% of the issued share capital of FIBI by December 31, 2017, or until the end of seven years from date of completion of the unification of the share capital of FIBI, the earlier of the two. Alternatively, the Bank must reduce its holdings in FIBI to a rate below 5% of the issued share capital of FIBI by December 31, 2016, or until the end of six years from date of completion of the unification of the share capital of FIBI, the earlier of the two. In addition, the Commissioner's approval specifies that in the event that the Bank does not reduce its holdings until the end of the above mentioned periods, as the case may be, than the excess number of shares in FIBI held by the Bank subsequent to the dates detailed above, shall be sold by a Trustee appointed for this purpose, this in accordance with the arrangements determined in this matter in the Commissioner's approval. Furthermore, it has been determined that the Bank shall not acquire shares in FIBI or any right in FIBI any other way, unless with the prior permission in writing by the Commissioner.

On September 6, 2010, following completion of the distribution and the actual payment in cash of the dividend, in accordance with the agreement, and upon obtaining the regulatory approvals with respect to the agreement, the conditions precedent have been fulfilled and the agreement came into effect.

It should be noted, that following the formation of the agreements with FIBI Holdings, the Bank includes a provision for taxes, in respect of its holdings in FIBI, this in view of the uncertainty regarding the continued holding by the Bank of the shares in FIBI and based on the assumption that over a period of time, the Bank will sell all of its holdings in FIBI.

(2) Data regarding the investment in FIBI

The net asset value of the Bank’s investment in FIBI as of December 31, 2012, is NIS 1,624 million. The market value of the Bank’s holdings in FIBI totaled on December 31, 2012, in NIS 1,446 million. The market value of this investment at March 14, 2012 was NIS 1,357 million.

(3) An opinion in the matter of the provision for impairment in value. Note 6 E (3) to the financial statements as of December 31, 2011 and Note 12 to the interim financial statements for March 31, 2012, described an opinion received by the Bank, rendered by Prof. Yoram Eden, CPA (Isr.), who gave his consent to the inclusion thereof in the financial statements (hereinafter, respectively, "March 2012 opinion" and "May 2012 Opinion"). In the said Opinions, Prof. Eden came to the general conclusion that the Bank does not need, in accordance with accepted accounting principles, to perform a provision for impairment regarding its investment in FIBI shares. The Bank examined the said opinions and decided to adopt them.

The August 2012 Opinion. Note 12 to the interim financial statements as of June 30, 2012, described an update (on the basis of FIBI's financial statements as of March 31, 2012) received by the Bank from Prof. Eden, CPA, of his Opinion from May 2012, who gave his consent to the inclusion thereof in the financial statements (hereinafter: "the August 2012 opinion"). In the framework of the opinion, Prof. Eden has reviewed the assumptions used by him in his May 2012 opinion, and has updated the opinion, in as much as this was called for in view of data in the financial statement for the first quarter of 2012 and in light of indications received from FIBI.

In his August 2012 Opinion, Prof. Eden stated the price of capital at a range of between 10.5% and 11.5%, this in view of the risks discussed in his Opinion. In his May 2012 Opinion, Prof. Eden stated the price of capital at the range of between 10.0% and 11.0%.

In conclusion of the August 2012 Opinion, Prof. Eden has reached the opinion that the recoverable value amount of the Bank's investment in shares of FIBI is in the range of between 88.4% and 97.9% of its stated value in the books of Discount Bank (before provision). In consequence thereof, the Bank has to recognize a provision for impairment at a rate lying within the said range, in accordance with the judgment of the Bank's Management.

The Bank reviewed the August 2012 Opinion and relied on it.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

Provision for impairment. The Bank believes that it might have been acceptable to adopt the upper value in the range defined in the said Opinion. However, in view of the layout for the sale of the investment, as detailed above, the Bank has decided to include in the financial report as of June 30, 2012, a provision for impairment at the rate of 7% of the equity value of the investment (an amount of NIS 113 million). In determining the assessment of the provision within the range defined in the said Opinion, the Bank had taken into consideration present market conditions as well as the said sale layout.

(4) November 2012 Opinion. Note 12 to the interim financial statements as of September 30, 2012, described an update (on the basis of FIBI's financial statements as of June 30, 2012) received by the Bank from Prof. Eden, CPA, of his Opinion from August 2012 from Prof. Eden, who gave his consent to the inclusion thereof in the financial statements (hereinafter: "the November 2012 opinion").

In conclusion of the opinion, Prof. Eden has reached the opinion that the recoverable value amount of the Bank's investment in shares of FIBI is in the range of between 88.9% and 98.5% of the amount of the Bank's share in the equity of FIBI. Whereas, in the previous quarter, the Bank reduced the value of its investment in FIBI by an amount of NIS 113 million, Prof. Eden is of the opinion that the stated book value of the investment, following the reduction in value, reflects the recoverable value amount of the investment and that no further reduction is required.

The Bank examined the November 2012 Opinion and decided to adopt it.

Update of opinion. The Bank has received an updated opinion from Prof. Eden, who gave his consent to the inclusion thereof in the financial statements (hereinafter: "the updated opinion"). In conjunction with the updated opinion, the issue of whether as a result of the issue of the financial statements of FIBI as of September 30, 2012, there is place for changes and/or updates in the assumptions and parameters serving as the basis for the opinion, and how, if at all, such changes affect the valuation amount of FIBI as included in the previous opinion - was considered, inter alia.

Prof. Eden noted that the updated opinion should be read in conjunction with the previous opinions, the detailed opinion dated March 27, 2012, the opinion dated May 2012 and the "Previous Opinion", and the content thereof shall also apply to the updated opinion, with required changes, as the case may be, respectively.

Updated valuation. Prof. Eden has reviewed the assumptions used by him in his previous opinions, and has updated the opinion, in as much as this was called for in view of data in the report for September 30, 2012, and in light of indications received from FIBI.

Limitations in performing the valuation. FIBI did not provide Prof. Eden, in his capacity as valuer on behalf of the Bank, any assistance or information, except for information which is made public anyways and a number of clarifications passed to him. In addition, FIBI has related to Prof. Eden various indications that enabled him to examine a part of the basic assumptions of the valuation. In view of this, Prof. Eden has been requested to assess the value of FIBI based on public information, and based on the information he had received from FIBI, as stated.

Prof. Eden stated that the financial statements issued to the public and the Report of the Board of Directors accompanying them, include information, which is mostly backwards looking. For the purpose of the preparation of a professional and reliable valuation, additional forward looking information is required, which may be obtained only from the entity subject to the valuation and its members of management.

Preparation of a valuation that is based only upon information open to the public is therefore problematic and from the nature of things, such valuation is more exposed to error. All the more, this is true in relation to a bank, where there is importance in receiving more detailed information regarding the bank's credit portfolio, as well as estimates of its management with respect to anticipated developments in the future, expected spreads, business plans, etc.

Performing a valuation based on the reports of FIBI's. As stated in the above opinion, for the purpose of performing the valuation, Prof. Eden relied mainly on public information only, and in particular, on audited annual financial statements and reviewed interim financial statements published by FIBI. These resources are considered reliable, and nothing has come to his attention that might indicate unreasonableness of the data made use by him or that the financial items included in FIBI's financial statements had not been presented in accordance with generally accepted accounting principles, and that the value of the said financial items requires any reduction/adjustment. Prof. Eden did not perform independent examinations of the data, accordingly his work does not constitute a verification of correctness, completion and accuracy of such data.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

Forward looking information. In his valuation, Prof. Eden stated that he also addressed the forward looking statement included in FIBI's Directors' Report. A forward looking statement includes uncertain information regarding the future, which is based upon information existing in FIBI's hands at date of the Report and includes evaluations and objectives of that bank as of that date. If such evaluations of management do not materialize, actual results may differ materially from the results expected or inferred from such data. Prof. Eden further noted that his valuation in itself contains forward looking statements, which reflect his evaluation concerning various parameters and based upon information available to him (public information). Prof. Eden noted that if such evaluations do not materialize, actual results may differ materially from the results estimated by him.

Conclusion. In conclusion of the opinion, Prof. Eden has reached the opinion that the recoverable value amount of the Bank's investment in shares of FIBI is in the range of between 93.2% and 103.2% of the amount of the Bank's share in FIBI's equity. Whereas the equity value of the Bank's investment in FIBI, after recording a provision for impairment in an amount of NIS 113 million, is lower than the recoverable amount of the investment, Prof. Eden is of the opinion that no material decline has occurred in the value of the investment in FIBI. Accordingly, in the opinion of Prof. Eden, the Bank is not required to record an additional provision for impairment in respect with its investment in shares of FIBI.

The Bank examined the updated opinion and decided to adopt it.

Personal interest. Prof. Eden stated in his opinion that he has no personal interest in the shares of Israel Discount Bank or in the shares of FIBI.

(The Bank granted Prof. Eden a letter of indemnification in respect 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).

F. MERGER BETWEEN FREENET A.K. COMMUNICATIONS LTD. ("FREENET") AND ISRAEL DISCOUNT CAPITAL MARKETS & INVESTMENTS LTD. ("DCMI").

DCMI and Freenet signed on December 28, 2011, an agreement for the merger of Freenet with and into DCMI. In December 2012, a tax decision was made with respect to the said merger, and following this, DCMI and Freenet applied to the Registrar of Companies for approval of the merger application.

7. BUILDINGS AND EQUIPMENT

A. Composition

	Consolidated				
	Buildings and land*	Equipment, furniture and vehicles	Hardware	Software	Total
	in NIS millions				
Cost of assets:					
Balance as at December 31, 2010	2,368	820	1,033	2,503	6,724
Additions	54	44	106	341	545
Assets designated for sale	(11)	-	-	-	(11)
Disposals	(24)	(18)	(62)	(20)	(124)
Balance as at December 31, 2011	**2,387**	**846**	**1,077**	**2,824**	**7,134**
Additions	40	49	98	317	504
Disposals	(68)	(54)	(218)	(19)	(359)
Balance as at December 31, 2012	**2,359**	**841**	**957**	**3,122**	**7,279**
Depreciation and impairment loss:					
Balance as at December 31, 2010	997	530	817	1,255	3,599
Depreciation for the year	77	53	101	360	591
Impairment loss	1	-	-	5	6
Reversal of impairment loss	(17)	-	-	-	(17)
Assets designated for sale	(8)	-	-	-	(8)
Disposals	(18)	(17)	(62)	(20)	(117)
Balance as at December 31, 2011	**1,032**	**566**	**856**	**1,600**	**4,054**
Depreciation for the year	70	47	94	382	593
Reversal of impairment loss	(3)	-	-	-	(3)
Disposals	(45)	(52)	(218)	(12)	(327)
Balance as at December 31, 2012	**1,054**	**561**	**732**	**1,970**	**4,317**
Carrying amount:					
Balance as at December 31, 2010	**1,371**	**290**	**216**	**1,248**	**3,125**
Balance as at December 31, 2011	**1,355**	**280**	**221**	**1,224**	**3,080**
Balance as at December 31, 2012	**1,305**	**280**	**225**	**1,152**	**2,962**
Average weighted depreciation rate for year 2011	4.3%	9.9%	21.7%	16.8%	12.0%
Average weighted depreciation rate for year 2012	3.7%	9.6%	21.5%	17.5%	11.9%

*Includes installations and leasehold improvements.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

A. Composition (continued)

	The Bank				
	Buildings and land*	Equipment, furniture and vehicles	Hardware	Software	Total
	in NIS millions				
Cost of assets:					
Balance as at December 31, 2010	1,713	451	766	1,901	4,831
Additions	35	24	63	252	374
Assets designated for sale	(11)	-	-	-	(11)
Disposals	(5)	(15)	(48)	(19)	(87)
Balance as at December 31, 2011	**1,732**	**460**	**781**	**2,134**	**5,107**
Additions	22	30	68	212	332
Disposals	(33)	(22)	(152)	(18)	(225)
Balance as at December 31, 2012	**1,721**	**468**	**697**	**2,328**	**5,214**
Depreciation and impairment loss:					
Balance as at December 31, 2010	749	254	592	875	2,470
Depreciation for the year	52	31	74	291	448
Impairment loss	1	-	-	5	6
Reversal of impairment loss	(17)	-	-	-	(17)
Assets designated for sale	(7)	-	-	-	(7)
Disposals	(4)	(14)	(48)	(19)	(85)
Balance as at December 31, 2011	**774**	**271**	**618**	**1,152**	**2,815**
Depreciation for the year	48	30	68	306	452
Reversal of impairment loss	(3)	-	-	-	(3)
Disposals	(24)	(21)	(153)	(13)	(211)
Balance as at December 31, 2012	**795**	**280**	**533**	**1,445**	**3,053**
Carrying amount:					
Balance as at December 31, 2010	**964**	**197**	**174**	**1,026**	**2,361**
Balance as at December 31, 2011	**958**	**189**	**163**	**982**	**2,292**
Balance as at December 31, 2012	**926**	**188**	**164**	**883**	**2,161**
Average weighted depreciation rate for year 2011	4.0%	9.3%	20.0%	16.7%	12.0%
Average weighted depreciation rate for year 2012	3.4%	9.2%	20.0%	17.3%	12.3%

*Includes installations and leasehold improvements.

B. The Bank and a consolidated subsidiary own leasehold rights for periods ending in the years 2014-2058.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
C. Depreciated balance of buildings and land includes:				
Installations and leasehold improvements depreciated balance	148	151	62	68
Balance of provision for impairment loss	14	32	12	30
D. Financial leasing rights:				
Balance of non-capitalized leasehold	13	26	10	22
Balance of capitalized leasehold	171	89	100	57
E. Depreciated balance of not yet registered buildings	235	239	62	63
F. Depreciated balance of buildings not in use by the bank, the majority of which are rented to other parties	25	18	14	6
G. Depreciated balance of buildings and equipment designated for sale	-	8	-	4
Impairment loss recognized in the current year	-	-	-	-
Reversal of impairment loss during the year	3	-	3	-
H. The cost of in-house development of computer software:				
The cost of software put into operation	2,262	1,991	2,064	1,835
Accumulated depreciation	(1,398)	(1,114)	(1,283)	(1,024)
Depreciable amount	864	877	781	811
Accumulated costs in respect of software under development	57	82	22	58
Total cost of in-house development of computer software	**921**	**959**	**803**	**869**
I. Gross value of fully depreciated fixed assets still in use	1,619	1,671	955	913
J. Recognized cost for fixed assets items in mounting stage:				
Cost of real estate	18	8	14	4
Cost of equipment	16	7	16	7

	for the year ended December 31		
	2012	2011	2010
	in NIS millions		
K. Details of operating lease contracts*			
Recognized operating lease expenses**			
Consolidated	139	131	128
The Bank	87	78	75

* Details of future non-cancellable, lease expenses, see note 19.c.1

**Includes minimum lease payment and contingent rent.

7A. INTANGIBLE ASSETS AND GOOWILL

	Consolidated		
	Goodwill[1]	Customer relations	Total
	in NIS millions		
Cost			
Balance as at December 31,2010, 2011 and 2012	**283**	**78**	**361**
Amortization and losses on impairment			
Balance as at December 31,2010	**140**	**58**	**198**
Amortization for the year	-	7	7
Loss on impairment	-	3	3
Other	1	-	1
Balance as at December 31,2011	**141**	**68**	**209**
Amortization for the year	-	10	10
Balance as at December 31,2012	**141**	**78**	**219**
Book value			
Balance as at December 31,2010	**143**	**20**	**163**
Balance as at December 31,2011	**142**	**10**	**152**
Balance as at December 31,2012	**142**	**-**	**142**

Footnote:

(1) Goodwill recognized in business combination (goodwill recognized upon acquisition of an affiliated company, included in the item "investment in affiliated companies").

8. OTHER ASSETS

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	In NIS millions			
Net deferred tax assets (see Note 29 I)	1,355	[1]1,416	855	[1]875
Excess advance tax payments over current provisions	85	130	29	89
Issue costs and discount expenses of subordinated capital notes	22	33	28	39
Income receivable	233	226	117	83
Surrender value of life assurance policies owned by a consolidated subsidiary	623	627	-	-
Assets in respect of the "Maof" market operations	14	211	14	211
Gold deposit	101	106	101	106
Assets received against clearing of debts	-	4	-	-
Other debtors and debit balances	229	379	24	201
Total other assets	**2,662**	**3,132**	**1,168**	**1,604**

Footnotes:

Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	In NIS millions			
Demand deposits	40,894	35,562	20,124	17,684
Time and other deposits	107,937	113,326	88,586	93,986
Savings plan deposits	3,104	4,480	3,100	4,395
Total deposits from the public	**151,935**	**153,368**	**111,810**	**116,065**

10. DEPOSITS FROM BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	In NIS millions			
Commercial banks:				
Demand deposits	1,251	1,401	338	251
Time deposits	1,870	2,028	2,612	3,957
Acceptances	192	197	122	126
Central banks:				
Schedule deposits	361	568	-	-
Specialized banking institutions:				
Deposits on demand	1	1	1	5
Schedule deposits	45	54	45	52
Total deposits from banks	**3,720**	**4,249**	**3,118**	**4,391**

11. SUBORDINATED CAPITAL NOTES

	Average maturity[1]	Internal rate of return[1]	Consolidated		The Bank	
			December 31		December 31	
	years	%	2012	2011	2012	2011
			in NIS millions			
Subordinated capital notes not convertible into shares[3]:						
In non-linked Israeli currency	4.97	6.34	3,019	2,907	327	214
In Israeli currency, linked to CPI	6.36	5.23	7,488	7,584	1,851	1,843
Subordinated capital notes convertible into shares:						
In Israeli currency, linked to CPI[2]	9.09	5.71	1,777	1,748	1,777	1,748
Total subordinated capital notes			**12,284**	**12,239**	**3,955**	**3,805**

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, 2012.

(2) Subordinated capital notes regarded as "hybrid tier I capital" (see Note 14.7 below).

(3) Of which: NIS 9,931 million, listed for trade on the Tel Aviv Stock Exchange (2011: NIS 9,945 million)

12. OTHER LIABILITIES

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Net provision for deferred taxes (see Note 29 I)	14	14	14	14
Payments excess current tax provisions over advance	47	19	-	1
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16 E, H)	403	396	200	180
Provisions for vacation pay, seniority bonus and retirement benefits	1,157	1,143	923	920
Deferred income	173	150	115	104
Payables for credit card activity	5,619	5,406	2,631	2,548
Provision for doubtful debts in respect of guarantees	171	172	134	135
Accrued expenses	577	715	251	386
Liabilities in respect of "Maof" market operations	14	211	14	211
Liabilities stemming from "Market making" activity	363	23	363	23
Other payables and receivables	1,236	(1)1,289	383	395
Total other liabilities	**9,774**	**9,538**	**5,028**	**4,917**

Footnotes:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS

A. The authorized, issued and paid-up nominal capital (In new Israeli Shekels):

	December 31,2012 and 2011	
	Authorized	Issued and Fully Paid-Up
Ordinary “A” Shares of NIS 0.1 par value each	196,100,000	105,386,930
6% Cumulative Preferred Shares,of NIS 0.00504 par value each (equivalent to 10 pounds sterling each)	202	202
Total shareholders equity	**196,100,202**	**105,387,132**

Ordinary "A" Shares are registered and are listed for trade on the Tel Aviv Stock Exchange.

B. 6% CUMULATIVE PREFERRED AUTHORIZED SHARE CAPITAL:

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 3.62, and at the time of liquidation to a distribution in an amount of NIS 60.36. 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 authorized 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 meetings of shareholders convened on December 26, 2006 and September 22, 2008, resolved to increase the Bank's authorized share capital by a total amount of 820 million ordinary A shares of NIS 0.1 par value each. 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 further details see Note 14 below).

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

In December 2006, May 2007 and September 2008, the Bank issued subordinate capital notes (Series "A") in an approximate par value of NIS 1,147 million (see Note 14(7)a hereunder). In respect of the said capital notes the Bank maintained in its share capital a pool of approx. NIS 470 million ordinary "A" shares (the said quantity is subject to adjustment to the benefit component included in the rights issue of December 2010).

In March 2009, the Bank issued approx. 350 million par value of subordinate capital notes Series "B" (see Note 14(7)b hereunder). In respect of the said capital notes, the Bank maintained in its authorized share capital a pool of approx. 267 million shares to be used, if required, in a forced conversion event (the said quantity is subject to adjustment to the benefit component included in the rights issue of December 2010).

(2) Increase of the authorized 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 Bank's authorized share capital 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. The Bank is committed towards the State of Israel, which at that date owned a 20% of the Bank's shares, that the shares constituting part of the Bank's authorized share capital, 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.

In December 2010 the bank completed a share offer to the public as well as a rights issue.

D. SHARE BASED PAYMENT TRANSACTIONS - AN OPTION PLAN FOR OFFICERS OF THE BANK

(1) Phantom plan for the acting Chairman of the Board and for the acting President & CEO

Within the framework of an approved remuneration plan in respect of the Chairman of the Board and the President & CEO (see Note 22 F), it had been determined that the Chairman of the Board and the President & CEO will be entitled to a phantom type remuneration, dependent on the performance of the Bank's shares. The Bank granted to the chairman of the Board a quantity of 6,511,628 phantom rights and to the President & CEO a quantity of 4,878,049 phantom rights (hereinafter: "the phantom rights")

The phantom rights do not entitle any rights to the Bank's shares and/or to any rights whatever stemming from the holding of the Bank's shares, excluding certain adjustments.

The phantom rights shall vest in five equal annual lots, each lot numbering one fifth of the total quantity of phantom rights, so that one annual lot shall vest in each year. The first annual lot pertaining to the Chairman of the Board vested on January 1, 2011, and his last lot shall vest on January 1, 2015. The first annual lot pertaining to the President & CEO vested on January 1, 2012 and his last lot vested on January 1, 2016.

Each annual lot of phantom rights is exercisable, in whole or in part, during a period of two years from date of vesting, thereafter it shall expire and will no longer entitle to any rights (hereinafter: "the exercise period"). The first annual lot pertaining to the Chairman of the Board expired on January 1, 2013.

The plan established circumstances when materialized, the vesting date of each annual lot of phantom rights shall be deferred or an annual lot shall expire. Net loss from ordinary operations in the Bank's most recent quarterly financial statements on a cumulative basis over the four quarters preceding the said vesting date issued prior to the vesting date of the relevant annual lot; A material deviation from the required total capital adequacy ratio in the Bank's most recent financial statements issued prior to the vesting date of the relevant annual lot. In this respect, a deviation at a rate exceeding 20% of the required total capital adequacy ratio will be considered a material deviation. A conversion event of the outstanding balance of principal and interest of subordinate capital notes (of whatever Series) issued by the Bank.

The plan includes provisions regarding shortening of the exercise period and granting phantom rights in the case of termination of engagement as well as provisions regarding the modification of the plan under certain circumstances.

In respect of each exercise notice, the Bank shall pay an amount equal to the difference between the closing market price for each ordinary "A" share of the Bank and the base price, multiplied by the number of phantom rights being exercised.

For this purpose, the "base price" is the last closing market price of each ordinary "A" share of the Bank on the trading date preceding the date of the approval of the Board of Directors granted to the Phantom plan, with the addition of CPI linkage increments according to the rise of the CPI between the known Index at date of approval by the Board and the known Index at date of exercise of the rights.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

The overall fair value of the rights (for five years), calculated by the Black & Scholes model, is NIS 14 million in respect of phantom rights granted to the Chairman of the Board, and NIS 12 million in respect of phantom rights granted to the President & CEO. The above economic value was computed on the basis of the assumption that all the phantom rights would be exercised on the last day of the exercise period determined in respect thereof, on the basis of the market closing price of an ordinary "A" share of the Bank on December 19, 2010 (NIS 8.092), a standard deviation of 32.9% for computation purposes and a risk-free interest rate of between 0% and 1.5% (according to the period). It should be noted that the above calculation serves as an indication only to the cost of the phantom award, and that the actual cost may change, as it is affected by changes in the market price of the shares during the period of the plan.

The expense in respect of the different lots will be recognized over the period up to their vesting dates. Until the final date of exercise of the phantom rights, at each reporting date the fair value of the plan shall be calculated in accordance with market conditions at those dates, the differences being recognized in the statement of income.

In the financial statements as of December 31, 2010, an expense of NIS 7.4 million was recognized, in respect of the proportionate share of all the tranches granted to the Chairman of the Board. The financial statements as of December 31, 2011, reflected a reduction of NIS 5 million in the expense with respect to the Chairman of the Board, and an expense of NIS 1.5 million in respect of the President & CEO. In the financial statements as of December 31, 2012, an expense of NIS 0.4 million was recognized with respect to the Chairman of the Board, and an expense of NIS 1.2 million in respect of the President & CEO (all amounts stated above include payroll taxes).

For further details, see item (5) below.

(2) An option plan for the Bank's officers

General. In its resolutions of the dates March 26, 2006, July 1, 2006 and July 25, 2006, the Board of Directors approved a stock option plan and the allotment to a Trustee of 9,806,391 option warrants in respect of the Bank's nine officers, including the former Internal Auditor and excluding the Bank's former Chairman of the Board and former President & CEO (hereinafter in this Note - "Officers").

The option warrants are non-marketable and are convertible into ordinary "A" shares of NIS 0.1 each, on terms and dates as determined in the option plan.

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, was NIS 6.379 (subject to adjustments). 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 the option warrants granted to two Officers, who began their employment with the Bank on March 1, 2006 and on April 2, 2006, was the market closing price of the Bank's shares on the last trading day prior to the beginning of work at the Bank of the respective officer.

The exercise period of two thirds of the warrants allotted under the plan began on January 5, 2009 and ended on January 4, 2011, and the exercise period of the remaining one third began on January 1, 2011 and ended 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.

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 initial implementation as from January 1, 2011, of International Financial Reporting Standard IFRS2 in the matter of "Share based payment", did not have an effect on the said estimates). The value of the benefit on behalf of the said nine officers will be allocated in the Bank's books as from the date of grant of the options (March 26, 2006), and until the beginning of the exercise period of each portion.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

The balance of the option warrants expired on December 31, 2012. All payroll expenses had been recognized until the end of 2010 as payroll expenses against a capital reserve. At date of expiry or exercise of the option warrants, which have been vested, the Bank allocated to the balance of premium the related part of the capital reserve.

For further details, see item (5) below.

(3) Issue of Options to additional Members of Management

General. In February 2010, the Board of Directors decided to approve a "phantom option" plan to whom acted at the time as Head of the Corporate Division (hereinafter: "offeree A") and to the Bank's Chief legal Advisor (hereinafter - "offeree "B"), this in continuation to previous resolutions in their respect.

"Phantom option" plan. Offeree A and Offeree B were entitled to a cash amount being the difference between the closing market price of the Bank's ordinary share 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 the cash benefit was supposed to be added the grossed up tax difference between the marginal tax applied 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 was meant to be determined according to the closing market price of the Bank's ordinary share, on the last trading day prior to the date of appointment as Executive Vice President (hereinafter: "trading day") (NIS 9.3 and NIS 9.17, respectively), together with linkage increments to the CPI (hereinafter: "the exercise price").

Offeree A has been offered 980,639 phantom options and Offeree B has been offered 817,199 phantom options. Offeree A and Offeree B were entitled to phantom options in two portions. In view of the termination of office of Offeree "A" on December 31, 2010, he is not entitled to the phantom options comprising the second lot. The phantom options of the first lot expired on June 30, 2011. The phantom options allotted to offeree "B" in the first lot expired on February 24, 2012. The options allotted to Offeree "B" in the second tranche, are exercisable until February 24, 2014.

As of the date of the decision the exercise price was NIS 10.066 and NIS 9.923 respectively (adjusted in respect of a dividend distributed on October 6, 2008).

The expense in respect of the first portion of the phantom options has been recognized in the income statement of the financial report for December 31, 2010 while the expense in respect of the second portion was distributed over the period to its date of entitlement.

The financial statements as of December 31, 2012, included a reduction in expense with respect to the said plan in a negligible amount (2011: reduction of expense in the amount of NIS 0.7 million; 2010 : expense of NIS 0.7 million) (the above amounts include payroll tax).

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

(4) Share based payment of the share option type - Quantitative details

A. Share based payment for the Bank's Officers

	2012		2011		2010	
Changes in option	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
Outstanding at beginning of the year	1,438,272	7.88	3,399,550	8.60	6,276,090	7.83
Exercised during the year[(2)]	-	-	-	-	2,876,540	7.03
Expired during the year	1,438,272	8.01	1,961,278	9.35	-	-
Outstanding at end of the year[(3)]	-	-	1,438,272	7.88	3,399,550	8.60

Footnotes:

(1) The exercise price is linked to the "known" CPI. In addition to linkage increments, the actual exercise price is subject to adjustments, as detailed above. On December 2, 2010 the exercise price was adjusted by an amount of NIS 0.107, in respect of a rights issue.

(2) The weighted average price of the share at the date of exercise of the options into shares during year 2010 was NIS 8.01.

(3) Options outstanding at the end of the year divided by ranges of exercise prices:

	December 31, 2011		December 31, 2010	
	Range 1	Range 2	Range 1	Range 2
Exercise price range (in NIS)	7.25	10.05	7.07	9.8-9.66
Number of options	1,111,392	326,880	1,438,272	1,961,278
Weighted average exercise price (in NIS)	7.25	10.05	7.07	9.73
Weighted average contractual life (years)	0.97	0.50	2.00	0.67
Of which exercisable:				
Number of options	1,111,392	326,880	-	1,307,518
Weighted average exercise price (in NIS)	7.25	10.05	-	9.73

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

(5) Share based payment of the share option type - Quantitative details

B. Share Based payment for the former Chairman of the Board and the former President & CEO

	2011		2010	
Changes in option	Number of Options	Weighted average exercise price [(1)] in NIS	Number of Options	Weighted average exercise price [(1)] in NIS
Outstanding at beginning of the year	6,472,220	9.07	16,180,550	8.97
Expired during the year	6,472,220	9.17	9,708,330	9.00
Outstanding at end of the year	**-**	**-**	**6,472,220**	**9.07**
Of which exercisable:	-	-	6,472,220	9.07

Footnotes:

(1) On December 2, 2010 the exercise price was adjusted by an amount of NIS 0.107, in respect of a rights issue.

(6) Liabilities arising from share-based payment transactions - Phantom plans - Quantitative details

Phantom plan for the Bank's officers, the Chairman of the Board and the President & CEO

	December 31	
	2012	2011
	in NIS thousands	
Total liabilities arising from share-based payment transactions	5,560	3,944
Intrinsic value of liabilities in respect of which the counterparty's right to cash has vested by the end of the quarter	-	-
Total expense (reversal of expense) charged to the statement of income	**1,616**	**(4,185)**

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.

