



ANNUAL REPORT 2011



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

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BOARD OF DIRECTORS

DR. JOSEPH BACHAR

Chairman of the Board

ILAN (EILON) AISH

ILAN BIRAN

(Outside Director)

JOSEPH CIECHANOVER - ITZHAR

ILAN COHEN

ELI ELIEZER GONEN

DAVID LEVINSON

EDITH LUSKY

(Outside Director)

RICHARD MORRIS ROBERTS

YALI SHEFFI

JORGE ZAFRAN

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

MANAGEMENT

REUVEN SPIEGEL

President & Chief Executive Officer

JOSEPH BERESSI

Senior Executive Vice President

Chief Accountant

Accounting Group

ESTHER DEUTSCH

Senior Executive Vice President

Chief Legal Adviser

Legal Advisory Group

YUVAL GAVISH

Senior Executive Vice President

Banking Division

ORIT ALSTER

Executive Vice President

Corporate Banking Division

SHLOMO AVIDAN

Executive Vice President

Operation and Logistic Division

YAIR AVIDAN

Executive Vice President

Chief Risk Officer

Risk Management Group

AVRAHAM (AVI) LEVI

Executive Vice President

Customer Assets Division

JOSEPH PERETS

Executive Vice President

Human Resources Group

IGAL RONAY

Executive Vice President

Finance Division

GILAD SOKOLON

Executive Vice President

Strategy, marketing and service division

SHAI VARDI

Executive Vice President

Technologies & Planning Division

NIR ABEL

Executive Vice President

Internal Auditor

RUTH MOSHKOVITZ

Corporate Secretary

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The first part of the paper discusses the importance of the research and the objectives of the study. It then presents a literature review of the existing research on the topic. The second part of the paper describes the methodology used in the study, including the data collection and analysis techniques. The third part of the paper presents the results of the study, and the fourth part discusses the conclusions and implications of the findings.

The research was conducted using a quantitative approach, and the data was collected from a sample of participants. The results of the study indicate that there is a significant relationship between the variables being studied. The findings suggest that the research has important implications for the field, and further research is needed to explore the topic in more detail.

In conclusion, the study has provided valuable insights into the research topic, and the findings have important implications for the field. The research was conducted using a rigorous methodology, and the results are reliable and valid. The findings suggest that the research has important implications for the field, and further research is needed to explore the topic in more detail.

THE DISCOUNT GROUP - GENERAL OVERVIEW AND PRINCIPAL DATA

The Board of Directors, on March 28, 2012, approved and authorized for publication the Bank's consolidated financial statements and its subsidiaries as of December 31, 2011.

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 seven 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 149 branches in Israel, direct banking services, on-line banking and Internet services.

The Bank has two banking subsidiaries in Israel - Mercantile Discount Bank Ltd. ("MDB") - a commercial bank serving customers in all fields of financial activity through 79 branches, and Discount Mortgage Bank Ltd.¹ ("DMB"), serving as the main arm of the Group in the mortgage loan field.

The activities in Israel also include:

- Credit cards - The Bank controls Israel Credit Cards Ltd. ("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." engages in investment banking, investments in private equity funds, in venture capital funds and in other non-financial investments. This subsidiary also engages in underwriting and managing the issue of securities, 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

¹For details regarding the decision to merge Discount Mortgage Bank Ltd. with and into the Bank, see below "Main investee companies".

holdings in FIBI, see Note 6 D to the financial statements).

OPERATIONS ABROAD

The overseas activity of the Discount Group is mostly conducted by subsidiary companies in the United States, South America (including representative offices in Latin America), in Switzerland and through 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 Zurich, as well as a representative office in Israel.

PRINCIPAL OPERATIONS DURING THE REPORTED PERIOD

During the reviewed period, the Bank has completed the staffing of its new Management. In addition the reorganization of the service layouts of the Corporate Division and of the Banking Division were completed and the Customer Asset Division has been established (see "Human resources" below).