(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 on January 29, 2006 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, that no dividends shall be distributed from earnings retained by the Bank up to September 30, 2004 (The Bank's retained earnings as at September 30, 2004, which, as stated, may not be distributed, amounted to NIS 2,704 million). If losses shall incurre after that date, no dividends shall be distributed until after such losses have been recovered. Dividends distributed from the sale of the Bank's material assets is subject to the prior written approval of the Supervisor.

(3) Restrictions established in instructions of the Supervisor of Banks

Proper Banking management Directive No. 311 determines restrictions on the distribution of dividends. Letters of the Supervisor of Banks in the matters of "Capital policy for interim periods" and "Basel III framework – Minimum core capital ratios" required banking corporations, among other things, to avoid a distribution of dividend, if as a result thereof, the banks might not attain the capital targets determined in the said letters.

(4) Distribution of a dividend in respect of preferred shares

On June 12, 2012, the General Meeting of Shareholders resolved to approve as final dividend for 2011, the interim dividend of 6%, paid on December 28, 2011, to the holders of 40,000 6% cumulative preference shares of NIS 0.00504 par value each, in a total amount of GBP 24,000.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

On November 28, 2012, the Bank's Board of Directors resolved to pay on December 27, 2012, 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 2013, to declare such dividend as final.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

General. The capital adequacy as of December 31, 2012, is computed according to the standard approach in accordance with Proper Banking Management Directive Nos. 201 and 211 regarding "Measurement and capital adequacy" (hereinafter: "Basel II guidelines").

1. Capital for calculating ratio of capital

	31 December	
	2012	2011
	in NIS millions	
Tier 1 capital post deductions	12,562	(4)(5)11,887
Tier 2 capital post deductions	6,862	7,173
Total capital	**19,424**	**19,060**

2. Weighted credit risk assets balance

	31 December	
	2012	2011
	in NIS millions	
Credit risk	120,686	120,256
Market Risk	2,238	1,875
Operational risk(6)	12,788	13,418
Total weighted credit risk assets balance	**135,712**	**135,549**

For notes to the table see after item 4.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

3. Ratio of capital to risk assets

	31 December	
	2012	2011
	in %	
A. The bank		
Ratio of original tier 1 capital to risk assets	8.6	8.1
Ratio of tier 1 capital to risk assets	9.3	8.8
Ratio of total capital to risk assets	14.3	14.1
Ratio of total minimum capital required by the Supervisor of Banks	**9.0**	**9.0**
B. Significant subsidiaries		
1. Mercantile Discount Bank LTD. and its subsidiaries		
Ratio of tier 1 capital to risk assets	10.5	9.7
Ratio of total capital to risk assets	15.0	13.2
Ratio of total minimum capital required by the Supervisor of Banks	**9.0**	**9.0**
2. Discount Bakcorp Inc. (1)		
Ratio of tier 1 capital to risk assets	14.2	14.3
Ratio of total capital to risk assets	15.4	16.5
Ratio of total minimum capital required by the Supervisor of Banks	**(2)8.0**	**(2)8.0**
3. Israel Credit Cards LTD.		
Ratio of tier 1 capital to risk assets	15.2	16.2
Ratio of total capital to risk assets	16.8	16.7
Ratio of total minimum capital required by the Supervisor of Banks	**(3)9.0**	**(3)9.0**

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	
	2012	2011
	in NIS millions	
A. Tier 1 capital		
Equity	11,838	(4)(5)(7)10,702
Minority interests in the equity of consolidated subsidiaries	296	(5)319
Complex capital instruments	1,747	1,723
Less goodwill	(142)	(142)
Less other intangible assets	--	(10)
Less net gains on fair value adjustments of available for sale securities	(415)	(7)(2)
Adjustments regarding put options granted to the non-controlling rights holders	81	(5)75
Less investments in non-realistic companies with significant influence	(843)	(4)(5)(778)
Total tier 1 capital	**12,562**	**11,887**
B. Tier 2 capital		
1. Upper tier 2 capital		
45% of net gains amount, pre related tax influence, on fair value adjustments of available for sale securities	297	-
General provision for doubtful debts	254	254
Complex capital instruments	1,383	1,362
Other upper tier II capital components	2	2
2. Lower tier II capital		
Subordinated capital notes	5,769	(4)(5)6,333
3. Amounts deducted from tier 2 capital		
Investments in non-realistic companies with significant influence	(843)	(4)(5)(778)
Total tier 2 capital	**6,862**	**7,173**

Footnotes:

(1) The data in this item was computed in accordance with the rules mandatory in the U.S.A.

(2) 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%.

(3) In view of the approach by the Supervisor of Banks, ICC is required to maintain a total capital ratio of not less than 15%, starting from December 31, 2010,as detailed in Note 33 to the financial statements.

(4) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(5) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(6) Calculation of the capital requirement in respect of the operational risk as of December 31, 2012, is based on the standard approach (TSA). Until September 30, 2012, the Bank applied the basic indicator approach (BIA) for calculating the capital requirement regarding operational risk, and this in accordance with Proper Banking Management Directive No. 206 in the matter of "Measurement and capital adequacy – operational risk". Accordingly, the data as of December 31, 2011, are not comparable to the current data. The change in the method of computation decreased the risk assets computed in respect of operational risk as of December 31, 2012, in the amount of NIS 1,306 million.

(7) Amended following an immaterial adjustment of the comparative figures at FIBI - see Note 1 c 8 to the financial statements.

5. Core capital target. The resolution of the Board of Directors regarding the "Strategic plan for the Discount Group for the years 2011-2013", has determined also targets for the core capital at the rate of 8% by the end of 2012 and 8.5% by the end of 2013.

Guideline in the matter of the minimum core capital ratios. On March 28, 2012, the Supervisor of Banks delivered to all banking corporations a guideline stating his intention to determine a higher minimum core capital ratio than that required at the present time. According to this guideline, all banking corporations will be required to attain a minimum core capital ratio of 9% as from January 1, 2015.

In addition, a banking corporation, the total outstanding Balance sheet assets of which on a consolidated basis comprise at least 20% of the total outstanding Balance sheet assets of the banking industry in Israel, will be required to attain a minimum core capital ratio of 10% as from January 1, 2017. This additional provision does not apply to the Bank.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

The core capital ratio is supposed to be computed in accordance with the instructions of Basel III and adjustments to be determined by the Supervisor of Banks.

Draft circular of the Supervisor of Banks regarding the adoption of Basel III instructions. On December 30, 2012, the Supervisor of Banks published a draft Proper Banking Management Directive No. 202 in the matter of Capital Measurement and Adequacy (hereinafter: "the Draft"). The Draft adopts the recommendation of the Basel III framework dated December 16, 2010, in the matter of "Basel III a global regulatory framework for more resilient banks and banking systems". The Draft, among other things, states more stringent requirements with respect to the components qualified for inclusion in equity, minimum capital targets, regulatory adjustments, deductions from capital and transitional instructions for implementation.

According to the draft, starting with January 1, 2015, the minimum total capital ratio, which the Bank will be required to attain, is 12.5%.

The Bank operates for the preparation of a detailed plan for attaining the capital targets, being at least the level of capital prescribed by the policy of the Supervisor of Banks and according to the time schedules published by him. In this respect, the Bank studies various possibilities of enlarging the capital base, which do not include an additional issue of shares by the Bank. Among other things, the Bank studies various alternatives for the sale of holdings or a part thereof. At this stage, it is not possible to determine which of the alternatives will be chosen, if at all, and the possibility exists that the Bank would not be required at all to choose any of the alternatives, as stated. However, whereas on the reporting date, there is no certainty that the assumptions of a continuous holding of the Bank's investments will in fact exist in full, the Bank recorded a provision for taxes in the amount of NIS 14 million, in respect of a part of its investments. It is emphasized that the recording of the said provision should not be construed as an indication of an expected materialization of any of the alternatives.

The core capital ratio as of December 31, 2012, reached a ratio of 8.6% (December 31, 2011: 8.1%). It should be noted that in view of the agreement to be signed between FIBI and the Bank and in view of the approvals granted in respect thereof (see Note 6 E (1) above), in which a layout has been determined for the sale of the Bank's holdings in FIBI, the Supervisor of Banks has permitted the Bank to exclude from the core capital the deduction in respect of the Bank's investment in FIBI.

6. Clarifications regarding hybrid capital instruments

A. 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.

B. Additional issues of hybrid capital instruments. In a letter dated June 30, 2010, the Supervisor of Banks drew attention of banks to the mention made in the draft recommendations in the matter of the "Strengthening the resilience of the banking sector", published by the Basel Committee, to hybrid capital instruments, which do not conform with the new conditions for recognition as capital, specified in the draft. The Supervisor of Banks clarified that it is his intension to adopt the final instructions to be published in this respect, and accordingly, banking corporations must take into consideration the high probability that new issues of such instruments will not be recognized in the future for capital adequacy purposes. In view of the above, the Bank has not issued hybrid capital instruments since the beginning of 2010.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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. On December 31, 2006 subordinate 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 subordinate capital notes will be deemed hybrid capital instruments and will be recognized as part of the Bank's primary capital (tier I). 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. 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 approx. NIS 147 million, through a private issue to classified investors (as defined in the Securities Regulations (Offer of Securities to the Public), 2007).

On September 22, 2008, the Supervisor of Banks approved the said capital notes as hybrid capital instruments recognized as part of the Bank's Tier I capital, as defined in Proper Banking Management Directive No. 311 - "The minimum capital ratio", subject to the following conditions:

a. The capital notes are to be issued under terms identical to those of the capital notes issued as part of the existing Series;

b. The rate of the Hybrid Tier I Capital is not to exceed 15% of the Bank's total Tier I capital;

c. The capital notes are not and will not be pledged in favor of the Bank or in favor of its subsidiary companies.

The Bank complies with the said conditions.

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 the Bank's ordinary "A" shares of NIS 0.1 par value each, 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 Bank's authorized share capital, 398.5 million of the Bank's ordinary "A" shares.

The subordinate capital notes are not secured by any pledge on the Bank's assets or by any other collateral. The Bank's liability 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 Bank's liability 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 the Bank's risk assets 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.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

(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 Bank's Board of Directors 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 Bank's independent auditors drew attention in their audit report or review report attached to the Bank's annual or interim financial statements, respectively, to notes to the financial statements regarding the Bank's inability to fulfill its obligations, as stated above;

(b) The Bank's Board of Directors 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 Bank's independent auditors 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 Bank's last financial statements 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 the Bank's ordinary "A" shares, of the circumstances described below occur:

(a) If the ratio of the overall tier I capital to the Bank's risk assets, as stated in the annual financial statements or in the Bank's quarterly interim financial statements 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 the Bank's risk assets, excluding the hybrid tier I capital (hereinafter - "the original tier I capital"), as stated in the annual financial statements or in the Bank's quarterly interim financial statements 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 the Bank's risk assets, as stated in the annual financial statements or in the Bank's quarterly interim financial statements 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 Bank's interim financial statements, 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 Bank's quarterly interim financial statements for the reporting period, falls in a certain quarter below 5%, immediate partial conversion will be implemented in an amount that would recover the Bank's original primary capital ratio published for that quarter to at least 5%;

(e) If the Bank's retained earnings become negative;

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

(f) If the Bank's independent auditors drew attention in their audit report or review report attached to the annual financial statements or to the Bank's interim financial statements, 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 basis points over the original margin determined for the first period of 15 years is enabled, after at least 15 years from the issuance date.

(10) Subordination - Except for the rights of creditors in accordance with similar capital instruments, the capital notes are subordinate to claims of all other creditors, including holders of capital notes issued as secondary capital.

(11) Collateral - The liabilities according to the capital notes are not secured by any collateral.

(12) Issuance to related entities - The Bank will not issue subordinate capital notes to provident funds and/or mutual funds controlled and/or managed by the bank (insofar as this condition is at the Bank's discretion in the primary allocation).

(13) Transparency - The terms of the issuance will be clear and disclosed, including full disclosure in the Bank's published annual financial statements of all conditions of the hybrid tier I capital, inter alia, the following details regarding the compound primary capital: amount, components, share in the total overall primary capital and principal characteristics.

Regarding recognition of the capital notes as 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.

For details regarding the issue of additional hybrid capital instruments, see Section 6(b) above.

B. Issue of hybrid tier I capital - Series "B"

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 the Bank's subordinated capital notes (Series "B") 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%).

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

The subordinate capital notes include special provisions, as detailed below, mainly compulsory conversion of the principal amount and/or interest into the Bank's ordinary "A" shares of NIS 0.1 par value each, 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 Bank's authorized share capital, 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 Bank's assets or by any other collateral. The Bank's liability 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 Bank's liability 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 the Bank's ordinary "A" shares 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 Bank's interim financial statements, once in every quarter, fell in a particular quarter below 5%, the said conversion shall be effected immediately.

For details regarding hybrid capital instruments, see Section 6B above.

8. The issue of upper tier II capital

Issue of upper tier II capital in 2009. In 2009, Discount Manpikim issued NIS 1,252 million par value subordinated capital notes (Series 1), 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 the Bank's risk assets 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. Redeamability - Only capital notes that have been fully paid up in cash may be considered upper tier II capital.
8. Collateral - the liability in accordance with the capital notes may not be secured by collateral.
9. Pledge on capital notes - the capital notes may not be financed and may not be pledged as security for a loan granted by the Bank or a subsidiary thereof.
10. Suspension of interest payments - Interest payments shall not be made if on their due date "suspending circumstances" prevail, as the term is defined below, and the payment thereof shall be deferred for unlimited periods. The suspending circumstances are:
    (a) The Bank's Board of Directors 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 Bank's inability to honor its liabilities, as above.
    (b) The Bank's Board of Directors 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 Bank's interim financial statements, 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 Bank's financial statements 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 Bank's Board of Directors that suspending circumstances no longer exist at that time, the suspended interest payments may be paid together with interest and linkage increments thereon:
    (a) The Bank has declared the payment of dividend to the holders of any class of its shares.
    (b) The Bank has announced a premature redemption, in full or in part, of the principal sum of the subordinated capital notes, or has redeemed the principal sum of the subordinated capital notes, in full or in part.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

(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 the Bank's creditors 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 Bank's Board of Directors 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 basis 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 capital 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 the Bank's tier I capital, 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 the Bank's tier II capital, for whatever reason. The Bank's obligation to pay the principal of the capital notes and the interest thereon stands parri passu with additional securities and/or additional securities that may be issued by the Bank or its subsidiaries and approved by the Supervisor of Banks as "hybrid capital instruments".
17. Allotment to related parties - The Bank shall not allot (to the extent that the matter depends on the Bank upon the initial issue) the hybrid capital notes to provident funds and/or mutual funds controlled and/or managed by the Bank.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

18. Transparency - The terms of issue will be clear and disclosed. In this respect, full disclosure shall also be given in the Bank's annual financial statements issued to the public, to the terms of the hybrid tier II capital. Such disclosure will include, among other thing, the following details regarding the hybrid capital: its amount, composition, its share as a percentage of the total inclusive tier I capital as well as it principal characteristics.

For details regarding clarification on the subject of hybrid capital instruments, see Section 6B above.

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, 2012 amounted to US$1,666 million (NIS 6,219 million) [December 31, 2011: US$1,488 million (NIS 5,684 million)].

In addition, IDB New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US$143 million (NIS 535 million) as of December 31, 2012 as a collateral for deposits received from it [as at December 31, 2011: US$220 million (NIS 841 million)].

B. IDB New York has sold securities, under buyback terms, in the amount of US$1,738 million (NIS 6,488 million) as of December 31, 2012 [as at December 31, 2011: US$2,067 million (NIS 7,899 million)].

C. Deferred notes issued by the Bank in accordance with a Prospectus of April 1997, are not secured by a pledge on the Bank's assets, 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 4 below 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, 2012, amounted to NIS 21 million (December 31, 2011: NIS 29 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 Bank's activity itself (nostro) as of December 31, 2012, was NIS 69 million (2011: NIS 53 million).

According to the Memorandum and Bye Laws of the Ma’of clearing house all member of the clearing house, including the Bank signed pledge agreements to secure their liabilities in favor of the Ma’of clearing house and deposited liquid security only (State of Israel bonds and/or cash).

The Bank provided the Ma’of Clearing House with a first degree pledge on all monies that had been deposited by the Bank in an account in the name of the Ma’of Clearing House at the Stock Exchange Clearing House and at an account in the name of the Ma’of Clearing House in another bank, all as collateral for amounts that the Bank will be liable for in respect of Ma’of transactions to which it is responsible towards the Ma’of Clearing House. The obligation is subject to conditions, and the Bank is entitled, under certain conditions, to demand the repayment of certain amounts. Within the framework of these accounts the Bank has pledged bonds and cash in favor of the Ma’of Clearing House, the amount of which at December 31, 2012, totaled NIS 854 million (December 31, 2011: NIS 779 million).

Mercantile Discount Bank ("MDB") 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, 2012, to NIS 73 million (December 31, 2011: NIS 74 million).

15. PLEDGES (CONTINUED)

Balance of collateral provided to the Ma'of Clearing House:

	Balance as of December 31, 2012	Highest balance during the year 2012	Average balance* in 2012	Balance as of December 31, 2011
	In NIS millions			
Cash	7	10	9	10
Securities	922	926	881	846

* 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 amounts 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. IDB (Swiss) Bank has pledged assets in the amount of CHF 0.5 million (December 31, 2011: CHF 0.5 million), as collateral for credit facilities in the amount of US$0.5 million.

I. As detailed in Note 19 C 5 hereunder, in accordance with the requirements of the Articles of the Tel-Aviv Stock Exchange Ltd. and the bylaws of the Stock Exchange Clearinghouse (hereinafter: "the Clearinghouse" or "Stock Exchange 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, 2012, to NIS 171 million (as at December 31, 2011: NIS 159 million).

MDB has created a similar pledge in favor of the Stock Exchange Clearing House. The value of the collateral as of December 31, 2012, amounted to NIS 11 million (December 31, 2011: NIS 9 million).

Balance of collateral provided to the Stock Exchange Clearing House:

	Balance as of December 31, 2012	Highest balance during the year 2012	Average balance* in 2012	Balance as of December 31, 2011
	In NIS millions			
Cash	17	20	17	14
Securities	165	165	160	153

* 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. 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 pledged on November 24, 2010, 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 (in addition to a floating pledge, at first charge, registered on these assets on July 26, 2007).

At the end of July 2007, the Bank deposited with the said account bonds valued, as at December 31, 2012, at NIS 3.51 billion (December 31, 2011: NIS 3.38 billion).

MDB 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 471 million (December 31, 2011: NIS 454 million).

15. PLEDGES (CONTINUED)

Details of the pledge agreement:

	Balance as of December 31, 2012	Highest balance during the year 2012	Average balance* in 2012	Balance as of December 31, 2011
	In NIS millions			
Pledged securities (market value)	3,981	3,988	3,889	3,830

* The report is based on outstanding monthly balances.

K. In addition, the Bank and MDB make deposits from time to time with the Bank of Israel, constituting (together with the securities deposited, as stated) the collateral for the credit granted by the Bank of Israel to the Bank and to MDB, within the framework of credit tenders.

The bank and MDB did not participate in the years 2011-2012 in the said credit tenders.

Details of the deposits:

	Balance as of December 31, 2012	Highest balance during the year 2012	Average balance* in 2012	Balance as of December 31, 2011
	In NIS millions			
Deposits with the Bank of Israel	14,175	23,835	19,245	23,401

* The report is based on outstanding monthly balances.

L. In accordance with Section 6(a) of the State Loans Law, 1979, the Accountant General announces from time to time, the appointment of certain entities, including the Bank, as "market makers" with respect to government bonds. Within the framework of the market making operations, the Treasury grants the market makers a facility for the borrowing of government bonds in order to cover short sale bond transactions, as part of the market making. Against the use of this facility, the Bank deposits with the Treasury as collateral amounts equal to the amount of the borrowed bonds. The balance of this deposit at December 31, 2012 was NIS 387 million.

M. 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, 2012, the Bank allocated in favor of foreign banks deposits in a total amount of NIS 425 million (December 31, 2011: NIS 407 million).

N. 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, 2012 amounted to NIS 41 million (December 31, 2011: NIS 36 million). The highest balance of the collateral in 2012 was 75 million, while the average balance was NIS 45 million.

15. PLEDGES (CONTINUED)

O. The sources and use of the securities that had been received and which the Bank is entitled to sell or pledge, at their fair value, before setoffs effect:

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	In NIS millions			
The sources:				
Securities received in security borrowing transactions against cash	387	142	387	142
Securities received in security borrowing transactions against securities	704	588	704	588
Total	**1,091**	**730**	**1,091**	**730**
The uses:				
Securities received in security borrowing transactions against cash	387	142	387	142
Securities received in security borrowing transactions against securities	704	588	704	588
Total	**1,091**	**730**	**1,091**	**730**

P. Details of securities pledged to the lenders:

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	In NIS millions			
Available for sale securities	3,544	3,449	2,246	2,140
Held-to-maturity securities	2,499	*2,428	2,367	2,247
Total	**6,043**	**5,877**	**4,613**	**4,387**

These securities have bee deposited as collateral with the lenders, who are not permitted to sell or pledge them.

* Reclassified in respect of subsidiary.

16. EMPLOYEE BENEFITS

A. (1) 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.

(2) As detailed in Note 1 D 15 above, the liability for payment of severance pay to such group of employees is presented in the financial statements at the higher of the amount of liability based on an actuarial computation, and the amount of liability computed by multiplying the monthly salary of the employees by the number of years of employment, as required by Opinion No.20 of the Institute of Certified Public Accountants in Israel.

(3) 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 between 3 to 8 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.

(4) 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.

(5) The Bank and its subsidiaries are not permitted to withdraw these deposits except for the purpose of making severance payments.

16. EMPLOYEE BENEFITS (CONTINUED)

B. A number of the Bank's employees and those of its consolidated banking 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's employees, is capitalized at a payroll increase rate of 2.5%. The financial statements include provisions for long-service bonuses totaling: Consolidated - NIS 419 million (2011: NIS 408 million); the Bank - NIS 315 million (2011: NIS 313 million).

An agreement with the representatives of the employees was signed in 2007, regarding the "Jubilee vacation" days, according to which, among other things, the entitlement of new employees to "Jubilee vacation" was abolished. In 2011, the Bank signed with the representative committee of the employees a "grades and stages" agreement, according to which, among other things, new employees engaged or moved to the position of regular employees as from January 1, 2012, shall not be entitled to a "jubilee award".

C. 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 liability for vacation pay is recognized over the period of employment in which the right to paid vacation accumulates. The liability is determined on the basis of the most recent salary in the reporting period with the addition of deferred payments. The financial statements include provisions for vacation pay as follows: Consolidated - NIS 137 million (2011: NIS 125 million); and for the Bank - NIS 104 million (2011: NIS 93 million).

D. Employees of the Bank and its subsidiaries are entitled to certain benefits after retirement. The said liability is computed on an actuarial basis using a discount rate of 4%, and is recognized over the period of employment of the employee. In addition, approx. thirty employees who accepted early retirement exchanged their retirement award with a pension for a determined period. This liability is presented at its discounted value based on a discount rate of 4%.

The amount of the provision at balance sheet date: Consolidated - NIS 601 million (2011: NIS 610 million); the Bank - NIS 504 million (2011: NIS 514 million).

It should be noted that the agreement "Grades and stages" signed in 2011, reduced the benefits granted to retirees of the Bank who were engaged as or converted to the status of regular employees, subsequently to January 1, 2012. These benefits match now the terms applying to employees under this agreement, and consist of presents for the holidays and medical expenses.

E. Provision and deposits due to employees' severance pay and allowance payments are as follows:

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Deposits	2,262	2,587	1,972	2,295
Provision	2,580	2,880	2,172	2,475
The excess of provision over the deposits is included in the item other liabilities (Note 12)	**(318)**	**(293)**	**(200)**	**(180)**

16. EMPLOYEE BENEFITS (CONTINUED)

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.

G. **Retirement plan 2011.** In June 2011, the Board of Directors has approved principles for a retirement plan designed for between 400 and 500 employees. The plan was put into operation at the end of October 2011, and terminated in March 2012. In actuality, until December 31, 2012, approx. 360 employees retired within the framework of the plan (four of which retired in 2011).

124 employees chose the monthly pension track. The aforesaid liability is fully covered by the balance of the provision for severance pay.

The terms of the monthly pension are as follows:

- A CPI-linked monthly pension for the entire lifetime of the retiree, from the date of his/her retirement;
- The monthly pension amounts are determined on the retirement date in accordance with an economic computation performed by the Bank, which derives from the amount of the balance in the severance pay fund that was converted to the pension;
- The employee can opt for a pension track with or without next of kin.
- The employee is given the option of choosing a guaranteed number of pension payments, based on his/her age.

In respect of pension payable to the retiree and/or his/her spouse upon reaching the age of 85 years (all according to the route chosen by the retiree), the Bank has purchased insurance coverage that would secure the payment of the said pension and which will be paid directly by the insurance company.

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 principal details concerning the said liability:

	As at December 31	
	2012	2011
	in US$ millions	
Amount of provision	54	49
Amount of deposits	31	21
Excess of provision over deposits included in Other liabilities (Note 12)	**23**	**28**
	%	%
The annual discount rate	3.98	4.15
The anticipated annual rate of return on the funds assets	3.90	8.25
The annual rate of increase in employee payroll	4.25	4.25

I. **An award plan for members of the Bank's management (2006-2010).** In terms of the plan the Bank granted 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 has been derived in part from the rate of the annual return on equity and in part by the decision of the President & CEO. The said distribution required the approval of the Bank's Board of Directors. The minimum annual rate of return required for a distribution of an award to members of management in a particular year, was 8.5%.

16. EMPLOYEE BENEFITS (CONTINUED)

J. Remuneration plan for members of the Bank's Management

1. General

Subsequent to having already been approved by the Audit Committee of the Board of Directors, after adopting the recommendation of the Payroll and Remuneration Committee of the Board, the Bank's Board of Directors resolved on August 31, 2011, to approve the remuneration plan for members of the Bank's Management and for the Bank's Internal Auditor, which includes an annual award and a long-term award. The remuneration plan is a three year plan covering the years 2011-2013.

The remuneration plan states that its principles will apply also, mutatis mutandis, as part of the remuneration plan for senior executives of the Bank's subsidiaries, subject to approval of the authorized organs of the said subsidiaries. And indeed, the Bank's principal subsidiaries in Israel have determined remuneration in accordance with the same principles, mutatis mutandis.

2. Annual award to members of Management (excluding the Chief Risk Officer, the internal auditor and the Chief Accountant)

(A) General

The annual award shall comprise an award based on a formula, computed according to attainment of quantitative indices (hereinafter: "computed award"), and an additional award to be determined at the discretion of the Bank's President & CEO (Hereinafter: "discretionary award").

The indices serving as a basis for the computation of the annual award shall be based on the goals set in the Bank's work plan for the years 2011-2013. The said annual award shall be approved in each year by the Audit Committee and the Board of Directors, subject to any law.

Payment of the annual award by installments. Payment of the annual award in respect of a particular calendar year shall be made in three installments: 60% of the annual award shall be paid no later than thirty days following the publication of the Bank's financial statements for the year in question. Two installments of 20% each shall be deferred and paid (linked to the CPI) following the publication of the financial statements for each of the two years following the said calendar year.

If in any award year not all basic conditions for the award are fulfilled, then all the deferred award installments that should have been paid on the dates set for payment in respect of the year of award shall be cancelled and not paid.

(B) Computed award

Maximum computed award. The annual computed award in respect of each Management member shall be limited to an amount not exceeding eight monthly salaries.

Basic conditions for entitlement to the computed award. Entitlement to an award in respect of a particular calendar year shall be subject to the fulfillment of all following conditions:

(1) The Bank's total capital adequacy ratio and the core capital ratio, according to the Bank's consolidated annual financial statements for that year, shall not fall below the total capital adequacy ratio and the core capital ratio, respectively, as determined in the work plan for that calendar year;

(2) The difference between the targeted return on risk assets (in percentages) as determined in the work plan for the year of the award, and the actual return on risk assets (as defined in the work plan) (hereinafter: "return on risk assets differential") shall be at a rate lower than 3%;

(3) The Bank shall display in its consolidated annual financial statements for the year of the award, net earnings of at least 75% of the amount of net earnings determined in the work plan for that year.

Computation of the computed award. This award is to be computed on the basis of three indices based upon the Bank's performance (hereinafter: "the quantitative indices") and upon an additional index to be determined by the Bank's President & CEO in respect of each Management member (hereinafter: "the additional index").

16. EMPLOYEE BENEFITS (CONTINUED)

The quantitative indices. Each quantitative index shall have a targeted goal, based on the goal approved for this index by the Board of Directors as part of the work plan for that year, and which in accordance therewith, minimum and maximum goals shall be computed for this index.

Attainment of the minimum goal, the targeted goal or the maximum goal in a particular year, shall entitle the member to 50%, 80% or 112.5% of the maximum computed bonus relating to that index, respectively. Any result between the minimum goal and the targeted goal, and any result between the targeted goal and the maximum goal, shall entitle the member to a percentage of that part of the maximum computed award applying to that index, based on a linear computation (between 50% and 80%, and between 80% and 112.5%, respectively).

Not withstanding the above and in any event, the comprehensive computed award in respect of each member of Management shall not exceed 100% of the maximum computed award.

Proximate to the beginning of each year, the Board of Directors shall determine in the work plan the targeted goals for that year. The manner of measurement of such goals shall be identical to that by which they are being measured within the framework of the work plan.

If, during a bonus year, the Bank's Board of Directors decides to change the goals in the Bank's work plan for that year, thereby impacting the indices that constitute the basis for the computed award, the Bank's Board of Directors will decide whether - as a consequence thereof - it is necessary to also adjust the goals used for the purpose of calculating the computed award for the members of management with respect to said year.

Following are the quantitative indices:

(1) Return on risk assets.

(2) Efficiency ratio. This index will be computed according to the manner in which the efficiency ratio is measured and reported in the consolidated financial statements.

(3) Operating and other income. This index is computed as the total of operating and other income in a particular calendar year, in accordance with the Bank's consolidated financial statements for that year.

The additional index. At the beginning of each award year, the Bank's President & CEO shall recommend, separately for each member of Management, an additional index. This additional index shall focus on the challenges facing the Division/Group which this member heads in the particular year. At his discretion, the President & CEO may recommend a different or identical index for all or part of Management members. The additional index as well as the goals on which it is based, as determined by the Bank's President & CEO, shall be brought at the beginning of the calendar year for approval of the Audit Committee and of the Board of Directors. To the extent that attainment of the determined index may be quantitatively computed – then the targeted goal, the minimum goal and the maximum goal relating to each additional index that is determined, will also be determined at the beginning of the award year, and attainment thereof shall be computed as detailed above regarding the quantitative goals. To the extent that a qualitative index is determined (attainment thereof cannot be quantitatively computed) - attainment of the goal shall be determined at the discretion of the President & CEO, where if the President & CEO is of the opinion that a certain member of Management is entitled to a share of the computed award in respect of this index, the President & CEO will determine a share of between 50% and 112.5% of the maximum rate of the computed award related to this index. Notwithstanding the above and in any event, the comprehensive computed award in respect of each member of Management in the award year shall not exceed 100% of the maximum computed award.

The additional index will not be calculated for 2011.

(C) The discretionary award

The total budget for the discretionary award. The additional budget for each award year will equal one half of the amount of the computed award to which all members of Management will be entitled in that award year (prior to the deferral of the award installment payments). The budget for the discretionary award shall not exceed an amount equal to four monthly salaries of each of the Management members. In an award year in respect of which Management members will not be entitled to any computed award, no budget allocation shall be made in respect of a discretionary award.

16. EMPLOYEE BENEFITS (CONTINUED)

Distribution of the budget for a discretionary award. The budget shall be allocated at the discretion of the President & CEO, subject to approval of the Audit Committee and the Board of Directors and subject to the following terms:

1. The amount out of the additional budget granted to each Management member shall not exceed a total of eight monthly salaries of
2. The total annual award to be granted in one award year to each member of Management shall not exceed a total of fourteen monthly salaries of that member.

When deciding upon the allocation of the additional budget between the different members of Management, the President & CEO shall, among other things, consider the following: attainment of the Bank's general goals concerning risk management; attainment of the Bank's general goals concerning compliance with the law, regulations and Bank procedures. Legal actions (including administrative proceedings) and reports issued by regulatory authorities should also be taken into consideration.

3. Annual award to the Internal Auditor, the Chief Risk Officer and the Chief Accountant

The annual award to the Internal Auditor, the Chief Risk Officer (CRO) and the Chief Accountant shall be based on a different mechanism, determined, among other things, according to directives of the Supervisor of Banks, in order to reflect the importance and sensitivity of the role they fulfill.

The annual award to the Internal Auditor shall be determined, following the end of each award year, at the discretion of the Audit Committee and the Board of Directors.

The annual award to the CRO shall be recommended, following the end of each award year, by the Risk Management Committee of the Board in consultation with the Bank's President & CEO, subject to approval of the Audit Committee and the Board of Directors.

The annual bonus for the Bank's Chief Accountant for each bonus year (after the year has ended) will be recommended by the Bank's President & CEO and will be subject to the approval of the Audit Committee of the Bank's Board of Directors.

In determining the said annual awards, the factors to be taken, among other things, into consideration are the work plan goals for any of the aforementioned officers, as well as the Bank's performance in the year of award and the maximum amount of the annual award (in monthly salary terms) to which each of the other members of Management are entitled in respect of that award year.

The said annual award as above shall not exceed a total of twelve monthly salaries for each of the two functionaries.

Entitlement to an award in respect of a particular year shall be subject to the fulfillment of all minimum conditions.

Payment of the annual award to the Internal Auditor, to the CRO and to the Chief Accountant in respect of a particular year shall be made in installments similarly to the manner of payment applying to the other members of Management.

4. Long-term award

Members of Management, including the CRO and to the Chief Accountant, as well as the Internal Auditor, are entitled to a long-term award depending on attainment by the Bank of cumulative net earnings goals over the period of the remuneration plan (the years 2011 to 2013). At the beginning of each of the years 2011, 2012 and 2013 a net earnings goal shall be determined within the framework of the Bank's annual budget and approved by the Board of Directors (hereinafter: "net earnings goal").

Soon after the approval of the Bank's annual financial statements for the year 2013, attainment by the Bank of the net earnings goals for the years 2011 to 2013 shall be examined. Reaching the targeted goal, the minimum goal or the maximum goal will entitle each member of Management to an amount of NIS 1,200 thousand, NIS 900 thousand or NIS 1,440 thousand, respectively. Each result between the minimum goal and the maximum goal will entitle them to an amount to be computed in a linear manner in accordance with the two goals between which the result lies.

5. Additional instructions

Within the framework of the plan, rules have been determined, applying upon termination of office, with respect to pending payments of award installments from prior years, the annual award in respect of the year of termination of employer/employee relations with a member of Management, and the payment of the long-term award. Rules regarding the payment of awards to Management members appointed in the course of an award year have also been determined within the framework of the plan.

16. EMPLOYEE BENEFITS (CONTINUED)

7. **Amount of the annual award for 2011.** Members of the Bank's Management, the Internal Auditor, the CRO and the Chief Accountant are entitled to an annual award in respect of the year 2011, in a total amount of NIS 4.1 million. In accordance with the terms of the plan, an amount of NIS 2.5 million out of the above award sum was in April 2012, and the balance will be divided into two deferred amounts the payment of which will be subject to the fulfillment of threshold conditions in respect of the years 2012 and 2013, respectively.

8. **Waiver of the award in respect of 2012.** In July 2012, members of the Bank's Management and the Bank's Internal Auditor (the beneficiaries of the said remuneration plan) informed of their decision (each electively) to waive the annual award due to them in respect of 2012, if and to the extent that they will be entitled to it, in accordance with the said remuneration plans. Following the decision of the senior management of Discount, and similarly to it, the members of management of Mercantile Discount Bank (the beneficiaries of the remuneration plans determined at MDB) also decided (each electively) to waive the annual award due to them in respect of 2012, if and to the extent that they will be entitled to it, in accordance with the remuneration plans approved by the respective companies in MDB. In October 2012, the Board of Directors of ICC in unison with and consent of members of the management of ICC, decided to reduce the bonus to the members of Management for 2012, by a significant rate. These decisions have been taken in continuation and in line with the savings and efficiency measures adopted by the Bank and in consideration of the existing public mood.

K. **Stock option plan for the Bank's officers.** For details regarding a stock option plan for the Bank's officers, see Note 13 E (1) and (2). For details regarding a phantom option plan for the Bank's officers, see Note 13 D (1) and (3).

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS

Consolidated

	December 31, 2012						
	Israeli currency		Foreign currency[1]				
	Non-linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	15,645	324	6,601	479	1,051	-	24,100
Securities	22,122	5,211	16,956	486	520	706	46,001
Securities borrowed or purchased under resale agreements	387	-	-	-	-	-	387
Credit granted to the public, net	68,444	17,542	24,683	4,896	2,046	-	117,611
Credit granted to the Government	1	1,612	74	-	9	-	1,696
Investments in affiliated companies	3	2	-	-	-	1,719	1,724
Buildings and equipment	-	-	-	-	-	2,962	2,962
Intangible assets and goodwill	-	-	-	-	-	142	142
Assets in respect of derivative instruments	2,865	49	341	178	71	91	3,595
Other assets	1,293	70	1,002	9	125	163	2,662
Noncurrect assets held for sale	-	-	-	-	-	-	-
Total assets	**110,760**	**24,810**	**49,657**	**6,048**	**3,822**	**5,783**	**200,880**
Liabilities							
Deposits from the public	83,620	10,363	45,435	8,394	4,123	-	151,935
Deposits from banks	1,771	257	1,604	57	31	-	3,720
Deposits from the Government	247	111	647	-	-	-	1,005
Securities loaned or sold under repurchase arrangements	-	-	5,452	-	-	-	5,452
Subordinated capital notes	3,019	9,265	-	-	-	-	12,284
Liabilities in respect of derivative instruments	3,091	514	381	369	130	91	4,576
Other liabilities	8,788	222	512	19	80	153	9,774
Total liabilities	**100,536**	**20,732**	**54,031**	**8,839**	**4,364**	**244**	**188,746**
Difference	10,224	4,078	(4,374)	(2,791)	(542)	5,539	12,134
Effect of non-hedging derivative instruments:							
Derivative instruments (except for options)	(9,624)	(867)	7,527	2,653	311	-	-
Options in the money, net (in terms of underlying asset)	187	-	(254)	33	34	-	-
Options out of the money, net (in terms of underlying asset)	(70)	-	112	(19)	(23)	-	-
Total	**717**	**3,211**	**3,011**	**(124)**	**(220)**	**5,539**	**12,134**
Options in the money, net (discounted par value)	201	-	(253)	15	37	-	-
Options out of the money, net (discounted par value)	1	-	434	(344)	(91)	-	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)

Consolidated (continued)

	December 31, 2011						
	Israeli currency		Foreign currency[1]				
	Non-linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	24,605	468	3,854	552	850	-	30,329
Securities	17,580	5,690	17,861	726	378	663	42,898
Securities borrowed or purchased under resale agreements	145	-	-	-	-	-	145
Credit granted to the public, net	64,043	18,407	26,069	5,548	2,316	-	116,383
Credit granted to the Government	26	1,590	18	-	6	-	1,640
Investments in affiliated companies	5	-	-	-	-	(3)(2)1,586	(3)(2)1,591
Buildings and equipment	-	-	-	-	-	3,080	3,080
Intangible assets and goodwill	-	-	-	-	-	152	152
Assets in respect of derivative instruments	1,672	7	*1,130	*60	*79	166	3,114
Other assets	(4)1,499	49	1,032	40	134	378	(4)3,132
Noncurrect assets held for sale	-	-	-	-	-	8	8
Total assets	**109,575**	**26,211**	**49,964**	**6,926**	**3,763**	**6,033**	**202,472**
Liabilities							
Deposits from the public	84,116	10,913	45,378	8,841	4,120	-	153,368
Deposits from banks	2,523	286	1,282	39	119	-	4,249
Deposits from the Government	244	100	581	-	-	-	925
Securities loaned or sold under repurchase arrangements	-	-	6,700	-	-	-	6,700
Subordinated capital notes	2,907	9,332	-	-	-	-	12,239
Liabilities in respect of derivative instruments	1,778	809	*1,199	*324	*156	166	4,432
Other liabilities	(2)8,340	99	591	51	64	393	(2)9,538
Total liabilities	**99,908**	**21,539**	**55,731**	**9,255**	**4,459**	**559**	**191,451**
Difference	9,667	4,672	(5,767)	(2,329)	(696)	5,474	11,021
Effect of non-hedging derivative instruments:							
Derivative instruments (except for options)	(6,850)	(1,700)	5,754	2,300	496	-	-
Options in the money, net (in terms of underlying asset)	(401)	-	292	95	14	-	-
Options out of the money, net (in terms of underlying asset)	349	-	(268)	(75)	(8)	2	-
Total	**2,765**	**2,972**	**11**	**(9)**	**(194)**	**5,476**	**11,021**
Options in the money, net (discounted par value)	(412)	-	522	52	(162)	-	-
Options out of the money, net (discounted par value)	1,194	-	(889)	(357)	49	3	-

* Reclassified between the various currencies.

Footnotes:

(1) Includes those linked to foreign currency.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8 to the financial statements.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE (CONTINUED)

A. The Bank

	December 31, 2012						
	Israeli currency		Foreign currency[1]				
	Non-linked	Linked to the CPI	In US$	In EURO	In other currencies	Non-monetary Items	Total
	NIS millions						
Assets							
Cash and deposits with banks	13,251	219	3,648	234	193	-	17,545
Securities	18,854	2,958	1,229	449	129	5	23,624
under resale agreements securities borrowed or purchased	387	-	-	-	-	-	387
Credit granted to the public, net	50,881	14,922	9,011	4,563	1,652	-	81,029
Credit granted to Governments	-	1,614	-	-	-	-	1,614
Investments in affiliated companies	808	214	-	-	-	8,154	9,176
Buildings and equipment	-	-	-	-	-	2,161	2,161
Debit balances of derivative financial instruments	2,859	45	287	177	68	85	3,521
Other assets	999	15	2	9	114	29	1,168
Total assets	**88,039**	**19,987**	**14,177**	**5,432**	**2,156**	**10,434**	**140,225**
Liabilities							
Deposits from the public	70,199	12,074	19,194	7,491	2,852	-	111,810
Deposits from banks	1,038	275	1,228	131	446	-	3,118
Deposits from the Government	112	111	-	-	-	-	223
Subordinated capital notes	327	3,628	-	-	-	-	3,955
Credit balances of derivative financial instruments	3,078	371	308	346	65	85	4,253
Other liabilities	4,688	122	86	6	30	96	5,028
Total liabilities	**79,442**	**16,581**	**20,816**	**7,974**	**3,393**	**181**	**128,387**
Difference	8,597	3,406	(6,639)	(2,542)	(1,237)	10,253	11,838
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	(8,809)	(1,254)	6,848	2,369	846	-	-
Options in the money, net, (in terms of base asset)	159	-	(226)	33	34	-	-
Options out of the money, net, (in terms of base asset)	(70)	-	112	(19)	(23)	-	-
Total	**(123)**	**2,152**	**95**	**(159)**	**(380)**	**10,253**	**11,838**
Options in the money, net, (discounted nominal value)	165	-	(217)	15	37	-	-
Options out of the money, net, (discounted nominal value)	1	-	434	(344)	(91)	-	-

Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE (CONTINUED)

A. The Bank (continued)

	December 31,2011						
	Israeli currency		Foreign currency[1]				
	Non-linked	Linked to the CPI	In US$	In EURO	In other currencies	Non-monetary Items	Total
	NIS millions						
Assets							
Cash and deposits with banks	22,609	336	2,815	265	259	-	26,284
Securities	14,630	3,250	370	662	35	13	18,960
under resale agreements Securities borrowed or purchased	145	-	-	-	-	-	145
Credit granted to the public, net	47,227	15,721	11,093	5,221	1,989	-	81,251
Credit granted to Governments	25	1,591	-	-	-	-	1,616
Investments in affiliated companies	752	229	288	-	-	(3)(2)7,809	9,078
Buildings and equipment	-	-	-	-	-	2,292	2,292
Debit balances of derivative financial instruments	1,676	4	1,075	58	71	158	3,042
Other assets	(4)1,201	15	34	7	126	221	1,604
Noncurrent assets held for sale	-	-	-	-	-	3	3
Total assets	**88,265**	**21,146**	**15,675**	**6,213**	**2,480**	**10,496**	**144,275**
Liabilities							
Deposits from the public	71,949	12,810	20,407	7,985	2,914	-	116,065
Deposits from banks	1,430	479	2,096	186	200	-	4,391
Deposits from the Government	122	99	-	-	-	-	221
Subordinated capital notes	214	3,591	-	-	-	-	3,805
Credit balances of derivative financial instruments	1,779	676	1,162	308	91	158	4,174
Other liabilities	4,358	30	175	23	10	321	4,917
Total liabilities	**79,852**	**17,685**	**23,840**	**8,502**	**3,215**	**479**	**133,573**
Difference	8,413	3,461	(8,165)	(2,289)	(735)	10,017	10,702
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	(6,367)	(1,553)	5,411	2,206	303	-	-
Options in the money, net, (in terms of base asset)	(428)	-	319	95	14	-	-
Options out of the money, net, (in terms of base asset)	351	-	(268)	(75)	(8)	-	-
Total	**1,969**	**1,908**	**(2,703)**	**(63)**	**(426)**	**10,017**	**10,702**
Options in the money, net, (discounted nominal value)	(456)	-	566	52	(162)	-	-
Options out of the money, net, (discounted nominal value)	1,196	-	(888)	(357)	49	-	-

* Reclassified.

Footnotes:

(1) Includes those linked to foreign currency.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8.

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, 2012

	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[6]	36,392	12,628	18,430	10,746	7,029
Liabilities	65,266	10,111	15,069	3,766	1,971
Difference	**(28,874)**	**2,517**	**3,361**	**6,980**	**5,058**
Derivative instruments (excluding options)	(4,602)	(1,633)	(2,341)	(144)	457
Options (in terms of underlying assets)	109	(100)	(20)	33	27
Israeli currency, CPI-linked:					
Assets	322	842	2,859	3,142	3,925
Liabilities	948	1,587	5,907	3,274	2,273
Difference	**(626)**	**(745)**	**(3,048)**	**(132)**	**1,652**
Derivative instruments (excluding options)	1	440	(800)	(344)	(639)
Options (in terms of underlying assets)	-	-	-	-	-
Foreign currency-local activity[3]:					
Assets[7]	7,234	3,743	1,214	1,412	1,342
Liabilities	17,899	6,926	7,321	347	167
Difference	**(10,665)**	**(3,183)**	**(6,107)**	**1,065**	**1,175**
Derivative instruments (excluding options)	4,601	1,193	3,141	488	182
Options (in terms of underlying assets)	(109)	100	20	(33)	(27)
Foreign currency-foreign activity of extensions:					
Assets	6,917	2,528	6,742	4,261	3,586
Liabilities	20,523	1,941	5,093	2,286	1,043
Difference	**(13,606)**	**587**	**1,649**	**1,975**	**2,543**
Derivative instruments (excluding options)	-	-	-	-	-
Non-monetary items:					
Assets	8	4	8	-	-
Liabilities	6	-	-	-	-
Difference	**2**	**4**	**8**	**-**	**-**
Options (in terms of underlying assets)	-	-	-	-	-
Total:					
Assets	50,873	19,745	29,253	19,561	15,882
Liabilities	104,642	20,565	33,390	9,673	5,454
Difference	**(53,769)**	**(820)**	**(4,137)**	**9,888**	**10,428**
Derivative instruments (excluding options)	-	-	-	-	-
Options (in terms of underlying assets)	-	-	-	-	-
B. Balance Sheet Amount at December 31, 2011					
Total:					
Assets[8]	54,173	20,783	29,180	23,130	15,148
Liabilities[8]	105,891	22,492	31,341	10,069	4,994
Difference	**(51,718)**	**(1,709)**	**(2,161)**	**13,061**	**10,154**
Derivative instruments (excluding options)[8]	-	-	-	-	-

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assetes and liabilities according to linkage base and according , to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provi.

(2) Includes past-due receivables totaling NIS 1,628 million (2011: NIS 1,461 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

							Balance sheet amount(4)		
	Over 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)
	6,317	5,916	16,298	6,124	680	120,560	1,900	110,760	4.09
	1,221	1,476	2,223	645	145	101,893	-	100,536	1.99
	5,096	**4,440**	**14,075**	**5,479**	**535**	**18,667**	**1,900**	**10,224**	**2.10**
	82	(268)	(1,330)	-	-	(9,779)	-	(9,624)	–
	22	22	20	4	-	117	-	117	–
	2,014	1,754	8,582	5,227	1,152	29,819	110	24,810	2.85
	1,392	1,393	6,860	342	-	23,976	-	20,732	2.97
	622	**361**	**1,722**	**4,885**	**1,152**	**5,843**	**110**	**4,078**	**(0.12)**
	317	477	(311)	3	-	(856)	-	(867)	–
	-	-	-	-	-	-	-	-	–
	825	1,026	2,609	279	25	19,709	496	18,060	2.53
	89	71	331	17	-	33,168	2	33,020	0.53
	736	**955**	**2,278**	**262**	**25**	**(13,459)**	**494**	**(14,960)**	**2.00**
	(399)	(209)	1,641	(3)	-	10,635	-	10,491	–
	(22)	(22)	(20)	(4)	-	(117)	-	(117)	–
	2,479	3,173	6,020	8,916	3,451	48,073	1,711	41,467	3.43
	846	1,381	1,814	-	-	34,927	134	34,214	3.01
	1,633	**1,792**	**4,206**	**8,916**	**3,451**	**13,146**	**1,577**	**7,253**	**0.42**
	-	-	-	-	-	-	-	-	–
	-	-	-	-	-	20	5,763	5,783	-
	-	-	-	-	-	6	238	244	-
	-	**-**	**-**	**-**	**-**	**14**	**5,525**	**5,539**	**-**
	-	-	-	-	-	-	-	-	–
	11,635	11,869	33,509	20,546	5,308	218,181	9,980	200,880	3.65
	3,548	4,321	11,228	1,004	145	193,970	374	188,746	2.03
	8,087	**7,548**	**22,281**	**19,542**	**5,163**	**24,211**	**9,606**	**12,134**	**1.62**
	-	-	-	-	-	-	-	-	–
	-	-	-	-	-	-	-	-	–
	12,362	9,817	33,070	16,993	3,326	217,982	10,034	202,472	3.93
	3,502	3,165	12,456	2,967	192	197,069	821	191,451	2.09
	8,860	**6,652**	**20,614**	**14,026**	**3,134**	**20,913**	**9,213**	**11,021**	**1.84**
	-	-	-	-	-	-	-	-	–

(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.
(6) Including current loan account credit facilities in the amount of NIS 4,463 million (2011: NIS 4,798 million) and an amount of NIS 1,474 million with no due date (2011: NIS 1,430 million).
(7) Including current loan account credit facilities in the amount of NIS 430 million (2011: NIS 757 million) and an amount of NIS 73 million with no due date (2011: NIS 106 million).
(8) Reclassified – cash flow differences from transactions in derivatives were reclassified from "Derivative instruments (excluding options)" to "Assets" or "Liabilities" in the balance sheet.

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, 2012

	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[6]	28,941	8,832	14,933	8,184	5,366
Liabilities	51,944	8,645	9,891	3,112	1,803
Difference	**(23,003)**	**187**	**5,042**	**5,072**	**3,563**
Derivative instruments (excluding options)	(4,630)	(1,337)	(1,938)	(4)	457
Options (in terms of base assets)	108	(101)	(26)	27	23
Israeli currency, CPI-linked:					
Assets	226	754	2,133	2,466	3,018
Liabilities	681	1,188	3,968	2,455	2,182
Difference	**(455)**	**(434)**	**(1,835)**	**11**	**836**
Derivative instruments (excluding options)	1	157	(1,249)	(425)	(618)
Options (in terms of base assets)	-	-	-	-	-
Foreign currency-local activity[3]:					
Assets[7]	7,358	3,628	1,245	1,290	1,210
Liabilities	16,585	6,977	7,019	331	178
Difference	**(9,227)**	**(3,349)**	**(5,774)**	**959**	**1,032**
Derivative instruments (excluding options)	4,629	1,180	3,187	429	161
Options (in terms of base assets)	(108)	101	26	(27)	(23)
Foreign currency-foreign activity of extensions:					
Assets	828	419	405	341	312
Liabilities	443	241	31	1	1
Difference	**385**	**178**	**374**	**340**	**311**
Derivative instruments (excluding options)	-	-	-	-	-
Non-monetary items:					
Assets	-	-	-	-	-
Liabilities	-	-	-	-	-
Difference	**-**	**-**	**-**	**-**	**-**
Total:					
Assets	37,353	13,633	18,716	12,281	9,906
Liabilities	69,653	17,051	20,909	5,899	4,164
Difference	**(32,300)**	**(3,418)**	**(2,193)**	**6,382**	**5,742**
Derivative instruments (excluding options)	-	-	-	-	-
Options (in terms of base assets)	-	-	-	-	-
B. Balance Sheet Amount at December 31, 2011					
Total:					
Assets[8]	43,339	13,564	14,590	15,664	8,927
Liabilities[8]	73,820	19,447	20,452	4,961	3,017
Difference	**(30,481)**	**(5,883)**	**(5,862)**	**10,703**	**5,910**
Derivative instruments (excluding options)[8]	-	-	-	-	-

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assets and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provi.

(2) Includes past-due receivables totaling NIS 1,510 million (2011: NIS 1,339 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.

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]: No fixed maturity date[2]	Balance sheet amount[4]: Total	The contractual rate of return,in percentages[5]
4,803	4,560	14,268	5,447	616	95,950	1,425	88,039	3.76
1,066	1,414	2,111	522	102	80,610	-	79,442	1.44
3,737	**3,146**	**12,157**	**4,925**	**514**	**15,340**	**1,425**	**8,597**	**2.32**
82	(268)	(1,330)	-	-	(8,968)	-	(8,809)	–
19	19	16	4	-	89	-	89	–
1,598	1,425	7,129	4,665	1,022	24,436	117	19,987	3.15
1,348	1,301	6,187	251	-	19,561	-	16,581	3.53
250	**124**	**942**	**4,414**	**1,022**	**4,875**	**117**	**3,406**	**(0.38)**
338	497	114	-	-	(1,185)	-	(1,254)	–
-	-	-	-	-	-	-	-	–
736	962	2,460	123	-	19,012	489	18,507	2.65
75	60	292	-	-	31,517	2	31,449	0.54
661	**902**	**2,168**	**123**	**-**	**(12,505)**	**487**	**(12,942)**	**2.11**
(420)	(229)	1,216	-	-	10,153	-	10,063	–
(19)	(19)	(16)	(4)	-	(89)	-	(89)	–
167	303	11	-	-	2,786	685	3,258	1.94
2	2	11	-	-	732	7	734	0.87
165	**301**	**-**	**-**	**-**	**2,054**	**678**	**2,524**	**1.07**
-	-	-	-	-	-	-	-	–
-	-	-	-	-	-	10,434	10,434	–
-	-	-	-	-	-	181	181	–
-	**-**	**-**	**-**	**-**	**-**	**10,253**	**10,253**	**-**
7,304	7,250	23,868	10,235	1,638	142,184	13,150	140,225	3.47
2,491	2,777	8,601	773	102	132,420	190	128,387	1.49
4,813	**4,473**	**15,267**	**9,462**	**1,536**	**9,764**	**12,960**	**11,838**	**1.98**
-	-	-	-	-	-	-	-	–
-	-	-	-	-	-	-	-	–
7,535	6,476	25,228	10,340	1,672	147,335	12,775	144,275	4.10
2,337	2,271	8,630	2,772	187	137,894	487	133,573	2.01
5,198	**4,205**	**16,598**	**7,568**	**1,485**	**9,441**	**12,288**	**10,702**	**2.09**
-	-	-	-	-	-	-	-	–

(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.

(6) Including current loan account credit facilities in the amount of NIS 2,798 million (2011: NIS 3,314 million) and an amount of NIS 1,302 million with no due date (2011: NIS 1,182 million).

(7) Including current loan account credit facilities in the amount of NIS 401 million (2011: NIS 561 million) and an amount of NIS 66 million with no due date (2011: NIS 59 million).

(8) Reclassified – cash flow differences from transactions in derivatives were reclassified from "Derivative instruments (excluding options)" to "Assets" or "Liabilities" in the balance sheet.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

A. Off-Balance Sheet Financial Instruments

	Consolidated		The Bank		Consolidated		The Bank	
	Balance (1)	Provision (2)	Balance (1)	Provision (2)	Balance (1)	Provision (2)	Balance (1)	Provision (2)
	December 31,2012				December 31,2011			
	in NIS millions							
Contract balances or their stated amounts at year end Transactions involving credit risk:								
Letters of credit	1,475	1	737	1	1,827	1	1,031	-
Credit guarantees	2,838	43	1,870	34	2,754	29	1,740	19
Guarantees for home purchasers	5,409	14	4,439	13	4,929	23	4,095	22
Other guarantees and obligations	4,620	31	3,976	26	4,905	30	4,284	25
Unutilized facilities for transactions in derivative instruments	1,024	-	966	-	771	1	710	1
Unutilized credit line for credit cards	15,482	22	4,201	6	14,450	19	4,046	7
Unutilized revolving and other credit lines	7,841	19	6,909	16	8,104	21	7,070	17
Irrevocable commitments to extend credit approved but not yet granted[3]	17,072	35	10,028	33	18,519	41	11,501	38
Commitment to issue guarantees	3,744	6	2,754	5	3,508	7	2,367	6

Footnotes:

(1) Contract balance or their stated amounts at period end before of provision for credit loss.

(2) Balance of provision for credit loss at period end.

(3) Including commitments to customers for granting credit within the framework of "an approval in principle and maintaining interest notes" in accordance with Proper Management Directive No, 451 "Procedures for the granting of housing loans".

B. Off-Balance sheet Commitment at year-end regarding activity based[1] on loan payments

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Balance of loans granted out of deposits repayable according to the repayment of the loans[2]				
Israeli currency - non linked	1,675	1,807	1,675	1,806
Israeli currency - linked to the CPI	1,146	1,255	1,111	1,218
Foreign currency	814	563	814	563
Total	**3,634**	**3,625**	**3,600**	**3,587**

Footnotes:

(1) Loans and deposits granted out of deposits, the repayment of which to the depositors is conditional upon the collection of these loans (or deposits),with a margin or with a collection commission (instead of a margin).

(2) Standing loans and government deposits made in respect thereof, totaling NIS 48 million (2011:NIS 62 million), have not been included in the table.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

Cash flows in respect of collection commissions and interest margins of activity based on loan requirements - Consolidated

	December 31,2012							2011
	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
In israeli currency, non-linked:								
Future contractual flows	-	1	-	3	4	-	8	7
Expected future flows based on Management's estimates of early repayments	-	1	-	3	4	-	8	7
Discounted expected future flows based on Management's estimates of early repayments(1)	-	1	-	2	2	-	5	3
In israeli currency, CPI-linked:								
Future contractual flows	9	15	13	24	17	-	78	84
Expected future flows based on Management's estimates of early repayments	8	13	12	22	16	-	71	60
Discounted expected future flows based on Management's estimates of early repayments(2)	8	13	12	21	12	-	66	56
In foreign currency:								
Future contractual flows	-	3	1	-	-	-	4	4
Expected future flows based on Management's estimates of early repayments	-	3	1	-	-	-	4	4
Discounted expected future flows based on Management's estimates of early repayments(3)	-	2	1	-	-	-	3	4

Information as to the granting of loans during the year by the mortgage banks:

	December 31	
	2012	2011
Loans out of deposits repayable according to the repayment of loans	1	1
Standing loans	1	1

Footnotes:

(1) The capitalization was performed according to weighted rate of 4.06% (2011: 5.29%).

(2) The capitalization was performed according to weighted rate of 0.83% (2011: 1.72%).