Implementation of the Supervisor of Banks guidelines regarding impaired debts and regarding employee rights (see Note 1 B to the financial statements) reduced the total equity as of December 31, 2010, by NIS 835 million and NIS 417 million, respectively. Despite the aforementioned, the Bank's management succeeded in meeting and surpassing the capital adequacy goals, in accordance with the layout approved by the Bank's Board of Directors.

The principal events during the reviewed period are the approval of the strategic plan for the Discount Group for the years 2011-2013 (see below), the signing of collective labor agreements, which constitute a breakthrough in labor relations at the Bank and the putting into action of a wide scope retirement plan, within the framework of which 340 employees retired from the Bank (see "Human resources" below).

Furthermore, in November 2011, the Bank's Board of Directors approved the merger of Discount Mortgage Bank Ltd. with and into the Bank, a move that once completed, will enable the offering to customers of valuable and varied propositions in accordance with their needs, will increase income through utilizing the potential existing in the business activity, and will obtain saving in expenses due to reduction in duplicity and the merger of head office units (see "Main investee companies" below).

In December 2011, the Board of Directors of Mercantile Discount Bank approved a plan, which includes business and organizational processes, which will enable Mercantile Discount Bank to maximize its business advantages on the one hand, and make its structure of expenditure more efficient on the other (See "Main investee companies" below).

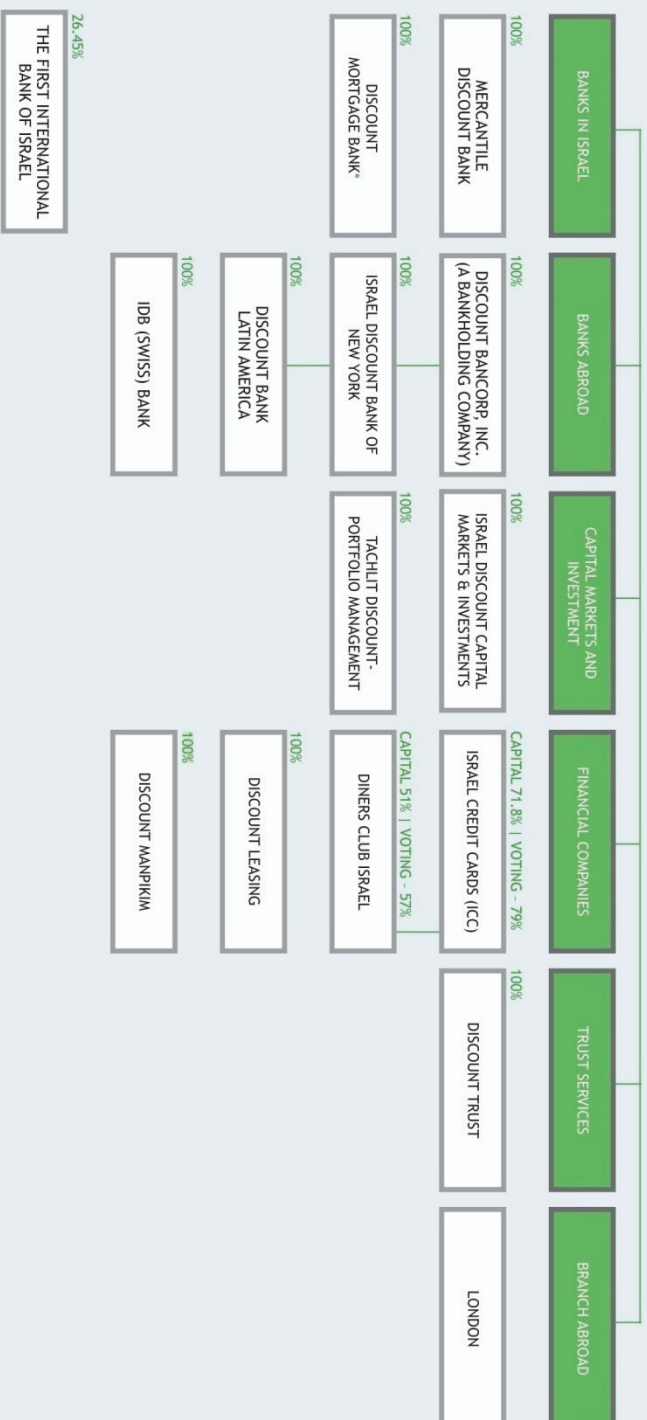
"Discount invest" service has recently been launched, an innovative capital market move within the framework of which the client has to his disposal, professional and upgraded communication channels, providing full coverage to all classes of customers and capital market operations. (See "Operations in the capital market" below).