(3) The capitalization was performed according to weighted rate of 0.60% (2011: 1.13%).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. Contingent liabilities and other special commitments

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
1. Long-term lease contracts - rent payable in future years:				
First year	114	123	58	57
Second year	94	92	48	51
Third year	83	71	40	37
Fourth year	63	60	30	31
Fifth year	55	47	26	22
Sixth year and thereafter	249	192	107	76
Total	**658**	**585**	**309**	**274**
2. Commitment to acquire buildings and equipment	59	80	33	51
3. Commitment to invest in private investment funds and in venture capital funds	352	267	-	15

4. The Bank and Mercantile Discount Bank ("MDB"), 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 Bank's share in the risk fund as of December 31, 2012, amounts to approx. NIS 21 million, comprising 2.85% of the total risk fund at that date. The share of MDB in the Risk Fund as of December 31, 2012, amounted to NIS 5 million, comprising 0.35% of the total amount of the Risk Fund as of 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.
5. 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 MDB 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).
6. a) The Bank is committed to indemnify the subsidiary Tachlit Discount - Portfolio Management Ltd. (formerly known as Tachlit Investment House Ltd.; hereinafter - "Tachlit") in respect of liability lawsuits filed against it by a letter of guarantee as alternative to insurance according to the Engagement in Investment Consulting and in Investment Portfolio Management (Equity capital and insurance) Regulations, 2000. The letter of guarantee is over and above the liability insurance purchased by Tachlit, in an amount of not less than US$5 million. Following the merger of Mercantile Capital Markets Ltd. into Tachlit, the letter of guarantee was expanded to include also a liability deriving from the professional liability of Mercantile Capital Markets Ltd. prior to the merger. The letter of guarantee is granted for the settlement of any amount up to NIS 14.5 million, linked to the CPI of November 1998, payable or which might become payable by Tachlit and/or its employees or executives (hereinafter: "the debtor") in respect of any liability stemming from the professional responsibility of the debtor towards a customer of Tachlit, in accordance with the terms of the letter of guarantee. The guarantee is in effect until May 15, 2015, inclusive.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

b) Tachlit is committed towards Tachlit Global Dollar Ltd., previously 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.. The indemnifications granted by the Bank, as stated, have expired upon the consummation of the transaction for the sale of the basket certificates operations (see Subsection 21 below), following which the Bank no longer holds (indirectly) means of control in the companies Tachlit Global Dollar Ltd. and Tachlit Basket Certificates Ltd.

It should also be noted, regarding Tachlit's commitments towards Tachlit Dollar WorldWide Ltd. and Synergetics Ltd., as stated above in this subsection, that as part of the transaction for the sale of the basket certificates operation, the parties signed a letter of assignment, according to which all obligations and rights deriving from the basket certificates operation have been irrevocably assigned to Synergetics Ltd., with specific reference to the commitment made by Tachlit Investment House to invest in two basket certificate companies (including Tachlit Dollar WorldWide Ltd.) assigned to Synergetics Ltd. As of the present time, as long as the commitment of Tachlit towards the basket certificate companies remains in effect, Synergetics Ltd. is obligated to indemnify Tachlit in case this commitment materializes.

7. The Bank's consolidated subsidiaries 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.

8. a) The Bank's previous Articles of Association, which were amended in March 2002, prescribed that the Bank shall indemnify any person who serves or served as a representative of the Bank, or at its request, as a Director in another company in which the Bank has an interest, for the expenses incurred by such person in connection with legal proceedings instituted against him in respect of acts of commission or omission in the course of fulfilling his duties as a Director of such other company, and for an amount he is ordered to pay under a judgment handed down in such legal proceedings, including by way of a settlement to which the Bank has agreed, unless the judicial authority in such proceedings has found that the acts as aforesaid on the part of such person were performed not in good faith. The Bank is entitled to issue a letter of indemnity to any such Director of another company, including a Director of the Bank who serves as a Director in the other company, at terms and conditions approved by the Board of Directors. Accordingly, the Bank has issued letters of indemnity, unlimited as to amount, to Directors who serve or served at the Bank’s request in other companies held, directly or indirectly, by the Bank.

b) According to the Bank's Articles of Association, any employee or clerk of the Bank who is not an executive officer, will be indemnified out of the Bank's funds 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 Israel Capital Markets and Investments, Ltd. (DCM) signed a letter of indemnification, according to which it is committed to indemnify Print, its subsidiary, in respect of all of its liabilities towards third parties. The letter of indemnification will remain in effect so long as DCM owns all of the issued and paid share capital of Print. For details regarding the merger between DCM and Print, see above in Note 6 F.

e) Discount Manpikim Ltd.("Manpikim"), a wholly owned and controlled subsidiary of the Bank, 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 that were published subsequent to the date of the resolution, in accordance with the said shelf prospectus.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

f) Manpikim 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) Manpikim 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) The Bank's Board of Directors approved the granting of indemnification by Manpikim to the Board members and CEO of Manpikim, with respect to a shelf Prospectus dated June 18, 2010, and shelf offer reports issued in accordance therewith. In any event, the maximum amount of the indemnification to be granted to all Directors and the President & CEO as a group, shall not exceed the gross proceeds of the public offerings and in any event not in excess of NIS 2 billion.

i) On October 31, 2012, and subject to approval of the general meeting of shareholders of Manpikim, the Board of Directors of Manpikim approved the granting of indemnification to Directors, the CEO and the Financial Comptroller of the company, with respect to a shelf Prospectus respecting a notice of acceptance of liability within the framework of the merger dated May 31, 2012, between Discount Mortgage Issues Ltd. and Manpikim ("the merger Prospectus"), in respect of a monetary liability that may be imposed on any of them, and in respect of reasonable legal fees, in connection with the merger Prospectus and the merger, including everything stemming from them and/or related to them, directly or indirectly, on condition that in no event shall the maximum cumulative amount of the indemnification granted to all those entitled to it, exceed the sum of NIS 200 million. The indemnification is subject to approval of the general meeting of shareholders of Manpikim.

j) Concurrently with approval of the engagement in an agreement for the sale of the provident fund management activity, the Bank committed to indemnify Discount Gemel Ltd. and its executive officers under conditions and circumstances in which the Bank is permitted to grant such indemnification in accordance with the relevant provisions of the Companies Law, with respect to their activity as officers of the company relating to approval of the sale agreement and implementation of the said sale, including any financial liabilities, expenses, consultation with legal and other experts, as required, and reasonable litigation expenses, provided that the cumulative amount required to be paid by the Bank shall not exceed the consideration receivable by the Bank under the sale agreement, and provided that realization of the indemnification will not impair the capital adequacy ratio, which the Bank is required to maintain under Proper Banking Management Directive No. 311, all as stated in the indemnification letter.

k) The agreement for the sale of the provident fund management activity 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 (June 2007), 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 US1$ 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 inceremnts (for details regarding the announcement by Clal Pension and Gemel Ltd. regarding an action filed against it and a motion to approve the action as a class action suite, see item 13.3 hereunder).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

l) 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.

m) **Liability Insurance of Officers.** A special meeting of the Bank's shareholders, held on March 21, 2012, approved the Bank's engagement for the purchase of an insurance policy with respect to Directors and other Officers, as well as the Internal Auditor, who act today and who had acted in the past in the Bank and in companies in which the Bank holds, directly or indirectly, an interest of 50% or more in their equity or voting rights, including two former Officers who had acted as Directors of consolidated subsidiaries and who are also the Bank's controlling shareholders. 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, 2012 through March 31, 2013, with maximum coverage in the amount of US$150 million for an event and for the period. The insurance premium for the policy will not exceed US$765 thousand. The Bank’s part (not including the subsidiaries) in the said premium will not exceed US$450 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.

On June 16, 2011, a special General meeting of shareholders approved the Bank's engagement in a policy with respect to the responsibility of the Bank's officers and of companies in which the Bank holds, directly or indirectly, an interest of 50% or more in the equity or voting rights for a period of one year as from April 1, 2011 and until March 31, 2012. The details of the policy are as described above.

Near to the date of publication of this report, the engagement of the Bank in an officers' liability insurance policy has been approved for 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 was for a period of eighteen months starting April 1, 2013 and ending September 30, 2014. As a general rule, The details of the insurance policy are the same as those of the policy approved on March 21, 2012, as described above (except for the change according to which the insurance premium will not exceed US$640 thousand a year, the Bank's share excluding the subsidiaries will not exceed US$380 thousand a year and the Bank's participation in the case of claims against any of the Officers, shall not exceed US$50 thousand per event).

The Bank's engagement with the said insurance policy, as stated, is subject to approval of the Bank's general meeting of shareholders, to be convened at a near date.

n) **Advance exemption 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 adequacy ratio in accordance with Regulation No. 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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 some of the Bank's bye-laws, regarding the granting of exemption and indemnification to the Bank's Directors and other Officers.

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.

o) On March 21, 2012, the Bank's General Meeting of Shareholders approved changes in the Sections dealing with exemption, indemnification and insurance in the Bank's by-laws, this in the wake of the enactment of the Act for the improvement of enforcement means by the Securities Authority.

Following the amendment of the Bank's articles in November 2012, the Bank is taking action to amend the undertaking for indemnification granted to officers of the Bank, in order to add an undertaking for indemnification in respect of expenses allowable for indemnification according to the law, within the framework of administrative enforcement procedures.

p) **Exemption and a commitment to indemnify of Directors and Officers of MDB.** On November 29, 2009, MDB's General meeting of Shareholders approved the granting of a commitment to indemnify and exemption to Directors and other Officers of MDB and providing a commitment for the indemnification of other Directors and officers and of certain of its subsidiaries, who held office at MDB and at those subsidiaries since the year 2002 onwards. The said commitment to indemnify and exemption were granted in accordance with principles and group limitations approved by the Bank's board in July 2009.

Following the amendment of the Bylaws of Mercantile Discount Bank, this bank convened a general meeting of shareholders to approve the amendment of the liability for indemnification granted to its officers, so as to add indemnification in respect of administrative enforcement proceedings, which may be indemnified by law.

q) **Exemption and a commitment to indemnify Directors and Officers of ICC and Diners.** In August 2011 'ICC's and Diners' general Meeting of Shareholders approved the granting of a commitment to indemnify and exemption to Directors and other Officers of ICC and Diners, accordingly, who held office at ICC and Diners, accordingly, since the year 2011 onwards. The said commitment to indemnify and exemption were granted in accordance with principles and group limitations approved by the Bank's Board of Directors on July 2009.

r) The Bylaws of association of DCMI include a provision, enabling, under certain conditions, the granting of an advance undertaking to indemnify an officer of DCMI. In the past, DCMI committed to indemnify its former officers in respect of a liability or expenses borne by them in connection with legal procedures filed against them stemming from their activities at DCMI. The Bank approved DCMI's commitment to grant advance undertakings to indemnify its officers, acting from time to time.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

9. The Bank's practice 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 Bank's ordinary course of business. 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.

10. 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 approx. US$3 million, in favor of the MasterCard Worldwide organization, to secure the activity of ICC within the framework of the Organization.

    c) ICC has granted an indemnification for all liabilities of its subsidiary companies: C.A.L (Financing), ICC Deposits and Iatzil Finance. Diners has granted an indemnification for all liabilities of Diners Financing.

    d) As security for the liabilities of E.R.N. (Israel) Ltd., an affiliated company of ICC, towards a certain commercial bank, ICC has issued a guarantee in the amount of approx. NIS 2 million.

11. Within the framework of permits granted to the Bank for the construction of a building at 156 Herzl Street, Tel Aviv, the Bank is obligated to the Tel Aviv Municipality 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.

12. **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 Bank's Management, 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 approx. NIS 1,125 million.

    12.1 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. 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

On September 25, 2011, the Court dismissed the claim. On December 15, 2011, the Claimant filed an appeal against the decision of the Court. An order regarding the procedure for submission the summation briefs in the appeal case was issued, and the case was fixed for July 29, 2013, for the oral completion of the briefs.

12.2 On September 1, 2004, a suit in a sum of NIS 500 million was brought by the liquidators of a company against forty defendants, one of which was the Bank, to the Tel Aviv District Court.

The suit against the Bank turns on three causes only, which relate to alleged injury valued at US$4 million in respect of the sale of an asset mortgaged to the Bank, which was sold for less than its true value; alleged injury valued at US$3 million in respect of 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; and alleged injury valued at US$9 million in respect of the return of deferred payment orders to the company in liquidation without the items passing through the company's bank account. It should be noted that the liquidators claim that the Bank's behavior 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 decision of October 24, 2012, fixed three dates in April 2013, for the hearing of preliminary arguments in this case.

The parties agreed to refer to mediation. A second mediation meeting was held on March 5, 2013, and mediation proceedings are continuing.

12.3 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 and Bank Hapoalim, 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 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.

On April 15, 2008, the banks applied to the Supreme Court for permission to appeal the decision of the District Court. 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.

On May 29, 2008, the Supreme Court ruled that the Attorney General to the Government of Israel should consider joining the proceedings. The Attorney General presented on May 30, 2010, his response. The position of the Attorney General of the Government supported that of the banks in the appeal, according to which the claim should not be approved as a class action suit, due to the lack of satisfactory evidential matter demonstrating the existence of a binding arrangement. The Attorney General recommended that the case be returned to the District Court in order to examine the existence of additional evidence, which might serve as a proper basis for approval of a class action suit.

Hearing of the appeal was held on March 13, 2011 in front of an expanded panel. On November 21, 2011, the Attorney General for the Government submitted his position, according to which, the determination by the Commissioner as to the transfer of information regarding commissions, constitutes an aggregated factor in a manner that justifies the approval of the action as a class action suit. (As detailed above, in a previous response submitted in this case on May 30, 2010, to the Supreme Court by the Attorney General for the Government, the latter supported the bank's arguments). In December 2011, the banks and the claimants filed their response to the response of the Government Attorney General. On November 23, 2012, a notice was submitted on behalf of the Bank regarding the ruling of the Court with respect to the decision of the Commissioner (a decision which limits the determination to only three types of commissions). On December 30, 2012, the Attorney General for the Government presented his response, according to which, there is nothing in the decision regarding the statement of the Commissioner which would change his position, as this constitutes a cumulative factor for the approval of the claim as a class action suit.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

The hearing of the case was fixed for July 23, 2013.

12.4 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 and Bank Leumi. 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, with an ostensible existence of a binding arrangement between the banks.

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 12.3 above.

12.5 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 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 approx. NIS 770 million).

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 15 below.

The Bank filed its response on March 19, 2009.

According to the decision of the District Court of October 7, 2009, the claim will be heard together with the claim described in Section 13.2 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 (as described in section 15 below).

A motion for renewal of the proceedings in this case was filed on September 12, 2012. The Bank's response was submitted on October 11, 2012. A motion was submitted on January 10, 2013, for a decision in the application for renewal of proceedings. The case is scheduled for a preliminary hearing on March 21, 2013.

12.6 On October 29, 2009, two companies submitted a lawsuit against the Bank, MDB 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 Bank's share in the alleged damage, based on its share in the credit consortium, is approx. 10% and that of MDB is 4%.

In accordance with the decision of the District Court, the Claimants filed a monetary claim of NIS 830 million, instead of a declarative relief.

The evidence proceedings in the case were completed. Summations have been presented in writing and the parties are awaiting a ruling.

12.7 On November 2, 1997 a law suite was filed with the Tel-Aviv District Court and a motion to approve the filing as a class-action suit against Discount Mortgage Bank ("DMB") and against three additional mortgage banks regarding the charging of commissions for life assurance and property insurance of borrowers (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank). The amount set in the class-action suit is NIS 500 million, with no specific allocation to the banks involved.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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 Court decided that it will be heard only after the Supreme Court will issue a judgment with respect to the said appeal. On December 5, 2011, the Court that hears the other motion, gave the compromise agreement the validity of a Court verdict.

12.8 On June 2, 2009, a lawsuit was filed with the Tel Aviv District Court against DMB together with a motion to approve the suit as a class action suit (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank).

The cause for the claim is the charge of an early redemption commission in the case of death of one of the borrowers, as a result of exercising the life insurance policy for the settlement of the balance of the loan.

The claimant requests the Court to instruct DMB 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.

On May 1, 2012, the Court ruled for the dismissal of the claim and the motion. The Court ruled that the charging of an early repayment commission bears no relation to the reason for the early repayment, therefore, the argument of the Claimant that a commission may not be charged in the case of an involuntary repayment, is not admitted.

On June 17, 2012, the Claimant appealed the decision to the Supreme Court. An order has been given for summation of arguments, and a hearing has been fixed for October 23, 2012, for completing the arguments.

12.9 On July 13, 2011, a claim was filed with the Tel Aviv District Court together with a motion for approval of the claim as a class action suit against the Bank, Automatic Banking Services Ltd. ("ABS"), Bank Hapoalim, Bank Leumi, and the First International Bank. The Claimants argue that a customer who wishes to use the ATM machines operated by ABS is required to pay a commission as stated on the monitor of the machine, and in addition is charged by the banks with a commission for a direct banking transaction, without ABS notifying the customer of the extra commission and without providing fair disclosure of this fact. The Claimants argue that charging the commission by the banks is forbidden. The damage claimed in respect of the group as a whole is assessed by the Claimants at NIS 153 million.

According to the notice of ABS and the Claimants dated May 23, 2012, the parties are conducting mediation proceedings.

At this stage the banks are not required to submit their response for the motion for approval.

The case is fixed for a preliminary hearing on May 2, 2013.

13. 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, as well as other claims, 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 evaluate their prospects of success, and therefore no provision has been included in respect therewith.

13.1 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 (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank). The action is for an amount of NIS 105 million.

The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, since the insured amounts included the land component, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

On 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 12.7 above. 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.

On December 5, 2011, the Court that hears the other motion, gave the compromise agreement the validity of a Court verdict between the parties.

13.2 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

The action is based on the statement of the Commissioner (see item 15 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.

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 approx. 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 12.5 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, was submitted by the banks to the Antitrust Tribunal (see item 15 hereunder). A further motion for renewal of the proceedings in this case was filed on September 12, 2012. The Bank's response was submitted on October 11, 2012. A motion was submitted on January 10, 2013, for a decision in the application for renewal of proceedings. The case is scheduled for a preliminary hearing on March 21, 2013.

13.3 On July 26, 2011, Clal Pension and Gemel Ltd. ("Clal Pension and Gemel") informed the Bank of an action together with a motion for approval of the action as a class action suit (hereinafter: "action" and "motion") filed against it and against other provident and further education funds management companies (hereinafter: "the Defendants").

The said action and motion allege unlawful discrimination of members of provident and further education funds by way of charging certain of the members reduced management fees thus preferring them over the rest of the members who do not enjoy or partly enjoy the benefit of reduced management fees.

The Claimants seek to plead on their behalf and on behalf of provident funds managed by the Defendants, who had been charged with higher management fees than the minimum management fees charged to certain members of the relevant provident funds, and among other things, seek an order terminating the alleged discrimination in the charging of management fees and the refund of the excess management fees collected compared to reduced management fees charged to other members.

Within the framework of the action, the Claimants seek to assess the alleged damage in respect of a period of five years prior to the date of the action so that the period relevant to the action includes on the face of it a period of eighteen months in which certain of the relevant funds had been managed prior to their sale by the Bank group.

Clal Pension and Gemel argue that the Bank had granted indemnification undertaking, relating to the period prior to the sale of the relevant funds, which may entitle it to indemnification by the Bank (see item 8 K above).

According to the action and motion, the damage caused to the members whom the Claimant seek to represent, with respect to funds managed by Clal Pension and Gemel (which include inter-alia, but not only, the funds purchased from the Bank group), is assessed in respect of the last five years, at between NIS 324 million (the reduction in management fees to the average fees collected by the funds) and NIS 648 million (the reduction in management fees to the minimum fees collected from certain members of the funds).

On December 20, 2011, the Defendants filed their response.

On March 8, 2012, the Appellant filed a motion with the High Court of Justice against the Commissioner of the Capital Market, Insurance and Savings, requesting the enforcement on provident funds of equality in charging management fees. The Commissioner has filed a preliminary response in which he refutes all arguments of the Appellant. In its ruling dated February 26, 2013, the High Court of Justice rejected the petition. The District Court fixed a preliminary hearing for March 17, 2013, in order to exhaust in advance the proceedings before the Supreme Court.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

13.4 A lawsuit together with a motion for its approval as a class action suit was filed with the Tel Aviv District Court on September 6, 2011, against Leumi Card, Bank Leumi, Israel Credit Cards, Discount Bank, FIBI, IsraCard and Bank Hapoalim (hereinafter together: "the credit card companies and the banks"), claiming a violation by them of the Consumer Protection Act and making unlawful profits on account of class members. Class members are defined as those who had engaged with any of the said credit card companies and banks in agreements for the cross-clearing of "Visa" or "MasterCard" credit cards ("trading houses") as well as customers of such trading houses, during the past seven years, or no later than August 31, 2006. The Claimants allege that the credit card companies and the banks enjoyed exorbitant commission rates, this due to the fact that the issuer commission over the years comprised a rate higher than the fair rate, as determined in the expert opinion submitted to the Antitrust Tribunal on May 23, 2011, within the framework of a motion for approval of a binding arrangement (see Note 33 B (1) below). The compensation demanded from the credit card companies and the banks amounts to NIS 1 billion. The claim brief has not yet been submitted to the Bank or to ICC.

13.5 A claim was filed on March 7, 2012, with the Tel Aviv District Court together with a motion for approval of the claim as a class action suit, against the Bank, ABS, Bank Hapoalim, FIBI, Bank Leumi, Bank Mizrahi-Tefahot, Casponet, Israel credit cards, and other claimants.

The Claimant assesses the amount of the claim at NIS 2.3 billion in respect of all Defendants. In his claim brief, the Claimant argues that the restriction imposed on the amount of cash that may be drawn from the automatic teller machines operated by ABS and Casponet, cause monetary damage to customers wishing to draw amounts higher than the allowed maximum amounts.

A delivery of the claim was effected on November 26, 2012. The Bank has been granted an extension until April 5, 2013, for submission of its response to the motion. A preliminary hearing was set for May 19, 2013.

13.6 On May 30, 2012, the Bank was given notice of a petition to approve a claim as a class action suit. The cause of the claim is the charging of customers' accounts with various legal expenses without court approval. In addition, the plaintiff also alleges that the Bank customarily adds the amount of legal expenses that are approved by the courts to the debit balance on customers' accounts, resulting is such amounts being subject to exceptional bank interest which is higher than the interest tariffs prescribed in the Adjudication of Interest and Linkage Law. The plaintiff states that the amount of the claim cannot be estimated at this stage.

The Bank's response to the motion was submitted on November 22, 2012. A preliminary hearing took place on March 3, 2013. The hearing of proof in the case was fixed for May 13, 2013.

13.7 On July 19, 2012, a law suit together with a motion for approval of the suit as a class action suit was filed with the Jerusalem District Court against Discount Mortgage Bank Ltd. (on June 28, 2012, Discount Mortgage Bank was merged with and into the Bank). The Claimants allege that DMB had concealed from its customers the existence of a "transaction permit" (under religious law) thus causing them financial damage.

The cause of the claim and the motion is violation of good faith and accumulating wealth by collecting interest in respect of arrears in contradiction to the "transaction permit". It is also claimed that loans and credit granted by DMB carry interest that includes a punitive component in contradiction to the interest applying under the "transaction permit".

The group, which the Claimants wish to represent, includes any person or other legal entity that had engaged with the Respondent in a credit and/or loan transaction carrying interest. The Claimants fixed the amount of the claim in respect all group members at NIS 538.7 million (for details regarding a claim under similar causes served against the Bank, see item 13.8 below). Motions have recently been filed requesting to combine together the hearing of all the motions requesting the approval of class action suits in the matter of "transaction permit".

A decision was given on December 2, 2012, for the transfer of the hearing of the case to the Tel Aviv District Court.

13.8 On August 16, 2012, a claim was received together with a motion for approval of the suit as a class action suit that were filed with the Jerusalem District Court. The Claimants allege that the Bank had concealed from its customers the existence of a "transaction permit" (under religious law) thus causing them financial damage. It was also argued that loans and credit granted by the Bank carry interest that includes a punitive component in contradiction to the interest applying under the "transaction permit". The group, which the Claimants wish to represent, includes any person or other legal entity that had engaged with the Respondent in a credit and/or loan transaction carrying interest. The Claimant fixed the amount of the claim in respect of all group members at NIS 6,042 million. The Bank's reply has not yet been submitted (for details regarding a claim under similar causes served against FIBI, see Section 14 below). Motions have recently been filed requesting to combine together the hearing of all the motions requesting the approval of class action suits in the matter of "transaction permit".

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

A decision was given on December 2, 2012, for the transfer of the hearing of the case to the Tel Aviv District Court.

13.9 A lawsuit together with a motion for approval of the suit as a class action suit was submitted on October 11, 2012, to the Tel Aviv District Court, against the Bank, FIBI, Leumi Bank and Mizrahi Bank.

The matter of the lawsuit is the value date attributed by the banks to payments made by debtors directly to their account at the Debt Execution Office. According to the Claimants, the banks attribute a different and later value date to such payments, which is the date on which these amounts are received from the Debt Execution Office. In respect of the said time difference, the banks charge the debtors with interest in arrears.

The Claimants argue that at this stage it is not possible to assess the amount of the claim, since in order to do so, specific examinations would have to be made at the banks.

13.10 A claim brief and a motion for approval of the claim as a class action suit, which had been filed with the Central Region District Court, were received on November 1, 2012. The claim was filed against Israel Credit Cards, against Diners Club and against two additional companies.

The Claimant alleges that the manner in which the Respondents provided revolving credit to customers through their "YOU" credit card was misleading and misrepresented. The Claimants argue that the Respondents provide revolving credit to holders of "YOU" credit cards charging especially exorbitant interest rates as compared with the accepted interest rates in the case of bank credit, and this without disclosing to the customer the fact that they are granting him credit not asked for, and/or the rate of interest that is being charged in respect for such credit.

The group which the Claimant represents is defined as all consumers who hold "YOU" credit cards and/or those who held such cards since it was first issued in June 2006, and who made use of revolving credit.

The Claimant stated the amount of the claim for all group members at NIS 119.5 million.

13.11 The Liquidator of a construction group filed with the Jerusalem District Court two claims against the Bank and other parties. One claim, on behalf of one company in the group, is for an amount of NIS 75 million. The other claim, on behalf of another company in the group, is for an amount of NIS 45 million. The said claims were served on the Bank in March 2013.

In both claims it is argued that the Bank and the other defendants enabled the flow of funds from accounts of the said companies to accounts of private companies in the same group. The argument is that the funds in question were the proceeds of bonds which the said companies issued to the public. According to the Liquidator, the Bank and the other defendants were obligated to prevent the transfer of these funds on grounds that these transfers were not made for the benefit of the said companies.

14. 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 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. The following procedure was mentioned: On July 19, 2012, FIBI was informed of a motion for approval of a claim as a class action suit in the amount of NIS 3.4 billion. The Appellants argue that the interest on arrears charged by FIBI includes a punitive component, which according to a "transaction permit" FIBI is not permitted to charge such interest. The Appellants further argue that the FIBI concealed the existence of a "transaction permit" in order to evade its provisions, thereby misleading the Appellants.

15. Following the investigation conducted since 2004 by the Antitrust Authority, the Antitrust Commissioner ("the Commissioner") issued on April 26, 2009, a statement under Section 43(a)(1) of the Antitrust Act, 1988, according to which binding arrangements existed between Bank Hapoalim B.M., Bank Leumi Le-Israel B.M., Mizrahi-Tefahot Bank, the First International bank of Israel Ltd. and the Bank (hereinafter: "the banks"), in the matter of communication of information regarding commissions ("the Commissioner's Statement"). According to that stated in the Commissioner's decision, these binding arrangements had been in effect since the beginning of the 90's of the previous century and until the beginning of the investigation of the Antitrust Authority in the matter, in November 2004.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

Under Section 43(e) of the Antitrust Law, the decision of the Commissioner serves as prima facie evidence for its contents in any legal proceedings.

In the wake of the publication of the Statement, the Bank and the other banks submitted appeals against the statement of the Commissioner. Within the framework of the appeal proceedings, the Bank filed a motion for the dismissal of arguments and attachments to the response of the Commissioner as well as a motion ordering the Commissioner to disclose investigation material not yet submitted.

In its decision of June 18, 2012, the Antitrust Tribunal agreed with the motion filed by the banks and ordered the deletion of certain sections of the response brief submitted by the Antitrust Commissioner with respect to the appeal, which related to commissions and to a matter that were not included in the statement of the Commissioner.

The Tribunal ruled that the Commissioner's decision must refer to concrete matters and cannot be based on general statements. Furthermore, the tribunal ruled that in presenting three examples for the transfer of information, the Commissioner stated determined boundaries, and that these cannot be extended by the submission of a response brief to an appeal and to include therein arguments and evidence relating to commissions and to additional matters that were not included in the decision, and which the banks had no proper opportunity of referring to them within the framework of the hearing.

Following the said decision, the Commissioner informed the Bank on July 29, 2012, that he considers to act on his authority and publish a supplemental decision regarding the transfer of information, which was included in the parts that had been deleted from his response brief, according to which such transfers of information constituted binding arrangements. The date for the filing of the Bank's position in this matter was deferred to March 31, 2013. The Bank is examining the implications of the announcement of the Commissioner and is considering what further action should be taken.

The hearing as regards the fixing of law procedures in the appeals was deferred to April, 2013.

At this stage, it is not possible to assess the results of the said proceedings and their implications.

16. (a) Israel Discount Capital Markets and Investments Ltd. (hereinafter: "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, 2012, DCMI has a commitment to additional investments in 12 such entities amounts totaling US$93 million (as of December 31, 2011, US$55.2 million).

(b) DCMI owns approx. 19.6% of the equity of Menif. The Board of DCMI had approved in the past the granting of guarantees for projects of Menif Company up to an amount of NIS 72.8 million. This facility is expected to be gradually reduced to an amount of NIS 54.5 million (linked to the CPI) in order to match the ratio of shareholding in Menif. As of December 31, 2012, guaranties have been provided in the amount of NIS 54 million (December 31, 2011: NIS 47.1 million).

(c) In addition, MDB has a commitment to invest in six venture capital funds amounts totaling NIS 4 million, as of December 31, 2012 (December 31, 2011: NIS 7 million).

(d) Two portfolio companies held by funds, in which DCMI has an interest, were sold in the first quarter of 2013. The consideration received by DCMI from the said funds in respect of the above mentioned sales, amounted to US$19.3 million, net of a part of the consideration amount held in escrow. The gain in this respect, which DCMI is expected to recognize in the first quarter of 2013, amounts to US$9.2 million, gross before tax, based on the consideration received net of the part held in escrow.

17. **An agreement 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 has established 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).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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%. Within the framework of winning the tender, the Bank was given the right to collect loan repayments which it will grant for deductions from the State employee's salaries.

The commissions 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 Bank's tariff.

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.

18. **An agreement for provision of services to the teaching staff.** On July 11, 2007, the Bank was informed of its success in 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 are to be granted at the Bank's responsibility. On September 26, 2007, the Bank signed an agreement in this matter. The original period of engagement was for five years, as from November 1, 2007 to October 31, 2012. (The Bank has announced its decision to continue the period of benefits for the teaching staff, both existing and new customers, for five additional years).

 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 could be converted into grants according to criteria of the Ministry of Education.

 On December 31, 2012, the Accountant General and the Bank signed an Addendum to the extension of the agreement, until December 31, 2013, or until thirty days prior notice is given by the customer for the termination of the engagement and of the extension, whichever is earlier ("period of extension").