MARKET SHARE AND ADITIONAL DETAILS

Based on data relating to the banking industry as of September 30, 2011, 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, 2011	December 31, 2010	December 31, 2009
	In %		
Total assets	17.5	17.4	17.9
Credit to granted the public, Net	15.2	16.1	16.6
Deposits from the public	17.5	17.1	17.8
Earnings from financing operations	18.8	19.2	23.0
Operating income	19.1	18.1	20.4

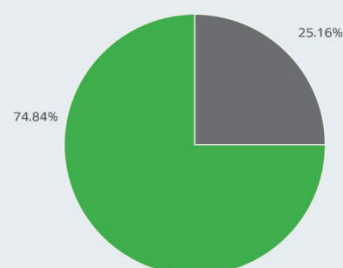
DISCOUNT GROUP STRUCTURE



*IN THE PROCESS OF MERGER WITH AND INTO THE BANK.

THE BANK'S SHAREHOLDERS

- Bronfman-Schron Group
- Public



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 US\$1 million and over, as well as foreign resident customers with financial wealth held at the Bank of US\$0.5 million and above. The segment also includes customers of 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 customers, as part of the services and products basket offered by the Bank.
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 derives income from payments transferred to it in respect of credit cards issued to its customers by ICC, at the Bank's initiative.
- **Operations in the Capital Market:** The operations in the capital market includes securities activity (excluding activity for the Bank's own account), portfolio management and pension products. The activity includes the Bank's operations in the securities field, pension layouts as well as the operations of a specialized subsidiary - Tachlit 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 industry classification is construction and real estate. This activity also includes customers of the construction and real estate segment of MDB, IDB New York and the London Branch and the loans for the purchase or construction of assets and the building project finance segment at DMB.
- **Mortgage Activity:** This activity includes the mortgage operations of the Discount Group in Israel (MDB and DMB). This segment includes the granting of loans for housing purposes (purchase, construction etc.) and the granting of loans for any purpose secured by a mortgage on a residential apartment or other property.

For 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 %	
	2011	2010	2009	2011	2010
	In NIS millions			compared compared with 2010 with 2009	
Income from financing operations before credit loss expenses	4,785	4,830	4,757	(0.9)	1.5
Credit loss expenses	778	821	998	(5.2)	(17.7)
Operating income after taxes	772	⁽²⁾ 552	⁽²⁾ 852	39.9	(35.2)
Net income attributed to the Bank's shareholders	852	⁽²⁾ 704	⁽²⁾ 918	21.0	(23.3)
Net earnings per one share of NIS 0.1 par value attributed to the Bank's shareholders - in NIS	0.81	⁽²⁾ 0.71	0.92		
The ratio of operating income before taxes to total equity in %	9.4	⁽²⁾ 11.6	18.4		
The ratio of operating income after taxes to total equity in %	8.4	⁽²⁾ 6.3	11.20		
Return on equity attributed to the Bank's shareholders, in %	8.2	⁽²⁾ 7.0	10.2		

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1

(2) Restated with respect to retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1.