 During the period of extension the Bank shall continue to grant all the services determined in the agreement and in the tender documents.

 The Bank has also extended the effect of the unconditional self undertaking in the amount of NIS 10 million, given as part of the terms of the tender. This undertaking shall remain in effect until June 30, 2014. However, if the Government of Israel shall notify before December 31, 2013, of the termination of the engagement and of the extension being the subject of the Addendum ("early termination"), then the effect of the self undertaking will terminate at the end of six months from the date of the early termination.

19. **Sale of investment in KFS (and an option agreement for the purchase of KFS shares).** On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of it holdings in the shares of KFS - 11.01% of the issued and paid share capital of KFS at date of issue - 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 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 thought 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

Being cautious, the Bank did not take into account, in computing the provision for impairment made, the economic value attributed to the option.

20. **Sale of the remaining interest in MDB's provident fund activities.** In July 2007, MDB entered into an agreement with a group of investors, for the sale of its control (51%) of the activities of its provident funds. According to the said agreement, the activities of the provident funds were transferred to Hadas Mercantile Provident Funds, in which MDB held a 49% interest.

    On April 13, 2010, MDB informed Hadas Arazim Ltd. of its intention to exercise the PUT option, received under the said agreement, for the sale of its 49% interest in Hadas Mercantile Provident Funds.

    Within the framework of the process conducted by the parties for the implementation of the realization notice, a dispute arose between MDB and the purchasers' group regarding the proper interpretation of certain sections in the agreement relating to the computation of the sale proceeds. The amount in dispute is estimated at between NIS 14 and NIS 16 million.

    MDB recorded in the financial statements a net profit in the amount of approx. NIS 28 million, derived from the amount that is not in dispute between the parties (the amount not in dispute was transferred to MDB in accordance with an agreement between the parties).

    According to a mechanism for the settlement of disputes determined in the agreement between the parties, a referee has been appointed to settle the dispute. The arbitrator gave his decision to the parties on February 6, 2012, according to which, Mercantile Discount Bank is entitled to an additional sum in the amount of NIS 11 million. At this stage the parties have the right to appeal the arbitrator's decision, in accordance with the outline determined in advance in the agreement. Accordingly, no income has been recognized at this stage in respect of the arbitrator's decision.

21. **Sale of the basket certificate operations.** A transaction was consummated on March 24, 2011 between Tachlit, a wholly owned subsidiary of the Bank, and Dash Apex Holdings Ltd. (hereinafter - "Dash"), Synergetica Ltd. (controlled by Michael Davis) (hereinafter - "Synergetica") and Mr. Michael Davis. According to which, Tachlit sold to Synergetica its full share of the basket certificates and indices products operations conducted under the brand name of "Tachlit basket certificates", including its shares in the companies through which the said operations are being conducted (hereinafter - "the sold operations" and the "designated companies" respectively), this in consideration for NIS 68 million, subject to adjustments determined. Net gain of NIS 29 million was recorded in the 2011 financial statements, in respect of the above transaction. In computing these gains, provisions have been taken into account in accordance with the assessments of the Bank's and of Tachlit managements regarding certain indemnifications granted as part of the transaction.

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.

    b. In 2004, the Bank's Board of Directors 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 Bank's Board of Directors 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 Bank's President & CEO). These matters have not been brought for approval by the general meetings of shareholders.

    d. In May 2005, the Bank's Board of Directors resolved to approve the past Chairman an award in the amount of NIS 1,255 thousand. This matter has not 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 Bank's Board of Directors 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

g. 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").

In the demand letter, the representative of the former Chairman of the Board suggested that the issue be submitted to the decision of a third party, in order to avoid referring the case to the Court.

h. The Bank's Board of Directors 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 Bank's Board of Directors 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 the former Chairman of the Board 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, the former Chairman of the Board 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.

i. On March 16, 2009, the representative of the former chairman informed that he agrees to the Bank's demand.

j. On March 18, 2009, the Bank and the former Chairman applied to Prof. Yaakov Ne'eman to act as above.

k. On March 18, 2009, the first meeting in front of Prof. Ne'eman was held, in which 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. It should be noted that the former Chairman limited his claim to NIS 17 million (the amount provided in the Bank's books as part of the specific provision and a non-specific provision).

l. 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. 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.

m. Though in the Bank's opinion, the consent of the shareholders, including the State, to the said process was not required, and that the said process is a proper one, agreeing with the circumstances and the good of the Bank and is based on the law, the Bank and the former Chairman of the Board applied to Prof. Yaakov Neeman asking for a deferment in the proceedings conducted by him. It was further agreed that in the event that Prof. Neeman would not be able to act as an expert umpire in this matter due to his anticipated appointment as a Government Minister, than the matter would pass to an alternative expert umpire.

n. Following negotiations held in the matter, the representatives of the State informed in a letter dated May 27, 2009, that they insist on their opposition to the payments to the former Chairman, as well as to the continuation of umpireship proceedings, and that in their opinion, such payments are subject to approval of the general meeting of shareholders.

o. Following that stated above, the representative for the former Chairman approached again requesting fulfillment of the Bank's commitments and resumption of negotiations in front of an external expert, as agreed.

Further to an approach made by the representative of the past Chairman, the Bank’s Board of Directors, decided on October 31, 2011 to continue the agreed process, subject to the reaching of an agreement regarding the identity of arbitrator and subject to an additional clarification of the matter with the Israeli Securities Authority.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

p. On December 14, 2011, the former Chairman filed a motion for a declaratory verdict, within the framework of which the Court was asked to determine that the Bank is committed to a decision/clarification process that had been agreed upon by the parties.

Prior to the hearing of the claim, an agreement had been reached as to the identity of another arbitrator, and accordingly the former chairman withdrew his motion.

q. On September 27, 2012, the Bank received the reply of the Israeli Securities Authority to its request for preliminary guidance. Among other things, the Authority informed that, taking into consideration all circumstances of the matter, including the period of time that had elapsed and the changing of Directors, and in accordance with the position of the Authority as communicated to the Bank in the past, the Authority does not find it proper to intervene in the process of approval of the remuneration of the past Chairman of the Board by an agreed referee, in lieu of legal proceedings, provided that the process does not constitute a compromise process, and that within the framework of which the Bank continues to reserve all its rights and arguments.

r. Following the decision of the Securities Authority, Dr. Joshua Rosensweig was appointed an expert umpire. A preliminary meeting was held before the expert umpire on December 21, 2012, and in continuation, two further meetings were held in which witnesses on behalf of the Claimant testified. The last proof submission meeting took place on March 17, 2013, at the end of which, the parties were given the right for short summation statements.

The expert umpire will issue his ruling following the end of the proof proceedings.

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 Bank's activity 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 in the course of the engagement period is estimated at the amount of departing from the transaction with the addition of the future potential exposure as determined in Proper Banking Management Directive No. 313 regarding the computation of the limitation on borrower indebtedness. 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, some are purchased and written as part of the Bank's asset and liability management (ALM) and the balance of which if defined as other derivatives.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

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. When it is determined that the embedded derivative has economic characteristics that are not clearly and closely connected to the economic characteristics of the host contract, and also that a separate instrument having the same terms would have been qualified as a derivative instrument, 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 expires, sold, cancelled or realized;

   c. The designation of the derivative as a hedging derivative is discontinued, due to the probability of the execution of the transaction being remote;

   d. A firm hedging commitment no longer complies with the definition of a firm commitment;

   e. Management cancels the designation of the derivative as a hedging derivative.

   When hedging accounting is discontinued due to the fact that a derivative is no longer qualified as an effective fair value hedge, 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.
7. Cash flow hedge

   The subsidiary IDB New York designates certain derivatives as hedge for cash flow. The accounting treatment of the change in the fair value of derivatives that hedge exposure to the change in the cash flow produced by an asset, liability or an anticipated transaction is dependent on the effectiveness of hedge ratios.

   - The effective part of the change in the fair value of a derivative, designated as a cash flow hedge, is reported in the first place in equity, as a component of other comprehensive income, and then, when the anticipated transaction affects the statement of income, it is classified to the statement of income.
   - The non-effective part of the change in the fair value of the derivative designated as above is immediately recognized in the statement of income.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. Volume of activity on a consolidated basis

	December 31, 2012				
	Interest rate contracts				
	Shekel/CPI	Other	Foreign currency contracts	Contracts on shares	Commodities and other contracts
	in NIS millions				
1. Par value of derivative instruments					
A. Hedging derivatives[1]					
Swaps	-	1,525	-	-	-
Total	**-**	**1,525**	**-**	**-**	**-**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	1,525			
B. ALM derivatives[1][2]					
Futures contracts	-	30	-	-	-
Forward contracts	3,723	6,529	12,043	-	-
Marketable option contracts					
Options written	-	-	465	-	-
Options purchased	-	-	465	-	-
Other option contracts					
Options written	-	900	7,444	-	-
Options purchased	-	1,600	7,243	*-	-
Swaps	-	67,914	47,798	-	-
Total	**3,723**	**76,973**	**75,458**	**-**	**-**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	35,514			
C. Other derivatives[1]					
Futures contracts	-	-	-	-	8
Forward contracts	-	-	838	-	16
Marketable option contracts					
Options written	-	-	4	5,552	3
Options purchased	-	-	4	5,552	3
Other option contracts					
Options written	-	154	242	233	138
Options purchased	-	157	244	233	138
Swaps	-	4,191	147	-	-
Total	**-**	**4,502**	**1,479**	**11,570**	**306**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	2,314			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts			1,549		

* An amount lower than NIS 1 million

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, 2011				
	Interest rate contracts				
	Shekel/CPI	Other	Foreign currency contracts	Contracts on shares	Commodities and other contracts
	in NIS millions				
1. Par value of derivative instruments					
A. Hedging derivatives[(1)]					
Swaps	-	686	-	-	-
Total	**-**	**686**	**-**	**-**	**-**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	686			
B. ALM derivatives[(1)(2)]					
Futures contracts	-	[(3)]764	-	-	-
Forward contracts	2,476	5,556	16,359	-	-
Marketable option contracts					
Options written	-	-	303	-	-
Options purchased	-	-	389	-	-
Other option contracts					
Options written	-	-	12,251	191	-
Options purchased	-	-	11,144	*-	-
Swaps	-	64,579	38,352	-	-
Total	**2,476**	**70,899**	**78,798**	**191**	**-**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	33,563			
C. Other derivatives[(1)]					
Futures contracts	-	-	-	-	[(3)]36
Forward contracts	-	-	449	-	93
Marketable option contracts					
Options written	-	[(3)]5	533	5,760	[(3)]3
Options purchased	-	[(3)]5	533	5,760	[(3)]3
Other option contracts					
Options written	-	560	346	151	1,374
Options purchased	-	560	586	152	1,290
Swaps	-	790	103	-	-
Total	**-**	**1,920**	**2,550**	**11,823**	**2,799**
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	395			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts			2,274		

* An amount lower than NIS 1 million

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.

(3) Correction of par value calculation.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. Volume of activity on a consolidated basis (continued)

	Interest rate contracts				
	Shekel/CPI	Other	Foreign currency contracts	Contracts on shares	Commodities and other contracts
	in NIS millions				
	December 31, 2012				
2. Gross fair value of derivative instruments					
A. Hedging derivatives					
Positive gross fair value	-	1	-	-	-
Negative gross fair value	-	63	-	-	-
B. ALM derivatives[(1)]					
Positive gross fair value	12	2,433	1,150	-	-
Negative gross fair value	76	2,748	1,657	-	-
C. Other derivatives					
Positive gross fair value	-	52	8	111	3
Negative gross fair value	-	51	14	110	3

	December 31, 2011				
A. Hedging derivatives					
Positive gross fair value	-	-	-	-	-
Negative gross fair value	-	37	-	-	-
B. ALM derivatives[(1)]					
Positive gross fair value	2	1,931	1,055	*-	-
Negative gross fair value	79	2,261	1,942	1	-
C. Other derivatives					
Positive gross fair value	-	41	38	177	27
Negative gross fair value	-	37	19	177	27

* An amount lower than NIS 1 million

Footnotes:

(1) 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)

B. Derivative instrument credit risk based on the counterparty to the contract on a consolidated basis

	Stock Exchange	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	In NIS millions					
	December 31, 2012					
Gross positive fair value of derivative instruments(1)	62	3,165	11	-	532	3,770
Net of set-off agreements	16	57	-	-	59	132
Balance of assets stemming from derivative instruments(2)	46	3,108	11	-	473	3,638
Off-balance sheet credit risk in respect of derivative instruments(3)	-	280	32	81	884	1,277
Total credit risk in respect of derivative instruments	**46**	**3,388**	**43**	**81**	**1,357**	**4,915**
	December 31, 2011					
Gross positive fair value of derivative instruments(1)	91	2,583	31	-	566	3,271
Net of set-off agreements	11	27	-	-	88	126
Balance of assets stemming from derivative instruments(2)	80	2,556	31	-	478	3,145
Off-balance sheet credit risk in respect of derivative instruments(3)	-	251	84	100	1,139	1,574
Total credit risk in respect of derivative instruments	**80**	**2,807**	**115**	**100**	**1,617**	**4,719**

Footnotes:

(1) Of which, NIS 43 million (December 31, 2011:NIS 31 million) of positive gross fair value of derivative instruments.

(2) Of which, a balance of non-related derivative instruments of NIS 3,595 million (December 31, 2011:NIS 3,114 million)

(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 and balances

	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Total
	In NIS millions				
	December 31, 2012				
Interest rate contracts					
Shekel/CPI	625	1,650	1,200	248	3,723
Other	13,723	17,137	32,008	20,132	83,000
Foreign currency contracts	48,318	21,763	4,485	3,920	78,486
Contracts on shares	11,076	100	394	-	11,570
Commodities and other contracts	7	23	276	-	306
Total	**73,749**	**40,673**	**38,363**	**24,300**	**177,085**
	December 31, 2011				
Interest rate contracts					
Shekel/CPI	458	888	792	338	2,476
Other	(1)9,904	(1)17,512	26,510	19,579	73,505
Foreign currency contracts	51,417	25,342	4,109	2,754	83,622
Contracts on shares	9,951	1,836	227	-	12,014
Commodities and other contracts	(1)2,403	(1)191	205	-	2,799
Total	**74,133**	**45,769**	**31,843**	**22,671**	**174,416**

Footnote:
(1) Corrected computation of the nominal value of "Futures" transactions.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS

A. GENERAL

The instruction of the 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 Bank's economic value, nor does the data purport to assess such value.

B. FAIR VALUE OF FINANCIAL INSTRUMENTS

Most of the Bank's financial instruments 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 and the effect of the non-controlling interests and the tax effect were not included.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

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 Bank's value 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, net - 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 (net of the effect of accounting write-offs and allowances for credit losses) 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, 2012, the Bank has classified some 95% of the indebtedness which has to be classified according to the directives of the Supervisor of Banks (December 31, 2011: 97%). The discounting interest rates have, generally, been determined according to the interest rates used in similar transactions made by the bank as of the date of the report.

In certain cases, where grading data is not available, the segmentation is made on the basis of an overall evaluation of the risk level relating to the business sectors in which the borrowers operate. In this respect, it should be noted that the general risk level, as evaluated for a particular business sector, is not necessarily identical to the risk level of a particular borrower operating in that sector, none the less, to the risk level relating to the credit which the Bank grants to that borrower.

The fair value of impaired debts was computed using discount interest rates reflecting the high credit risk inherent therein. In any case, these discounting rates were not lower than the highest interest rate used by the Bank in its transactions as of the date of the report.

Increasing the discount interest rate by 1 basis point would have reduced the fair value of the problematic debts by NIS 50 million. Increasing the discount interest rate by 0.1 basis point would have reduced the fair value of the problematic debts by NIS 3 million (compared to NIS 72 million and NIS 5 million, respectively, as of December 31, 2011).

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 80 million (compared to NIS 111 million at December 31, 2011). The average period to maturity of assets in the CPI-linked segment, based on the original cash flow, which does not take into consideration early redemptions, reached on December 31, 2012 4.04 years, compared to 3.70 years, taking into consideration the forecast for early redemptions.

The general, supplemental and special allowances 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, bonds 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 subordinated capital 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.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

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 2 million (compared to NIS 7 million at December 31, 2011). The average period to maturity of liabilities in the CPI-linked segment, based on the original cash flow, which does not take into consideration early redemptions, reached on December 31, 2012 3.84 years, compared to 3.79 years, taking into consideration the forecast for early redemption.

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.

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[4]

	December 31, 2012				
		Fair value			
	Book value	Level 1[1]	Level 2[1]	Level 3[1]	Total
	in NIS millions				
Financial assets:					
Cash and deposits with banks	24,100	7,973	-	16,116	24,089
Securities[2]	46,001	29,277	16,533	641	46,451
Securities borrowed or purchased under resale agreements	387	-	-	387	387
Credit to the public, net	117,611	1,528	5	116,528	118,061
Credit to the Government	1,696	-	-	1,676	1,676
Assets in respect of derivative instruments	3,727	112	3,201	414	3,727
Other financial assets	1,108	14	43	1,051	1,108
Influence of deduction agreements	(132)	-	-	-	(132)
Total financial assets	**[3]194,498**	**38,904**	**19,782**	**136,813**	**195,367**
Financial liabilities:					
Deposits from the public	151,935	16,888	113,796	21,714	152,398
Deposits from banks	3,720	102	3,088	569	3,759
Deposits from the Government	1,005	3	788	226	1,017
Securities loaned or sold under buy-back arrangements	5,452	-	-	6,067	6,067
Subordinated capital notes	12,284	11,032	83	2,847	13,962
Liabilities in respect of derivative instruments	4,708	113	4,041	554	4,708
Other financial liabilities	7,652	356	14	7,282	7,652
Influence of deduction agreements	(132)	-	-	-	(132)
Total financial liabilities	**[3]186,624**	**28,494**	**121,810**	**39,259**	**189,431**
Off-balance sheet financial instruments					
Transactions involving credit risk	71	-	-	71	71

Footnotes:

(1) Level 1 - fair value measurements using quoted prices in an active market. Level 2 - fair value measurements using other significant observable inputs. Level 3 - fair value measurements using significant unobservable inputs.

(2) For further details of the stated balance sheet amount and the fair value of securities, see Note 2.

(3) Of which: assets and liabilities in the amount of NIS 52,073 million and NIS 46,482 million, respectively, the stated balance sheet amounts of which are identical to their fair value (instruments stated in the balance sheet at their fair value). For additional information regarding instruments measured at fair value on a recurrent basis and on a non-recurrent basis, see Notes 21 E - 21 F.

(4) Following the adoption of the updated accounting standard ASU 2011-04, in the matter of measurement of fair value, the presentation format of the Note has been changed. The instruction is applied by the "from now onwards" method, therefore the disclosure format for the comparative data has not been adjusted.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

D. Composition - consolidated[3] (continued)

	December 31, 2011			
	Stated balance			Fair value
	(1)	(2)	Total	
	in NIS millions			
Financial assets:				
Cash and deposits with banks	*6,472	*23,857	30,329	30,341
Securities	36,378	6,520	42,898	43,118
Securities borrowed or purchased under resale agreements	-	145	145	145
Credit to the public, net	*13,025	*103,358	116,383	116,363
Credit to the Government	24	1,616	1,640	1,640
Assets in respect of derivative instruments	3,114	-	3,114	3,114
Other financial assets	1,219	-	1,219	1,219
Total financial assets	**60,232**	**135,496**	**195,728**	**195,940**
Financial liabilities:				
Deposits from the public	*33,565	*119,803	153,368	153,694
Deposits from banks	*1,362	*2,887	4,249	4,246
Deposits from the Government	547	378	925	931
Securities loaned or sold under buy-back arrangements	-	6,700	6,700	7,415
Subordinated capital notes	-	12,239	12,239	13,047
Liabilities in respect of derivative instruments	4,432	-	4,432	4,432
Other financial liabilities	7,256	-	7,256	7,256
Total financial liabilities	**47,162**	**142,007**	**189,169**	**191,021**

* Reclassified between columns (1) and (2)

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.

(3) Following the adoption of the updated accounting standard ASU 2011-04, in the matter of measurement of fair value, the presentation format of the Note has been changed. The instruction is applied by the "from now onwards" method, therefore the disclosure format for the comparative data has not been adjusted.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. Items measured at fair value - consolidated

1. Items measured at fair value on a recurring basis

	December 31, 2012					
	Fair value measurements using -					
	Quoted prices in an active market (level 1)	Other significant observable inputs (level 2)	Significant unobservable inputs (level 3)	Influence of deduction agreements	Total fair value	Book value
	In NIS millions					
Assets						
Available for sale securities						
Of the Israeli Government	19,760	850	-	-	20,610	20,610
Of foreign governments	238	679	-	-	917	917
Of Israeli financial institutions	680	49	-	-	729	729
Of foreign financial institutions	36	2,531	-	-	2,567	2,567
Mortgage-backed-securities and Assets -backed-securities	-	9,754	-	-	9,754	9,754
Of others in Israel	499	206	-	-	705	705
Of others abroad	-	74	-	-	74	74
Shares	59	4	-	-	63	63
Total available-for-sale securities	**21,272**	**14,147**	**-**	**-**	**35,419**	**35,419**
Trading Securities						
Of the Israeli Government	2,822	-	-	-	2,822	2,822
Of foreign governments	-	4	-	-	4	4
Of Israeli financial institutions	19	-	-	-	19	19
Of foreign financial institutions	-	33	-	-	33	33
Mortgage-backed-securities and Assets -backed-securities	-	53	-	-	53	53
Of others in Israel	18	-	-	-	18	18
Of others abroad	-	2	-	-	2	2
Shares	1	1	-	-	2	2
Total trading securities	**2,860**	**93**	**-**	**-**	**2,953**	**2,953**
Credit to the public in respect of securities loaned	1,528	5	-	-	1,533	1,533
Assets in respect of derivative instruments						
Shekel/CPI Interest Rate Contracts	-	-	12	-	12	12
Other Interest Rate Contracts	-	2,406	80	-	2,486	2,486
Foreign Exchange Contracts	6	787	322	(117)	998	998
Equity Derivative Contracts	106	5	-	(15)	96	96
Commodity and other Contracts	-	3	-	-	3	3
Total assets in respect of derivative instruments	112	3,201	414	(132)	3,595	3,595
Other	-	43	-	-	43	43
Assets in respect of the "Maof" market operations	14	-	-	-	14	14
Total assets	**25,786**	**17,489**	**414**	**(132)**	**43,557**	**43,557**
Liabilities						
Deposit from the public in respect of securities borrowed	694	10	-	-	704	704
Liabilities in respect of derivative instruments						
Shekel/CPI Interest Rate Contracts	-	-	76	-	76	76
Other Interest Rate Contracts	-	2,856	-	-	2,856	2,856
Foreign Exchange Contracts	7	1,185	478	(117)	1,553	1,553
Equity Derivative Contracts	106	-	-	(15)	91	91
Commodity and other Contracts	-	-	-	-	-	-
Total liabilities in respect of derivative instruments	113	4,041	554	(132)	4,576	4,576
Other	-	14	-	-	14	14
Commitments in respect of the "Maof" market operations	14	-	-	-	14	14
Short sales of securities	342	-	-	-	342	342
Total liabilities	**1,163**	**4,065**	**554**	**(132)**	**5,650**	**5,650**

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. Items measured at fair value - consolidated

1. Items measured at fair value on a recurring basis (continued)

	December 31, 2011					
	Fair value measurements using -					
	Quoted prices in an active market (level 1)	Other significant observable inputs (level 2)	Significant unobservable inputs (level 3)	Influence of deduction agreements	Total fair value	Book value
	In NIS millions					
Assets						
Available for sale securities						
Of the Israeli Government	16,624	367	-	-	16,991	16,991
Of foreign governments	145	692	-	-	837	837
Of Israeli financial institutions	758	4	-	-	762	762
Of foreign financial institutions	58	2,009	-	-	2,067	2,067
Mortgage-backed-securities and Assets -backed-securities	-	11,842	-	-	11,842	11,842
Of others in Israel	123	155	-	-	278	278
Of others abroad	-	199	-	-	199	199
Shares	22	11	-	-	33	33
Total available-for-sale securities	**17,730**	**15,279**	**-**	**-**	**33,009**	**33,009**
Trading Securities						
Of the Israeli Government	3,037	181	-	-	3,218	3,218
Of foreign governments	-	6	-	-	6	6
Of Israeli financial institutions	4	-	-	-	4	4
Of foreign financial institutions	-	45	-	-	45	45
Mortgage-backed-securities and Assets -backed-securities	-	54	-	-	54	54
Of others in Israel	27	-	-	-	27	27
Of others abroad	-	10	-	-	10	10
Shares	3	2	-	-	5	5
Total trading securities	**3,071**	**298**	**-**	**-**	**3,369**	**3,369**
Credit to the public in respect of securities loaned	1,191	-	-	-	1,191	1,191
Assets in respect of derivative instruments*						
Shekel/CPI Interest Rate Contracts	-	-	2	-	2	2
Other Interest Rate Contracts	-	1,868	104	-	1,972	1,972
Foreign Exchange Contracts	15	702	345	(111)	951	951
Equity Derivative Contracts	175	2	-	(10)	167	167
Commodity and other Contracts	2	13	12	(5)	22	22
Total assets in respect of derivative instruments	192	2,585	463	(126)	3,114	3,114
Other	-	31	-	-	31	31
Assets in respect of the "Maof" market operations	211	-	-	-	211	211
Total assets	**22,395**	**18,193**	**463**	**(126)**	**40,925**	**40,925**
Liabilities						
Deposit from the public in respect of securities borrowed	490	18	-	-	508	508
Liabilities in respect of derivative instruments						
Shekel/CPI Interest Rate Contracts	-	-	79	-	79	79
Other Interest Rate Contracts	5	2,322	-	-	2,327	2,327
Foreign Exchange Contracts	14	1,070	873	(111)	1,846	1,846
Equity Derivative Contracts	175	2	-	(10)	167	167
Commodity and other Contracts	2	16	-	(5)	13	13
Total liabilities in respect of derivative instruments	196	3,410	952	(126)	4,432	4,432
Other	-	22	-	-	22	22
Commitments in respect of the "Maof" market operations	211	-	-	-	211	211
Short sales of securities	23	-	-	-	23	23
Total liabilities	**920**	**3,450**	**952**	**(126)**	**5,196**	**5,196**

*Derivative instruments, the credit risk in their respect is determined on the basis of unobservable inputs, have been moved from Level 2 to Level 3, in accordance with the clarification of the Supervisor of Banks.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. Items measured at fair value - consolidated

2. Items measured according to fair value not on a recurring basis

	December 31, 2012					
	Level 1	Level 2	Level 3	Total fair value		Loss for the year ended December 31,2012
	In NIS millions					
Impaired credit the collection of which is collateral dependent	-	-	786	786	-	200
Other	-	12	-	12	-	2

F. Changes in items measured at fair value on a recurring basis included in item 3 - consolidated

1. For 2012:

	Fair value as at December 31, 2011	Total realized and non realized gains (losses) included in the statement of income	Issuences	Acquisitions	Clearings	Transfers to or from level 3	Fair value as at December 31, 2012	Non realized losses in respect of held instruments as at December 31, 2012
	in NIS millions							
Net Liabilities in respect of derivative instruments(2)								
Interest Rate Contracts	(77)	(1)(12)	-	-	25	-	(64)	(1)(10)
Foreign Exchange Contracts	(814)	(1)(14)	-	-	367	28	(433)	(1)(146)

Footnotes:

(1) Included in the statement of income in the item "non-interest financing income"

(2) Excluding (with the approval of the Supervisor of Banks) derivative instruments, in respect of which the credit risk is determined on the basis of unobservable inputs, which have been reclassified to Level 3, in accordance with a clarification of the Supervisor of Banks.

2. For 2011:

	Fair value as at December 31, 2010	Total realized and non realized gains (losses) included in the statement of income	Issuences	Acquisitions	Clearings	Transfers to or from level 3	Fair value as at December 31, 2011	Non realized gains (losses) in respect of held instruments as at December 31, 2011
	in NIS millions							
Net Liabilities in respect of derivative instruments(2)								
Interest Rate Contracts	(55)	(1)(32)	-	-	10	-	(77)	(1)(33)
Foreign Exchange Contracts	(962)	(1)28	(281)	278	123	-	(814)	(1)53

Footnotes:

(1) Included in the statement of income in the item "non-interest financing income",

(2) Excluding (with the approval of the Supervisor of Banks) derivative instruments, in respect of which the credit risk is determined on the basis of unobservable inputs, which have been reclassified to Level 3, in accordance with a clarification of the Supervisor of Banks.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

G. Transfers between hierarchy levels of fair value

In the second quarter of 2012, all of the exotic options were transferred from Level 3 to Level 2, since the significant unobservable input have become observable (total of NIS 28 million as of June 30, 2012).

In the third quarter of 2012, in accordance with a clarification of the Supervisor of Banks, derivative instruments, the credit risk in respect of which is measured on the basis of unobservable inputs, were reclassified from Level 2 to Level 3 (a total amount of NIS 357 million as of September 30, 2012).

H. Additional details regarding significant unobservable inputs and valuation techniques used for the measurement of fair value of items classified to level 3

1. Quantitative information regarding the measurement of fair value at level 3

	Fair value as at December 31, 2012	Valuation Techniques	Unobservable inputs	Range of Inputs (Weighted Average)
	In NIS millions			In %
Impaired credit the collection of which is collateral dependent	786	Discounted cash flow, assessments and evaluation	Discount rate, real estate market inputs	
Net Liabilities in respect of derivative instruments				
Shekel/CPI Interest Rate Contracts	(64)	Discounted cash flow	One year period inflation expectations	0.34%-2.38% (1.66%)
Foreign Exchange Contracts	(433)	Discounted cash flow	One year period inflation expectations	0.32%-2.39% (1.77%)

2. Qualitative information regarding the measurement of fair value at level 3

Significant unobservable inputs, which were used to measure the fair value of derivative financial instruments, are expectations of inflation up to one year.

As the inflation forecasts rise (fall) and the Bank commits to pay the index-linked amount, so the fair value falls (rises). As the inflation forecasts rise (fall) and the counterparty to the transaction is obligated to pay the Bank the index-linked amount, so the fair value rises (falls).

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

General - This Note is presented for the first time in accordance with the format determined by the Supervisor of Banks, within the framework of adoption of IAS-24 (see Note 1 d 25 above).