BALANCE SHEET

	As at December 31		
	2011	2010	Rate of change
	In NIS millions		in %
Total assets	202,491	185,576	9.1
Credit granted to the public, net	116,383	118,666	(1.9)
Securities	42,898	37,176	15.4
Deposits from the public	153,368	138,011	11.1
Equity attributed to the Bank's shareholders	10,745	⁽²⁾ 10,824	(0.7)
Total equity	11,115	⁽²⁾ 11,152	(0.3)

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1

(2) Restated with respect to retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1.

FINANCIAL RATIOS

	As at December 31	
	2011	2010
	in %	
Ratio of total equity to total assets	5.5	⁽²⁾ 6.0
Ratio of capital to risk assets (Basel II)	14.08	⁽²⁾ 13.22
The core capital ration	8.06	⁽²⁾ 7.60
Ratio of the credit loss expenses regarding credit granted to the public	0.65	0.66
Ratio of credit granted to the public, net, to total assets	57.5	63.9
Ratio of credit granted to the public, net, to deposits from the public	75.9	86.0
Ratio of deposits from the public to total assets	75.7	74.4
Ratio of operating income to operating expenses	46.1	⁽²⁾ 47.0
Operating expenses to total income	78.1	⁽²⁾ 75.6
Risk assets adjusted return(3)	8.1	6.7

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1

(2) Restated with respect to retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1.

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

DEVELOPMENTS IN THE MARKET PRICE OF THE DISCOUNT SHARES

	Closing price at end of the trading day			Rate of change in
	2.1.2011	29.12.2011	25.3.2012	2011
Discount share	825.00	510.00	510.00	(38.2)
The Banks index	1,433.92	925.95	1,028.37	(35.4)
The TA 25 index	1,327.24	1,085.59	1,127.93	(18.2)
Discount market value (in NIS billions)	8.69	5.37	5.37	(38.2)

THE DISCOUNT GROUP STRATEGIC PLAN FOR THE YEARS 2011-2013

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. The preparations for the formation of a 5 year strategic plan will begin in the second half of 2012.

The strategic plan is based on the following layers:

- A. Capital Management – Targets have been set within the framework of the strategic plan for the strengthening of the group's capital infrastructure. Further to the Board's decision of March 2, 2011 (as detailed in the immediate report dated March 3, 2011, Ref. No. 2011-01-068337), which determined that the core capital ratio shall not fall below 7.5% until the end of 2011, core capital targets have been determined at the rate of 8% by the end of 2012 and 8.5% by the end of 2013. It has been further determined that the management of the capital shall be conducted through an efficient allocation of the risk assets of the group, and that measures would be taken to increase income.
- B. The absorption of a goal directed management culture.
- C. Improving the performance ability of the management information systems of the Group, for the integration of a performing organizational culture.
- D. Effective management of human resources.
- E. Group synergy – extraction of potential synergy in the marketing, operating and financial fields, with a view of obtaining the maximum operational efficiency and intensifying supervision and control within the Group.
- F. Group risk management on the basis of a differential "binding professional guideline" format in respect of the subsidiary companies.
- G. Efficiency - The Board of Directors has adopted an efficiency plan for the Group, within the framework of which a target has been set, according to which the group's efficiency ratio (total operating expenses in relation to total income) shall not exceed 69% in 2013 (as of June 30, 2011, on the eve of approval of the strategic plan, 74.5%). An adverse change in the economic situation or changes in regulation might postpone the implementation of this target. A central component of the efficiency plan is the labor relation issue at the Bank. For details regarding agreements between the Bank, the representative committee of the employees and the Union of Clerks signed in June 2011, and regarding the setting in motion a retirement plan, see under "Human resources" below. The strategic plan also includes efficiency measures in the field of operations and information systems in the Group.
- H. Measures intended to increase profitability - following a number of years in which the Bank focused on the expansion of its customer base, the new strategic plan focuses on increasing profitability, while maintaining the risk profile of the Group within the framework of the limitations and guidelines that had been and will be determined by the Board of Directors. Within this framework, the group will act to improve performance in the following fields: capital market activity, middle market banking, small businesses, households, direct channels and private banking for Israeli customers.

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 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 Bank's point of view and its subsidiaries at the time of preparation of the financial statements as to future events, based on evaluations that are uncertain. The Bank's evaluations and business plans 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.

EXPLANATIONS REGARDING THE BUSINESS CONDITION OF THE GROUP

INCOME AND PROFITABILITY

The Group's net income in 2011 amounted to NIS 852 million, compared with NIS 704 million in 2010, an increase of 21.0%.

Return on equity attributed to the Bank's shareholders for 2011 was 8.3%, compared with 7.0% in 2010.

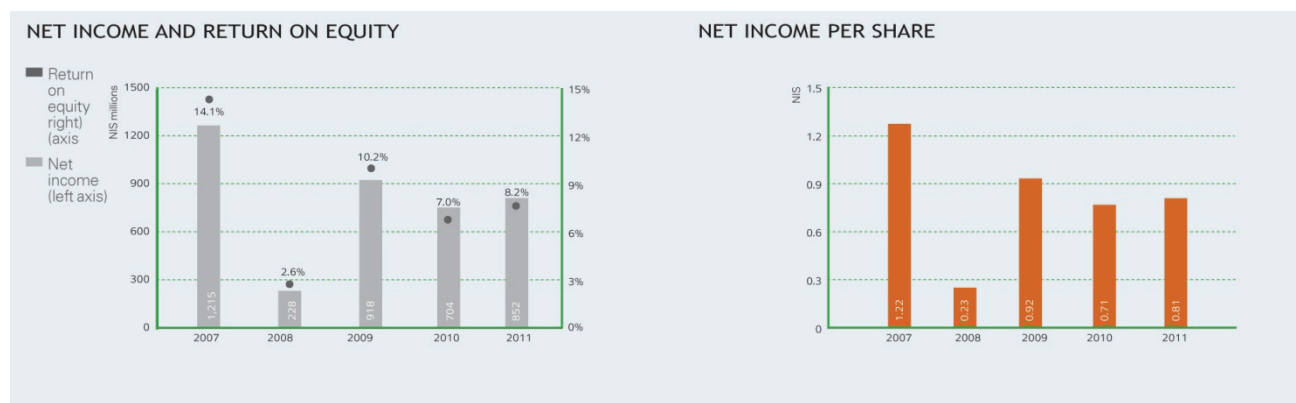
Net earnings per one share of NIS 0.1 par value amounted in 2011 to NIS 0.82, compared with NIS 0.71 in 2010.

The main factors that had an effect on the business results of the Group in 2011, compared with 2010:

- (a) A decrease in income from financing activities before credit loss expenses, an amount of NIS 45 million (0.9%).
- (b) A decrease in credit loss expenses, an amount of NIS 43 million (5.2%).
- (c) An increase in operating and other income, an amount of NIS 30 million (1.1%).
- (d) An increase in operating and other expenses of NIS 179 million (3.2%), affected from an increase of 7.5% in payroll and related expenses.
- (e) A tax expense of NIS 87 million on earnings from ordinary operations in 2011, compared with NIS 458 million in 2010. The decrease in the provision for taxes was affected mostly from an increase of NIS 164 million in the balance of deferred tax assets (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 I below). The abovementioned does not include an additional amount of NIS 13 million, the effect on the Bank's share in the

profits of the First International Bank.

- (f) A decline in the Bank's share in earnings from ordinary operations of affiliates, after tax, an amount of NIS 83 million (44.6%).
- (g) An increase in net profit from extraordinary operations after tax, an amount of NIS 25 million.