A. Balances

	December 31, 2012							
	Interested parties[1]						Related parties held by the Bank[1]	
	Controlling Shareholders[2]		Key management personnel[3]		Others[4]		Affiliated[5]	
	(6)	(7)	(6)	(7)	(6)	(7)	(6)	(7)
	in NIS millions							
Assets:								
Deposits with banks	-	-	-	-	-	-	23	402
Credit to the public	-	-			273	365	296	387
Allowance for credit loss	-	-	-	-	(10)	(10)	(1)	(1)
Credit to the public, net	-	-			263	355	295	386
Investments in affiliated companies[8]	-	-	-	-	-	-	1,724	1,724
Other assets	-	-	-	-	1	1	32	82
Liabilities:								
Deposits from the public	7	11	4	6	6	21	2,524	3,909
Deposits from banks	-	-	-	-	-	-	112	163
Subordinated capital notes	-	-	-	-	-	-	8	9
Other liabilities	-	-	27	27	29	29	41	57
Shares (included in shareholders' equity)[9]	2,978	2,978	**-	**-	-	-	-	-
Credit risk in sheet financial off-balance- instruments[10]	3	3	2	2	11	16	98	124

* In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 1 million for credit received by a third party .

** Amount lower than NIS 1 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, 2011							
	Interested parties[1]						Related parties held by the Bank[1]	
	Controlling Shareholders[2]		Key management personnel[3]		Others[4]		Affiliated[5]	
	[6]	[7]	[6]	[7]	[6]	[7]	[6]	[7]
	in NIS millions							
Assets:								
Deposits with banks	-	-	-	-	-	-	36	39
Credit to the public	-	-	1	1	137	263	408	594
Allowance for credit loss	-	-	-	-	(1)	(7)	(1)	(2)
Credit to the public, net	-	-	1	1	136	256	407	592
Investments in affiliated companies[8]	-	-	-	-	-	-	[12][13]1,591	[12][13]1,591
Other assets	-	-	-	-	1	1	53	114
Liabilities:								
Deposits from the public	3	4	2	2	56	61	3,471	3,833
Deposits from banks	-	-	-	-	-	-	116	195
Subordinated capital notes	-	-	-	-	-	-	4	5
Other liabilities	-	-	33	33	19	20	58	68
Shares (included in shareholders' equity)[9]	[12][13][14]2,693	[12][13][14]2,693	**-	**-	-	-	-	-
Credit risk in sheet financial off-balance-instruments[10]	3	3	1	1	-	-	96	1,066

* In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 10 million for credit received by a third party .

** Amount lower than NIS 1 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

	in NIS millions			
	Interested parties[1]			Related parties held by the Bank[1]
	Controlling Shareholders[2]	Key management personnel[3]	Others[4]	Affiliated companies[5]
	For the year ended December 31, 2012			
Interest income, net*	-	-	13	(73)
credit loss expenses	-	-	(9)	-
Non-interest income	-	-	(12)	(50)
Operational and other expenses**	-	(42)	-	(43)
Total	**-**	**(42)**	**(8)**	**(166)**
	For the year ended December 31, 2011			
Interest income, net*[11]	-	-	10	(71)
credit loss expenses	-	-	-	(1)
Non-interest income[11]	-	-	3	82
Operational and other expenses**	-	(55)	-	(29)
Total	**-**	**(55)**	**13**	**(19)**
	For the year ended December 31, 2010			
Interest income, net*	-	-	4	(41)
credit loss expenses	-	-	-	-
Non-interest income[11]	-	-	5	10
Operational and other expenses**	-	(58)	-	(23)
Total	**-**	**(58)**	**9**	**(54)**

* See Note D.
** See Note C.

C. Remuneration and any other benefit to interested parties (from the banking corporation and from investee companies)

	For the year ended December 31					
	2012		2011		2010	
	Key management personnel[4]		Key management personnel[4]		Key management personnel[4]	
	Total benefit	Number of benefit Recipients	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	38	17	49	21	52	15
Directors who are not employed by the Bank or on its behalf	4	14	6	15	6	18
Total	**42**	**31**	**55**	**36**	**58**	**33**

* Of which short-term employee benefits: NIS 33 million, other long-term benefits and post employment benefits: NIS 3 million; share based payments NIS 2 million.
** Of which short-term employee benefits: NIS 45 million, other long-term benefits and post employment benefits: NIS 8 million: NIS 4 million share based payments reduction of expense.
*** Of which short-term employee benefits: NIS 39 million, other long-term benefits and post employment benefits: NIS 5 million: NIS 8 million share based payments.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

D. Interest income, net, in transactions of the Bank and its consolidated subsidiaries with related and interested parties*

	Consolidated			Of which from Affiliated Companies		
	2012	2011(11)	2010(11)	2012	2011(11)	2010(11)
	in NIS millions					
A. On assets						
Credit to the public	18	20	8	5	9	4
Deposits with Banks	-	-	(1)	-	-	(1)
Total	**18**	**20**	**7**	**5**	**9**	**3**
B. On liabilities						
Deposits from the public	(71)	(69)	(17)	(71)	(68)	(17)
Deposits from the banks	(7)	(11)	(26)	(7)	(11)	(26)
Subordinated capital notes	-	(1)	(1)	-	(1)	(1)
Total	**(78)**	**(81)**	**(44)**	**(78)**	**(80)**	**(44)**
Total Interest income, net	**(60)**	**(61)**	**(37)**	**(73)**	**(71)**	**(41)**

* 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 & D:

(1) Interested party – as defined in item 80 d (4) of the Public Reporting Directives.
Related party – as defined in International Accounting Standard 24 Disclosure regarding a related party who is not an interested party.
(2) Controlling shareholder – as defined in the Securities Law.
(3) Key management personnel – in accordance with item 80 d (4) of the Public Reporting Directives.
(4) In accordance with item 80 d (5) of the Public Reporting Directives.
(5) Affiliated companies - In accordance with item 80 d (8) of the Public Reporting Directives.
(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 Investments in Investee Companies - Note 6.
(9) Holdings of interested parties and of related parties in the equity of the banking corporation.
(10) Credit risks in off-balance sheet financial instruments as computed for restrictions on the indebtedness of borrowers.
(11) Reclassified, following initial implementation of the Supervisor of Banks directive in the matter of a new format of the Statement of Income, see Note 1 C 5.1 to the financial statements.
(12) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2 to the financial statements.
(13) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.
(14) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

E. 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 core controlling interest in 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 that 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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

F. Remuneration for the acting Chairman of the Board and to the acting President & CEO

Employment agreement with the Chairman of the Board. The Bank's Chairman of the Board took office on January 3, 2010. Following receipt of the confirmation of the Audit Committee of the Board and following a review of the recommendation of an ad-hoc Committee of the Board in the matter of the remuneration to the Chairman of the Board, the Board of Directors resolved on October 4, 2010, to approve the Bank's engagement in a personal employment agreement with the Bank's Chairman of the Board. The period of the agreement will be five years beginning on January 3, 2010 (hereinafter: "the agreement period"). The Chairman's Employment agreement was approved by a special General Meeting of Shareholders held on November 10, 2010.

Among other things, the agreement provides to the Chairman of the Board a onetime signature award by the Bank, in the amount of NIS 500 thousands, in respect of the short period of time that had elapsed between the date on which he was offered the position of Chairman of the Board and the date on which he assumed the office.

The Chairman of the Board of Directors is engaged in a full-time position and is not entitled to engage in any other fully paid occupation without the prior consent of the Board of Directors. In consideration for executing his duties, the Chairman is entitled to a monthly salary of NIS 150,000, to be updated every three months in accordance with the rise in the CPI as compared with the CPI published in January of 2010.

The Chairman is entitled to an annual award, as detailed in subsection (h) below. The Chairman is also entitled to remuneration of the "phantom" type, derived from the performance of the Bank's shares, as detailed in Note 13 D (1). The agreement states also the duties imposed on the Chairman, among which are a "cooling-off" and non-competition periods of six months and a confidentiality duty.

The Chairman is entitled to paid vacation, sick leave, convalescence pay and a suitable motor vehicle, social benefits (severance pay in accordance with the Law, provident fund, loss of work ability insurance and further education fund) as well as other benefits.

Upon termination of office, the Chairman is entitled, according to the agreement, to severance pay under the Law, this in addition to his entitlement to the funds and rights accumulated in his favor in respect of the provisions for pension to be created by the Bank. In addition, the Chairman is entitled to early notice of six months, during which he will be entitled to remuneration and related benefits in accordance with the agreement and to an adaptation period of six months.

However, if the early notice period begins before the end of three years since the beginning of the agreement period, following termination of office initiated by the Bank, or, alternatively, due to the transfer of control of the Bank, then the adaptation period will be nine months. During the adaptation period the Chairman will be entitled to a monthly salary and related benefits in accordance with the engagement agreement. In the event that the agreement period comes to its end and is not extended, the Chairman will be entitled to an early notice period as well as to an adaptation period of six months.

Employment agreement of the President & CEO. On December 20, 2010, the Audit Committee of the Board and the Board of Directors resolved to approve the Bank's engagement in a personal employment agreement with the Bank's acting President & CEO. The period of the agreement is five years beginning on January 1, 2011 (hereinafter: "the agreement period").

The President & CEO is employed in a full-time position and is not entitled to engage in any other fully paid occupation, without the prior consent of the Board of Directors. In consideration for executing his duties, the President & CEO is entitled to a monthly salary of NIS 167,500, to be updated every three months in accordance with the rise in the CPI as compared with the CPI published in December of 2010.

The President & CEO is entitled to an annual award, as detailed in subsection (h) below. The President & CEO is also entitled to remuneration of the "phantom" type, derived from the performance of the Bank's shares, as detailed in Note 13 D (1). The agreement states also the duties imposed on the President & CEO, among which are a "cooling-off" and non-competition periods of six months and a confidentiality duty.

The Bank bared house rental payments for the President & CEO in an amount of up to NIS 90 thousand, in respect of a rental period that began on the date of his taking office as the Bank's President & CEO and until August 31, 2011. All taxes pertaining to the said payments, if at all, shall be grossed up and paid by the Bank on his behalf.

The President & CEO is entitled to paid vacation, sick leave, convalescence pay and a suitable motor vehicle, social benefits (severance pay in accordance with the Law, provident fund, loss of work ability insurance and further education fund) as well as other benefits.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

Upon termination of office, the President & CEO is entitled, according to the agreement, to severance pay under the Law, this in addition to his entitlement to the funds and rights accumulated in his favor in respect of the provisions for pension to be created by the Bank. In addition, the President & CEO is entitled to early notice of six months, during which he will be entitled to remuneration and related benefits in accordance with the agreement and to an adaptation period, as follows: if termination of office is initiated by the President & CEO - the adaptation period will be six months; if termination of office is due to any other reason, then the following terms apply: if the early notice period begins prior to the end of two years since the beginning of the agreement period - the adaptation period will be eighteen months; if the early notice period begins after the end of two years since the beginning of the agreement period but before the end of three years - the adaptation period will be twelve months; if the early notice period begins after the end of three years since the beginning of the agreement period but before the end of four years - the adaptation period will be nine months; if the early notice period begins after the end of four years since the beginning of the agreement period - the adaptation period will be six months. In the event that the agreement period comes to its end and is not extended, the President & CEO will be entitled to an early notice period as well as to an adaptation period of six months. During the adaptation period the President & CEO will be entitles to a monthly salary and related benefits in accordance with the employment agreement, but shall not be entitled in its respect to any annual award (or to a part thereof).

In the period from January 1, 2011 and until February 28, 2011, the President & CEO continued to act also as CEO of IDB New York. During this period, the President & CEO was entitled to 80% of his monthly salary payable by the Bank. This amount was deducted during this period, from the amount of the monthly salary to which he was entitled from IDB New York (accordingly, the gross monthly salary payable to him by IDB New York will be NIS 104 thousand).

G. Awards to the acting Chairman of the Board and to the acting President & CEO

Award to the Chairman of the Board in respect of 2010. The Audit Committee and the Board of Directors were authorized to decide on an annual award to be granted to the Chairman of the Board in respect of 2010 at their discretion in accordance with criteria to be formed. No decision regarding this matter has in fact been made.

Awards in respect of 2011 and thereafter. Beginning with the year 2011, for each calendar year or a part thereof, in which the Chairman of the Board or the President & CEO, respectively, will be in office, the annual award will be granted in accordance with attainment of indices as detailed below, the targets in respect of which shall be based upon the targets set in the Bank's work plans for the years 2011-2014 as regards the Chairman of the Board (2011-2015 as regards the President & CEO) and in accordance with principles, the essence of which is stated below. The said annual award to the Chairman of the Board shall be approved in each year, subject to the law, whether by the Audit Committee and the Board of Directors, on condition that predetermined minimum targets in respect of the quantitative indices (see hereunder) shall be approved by the General Meeting of Shareholders, or annually by the General Meeting of Shareholders following approval by the Audit Committee and the Board of Directors.

Ceiling for the annual award. The annual award to the Chairman of the Board shall be limited to an amount not exceeding NIS 2.4 million (gross), linked to the CPI for December 2009. The annual award to the President & CEO shall be limited to an amount not exceeding NIS 2.8 million (gross), linked to the CPI for November 2010.

Minimum terms for entitlement. Entitlement in respect of any calendar year shall be conditioned upon the fulfillment in that particular year of all the following cumulative minimum terms:

1) The targeted return on risk assets determined in the work plan for the year of the award (in percentages) net of the actual return on risk assets (as defined in the plan) (hereinafter: "the return differential on risk assets") shall be at a rate lower than 3%;
2) The ratio of total capital adequacy and the core capital ratio of the Bank according to its annual financial statements for that year, shall not fall below the ratio of total capital adequacy and the core capital ratio of the Bank, respectively, as determined in the work plan for that calendar year;
3) The Chairman of the Board and the President & CEO, respectively, have been awarded a grade higher than "1" with respect to the qualitative index.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

Installment payments. The payment of the annual award in respect of a particular calendar year shall be made in three installments: an amount of 60% of the annual award will be paid no later than thirty days following the issue of the Bank's financial statements for the year of the award. Two deferred award payments of 20% of the award each will be paid following the issue of the financial statements for each of the two consecutive years to the year of the award (linked to the CPI).

Negative award. In a calendar year, in which the "the return differential on risk assets" is higher than 2%, a "negative award" shall be charged, computed as follows: "the return differential on risk assets" minus 2%, multiplied by 100, multiplied by the "cumulative annual award". In this respect, the "cumulative annual award" shall equal the full annual award computed for that calendar year (100%) with the addition of deferred award payments in respect of prior years that should have been paid in that same calendar year.

The negative award amount shall not exceed in any event in a particular year the amount of the cumulative annual award.

In the event that "the return differential on risk assets" in a particular calendar year will be at the rate of 3% or higher, then no annual award payment shall be made in respect of that calendar year, neither shall be paid the deferred award installments in respect of prior years that should have been paid on date of granting the annual award for that year.

Computation of the annual award. The annual award shall be computed on the basis of three indices based on the Bank's performance (hereinafter: "the quantitative indices") and on an additional qualitative index (hereinafter: "the qualitative index").

In the event that the engagement agreement with the Chairman of the Board or with the President & CEO will be terminated during any calendar year, for whatever reason, a proportionate annual award shall be paid for that year until the end of the prior notice period (no entitlement for an annual award, in whole or in part, shall exist in respect of the adaptation period). All deferred award installments shall be paid on that date even if their payment date is not yet due.

Quantitative indices. For each quantitative index, the Board of Directors shall determine at the beginning of the year a target goal according to which minimum and maximum goals will be computed. Attaining the minimum goal in a particular year will entitle the officer to 50% of the maximum annual award relating to that index. To the extent that the goal attained will be higher than the minimum goal so will the percentage of the maximum award increase in accordance with formulas detailed in the plan.

Attainment of the target goal will entitle the officer to 100% of the maximum annual award relating to that index.

Attaining a goal in excess of the target goal and up to the maximum goal will increase the share of the award relating to that index by up to 112.5% of the proportionate share of the maximum annual award relating to that index, provided that the total annual award shall not exceed the maximum annual award.

Proximate to the beginning of each year the Board of Directors shall determine in the work plan target goals for that year. Their manner of measurement shall be identical to the manner in which they are measured in the work plan.

If after the determination of the indices and/or goals in the work plan (hereinafter: "the original goals"), the Bank's Board of Directors shall decide to change the goals in the Bank's work plan, this will not require a change in goals for the purpose of computing the annual award for this year. Notwithstanding the above, in any year in which goals are changed by the Board of Directors, as stated, due to external circumstances affecting the banking industry in Israel, the Board may decide to reduce or cancel the negative award for that year, if such a negative award applies according to the original goals.

Following are the quantitative indices:

(1) **Actual return on risk assets.** The weight of this index in the total annual award is 30% of the maximum annual award; the minimum goal for this index being 1% below the target goal and the maximum goal being 0.5% above the target goal.

(2) **Efficiency ratio.** This index is considered as the ratio between the total operating and other expenses in a particular calendar year (according to the Bank's financial statements for that year), and the profit from financing operations before credit loss expenses (allowances for doubtful debts) plus all operating and other income in that year (according to the Bank's financial statements for that year).

The weight of this index is 20% of the maximum annual award; the minimum goal for this index being 3% above the target goal and the maximum goal being 1.5% below the target goal.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

(3) Operating and other income. This index is computed as the total of operating and other income in a particular calendar year according to the Bank’s financial statements for that year.

The weight of this index is 30% of the maximum annual award; the minimum goal for this index being 80% of the target goal and the maximum goal being 110% of the target goal.

Qualitative index. At the end of each year, a qualitative evaluation shall be made on the basis of the criteria, the principal items of which are detailed below, and according to a grading of 1 to 3, as follow: "1" - under performance by the qualitative index; "2" - reasonable performance by the qualitative index; "3" - good performance by the qualitative index.

Allotment of grade "1" will deny all (100%) of the annual award; allotment of grade "3" entitles to the full amount of the award which may be granted in respect of the qualitative index. The qualitative index entitles to up to 20% of the maximum annual award. Any grading between "1" and "3" entitles to a proportionate part of the maximum amount which may be granted in respect of the qualitative index to be computed according to a formula determined in the plan.

The qualitative evaluation grading shall be considered as an average of the grades determined by all members of the Bank's Board, marked in a questionnaire to be completed by each of them in accordance with the said grading scale and in accordance with the following criteria, and shall be approved by the Audit Committee and of the Bank’s Board of Directors.

The criteria on the basis of which the said qualitative evaluation grading shall be determined, are the contribution made by the Chairman of the Board to supervision and control in areas concerning corporate governance, directives of the Supervisor of Banks (including directives in the matter of "Basel II"), internal audit and audit reports of Regulators (such as the Bank of Israel and the Israel Securities Authority), operational risks and control of risk levels of the Bank's Group; or the contribution made by the President & CEO in respect of the formation of goals and of leadership, advancement and implementation of processes and their realization in the said areas, respectively.

Amount of the annual award for 2011. The Chairman of the Board and the President & CEO are entitled to an annual award in respect of the year 2011, in total amounts of NIS 1,629 million and NIS 1,889 million, respectively. In accordance with the terms of the plan, amounts of NIS 997 million and NIS 1,133 million, respectively, out of the above award sums was paid in 2012, and the balance will be divided respectively, into two deferred amounts the payment of which will be made in accordance with the "payment spread" mechanism, and will be subject to a "negative award" mechanism, all as detailed

above. The entitlement to the award is created by attaining all threshold terms. The amount of the award is determined taking into account the extent of reaching the quantitative indices and the qualitative index.

The annual awards to the Chairman of the Board and to the President & CEO were approved by the Audit Committee on March 21 and 26, 2012. The annual award to the Chairman of the Board in respect of 2011 was approved by the Board of Directors on March 28, 2012, and by the General Meeting of the Shareholders on June 12, 2012.

Waiver of the award in respect of 2012. In July 2012, the Bank's Chairman of the Board, the President & CEO together with the Bank's members of the Management and the Bank's Internal Auditor (see Note 16 J above) informed of their decision (each electively) to waive the annual award due to them in respect of 2012, if and to the extent that they will be entitled to it. This, in continuation and in line with the savings and efficiency measures adopted by the Bank and in consideration of the existing public mood.

H. Remuneration plan for the Former President

On January 30, 2007, the Bank's audit committee approved a comprehensive remuneration plan for the President & CEO who retired from office on December 31, 2010 (hereinafter: "the former President").

The remuneration plan was formulated for a period of five years (as from February 2006) and included short-term remuneration (salaries and annual bonuses) and long-term remuneration (stock option plan). The entitlement to annual bonuses and to the option plan were dependent on Discount Group’s results and performance and on the yield from the Bank’s shares, both per se and compared to the other large banking groups. Entitlement to annual bonuses was limited to monetary ceilings.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

Employment agreement with the Bank's former President. On July 18, 2007 the Bank's Board of Directors decided, after receiving the Bank's Audit Committee's, approval, to approve a new personal employment agreement between the former President (replacing the previous employment agreement with him), for a period of five years, as from February 1, 2006.

The former President has been 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 former President 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 former President employment has been a full time position and he was not permitted to accept another paid position, without the prior consent of the Board of Directors. The monthly salary of the former President has been NIS 178,700, gross, and was updated every three months according to the rate of increase in the CPI, relative to the index published on January 15, 2006. The previous President was entitled to paid vacation, sick leave, convalescence pay and a suitable motor vehicle, social benefits (severance pay in accordance with the Law, provident fund, loss of work ability insurance and further education fund) as well as other benefits.

The agreement also included provisions regarding responsibilities levied on the former President, being among others: provisions regarding a cooling off period of three months and maintenance of confidentiality.

The employment agreement of the former President stipulates that the Bank will grant him, annually as from 2006 until 2010, a special bonus that will not exceed twice his annual salary (hereinafter: "the maximum annual bonus"). The former President did not attain in 2010 the determined indices; therefore he was not entitled to an award in respect of this year.

I. "INTERESTED PARTY" TRANSACTIONS - IDB NEW YORK

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").

The company paid in 2010 rental fees of US$243 thousand (2009 - US$324 thousand).

The Lessee informed IDB New York of his wish to terminate the lease agreement prior to the end of the lease period. The Lessee informed IDB New York that he has an alternative lessee interested in renting the property. IDB New York decided to occupy the said floor and use it for its own purposes, especially in view of the expansion of the local private banking unit.

On September 15, 2010, the Audit Committee approved and on September 20, 2010, in a resolution that does not require approval by the general meeting of shareholders, at date of adoption, the Board of Directors approved the termination of the lease agreement, following which the property held by the lessee will revert to IDB New York. In addition, upon approval of the termination of the lease agreement, the lessee will pay IDB New York a one-time fine in an amount equal to the annual rental amount of US$325,000, this in consideration for the early termination of the lease agreement. Upon the obtaining of the approvals as stated above, the rental agreement was terminated and the fine was paid.

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 payments amount to US$20 per sq. meter, linked to the CPI since date of signing, and the lease period was for five years with an option granted to the lessee to extend the lease period by two additional periods of five years each. Management fees are paid according to actual costs. Towards the end of the rental period, the agreement was extended for an additional period of five years. According to the terms of the agreement, the rental fees for the additional period increased by 20%. All other rental terms remained unchanged.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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, 2012, amounted to NIS 7,482 million (as at December 31, 2011 - NIS 7,599 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 4 and Note 19 C 5.

M. Investee companies of the Bank are included in the framework of the undertaking granted by the Bank to VISA Europe and to Mastercard as stated in Note 19 C 10 items a and b.

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 by the Bank as Directors of certain subsidiaries, including two former officers who acted as Directors of consolidated subsidiaries and who are also the Bank's controlling shareholders - see Note 19 C 8, items M and N.

O. Upon granting of the control permit of Discount 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 No. 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, also 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 Bank's control, or alternatively, report the details of any debt or deposit as above.
- In addition to the above, Mr. Milstein shall immediately report to the Secretary and to the Chief Accountant of the Bank, any transaction or debt as above of himself, his spouse, his children, their spouses and corporations owned by them and which are interested parties in the Bank or are related parties to the Bank.

  For the purpose of this item, interested parties and related parties are as defined in the public reporting instructions.
- The Report issued to the public shall include adequate disclosure of this arrangement.

  The Bank received a declaration from Mr. Milstein as required.

P. 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 external directors and to other present and future Directors of the Bank (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 external director), 2000, as amended in the Companies Regulations (Amendment) (Rules for remuneration and expenses to an external director), 2008, in accordance with the Bank's grade. 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.

Q. On June 30, 2010, the special meeting of the Bank's shareholders approved the payment of a monthly remuneration to Dr. Itzhak Sharir, who acted as Director of the Bank until October 26, 2011, in respect of his duties as Chairman of the Board of Israel Discount Capital Markets and Investments Ltd., in the amount of NIS 12,500 per month, plus VAT as required by law, in effect from date of his appointment as Chairman of the Board (March 14, 2010).

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

R. Terms of transactions with interested and related parties

All business with interested and related parties has been transacted in the ordinary course of business and under terms similar to those of transactions with parties that are not related to the Bank and to its consolidated subsidiaries. Interest charged and interest paid in respect of balances with interested and related parties are at the regular rates at the ordinary course of business with parties that are not related to the Bank.

S. For details regarding option plans for members of the Bank's Management, who are part of the managerial key personnel of the Bank, see Note 13(d) (2) and (3). For details regarding a remuneration scheme for members of Management of the Bank, see Note 16(j).

23. INTEREST INCOME AND EXPENSES - CONSOLIDATED

	Consolidated			The Bank		
	2012	(4)2011	(4)2010	2012	(4)2011	(4)2010
	in NIS millions					
A. Interest Income(2)						
Credit to the public	5,937	6,469	5,848	4,066	4,605	4,080
Credit to Governments	26	40	36	24	40	36
Deposits with the Bank of Israel and cash	415	512	157	368	455	145
Deposits with Banks	64	85	84	69	69	85
Securities borrowed or purchased under repurchase agreements	7	6	4	7	5	4
Bonds(1)	1,360	1,278	1,226	741	580	495
Other assets	34	23	45	7	1	29
Total interest income	**7,843**	**8,413**	**7,400**	**5,282**	**5,755**	**4,874**
B. Interest Expenses(2)						
Deposits from the public	(2,254)	(2,452)	(1,582)	(2,150)	(2,375)	(1,652)
Deposits from the Government	(11)	(9)	(6)	(2)	(3)	(2)
Deposits from banks	(98)	(123)	(112)	(61)	(84)	(66)
Securities loaned or sold under repurchase arrangements	(227)	(243)	(274)	-	-	-
Subordinated capital notes	(789)	(921)	(874)	(274)	(341)	(329)
Other liabilities	(5)	(5)(48)	(1)	-	(28)	-
Total interest expenses	**(3,384)**	**(3,796)**	**(2,849)**	**(2,487)**	**(2,831)**	**(2,049)**
Interest Income, Net	**4,459**	**4,617**	**4,551**	**2,795**	**2,924**	**2,825**
C. Details of the net effect of hedge derivative instruments on interest income and expenses:						
Interest income(3)	(28)	(23)	-	(28)	(22)	-
D. Accrual basis, interest income from bonds:						
Held-to-maturity	260	279	251	116	116	89
Available for-sale	1,019	905	905	554	389	345
Trading	81	94	70	71	75	61
Total included in interest income	**1,360**	**1,278**	**1,226**	**741**	**580**	**495**

Footnotes:

(1) Financing income generated by mortgage backed securities (MBS) - in US $ millions	67	85	105	-	-	-
Financing income generated by mortgage backed securities (MBS) - in NIS millions	258	306	394	-	-	-

(2) Including the effective component of hedging relationships.

(3) Details of the effect of hedge derivative instruments on subsection A.

(4) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(5) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

24. NON-INTEREST FINANCING INCOME - CONSOLIDATED

	Consolidated			The Bank		
	2012	(4)2011	(4)2010	2012	(4)2011	(4)2010
	in NIS millions					
A. Non-interest financing income from operations not for trading purposes						
1. From operations in derivative instruments						
Net expenses in respect of ALM derivative instruments(3)	(367)	(160)	(780)	(361)	(120)	(710)
Total from operations in derivative instruments	**(367)**	**(160)**	**(780)**	**(361)**	**(120)**	**(710)**
2. From investments in bonds:						
Gains on sale of held-to-maturity bonds, including provisions for impairment	-	3	(42)	-	-	-
Gains on sale of available-for-sale bonds	336	153	272	215	93	182
Losses on sale of available-for-sale bonds	(12)	(11)	(1)	(2)	(4)	(1)
Provision for decline in value of available-for-sale bonds	(17)	(22)	(7)	-	(14)	(3)
Total from investments in bonds	**307**	**123**	**222**	**213**	**75**	**178**
3. Net exchange rate differences	**265**	**(76)**	**648**	**245**	**(401)**	**777**
4. Net profit (losses) from investments in shares:						
Gains on sale of shares available-for-sale	75	112	53	6	-	6
Provision for impairment in value of available-for-sale shares	(11)	(20)	(33)	-	-	(26)
Dividends from available-for-sale shares	18	6	11	-	-	-
Profit on sale of shares and activities of affiliated companies	-	48	(7)48	-	-	-
Loss on sale of shares in affiliated companies	-	(4)	-	-	-	-
Total investment in shares	**82**	**142**	**79**	**6**	**-**	**(20)**
5. Net income (loss) on the sale of loans	**(1)**	**46**	**(3)**	**-**	**53**	**-**
Total non-interest financing income from operations not for trading purposes	**286**	**75**	**166**	**103**	**(393)**	**225**
B. Non-interest financing income from operations for trading purposes(5):						
Net income (losses) in respect of other derivative instruments	34	4	(3)	8	2	(4)
Net realized and non-realized income on adjustment of trading bonds to fair value(1)	34	20	1	27	24	1
Net realized and non-realized income (losses) on adjustment of trading shares to fair value(2)	(2)	(1)	8	-	(1)	10
Total from trading operations(6)	**66**	**23**	**6**	**35**	**25**	**7**
Details of non-interest financing income from operations for trading purposes, according to risk exposure						
Interest rate exposure	56	17	(8)	26	23	(6)
Foreign currency exposure	-	1	1	-	-	-
Share exposure	10	5	13	9	2	13
Total, according to risk exposure	**66**	**23**	**6**	**35**	**25**	**7**
Total non-interest financing income	**352**	**98**	**172**	**138**	**(368)**	**232**

Footnotes:

(1) Of which, a part of the income (losses) relating to trading bonds that are still on hand at balance sheet date	6	(3)	(39)	4	(4)	(39)
(2) Of which, a part of the income relating to trading shares that are still on hand at balance sheet date	-	-	7	-	-	7

(3) Derivative instruments comprising a part of the Bank's asset and liability management layout, not designated for hedge relations

(4) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(5) Including exchange rate differences from trading operations

(6) For interest income on investments in trading bonds, see Note 23, above.

(7) See Note 19 C 20, above.

24. NON-INTEREST FINANCING INCOME - CONSOLIDATED (CONTINUED)

Additional details

A. **Sale of VISA Inc. shares -** at the end of 2008, within the framework of the distribution of the proceeds from the public offering made by Visa International among the members of the VISA Europe Organization, ICC and the Bank received Visa Inc. shares, which had a lock-up period until March 25, 2011. On January 21, 2010, the board of directors of VISA International announced a plan for the release from the trading limitations.

During 2010, ICC and the Bank realized shares of VISA Inc. recognizing gains of NIS 26 million (NIS 6 million for the Bank). In March 2011, ICC realized the rest of the shares, recognizing net gains of NIS 13 million. In March 2012, the Bank realized the rest of the shares, recognizing net gains of NIS 6 million.

B. **Realization of funds.** During 2012, funds held by Discount Capital Markets, realized certain investments. In respect of its share in such realization, Discount Capital Markets recorded net gains of NIS 69 million (2011 – NIS 99 million; 2010 – NIS 27 million)..

C. In 2010, the Bank recorded a provision for impairment and recognized losses on realization in respect of a fund of hedge funds in the amount of NIS 26 million.

D. For details regarding the sale of the basket certificates operation, in respect of which a net gain of NIS 48 million was recognized in 2011, see Note 19 C 21 above.

25. COMMISSIONS

	Consolidated			The Bank		
	2012	(1)2011	(1)2010	2012	(1)2011	(1)2010
	in NIS millions					
Ledger fees	602	617	633	369	388	401
Credit cards	924	922	913	90	99	104
Operations in securities and in certain derivative instruments	288	300	338	196	210	232
Commissions from the distribution of financial products	100	102	99	93	88	85
Management, operational and trusteeship services for institutional bodies	24	32	35	-	-	-
Handling credit	311	258	254	213	159	156
Conversion differences	108	113	119	80	85	92
Foreign trade services	55	57	59	45	47	46
Net income from credit portfolio services	18	16	18	15	14	17
Commissions on financing activities	174	181	178	115	117	108
Other income	81	72	79	52	53	54
Total fees	**2,685**	**2,670**	**2,725**	**1,268**	**1,260**	**1,295**

Footnote:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

26. OTHER INCOME

	Consolidated			The Bank		
	2012	(1)2011	(1)2010	2012	(1)2011	(1)2010
	In NIS millions					
Management fees from consolidated subsidiaries	-	-	-	6	5	6
Profit from severance pay funds	178	(2)41	63	162	34	59
Capital income on sale of buildings and equipment	31	35	9	8	-	3
Capital loss on sale of buildings and equipment	(4)	-	-	(1)	-	-
Reversal of provision for impairment in value of buildings and equipment	3	6	-	3	6	-
Other income	12	87	27	55	125	65
Total other income	**220**	**169**	**99**	**233**	**170**	**133**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(2) Reclassified, see Note 1 C 5.3.

Additional details:

An agreement has been signed in 2011 for the settlement of the claims of the Bank and of a consolidated subsidiary against an insurance company. In this respect, an income of NIS 74 million was recognized in 2011, most of it reflected in the item "Other operating income".

27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2012	2011	2010	2012	2011	2010
	in NIS millions					
Salaries	2,222	2,317	2,169	1,394	1,511	1,400
Expense resulting from share based payment transactions[1]	1	(4)	7	1	(4)	7
Severance pay, pension, continuing education fund, seniority bonuses, vacation and medical insurance	592	(3)(4)516	417	396	332	287
National Insurance and payroll taxes	508	469	451	381	353	340
Other related expenses	121	124	116	47	56	59
Adjustment of reserves for salary-related expenses due to changes in salaries during the year	-	(4)22	51	-	-	26
Voluntary retirement program expenses[2]	-	22	7	-	-	7
Total salaries and related expenses	**3,444**	**3,466**	**3,218**	**2,219**	**2,248**	**2,126**
Includes: Overseas salaries and related expenses	464	456	408	16	16	17

Footnotes:

(1) See Note 13 D.

(2) Including payroll tax.

(3) Reclassified, see Note 1 C 5.3.

(4) Reclassified, in this note.

28. OTHER EXPENSES

	Consolidated			The Bank		
	2012	2011	2010	2012	2011	2010
	In NIS millions					
Advertising	220	198	219	63	56	97
Communications	123	125	128	65	62	69
Computer services	168	(2)159	130	98	97	98
Office expenses	32	36	32	18	21	18
Insurance	56	66	63	9	10	12
Professional services	151	166	172	70	78	80
Directors' fees	14	17	15	5	7	7
Instruction and training	15	(2)15	26	12	10	12
Commissions	156	(2)143	(2)134	29	28	22
Other	234	(1)(2)284	(1)(2)326	103	105	132
Total other expenses	**1,169**	**1,209**	**1,245**	**472**	**474**	**547**

Footnote:
(1) Reclassified, see Note 1 C 7.
(2) Reclassified, in this note.

29. PROVISIONS FOR TAXES ON INCOME

A. Composition

	Consolidated			The Bank		
	2012	(1)2011	(1)2010	2012	(1)2011	(1)2010
	in NIS millions					
Taxes for current year(4)	490	(2)289	(2)517	181	18	(2)203
Taxes for previous years	(69)	(2)(92)	(2)20	(69)	(2)(92)	(2)4
Total current taxes	**421**	**197**	**537**	**112**	**(74)**	**207**
Addition (deduction):						
Deferred taxes for current year	(104)	(2)(153)	(53)	(75)	(2)(102)	(15)
Deferred taxes for previous years	90	(2)70	(5)	84	(2)63	-
Total deferred taxes(3)	**(14)**	**(83)**	**(58)**	**9**	**(39)**	**(15)**
Total provision for taxes (tax saving) on operating profit	**407**	**114**	**479**	**121**	**(113)**	**192**
Of which: provision for taxes (tax saving) abroad	75	14	77	(16)	(30)	(12)

Footnotes:
(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.
(2) Reclassified.
(3) Deferred taxes:

	Consolidated			The Bank		
	2012	2011	2010	2012	2011	2010
	in NIS millions					
Creation and reversal of temporary differences	10	17	(58)	28	36	(15)
Change in the tax rate	(24)	(100)	-	(19)	(75)	-
Total deferred taxes	**(14)**	**(83)**	**(58)**	**9**	**(39)**	**(15)**

(4) Of which, an amount of benefits deriving from loss for tax purposes, tax credit or a temporary difference from a prior period, not recognized in the past and used to decrease current tax expenses	9	14	7	-	-	-

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

B. Reconciliation between the theoretical tax which would apply had the income been taxed at the statutory tax rate applying to the Banking corporations in Israel, to the provision of taxes on operating income as charged in the statement of income:

	Consolidated			The Bank		
	2012	(1)2011	(1)2010	2012	(1)2011	(1)2010
Statutory tax rate on banks in Israel	35.53%	34.48%	35.34%	35.53%	34.48%	35.34%
	in NIS millions					
Income tax at the statutory tax rate	413	321	377	105	(49)	160
Income tax (tax savings) on:						
Income of foreign subsidiaries	15	(87)	62	-	-	-
General and supplemental allowance for doubtful debts	-	-	6	-	-	7
Income exempt from tax or taxed at preferred rates	13	5	12	15	8	12
Adjustment differences on depreciation and capital gains	(1)	-	1	-	-	1
The effect of payroll tax saving in respect of current losses.	-	(3)31	-	-	(3)31	-
Other non-deductible expenses	15	(2)(3)29	(3)27	8	(3)21	(3)5
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	(9)	(17)	(8)	-	(3)	(1)
Change in the balance of deferred taxes resulting from the change in tax rates	(27)	(106)	4	(22)	(81)	4
Taxes for prior years	9	(37)	8	6	(41)	-
Additional amounts payable with respect to problematic debts	12	(3)3	(3)7	9	-	(3)4
Income of Israeli subsidiaries	(33)	(28)	(17)	-	1	-
Provision for taxes (tax saving) on income	**407**	**114**	**479**	**121**	**(113)**	**192**

Footnotes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Reclassified.

C. (1) Final tax assessments have been issued to the Bank for the tax years up to and including 2008. Final withholding tax assessments have been issued to the Bank for the years up to and including 2007. In January 2013, the Bank received a withholding tax assessment for the tax year 2008, according to which, the payment of an immaterial amount is demanded from the Bank. The Bank is disputing this demand.

(2) Following the settlement of the income tax assessment for the years 2006-2007, excess provisions for tax amounting to NIS 41 million were reversed in 2011.

(3) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2005 to 2009.

D. The consolidated balance as of December 31, 2012, of the carry forward tax losses, deductibles and timing differences amounted to NIS 203 million (December 31, 2011: NIS 254 million).

E. 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.

F. **Deferred tax liabilities not recognized**

As of December 31, 2012, deferred tax liabilities in the amount of NIS 448 million, in respect of temporary differences in the amount of NIS 1,678 million, relating to investments in subsidiaries, were not included, since the Bank does not intend to realize these investments in the foreseeable future..

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

G. Items in respect of which deferred tax assets were not recognized

Deferred tax assets were not recognized in respect of the following items::

	Consolidated		The Bank	
	December 31			
	2012	2011	2012	2011
	in NIS millions			
Deductible temporary differences	1	-	-	-
Loss for tax purposes	50	63	1	1
	51	**63**	**1**	**1**

H. balances of deferred taxes receivable and provision for deferred taxes:

1. Consolidated

	Deferred tax receivable				Provision for deferred taxes			
	balance		The average tax rate		balance		The average tax rate	
	2012	2011	2012	2011	2012	2011	2012	2011
	in NIS millions		in percentage		in NIS millions		in percentage	
On allowance for credit losses	704	713	35.9	35.1	-	-	-	-
On provision for vacation pay, jubilee awards and provision of retirees	428	399	35.8	35.1	-	-	-	-
On excess of provision of severance pay	114	112	35.5	34.7	-	-	-	-
On income tax carry- forward deductions	71	(1)108	25.0	25.0	-	-	-	-
On foreign operations	247	287	35.5	34.5	-	-	-	-
On securities	-	-	-	-	4	5	37.3	33.0
On adjustment of depreciable non-monetary assets	-	-	-	-	191	(1)200	33.9	33.6
On other monetary assets	46	49	31.8	30.3	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	74	61	34.8	31.6
Total, net	**1,610**	**1,668**	**35.0**	**34.0**	**269**	**266**	**34.2**	**33.2**

Footnote:

(1)Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

H. 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	
	2012	2011	2012	2011	2012	2011	2012	2011
	in NIS millions		in percentage		in NIS millions		in percentage	
On allowance for credit losses	545	554	35.9	35.1	-	-	-	-
On provision for vacation pay, jubilee awards and provision of retirees	368	343	35.9	35.1	-	-	-	-
On excess of provision of severance pay	73	72	35.9	35.1	-	-	-	-
On income tax carry- forward deductions	71	(1)108	25.0	25.0	-	-	-	-
On securities	-	-	-	-	-	2	-	35.1
On adjustment of depreciable non-monetary assets	-	-	-	-	166	(1)176	34.2	33.9
On other monetary assets	24	23	35.9	35.1	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	74	61	34.8	31.6
Total, net	**1,081**	**1,100**	**34.9**	**33.9**	**240**	**239**	**34.4**	**33.4**

Footnote:
(1)Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

I. Balances of deferred taxes receivable and provision for deferred taxes (continued)

The change in deferred tax assets and tax liabilities is attributed to the following items:

1. Consolidated

	Allowance for credit losses	Interest and securities	Investments in investee companies	Overseas operations	Adjustment of depreciable non-financial assets	Employee benefits	Carry forward deductions for tax purposes	Other	Total
				in NIS millions					
Balance of tax asset (tax liability) as of January 1, 2012	713	(5)	(61)	287	(200)	511	108	49	1,402
Changes recognized in the statement of income	(25)	47	4	(12)	13	19	(37)	(4)	5
Effect of the change in the tax rate	16	-	-	-	(4)	12	-	1	25
Changes recognized in the equity	-	(46)	(17)	(18)	-	-	-	-	(81)
Financial statements translation adjustments	-	-	-	(10)	-	-	-	-	(10)
Balance of tax asset (tax liability) as of December 31, 2012(1)(2)	**704**	**(4)**	**(74)**	**247**	**(191)**	**542**	**71**	**46**	**1,341**
(1)Deferred tax asset	704	-	-	247	-	542	71	46	1,610
Balances available for setoff									(255)
Deferred tax asset as of December 31, 2012									**1,355**
(2)Deferred tax liability	-	-	-	-	(14)	-	-	-	(14)
Deferred tax liability as of December 31, 2012									**(14)**
Balance of tax asset (tax liability) as of January 1, 2011	141	14	(62)	221	(1)(171)	391	(1)51	52	637
Changes recognized in the statement of income	(86)	(29)	(32)	21	(3)	46	42	(6)	(47)
Effect of the change in the tax rate	50	-	-	-	(26)	74	-	3	101
Changes recognized in the equity	608	10	33	45	-	-	15	-	711
Balance of tax asset (tax liability) as of December 31, 2011(1)(2)	**713**	**(5)**	**(61)**	**287**	**(200)**	**511**	**108**	**49**	**1,402**
(1)Deferred tax asset	713	-	-	287	-	511	108	49	1,668
Balances available for setoff									(252)
Deferred tax asset as of December 31, 2011									**1,416**
(2)Deferred tax liability	-	-	-	-	(14)	-	-	-	(14)
Deferred tax liability as of December 31, 2011									**(14)**

Footnote:

(1)Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

I. Balances of deferred taxes receivable and provision for deferred taxes (continued)

The change in deferred tax assets and tax liabilities is attributed to the following items (continued):

2. The Bank

	Allowance for credit losses	Interest and securities	Investments in investee companies	Overseas operations	Adjustment of depreciable non-financial assets	Employee benefits	Carry forward deductions for tax purposes	Other	Total
	in NIS millions								
Balance of tax asset (tax liability) as of January 1, 2012	554	(2)	(61)	-	(176)	415	108	23	861
Changes recognized in the statement of income	(22)	-	4	-	14	17	(37)	1	(23)
Effect of the change in the tax rate	13	-	-	-	(4)	9	-	-	18
Changes recognized in the equity	-	2	(17)	-	-	-	-	-	(15)
Balance of tax asset (tax liability) as of December 31, 2012(1)(2)	**545**	**-**	**(74)**	**-**	**(166)**	**441**	**71**	**24**	**841**
(1)Deferred tax asset	545	-	-	-	-	441	71	24	1,081
Balances available for setoff									(226)
Deferred tax asset as of December 31, 2012									**855**
(2)Deferred tax liability	-	-	-	-	(14)	-	-	-	(14)
Deferred tax liability as of December 31, 2012									**(14)**
Balance of tax asset (tax liability) as of January 1, 2011	101	20	(62)	8	(1)(152)	331	(1)51	22	319
Changes recognized in the statement of income	(68)	(21)	(32)	(8)	-	19	42	(2)	(70)
Effect of the change in the tax rate	33	-	-	-	(24)	65	-	3	77
Changes recognized in the equity	488	(1)	33	-	-	-	15	-	535
Balance of tax asset (tax liability) as of December 31, 2011(1)(2)	**554**	**(2)**	**(61)**	**-**	**(176)**	**415**	**108**	**23**	**861**
(1)Deferred tax asset	554	-	-	-	-	415	108	23	1,100
Balances available for setoff									(225)
Deferred tax asset as of December 31, 2011									**875**
(2)Deferred tax liability	-	-	-	-	(14)	-	-	-	(14)
Deferred tax liability as of December 31, 2011									**(14)**

Footnote:

(1)Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

J. Taxes on income recognized directly to the equity:

Consolidated

	For the year ended December 31,								
	2012			2011			2010		
	Before tax	Tax expenses (tax benefits)	Net of tax	Before tax	Tax expenses (tax benefits)	Net of tax	Before tax	Tax expenses (tax benefits)	Net of tax
	in NIS millions								
Adjustments from translation of financial statements	(77)	-	(77)	1	-	1	-	-	-
Cash flow hedge	(3)	(1)	(2)	(15)	(7)	(8)	-	-	-
Available for sale financial assets	602	218	384	(171)	(64)	(107)	131	42	89
Other comprehensive income in respect of associates	72	42	30	(57)	(29)	(28)	(9)	(1)	(8)
Total amount of taxes recognized in the equity	**593**	**259**	**334**	**(242)**	**(100)**	**(142)**	**122**	**41**	**81**

K. **Tax legislation changes**

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.

Following the said amendment, the statutory tax rate applying to banking corporations stood at 35.34% in 2010 and 34.48% in 2011.

On December 5, 2011, the Knesset passed the Tax Burden Amendment Act (Legislation Amendments), 2011, which implements the Chapter on taxation in the Trachtenberg Committee report. According to the Act, the reduction in tax rates that had been determined in the Economic Efficiency Act, as discussed above, will be cancelled, and as from the year 2012 and thereafter the company tax will be at the rate of 25%.

Current taxes for the years 2010-2011 were computed according to the tax rates as determined in the Economic Efficiency Act. The balances of deferred taxes as of December 31, 2011 were computed in accordance with the new tax rate as determined in the Tax Burden Amendment Act, based on the tax rate that was anticipated on the reversal dates. The effect of the change in the tax rate on the financial statements as of December 31, 2011, was reflected in the increase in the deferred tax balances (compared to the tax situation without these legislation changes) in the amount of NIS 164 million and with an increase of the same amount in net income for the period.

The Deficit Reduction and Change in Tax Burden (Legislation amendments) Act, 2012, (hereinafter: "the Act") was published on August 13, 2012. The Act includes several changes in taxation, including an increase in the rate of National Insurance contributions payable by employers. Starting with January 2013, the rate of National Insurance contributions payable by employers in respect of that part of the salary in excess of 60% of the average market wage, increased from the present rate of 5.9% to a rate of 6.5%. In January 2014 and in January 2015, this rate will increase to 7% and 7.5%, respectively.

A Value Added Tax Order was published on August 2, 2012, which updates the VAT rate applying to transactions and the import of goods, fixing it at 17% with effect from September 1, 2012.

A Value Added Tax Order (Tax rate applying to non-profit organizations and financial institutions) (Amendment), 2012, was published in the Official Gazette on August 30, 2012, according to which the rate of payroll tax and profit tax increased as from September 1, 2012, to 17%.

As a result of the said amendment, the statutory tax rates applying to financial institutions increased in 2012, from a rate of 35.34% to 35.53%, and as from the year 2013 and thereafter, the rate will increase to 35.9%. Furthermore, the rate of payroll tax applying to financial institutions increased to 17% in respect of the payroll due for work in the month of September 2012 and thereafter, instead of a rate of 16% for 2012 and 15.5% for 2013 and thereafter.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

An increase in the balance of deferred tax assets was recorded in the financial statements, and as a result, an income of NIS 25 million was recorded in 2012.

Concurrently, current tax payments (payroll tax and profit tax) as well as the National Insurance contributions of the Bank and its subsidiaries in Israel and the rest of the Bank's expenses are increasing, due to the increase in the rate of VAT.

L. **Merger between the Bank and Discount Mortgage Bank Ltd. ("DMB")**

Future tax implications of the merger. Following the merger, the Bank would be subject to certain restrictions for a period of two years, beginning with the end of the tax year in which the merger had been effected ("the required period"), the principal of which are as follows:

- During the required period, a controlling shareholder may sell up to 10% of the Bank’s shares held by him at date of the merger, it may be possible to effect a private offering of the Bank’s shares to a third party of up to 20% of the share capital following the allotment, and it may also be possible to perform a public offering on condition that during the required period, the rights pertaining to the Bank’s controlling shareholder shall not fall below 51% of any of the rights in the Bank.
- The majority of the fixed assets (over 50%) held by the Bank and by DMB shall not be sold during the required period (excluding a forced sale), and they should be used in the Bank’s ordinary course of business.

It should be noted that non-compliance with the restrictions imposed on the Bank and/or on its controlling shareholder and/or the non-compliance with the terms of the ruling of the Income Tax Authorities, may result in the merger process becoming a tax event, namely in the cancellation of the tax benefits granted in advance, so that the merging companies will be subject to the taxes and levies from which they had been exempted with the addition of interest and linkage increments from date of the merger. It should be noted that the above terms are stated in the Ordinance, and that changes might be made to such terms in accordance with a preliminary guideline that will be issued, if at all.

Decision of the Income Tax Authority. On May 10, 2012, the Income Tax Authorities signed on the decision ("the tax decision") in the matter of the merger of DMB into the Bank – a merger under Section 103b of the Ordinance (namely, an exempt merger), according to which, subject to the fulfillment of the terms detailed in the Ordinance and of the tax decision, that the details of the merger plan, as presented in the application submitted to the Tax Authorities, are in compliance with the terms of Sections 103 c (1) and (7) of the Ordinance, and that the merger shall become effective on December 31, 2011.

Following are the terms of the merger decision:

- To remove doubt, the merger decision clarified that no new rights in the Bank shall be allotted to its shareholders in respect of the merger. Accordingly, upon the sale of the Bank's shares, the cost of investment in shares of DMB shall not be added to the original cost of the Bank shares.

  Furthermore, the provisions of Section 103 e of the Ordinance will apply to assets transferred to the Bank, and no additional amounts will be attributed to them in excess of their original price as stated in the books of DMB.
- To remove doubt, it was further clarified that amounts expended in acquiring the rights in DMB, including rights acquired through the purchase offer of 2007 (within the framework of which the Bank had acquired the DMB shares then held by the public), shall not be entitled to deduction and/or setoff, and shall not be recognized as an asset tax wise, shall not be allowed as an additional original cost and no deduction whatsoever will be allowed in their respect.
- It is agreed that any expense or deduction accumulated at DMB and/or at the Bank until date of the merger and not allowed tax wise until that date (hereinafter: "the expenses"), and had these been allowed, a tax loss would have been created at merger date, such expenses will be recognized as part of the loss of DMB and/or the Bank, as the case may be, until date of the merger, and the provisions of Section 103 h of the Ordinance shall apply to them, all this if allowed as a deduction tax wise within a period of two years since date of the merger.

  For this purpose, an "expense or deduction accumulated" – any provision, except for impaired debts as determined in the agreement stating the principles for impaired debts, dated February 14, 2012.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

The decision clarifies that the above stated does not derogate from the provisions of Section 103 h of the Ordinance. It is also clarified that the tax decision does not serve as an approval for the deduction tax wise of the said expenses, a matter that would be studied by the Tax Assessing Officer.

- If it transpires that any of the terms determined in Section 103 c of the Ordinance is not fulfilled on its due date, the Bank and DMB will be charged with taxes and obligatory payments from which they had been exempted, together with interest and linkage increments from date of the merger to date of payment, all in accordance with the provisions of Section 103 j of the Ordinance. In such a case, immediately proximate to the date of the violation, an expert valuation of DMB as of date of the merger, will be submitted to the Tax Assessing Officer, in accordance with the Income Tax Regulations (Application for an advance approval of a merger plan), 1993. The said valuation required the approval and consent of the Assessing Officer.
- The Bank is committed to inform the Director of Property Taxes as to the issue of the said tax decision, which, among other things, includes the transfer of the real estate property owned by DMB (at 16/18 Beit Hashoava Lane, Tel Aviv) and pay acquisition tax of 0.5%, within 40 days of the date of the tax decision. To avoid doubt, the tax decision clarifies that the acquisition date will be November 23, 2011 (date of change in the organizational structure) (a notice, as stated, has been duly delivered).
- A valuation of the property shall be submitted to the property tax department of the professional division within 30 days from the date of the tax decision (a valuation, as stated, has been duly delivered).
- The Bank is committed to submit to the Director of Property Taxes, within 30 days from the end of two years from November 23, 2011 (date of change in the organizational structure), a confirmation stating that it had fulfilled all provisions of part II of the Ordinance and of the tax decision.
- It has been agreed that surplus expenses in the hands of the Bank prior to the merger, shall be entitled for setoff against income tax or land betterment tax due by the Bank (subsequent to the merger) in equal installments over a period of five years from date of the merger (20% annually).
- The tax decision was granted subject to the fulfillment in full of all other terms stated in the Ordinance and in the tax decision, including terms relating to the required period, as defined in Section 103 of the Ordinance, beginning with the date of the merger.

With respect to the transfer of staff –

- The tax decision approved the transfer of the staff in accordance with the provisions of Section 103 p of the Ordinance.
- Also approved was the transfer of ownership in all provident funds transferred in the names of employees transferred from DMB to the Bank, and that the transfer of funds deposited in the said provident funds will be exempt from withholding tax at source in accordance with Section 2 (a)(6) of the Income Tax Regulations (Tax exemption in respect of a transfer and change of designation of funds deposited with provident funds), 1990.
- The transferred employees will be entitled to continuity of their rights for severance benefits, as stated in Section 103 p of the Ordinance, and upon their retirement from the Bank, the period of their employment with DMB and the Bank will be taken into account in computing the tax exemption on severance benefits.
- It has been agreed that where an employee had retired prior to the date of merger or due to the merger, and had received from DMB a tax exempt retirement benefit in accordance with Section 9(7a) of the Ordinance, and within six months from date of retirement has renewed his employment with the Bank, the said retirement benefit that had been received by him will be deemed a salary and the Bank will withhold the required tax from this amount.
- It has been agreed that any payment made to the employees of the banks involved in the change in the organizational structure as a result of such change by the merged banks, will be deemed employment income and tax will be withheld there from in accordance with the Income Tax Regulations (Withholding tax from salaries and wages and payment of employer tax), 1993.

29. PROVISIONS FOR TAXES ON INCOME (CONTINUED)

General terms:

- The Bank and DMB have committed to include in their financial statements and in the tax adjustment statements, a note describing the changes created by the merger including the terms of the tax decision, starting with the first statements submitted after the date of the tax decision.
- The tax decision clarified that it should not be deemed to be a tax assessment and/or confirmation of the facts presented to the Tax Authorities. The facts presented as above might be examined by the Tax Assessing Officer.
- The tax decision clarified that it had been issued on the basis of presentations and documents provided to the Tax Authorities, in writing or orally, including those detailed in the tax decision, and subject to the terms specified in Part II of the Ordinance.
  The tax decision will be retroactively cancelled if it transpires that the details and facts presented as part of the application are incorrect or are materially incomplete, or if it transpires that material items presented have not materialized or that the terms specified by the Director in this tax decision have not been fulfilled.
- The tax decision clarifies that any expense involved, directly or indirectly, in this change in the organizational structure, including legal, accounting, experts, consulting expenses and any levies, may not be allowed, whether directly or indirectly, the parties to the change in status detailed in the tax decision, and/or to parties related to them, as a deduction tax wise or as an expense under Section 17 of the Ordinance.
- The Bank and DMB are obliged, jointly and separately, to confirm in writing to the mergers and splits department of the Tax Authority and to the Tax Assessing Officer, within thirty days from date of the tax decision, that they agree to accept all the terms of the tax decision as stated, without any qualification. If the said confirmations are not received by the due date, the tax decision will be retroactively withdrawn (approvals, as stated, have been duly delivered).

M. **Taxation of the foreign banking subsidiaries.** In accordance with an agreement reached with the Israeli Tax Authorities, the earnings of the foreign banking subsidiaries are added to the Bank's chargeable income, so that the Bank complements the taxes paid abroad on the pre-tax accounting profits of the foreign subsidiaries to the amount of taxes that would have been paid in Israel based on the tax rate applicable to the Bank in Israel.

30. LEGISLATION INITIATIVES

Several legislation issues exist (laws, regulations and administrative instructions) which are at different stages of the enactment proceedings. Certain of these issues are liable to have an adverse effect on the Bank's operations and its consolidated subsidiaries and their business results in the future. The Bank is not able to evaluate the scope of such effect.

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 determine, among other things, the disclosure requirements and the manner of presenting the financial results of segments in the financial statements.

In July 2005, the Supervisor of Banks published a "Questions and Answers" file about the disclosure of segment information. The said file stated, among other things, that the segments requiring disclosure in the Note are: 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).

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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 ("MDB") Banking 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 MDB in that Bank's household segment - private customers of MDB, whose activities are typical of those households, including credit of 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 Banking Division and customers of MDB which are defined as small companies and small businesses with borrowings of up to NIS 10 million.
- **Corporate Banking:** The segment includes mainly corporations with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 50 million, which are customers of the Bank and of MDB. The segment also includes customers of IDB New York's corporate banking segment.
- **Middle Market banking:** This segment includes mainly corporations with annual turnovers exceeding NIS 30 million and/or total indebtedness of NIS 10-50 million, which are customers of the Bank and of MDB. The segment also includes customers of IDB New York's commercial banking segment.
- **Private banking:** This segment includes as part of the Bank's customers (individuals and corporations) who receive banking services at the private banking centers. These customers are generally Israeli customers with financial wealth held with the Bank of NIS 4 million and over, to foreign resident customers with financial wealth held at the Bank of US$1 million and above. The segment also includes customers of MDB and the London branch 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 the nostro operations of the Bank, MDB and IDB New York involving securities and other banks for their own account, as well as management of market and liquidity risks and dealing room operations, including those involving financial derivatives. This segment also includes the Bank's share in the income of FIBI and its share in the income of its affiliated companies which operate in a supporting capacity. The segment also includes the sub-segment of non-financial corporations, which includes 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 credit loss expenses. 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 Bank's nostro securities and from deposits from the public are also reflected in the "Financial Management" segment.

Credit loss expenses are included in the segment in which the activity of the customer is reflected, in respect of which the expenses have been written. In the same manner, collection is also reflected in the segment in which the activity of the customer is reflected.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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 dealing room.

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 Bank's various units. (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 Banking 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.

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 35.34% (2011: 34.48%).

Segments showing a loss recorded a tax income computed also on the basis of the statutory tax rate.

The difference between the net taxes attributed to the segments of operation and the provision for taxes recorded in the income statement, is charged to the "Financial Management" segment.

3. Allocation of capital and computation of the return

Shareholders' equity and subordinated capital notes, being part of the financing sources of credit, are being allocated to each segment in respect of its risk assets. According to directives of the Supervisor of Banks, the segments of operations are credited with imputed interest on the capital allocated to them, on the basis the risk assets attributed to the segment.

The average balance of risk assets presented in the Note was computed in relation to risk assets calculated in accordance with the principles of Basel II (until December 31, 2009 - according to the principles of Basel I).

Computation of the return in each segment was made in accordance with the equity attributed, as stated, to the segment. Until 2010, each segment had been allocated capital at the rate of 7%. Since 2011, the allocation of capital increased to 7.5%, in accordance with the target determined by the Bank's Board of Directors.

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 the Bank's customers, 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 head offices, and the total expenses of the head offices and administrations to the customers whom they serve. Finally, the costs of the general head office units (management, human resources, comptroller, operations and computer services, etc.) to all the customers of the Bank.