Net income attributed to the Bank's shareholders in the fourth quarter of 2011 amounted to NIS 222 million, compared with NIS 121 million in the third quarter of the year, an increase of 83.5%, and compared with NIS 131 million in the fourth quarter of 2010, an increase of 77.1%.

The major factors affecting the business results of the Group in the fourth quarter of 2011, compared with the previous quarter, were:

- A. An increase in income from financing operations before credit loss expenses, an amount of NIS 73 million (6.8%).
- B. An increase in the credit loss expenses, an amount of NIS 26 million (11.5%).
- C. A decrease in operating and other income, an amount of NIS 60 million (8.4%).
- D. A decrease in operating and other expenses, an amount of NIS 17 million (1.2%).
- E. Tax savings from ordinary operations in the amount of NIS 134 million in the fourth quarter of 2011, compared with NIS 52 million in the previous quarter. The tax savings stems from an increase of NIS 164 million in the balance of deferred tax assets (see above). The aforementioned does not include an additional amount of NIS 13 million, the effect on the Bank's share in the profits of the First International Bank.
- F. An increase in the Bank's share in earnings from ordinary operations of affiliated companies, net of taxes, of NIS 14 million (155.6%).

DEVELOPMENTS IN INCOME AND EXPENSES

Following are the developments in certain income statement items in 2011, compared with 2010:

	As at December 31		Rate of change
	2011	2010	
	in NIS millions		in %
Income from financing activities before credit loss expenses ⁽¹⁾	4,785	4,830	(0.9)
Credit loss expenses ⁽¹⁾	778	821	(5.2)
Income from financing activities after credit loss expenses	4,007	4,009	(0.0)
Operating commissions	2,489	2,547	(2.3)
Net income on investment in shares	92	31	196.8
Other income	109	⁽³⁾ 82	32.9
Total operating and other income	2,690	2,660	1.1
Salaries and related expenses	3,459	⁽³⁾ 3,218	7.5
Maintenance and depreciation of buildings and equipment	1,159	1,148	1.0
Amortization and impairment of intangible assets and goodwill ⁽²⁾	17	*49	(65.3)
Other expenses	1,203	*1,244	(3.3)
Total operating and other expenses	5,838	5,659	3.2
Operating income before taxes	859	1,010	(15.0)
Provision for taxes on operating income	87	⁽³⁾ 458	(81.0)
Operating income after taxes	772	552	39.9
Bank's share in operating income net of tax effect of affiliated companies	103	186	(44.6)
Net income from extraordinary operations, net of taxes, before attribution to non-controlling rights holders	61	36	69.4
Net income attributed to bank's shareholders	852	704	21.0
Return on equity attributed to the Bank's shareholders, in %	8.2	7.0	

* Reclassified, see Note 1 B (4).

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

Following are the developments in certain income statement items in the fourth quarter of 2011, compared with the third quarter of 2011 and the fourth quarter of 2010:

				Rate of Change compared to	
	Q4 2011	Q3 2011	Q4 2010	Q3 2011	Q4 2010
	In NIS millions			in %	
Income from financing activities before credit loss expenses ⁽¹⁾	1,140	1,067	1,293	6.8	(11.8)
Credit loss expenses ⁽¹⁾	252	226	274	11.5	(8.0)
Income from financing activities after credit loss expenses	888	841	1,019	5.6	(12.9)
Operating commissions	614	621	646	(1.1)	(5.0)
Net income on investment in shares	14	26	31	(46.2)	(54.8)
Other income	30	71	⁽³⁾ 26	(57.7)	15.4
Total operating and other income	658	718	703	(8.4)	(6.4)
Salaries and related expenses	828	873	⁽³⁾ 855	(5.2)	(3.2)
Maintenance and depreciation of buildings and equipment	310	283	324	9.5	(4.3)
Amortization and impairment of intangible assets and goodwill ⁽²⁾	2	11	*23	(81.8)	(91.3)
Other expenses	321	311	*364	3.2	(11.8)
Total operating and other expenses	1,461	1,478	1,566	(1.2)	(6.7)
Operating income before taxes	85	81	⁽³⁾ 156	4.9	(45.5)
Provision for taxes (tax savings) on operating income	(134)	(52)	⁽³⁾ 104	157.7	-
Operating income (loss) after taxes	219	133	52	64.7	321.2
Bank's share in operating income net of tax effect of affiliated companies	23	9	87	155.6	(73.6)
Net income attributed to bank's shareholders	222	121	131	83.5	69.5
Return on equity attributed to the Bank's shareholders, in %	8.7	4.7	5.1		