According to the system described above, each customer "bears" its own relevant expenses, which are accumulated in the various segments according to the affiliation of customers to these segments.

The format described above does not allow the determination as to what expenses of one segment were charged to another segment (referred to in the reporting format as "inter-segment activity"). The Supervisor of Banks permitted the Bank to report on the basis of the mechanism it developed for the purpose of allocating income and expenses, and inconsequence thereof not to report inter-segment transfers.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments

	For the year ended December 31,2012							
						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Interest income, net								
- From external sources	237	751	1,453	774	(29)	2	1,271	4,459
- Intersegmental	1,205	26	(421)	(170)	414	-	(1,054)	-
Total Interest income, net	1,442	777	1,032	604	385	2	217	4,459
Non-interest financing income	27	6	50	15	10	61	183	352
Commissions and Other income	1,497	492	442	184	231	2	57	2,905
Total income	**2,966**	**1,275**	**1,524**	**803**	**626**	**65**	**457**	**7,716**
Credit loss expenses	19	98	467	127	10	-	5	726
Operating and other expenses	2,600	777	675	415	575	7	777	5,826
Profit (loss) before taxes	347	400	382	261	41	58	(325)	1,164
Provision for taxes (tax savings) on profit	88	128	127	86	17	7	(46)	407
Profit (loss) after taxes	**259**	**272**	**255**	**175**	**24**	**51**	**(279)**	**757**
Bank's share in operating income of affiliated companies	3	-	-	-	-	1	100	104
Net income from ordinary operations Attributed to the non-controlling rights holders	(38)	(9)	(10)	(2)	-	-	-	(59)
Net Income (loss) Attributed to the shareholders of the Bank	**224**	**263**	**245**	**173**	**24**	**52**	**(1)(179)**	**802**
Return on equity (percentage)	**10.7**	**29.5**	**5.9**	**10.2**	**6.4**	**54.6**	**(9.4)**	**7.1**
Average Assets	37,433	12,592	45,901	18,548	6,561	824	81,275	203,134
Of which - Investment in Investee companies	10	(2)	-	-	-	29	1,570	1,607
Average Liabilities	68,692	16,085	27,371	6,923	38,008	729	33,845	191,653
Average Risk-assets	28,020	11,858	55,557	22,690	5,182	1,271	14,587	139,165
Average assets of provident and mutual funds	-	-	-	-	-	-	1,977	1,977
Average securities	34,064	7,088	90,787	7,319	26,609	-	-	165,867
Average other assets under management	4,259	344	590	2,040	310	-	-	7,543
Margin from credits activity	814	643	950	527	89			
Margin from deposits activity	628	134	82	77	296			
Total Interest income, net	**1,442**	**777**	**1,032**	**604**	**385**	**2**	**217**	**4,459**

Note:
(1) For details regarding the provision for impairment in value of the investment in FIBI, see Note 6 E (3).

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments (continued)

	For the year ended December 31,2011[(3)]							
						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Interest income, net[(1)]								
- From external sources	[(2)](757)	644	2,009	885	(568)	6	2,398	4,617
- Intersegmental	2,284	143	(1,076)	(213)	905	-	(2,043)	-
Total Interest income, net[(1)]	1,527	787	933	672	337	6	355	4,617
Non-interest financing income[(1)]	47	13	56	11	11	76	(116)	98
Commissions and Other income[(1)]	1,497	451	414	216	256	(3)	[(4)]8	2,839
Total income	**3,071**	**1,251**	**1,403**	**899**	**604**	**79**	**247**	**7,554**
Credit loss expenses	148	109	287	161	37	-	36	778
Operating and other expenses	2,541	875	574	511	569	6	[(4)]769	5,845
Profit (loss) before taxes	382	267	542	227	(2)	73	(558)	931
Provision for taxes (tax savings) on profit	113	87	180	74	2	6	(348)	114
Profit (loss) after taxes	**269**	**180**	**362**	**153**	**(4)**	**67**	**(210)**	**817**
Bank's share in operating income of affiliated companies	3	-	-	-	-	-	[(2)(5)]98	101
Net income from ordinary operations Attributed to the non-controlling rights holders	[(2)](53)	(6)	(9)	(3)	-	-	-	(71)
Net Income (loss) Attributed to the shareholders of the Bank	**219**	**174**	**353**	**150**	**(4)**	**67**	**(112)**	**847**
Return on equity (percentage)	**9.0**	**16.5**	**9.9**	**8.6**	**(1.1)**	**77.3**	**(10.3)**	**8.2**
Average Assets	37,054	13,427	43,289	19,381	6,474	718	71,551	191,894
Of which - Investment in Investee companies	10	(2)	-	-	-	28	1,509	1,545
Average Liabilities	64,177	14,284	25,405	7,997	35,512	721	33,002	181,098
Average Risk-assets	32,261	14,007	47,612	23,233	5,261	1,156	16,460	139,990
Average assets of provident and mutual funds	-	-	-	-	-	-	2,295	2,295
Average securities	34,324	8,574	85,985	10,593	25,333	-	-	164,809
Average other assets under management	3,690	364	412	1,248	2,249	-	-	7,963
Margin from credits activity	848	645	860	585	95			
Margin from deposits activity	679	142	73	87	242			
Total Interest income, net[(1)]	**1,527**	**787**	**933**	**672**	**337**	**6**	**355**	**4,617**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Reclassified - following the reclassification made by Mercantile Discount Bank, intended to reflect updated definition of segments of operations resulting from a change in the organizational structure at Mercantile Discount Bank, and in order to reflect the results of a comprehensive expenditure survey, conducted for the purpose of updating the distribution of expense data by segments of operation of the Mercantile Discount Bank.

(4) Reclassified, see Note 1 C 5.3.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments (continued)

	For the year ended December 31,2010[(2)]							
						Financial		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Financial Management	Total Consolidated
	in NIS millions							
Interest income, net[(1)]								
- From external sources	1,940	1,136	736	807	291	4	(363)	4,551
- Intersegmental	(587)	(267)	277	(145)	35	-	687	-
Total Interest income, net[(1)]	1,353	869	1,013	662	326	4	324	4,551
Non-interest financing income[(1)]	[(4)]8	2	9	19	5	11	[(4)]118	172
Commissions and Other income[(1)]	1,553	499	315	224	229	(26)	30	2,824
Total income	**2,914**	**1,370**	**1,337**	**905**	**560**	**(11)**	**472**	**7,547**
Credit loss expenses	195	218	215	181	10	-	2	821
Operating and other expenses	2,404	913	607	528	477	4	726	5,659
Profit (loss) before taxes	315	239	515	196	73	(15)	(256)	1,067
Provision for taxes (tax savings) on profit	97	83	164	39	34	(9)	71	479
Profit (loss) after taxes	**218**	**156**	**351**	**157**	**39**	**(6)**	**(327)**	**588**
Bank's share in operating income (loss) of affiliated companies	3	(1)	-	-	-	4	[(5)]166	172
Net income from ordinary operations Attributed to the non-controlling rights holders	(70)	-	-	-	-	-	-	(70)
Net Income (loss) Attributed to the shareholders of the Bank	**151**	**155**	**351**	**157**	**39**	**(2)**	**(161)**	**690**
Return on equity (percentage)	**7.2**	**14.5**	**9.2**	**10.0**	**12.0**	**(2.4)**	**(14.7)**	**6.9**
Average Assets	33,405	15,467	45,410	17,946	6,591	[(3)]788	[(3)]66,577	186,184
Of which - Investment in Investee companies	9	(1)	-	-	-	23	1,613	1,644
Average Liabilities	59,397	15,233	21,690	10,169	36,346	721	32,468	176,024
Average Risk-assets	29,851	15,320	54,417	22,452	4,645	1,094	14,504	142,283
Average assets of provident and mutual funds	27	10	230	16	187	-	2,292	2,762
Average securities	33,180	9,697	75,119	13,939	22,469	-	-	154,404
Average other assets under management	3,614	347	182	1,361	2,187	-	-	7,691
Margin from credits activity	871	756	927	566	101			
Margin from deposits activity	482	113	86	96	225			
Total Interest income, net[(1)]	**1,353**	**869**	**1,013**	**662**	**326**	**4**	**324**	**4,551**

Notes:

(1) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(2) Reclassified - following the reclassification made by Mercantile Discount Bank, intended to reflect updated definition of segments of operations resulting from a change in the organizational structure at Mercantile Discount Bank, and in order to reflect the results of a comprehensive expenditure survey, conducted for the purpose of updating the distribution of expense data by segments of operation of the Mercantile Discount Bank.

(3) Reclassified, classification of the income from realization of certain shares from the financial Management segment to the Non-Financial Companies sub-segment.

(4) Reclassified, classification of the income from realization of certain shares from the Household segment to the financial Management segment.

(5) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

D. Information on geographical areas

	Income[1]			Net Income			Total Assets	
	For the year end December 31						As at December 31	
	2012	2011[3]	2010[3]	2012	2011[3]	2010[3]	2012	2011
	in NIS millions							
Israel	6,638	6,564	6,316	719	[2][4]935	[4]574	159,424	[2][4][5]162,295
Europe	126	101	116	(52)	(194)	(33)	4,238	4,336
North America	773	728	951	117	84	126	33,055	31,992
South America	179	161	164	18	22	23	4,163	3,849
Total Overseas	**1,078**	**990**	**1,231**	**83**	**(88)**	**116**	**41,456**	**40,177**
Total Consolidated	**7,716**	**7,554**	**7,547**	**802**	**847**	**690**	**200,880**	**202,472**

Notes:

(1) Income – Interest income, net, before credit loss expenses and non-interest income.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Reclassified following the initial implementation of the directives of the Supervisor of Banks regarding the new format for the statement of income, see Note 1 C 5.1.

(4) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8 to the financial statements.

(5) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7 to the financial statements.

32. EARNMARKED DEPOSITS, CREDIT AND DEPOSITS FROM EARNMARKED DEPOSITS

	Consolidated		The Bank	
	December 31		December 31	
	2012	2011	2012	2011
	in NIS millions			
Credit and deposits from earmarked deposits				
Credit granted to the public	177	*218	177	*218
Total	**177**	**218**	**177**	**218**
Earmarked deposits				
Deposits from the public	2	2	2	2
Deposits from the Government	178	196	178	196
Total	**180**	***198**	**180**	***198**

Reclassified – Setoff of intercompany balance with DMB.

33. CREDIT CARD ACTIVITY

A. Holding means of control in Diners

The establishment of the YOU customer club and the sale of the means of control in Diners. Pursuant to an agreement dated November 29, 2005, ICC sold to 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 an effort for the strengthening of the cooperation and intensifying the penetration of YOU Club into the market, addendum to the set of agreements between ICC and Blue Square Israel Ltd., MEGA Retail Ltd., Dor Allon Energy (1988) Ltd., Dor Allon Finance Ltd. and the Blue Square-Dor Allon Consumer Club (hereinafter jointly: "the Allon Group"), in the matter of the continued joint ownership of Diners was signed on August 31, 2011. According to the Addendum, the existing agreement in the matter of the joint activity in Diners was changed and the YOU Club agreement was extended until the end of 2015. The Addendum outlines a new distribution method for the earnings of Diners so that it will not be subject to attaining a quantitative target for the operations of YOU Club. The Addendum to the agreement also grants the Allon Group the right to realize their investment in Diners as from December 31, 2015, at the value specified in the agreement (PUT option).

33. CREDIT CARD ACTIVITY (CONTINUED)

B. Arrangements between the credit card companies and between such companies and the banks

1. **Arrangements between credit card companies – VISA Cards.** At the beginning of September 2001, ICC, The First International Bank ("FIBI"), 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.

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.

A provisional permit for the agreement. 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. On August 7, 2011, the Tribunal instructed that the provisional permit be extended until December 31, 2011, on condition that the average rate of the cross commission, shall not exceed 0.875%, starting with November 1, 2011.

Amended cross clearing arrangement – reduction of the issuer commission rate. On December 28, 2011, the Commissioner and the Appellants submitted for approval of the Tribunal a motion requesting a status of a Court verdict for a compromise agreement between them, to which had been attached an amended cross clearing arrangement(hereinafter: "status request" and "the amended arrangement", respectively).The compromise agreement determines, among other things, as follows:

- The Commissioner informs that in view of the exogenous changes that have occurred since the submission to the Tribunal of the complementary opinion, and following his examination of the arguments detailed in the complementary opinion, he is of the opinion that the issuer commission of 0.7% is the proper commission for the purpose of the compromise agreement;
- The reduction of the issuer commission to 0.7% shall be applied gradually as detailed in the amended arrangement, as follows:
  (1) Until June 30, 2012, the issuer commission will amount to an average rate not exceeding 0.875%;
  (2) As from July 1, 2012, the issuer commission will be reduced for a period of six months, to an average rate not exceeding 0.8%. Also, the addition at the rate of 0.15% in respect of transactions where the magnetic strip on the credit card or on the clever card has not been read at the Point of Sale (P.O.S.), shall be cancelled;
  (3) As from January 1, 2013, the issuer commission will be reduced for a period of six months, to an average rate not exceeding 0.75%;
  (4) As from July 1, 2013, the issuer commission will be reduced for a period of one year, to an average rate not exceeding 0.735%;
  (5) As from July 1, 2014 and until the termination of the arrangement period (December 31, 2018) the issuer commission will be reduced to an average rate not exceeding 0.7%.

The Antitrust Tribunal approved on March 7, 2012, the said compromise arrangement.

On April 29, 2012, Clalit Health Services filed an appeal with the Supreme Court against the decision of the Antitrust Tribunal. The appeal focuses on the "Clalit" arguments, with regard to its non-classification in the bottom category of trading houses. The case is fixed for hearing on September 30, 2013. According to an order of the Supreme Court, summation briefs in writing and responses to the summation briefs shall be submitted by the parties until the end of July 2013.

33. CREDIT CARD ACTIVITY (CONTINUED)

It should be noted that the effect of the reduction in the cross commission results from various parameters, including: the scope of commissions collected from trading houses, the scope of royalties paid to banks with whom ICC is engaged in a joint issuance agreement, various operating commissions, the volume of clearing operations, including the opening to competition of the IsraCard credit card market, and more. It is difficult to evaluate each one of the said parameters in itself and to evaluate their combined effect and particularly in view of the fact that their effect is reflected gradually over a period of time. In view of the above, ICC believes that it is not possible to assess the scope of the effect of the reduction in the cross commission on its business results. However, ICC and the Bank are of the opinion that the business results of ICC will be materially adversary affected as a result of the said reduction in the cross commission.

2. **"IsraCard" credit cards clearing arrangement.** On May 14, 2012, IsraCard Ltd. and ICC signed a license agreement, according to which ICC has been granted a non-exclusive license for the clearing of IsraCard credit card transactions in Israel. In accordance with the license, ICC would be entitled to clear transactions made at trading houses in Israel by means of IsraCard credit cards, using the cross-clearing interface, and for this purpose, engage with trading houses in Israel for the supply of clearing services, and to supply services related to the clearing of transactions made through the cards (card services). The agreement will be in force from May 15, 2012 and until May 15, 2017. In consideration for the license, ICC is committed to pay a one-off license fee plus an annual fee computed in accordance with a mechanism determined in the agreement (as a function of the clearing turnover).

Concurrently, the parties signed a cross-clearing agreement with respect to transactions to be effected by IsraCard credit cards, according to which the said clearing will be effected using the joint interface under the terms of the agreement relating to the clearing of transactions made by the VISA and MaterCard credit cards (as they apply from time to time) (hereinafter: "the Arrangement").

The cross-clearing agreement entered into effect upon its approval in accordance with the Antitrust Act, and shall expire on date of expiry of the license or on date of expiry of the Arrangement, whichever is earlier.

On September 13, 2012, the Antitrust Commissioner granted an exemption, for a period of three years, in respect of the arrangement between the company and IsraCard Ltd. as well as to the arrangement between LeumiCard Ltd. and IsraCardLtd., under the terms stated in the Commissioner's decision, including:

- IsraCard will not collect from the company and from LeumiCard any additional payment in excess of the issuer commission, a one-time license fee and an additional payment being a percentage of the turnover of clearing "IsraCard" transactions, as determined in the exemption;
- The cross-clearing commission rates ("issuer commission") payable by the clearing agent of the IsraCard brand to the Issuer of this brand, shall not exceed the rates specified in the cross-clearing arrangement approved on March 7, 2012, in a rulling of the Antitrust Tribunal;
- The cross-clearing of the IsraCard brand shall be subject to the terms for approval of the cross-clearing arrangement for the MasterCard and VISA brands approved by the said ruling.

  On February 7, 2013, IsraCard applied to the Antitrust Tribunal requesting approval for the terms of arrangement in accordance with the provisions of an agreement between IsraCard and ICC, replacing the terms determined in the decision of the Commissioner.

3. **A joint issuance agreement between ICC and owner banks.** Agreements were recently reached between FIBI and ICC and also between the Bank and ICC, regarding the terms of the issuance agreement between ICC and each of the aforesaid banks. To date, the engagement between the parties has been approved by only some of the authorized organs of the parties. According to the outline of the agreement, there will be a material increase in the rate of royalties that are paid to the Bank and to FIBI. The changes in the terms of the joint issuance agreement with FIBI will be implemented with effect from the beginning of 2012, while the changes in the terms of the joint issuance agreement with the Bank will be implemented with effect from the beginning of 2013. The issuance agreements will be valid for 5-year periods. The Bank believes that the said change in terms will not impair the profitability of the credit card operations segment (at the Group level).

Talks are being held between the parties to consider the possibility of granting an equity-based compensation instrument to FIBI (“The Instrument”), which, under certain circumstances, would give ICC an option to convert it into a cash payment. The exercise of the instrument will be contingent on FIBI’s holdings in ICC being less than 10%.

33. CREDIT CARD ACTIVITY (CONTINUED)

4. **A joint issuance agreement with Mizrahi-Tefahot Bank.** On November 18, 2008, ICC and Diners signed an agreement with Mizrahi-Tefahot Bank for the joint issuance of VISA, MasterCard and Diners Club credit cards, including Mizrahi-Tefahot branded cards, and for determining operating arrangements and providing services by ICC and/or Diners for credit cards issued by them and distributed by Mizrahi-Tefahot Bank to its customers. This agreement replaces the agreement between the parties dated July 26, 1995, as amended.

   The agreement is for a period of five years from date of signature. In the event that the option for the purchase of ICC shares described hereunder is exercised or redeemed, the period of the agreement will be extended to ten years from date of signature. The agreement period will be extended by additional periods of two years, unless a notice in writing is given by one party to the other, six months prior to the end of each period or additional period, of its reluctance to further extend the period of the agreement.

   The grant of an option to Mizrahi-Tefahot Bank to purchase up to 10% of ICC's share capital. Within the framework of the joint issuance agreement described above, Mizrahi-Tefahot Bank was granted an option to purchase from ICC, by way of a share issue, up to 121,978 ordinary shares in ICC, comprising at date of the agreement, 10% of the fully diluted ordinary share capital of ICC. The amount of shares allotted may be higher in the event that prior to the exercise of the option, ICC will issue shares at a price reflecting a value lower than market 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 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 exercise).

   The agreement is subject to all regulatory requirements under any law, if such exist.

5. **A joint issue agreement with Union Bank.** On July 1, 2010, ICC and Diners Club signed an agreement with Union Bank of Israel Ltd. (hereinafter - "Union Bank"). The agreement is for a period of ten years and it replaces a previous agreement between the parties, which expired on that date. Under this agreement, ICC and Diners club will issue credit cards, bank cards and combined cards to customers of Union Bank. The agreement determined operating arrangements and the granting of services by ICC and/or Diners Club for credit cards issued by them and distributed by Union Bank to its customers.

33. CREDIT CARD ACTIVITY (CONTINUED)

The granting of an option to Union Bank to purchase 3% of ICC's share capital. Within the framework the agreement, as described above, Union Bank has been granted a non-transferable option to purchase from ICC 32,934 ordinary shares of NIS 0.0001 par value each in ICC, which comprised at date of the agreement 3% of the issued and paid ordinary share capital of ICC, subject to adjustment events determined in the agreement, and this at date of completion of a public issue of securities of ICC, if such will materialize, and subject to the completion of the issue. The exercise price of the option reflects a discount of 25% on the gross price of the shares as determined in the prospectus for the public offer. ICC, at its own judgment, has the right to exchange the option shares for a one-time payment in an amount equal to the exercise price multiplied by the total number of the option shares as if the option has been fully exercised.

The shares arising from the exercise of the option, if at all, shall not be transferable to a competitor of ICC.

The option is in effect during the period of the agreement, subject to a series of business conditions as determined in the agreement.

ICC's decision to issue shares to Union Bank requires the approval of the Bank's Board of Directors.

C. Events regarding the clearing of international electronic trade transactions and other matters. In the second half of 2009 and in the beginning of 2010, ICC faced allegations made by VISA Europe and the Global MasterCard Organization (hereinafter: "the international organizations") with respect to prima facie violations of the rules of these organizations pertaining to the clearing of international electronic trade, in transactions effected by a subsidiary of ICC, ICC International (which had in the meantime been merged with and into ICC). In this framework, fines have been imposed on ICC and its activity in this field of operations has been restricted for a period of several months.

ICC has immediately implemented a reduction plan in order to comply with the requirements of the international organizations, in the framework of which it applied various measures, including changes in the company's management.

A number of trading houses and clusterers had raised demands regarding the burden of monetary sanctions applying to them and the reduction in electronic trade clearing operations conducted with them, which as alleged by them, resulted in heavy damage. Recently, one of the clusterers, has once more raised demands in material amounts in respect of alleged damage. ICC dismisses the demands of the clusterer.

Several internal audits conducted at ICC International towards the end of 2009 and in the first quarter of 2010 by the Internal Auditor of ICC and ICC International, produced findings that indicate deficiencies in various areas.

The Internal Auditor also examined various aspects related to the operations of ICC, including improper conduct by organs of ICC and suspicion in respect of various unauthorized engagements. The audit findings have been discussed by the relevant organs of ICC.

With the help of outside consultants, ICC's management conducted a process of drawing conclusions as regards the deficiencies found.

Police investigation. During the period of December 2011 – February 2012, investigators of the Israel Police entered the ICC offices in Givataim and seized various documents and computer material. The search warrant presented by the investigators indicated an investigation in the matter of "reasonable suspicion regarding the felony of false entries in corporate documents, money laundering and fraudulent possession". To the best knowledge of ICC and the Bank, the investigation relates mostly to the activity of ICC International, which operated in the field of international electronic trade clearing. To the best knowledge of ICC and the Bank, employees of ICC have been asked to provide evidence and explanations, but there were no present employees or officers interrogated by the police under warning.

34. INTERIM REPORT OF THE TEAM FOR EXAMINING THE INCREASE IN COMPETITION IN THE BANKING INDUSTRY

On July 15, 2012, the team, headed by the Supervisor of Banks, who was appointed in December 2011, by the Governor of the Bank of Israel and the Minister of Finance, following the recommendation of the Committee for Social-Economic Change ("Trachtenberg Committee), issued an interim report for comments by the public.

The team had reviewed competitive aspects in the banking industry and in the financial system, as well as developments in the Israeli credit market in the last decade.

The team examined various measures for increasing competition in the banking industry, among other:

34. INTERIM REPORT OF THE TEAM FOR EXAMINING THE INCREASE IN COMPETITION IN THE BANKING INDUSTRY (CONTINUED)

- Increase in the number of participants within and outside the banking industry – the team reviewed several alternatives for increasing the number of players in this sector, including an increase in activity of off-banking credit suppliers (institutional and other bodies), encouraging the establishment of an internet bank and credit unions, encouraging the entry of foreign banks into the market in Israel and expanding the banking operations of the Post Office Bank. The Supervisor of Bank is to advance the establishment of an internet bank and credit unions, and guide entrepreneurs, both by modifying the regulations and by providing suitable guidance;
- Internet banking as a significant tool for increasing competition among banks and removal of barriers regarding the transfer of customers from bank to bank. Among other things, the team recommended the opening of bank accounts through the internet, facilitate the process of closing a current account, also through use of the internet, the publishing of interest rates in effect and increasing accessibility to sources of information for comparison purposes;
- Information in the hands of the customer ("bank identity card") - the team recommends the formation of concentrated and summarized information regarding the aspects of customer activity, providing to the customer relevant and comparable data, which will enable competing banks to evaluate the customer;
- Improving information regarding "credit bureau" – extending the information existing at present at credit bureaus, providing information to credit bureaus for the establishment of a statistical model for credit rating; providing information about customers at their request through technological means, and providing information regarding internal rating of borrowers to potential lenders (as part of the said "bank identity card");
- Regularizing of aspects relating to the off-banking credit market, in particular – applying of equal rules on all factors engaged in the granting of credit, both banking and off-banking;
- Increasing competition regarding savings of individuals (households) – determining reduced commission rates on investments in short-terms loans (MAKAM) and in monetary funds, comprising an alternative investment tool to shekel deposits, and abolition of management fees in their respect;
- Supervision over commissions, including: abolition of commissions in respect of an information card and cash withdrawal card; supervision over commission regarding the mailing of notices to the customer; abolition of commission regarding the handling of loans and collateral for loans in amounts of up to NIS 100 thousand (instead of NIS 50 thousand at present); reducing the number of commissions regarding foreign currency transactions; abolition of the commission regarding the change in date of charging credit card transactions;
- Bank customer securities activity – increasing transparency regarding commissions relating to securities transactions, re-pricing of services and facilitating the movement of customers between the banking industry and the off-banking sector;
- Small business sector - reduction in commissions relating to small businesses and facilitating the process of early repayment of commercial credit;
- Maintaining benefits and discounts in credit and deposits – determination of an arrangement whereby, in the case of loans and deposits carrying variable interest, where a discount or benefit is offered in the rate of interest compared to the published interest rate, the benefit will apply throughout the period of the deposit or the benefit.

The team noted that certain of the measures would require legislation amendments in cooperation of the Ministry of Justice, the Ministry of Finance and the Bank of Israel. Nevertheless, certain of the measures require the amendment of Proper Banking Management Directives and reporting instructions, which are subject to the authority of the Supervisor of Banks, and will have to be effected within the framework of the accepted procedures of the Supervisor of Banks regarding amendment of the instructions.

Banking Rules (Customer service) (Commissions) (Amendment), 2012. The Banking Rules (Customer service) (Commissions) (Amendment), 2012 (hereinafter: "the Amendment") were published in the Official Gazette on December 27, 2012, as a move for the implementation of the recommendations of the team examining competition in the banking industry. The main items of the Amendment are:

- Revocation of the small business management fee commission;
- Revocation of the information card commission;
- Revocation of cash withdrawal card commission;
- Credit and collateral handling commission – increasing the exemption from a maximum level of NIS 50,000 to a maximum level of NIS 100,000.
- Fixing a maximum commission for the buying or selling of securities;
- Revocation of securities deposit management fees in respect of MAKAM and monetary funds;

34. INTERIM REPORT OF THE TEAM FOR EXAMINING THE INCREASE IN COMPETITION IN THE BANKING INDUSTRY (CONTINUED)

- Revocation of the minimum commission within the framework of securities deposit management fees;
- Differential pricing in respect of the buying and selling of securities on the Internet;
- Expanding the supervision over the transfer of securities deposit commission also to the transfer of a customer's deposit outside the banking industry;
- Amendment of the definition of a "senior citizen" – presentation of a senior citizen card shall no longer be required in order to enjoy the price of a direct banking transaction also in respect of four teller transactions per month. This benefit shall be granted automatically upon the customer reaching the age stated in the Law;
- Banks are required to publish on their home page of their Internet websites a direct link to the commission tariff page;
- Bank guarantee – law enactment for the statement of the Supervisor of Banks, effective as from March 1, 2012, according to which, a bank guarantee collateralized by a cash deposit, shall enjoy a reduced rate of commission;
- Revocation of commission in respect of the change of date of charging credit card transactions.

The Amendment is effective as from January 1, 2013. The Bank has made the necessary changes required by the Amendment.

Letter of the Supervisor of Banks regarding the re-pricing of commissions in respect of securities operations. On November 28, 2012, the Supervisor of Banks instructed banking corporations to take action and re-price the commissions charged for the buying, selling and maturing of shares and bonds, taking into account the changes by power of the Amendment and the need to adjust them, to the extent possible, to their actual cost. Banking corporations have to inform the Supervisor of Banks by March 1, 2013, of the new rates of commissions, together with the publication of a notice to the public as to such changes. In addition, the Supervisor of Banks instructed to change the manner of granting rebates on commissions in respect of securities operations, so that it will be based on the rate or amount of the commission and not on the basis of a rebate rate from the rate or amount of the tariff commission, this in respect of new agreements or renewed agreements as from March 1, 2013. The Bank is preparing for the implementation of the instructions of the Supervisor of Banks.

At this early stage, prior to the formation of the final report and prior to the required legislation and regulation amendment process, it is not possible to evaluate the impact of implementation of the recommendations of the team and its materiality. Nevertheless, if the recommendations included in the draft report in general, and those included in the draft principles in particular, are implemented according to their letter, they may have a material negative impact, upon the Bank's earnings in the future.

35. EARNING PER SHARE

	Consolidated		
	2012	2011	2010
Basic earnings per share of NIS 0.1 (in NIS)			
Total net income, attributed to bank's shareholders	**0.76**	(1)(2)(3)**0.80**	(1)(2)(3)**0.69**
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	**1,053,869**	**1,053,869**	**997,578**

Footnotes:

(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.

(2) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(3) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 C 8.

36. INFORMATION BASED ON NOMINAL DATA FOR TAX PURPOSES - THE BANK

	December 31,	
	2012	2011
	in NIS millions	
Balance Sheet		
Total assets	139,874	(3)(2)(1)143,904
Total liabilities	128,372	133,567
Equity capital attributed to the Bank's shareholders	11,502	(3)(2)(1)10,337

	For the Year Ended on December 31	
	2012	2011
	in NIS millions	
Statement of Income		
Net income	833	(3)(2)(1)868

Footnote:

(1) Restated in respect of the retroactive implementation of the directives of the Supervisor of Banks regarding put options granted to the non-controlling rights holders, see Note 1 D 2.2.

(2) Restated with respect to the retroactive implementation of IAS 12, "Income taxes", see Note 1 D 18.7.

(3) Amended following an immaterial adjustment of the comparative figures at FIBI – see Note 1 c 8.

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BANKING
Mercantile Discount Bank

CAPITAL MARKETS
Israel Discount Capital Markets & Investments
Tachlit Discount - Portfolio Management

FINANCIAL
Israel Credit Cards
Diners Club
Discount Leasing
Discount Manpikim

TRUST SERVICES
Discount Trust

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Short Hills, NJ Branch:
150 JFK Parkway
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