* Reclassified, see Note 1 B (4).

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

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

Income from financing activities before credit loss expenses amounted to NIS 4,785 million in 2011, compared with NIS 4,830 million in 2010, a decrease of 0.9%.

After eliminating adjustments to fair value of derivative financial instruments, the effect of tax hedging, gains and provisions for impairment of bonds, interest collected on problematic debts and gains on sale of loans earnings from financing operations before credit loss expenses amounted to NIS 4,725 million, compared to NIS 4,571 million in 2010, an increase of 3.4%.

Following are details of the impact of certain components of financing income:

2011					
in NIS millions					
	Annual	Fourth quarter	Third quarter	Second quarter	First quarter
Reported financing income	4,785	1,140	1,067	1,289	1,289
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)
Gains on sale of available-for-sale bonds held to maturity, net	(146)	(3)	(49)	(27)	(67)
Impairment provision for available-for-sale bonds	12	9	-	3	-
Net realized and unrealized losses (earnings) on bonds in the trading portfolio	(19)	(19)	(14)	5	9
Income on sale of loans	(53)	-	-	(53)	-
Financing income after adjustments	4,725	1,167	1,204	1,163	1,191

2010					
Reported financing income	4,830	1,293	1,331	1,091	1,115
Effect of adjustments to fair value of derivative financial instruments ALM	146	(74)	5	86	129
Effect of tax hedging in respect of IDB New York	(79)	(41)	(73)	57	(22)
Provision for impairment of held to maturity bonds	42	20	2	20	-
Gains on sale of available-for-sale bonds , net	(271)	(30)	(89)	(53)	(99)
Impairment provision for available-for-sale bonds	8	6	1	1	-
Net realized and unrealized losses (earnings) on bonds in the trading portfolio	(1)	17	(2)	(8)	(8)
Interest collected on problematic debts	(104)	(27)	(22)	(21)	(34)
Financing income after adjustments	4,571	1,164	1,153	1,173	1,081

The principle factors affecting profits from financing operations before credit loss expenses in 2011, compared with 2010, were:

- An increase at the average rate of 11.5% in the income producing financial assets, from an amount of NIS 280,624 million to NIS 313,029 million.
- Adjustments to fair value of derivative financial instruments which created a positive gap of NIS 95 million, due to lack of matching between the methods of accounting for the value of base assets for these transactions, measured on an accrual basis, and of accounting for the value of the derivative financial instruments used as hedge for such base assets, measured on a fair value basis.
- A net decrease in other finance (as seen from the following Management Review) in the amount of NIS 85 million, mainly due to a decrease in gains on realization and adjustments of bonds and a decrease in interest collected on problematic debts that was offset against gains on sale of loans.
- Hedging activity made by the Bank until the end of 2011, in order to eliminate the volatility in the provision for taxes, stemming from changes in the value of investment in consolidated subsidiaries abroad due to the devaluation or appreciation of currency exchange rates, resulted in a decrease of NIS 95 million in profit from financing operations in 2011, compared to an increase of NIS 79 million in 2010. The effect of such hedge operation was offset in full against the taxes on income item. For details regarding the cancellation of the hedge and its consequences, see "Capital management" under "Capital resources", below.

Income from financing activities before credit loss expenses in the fourth quarter of 2011 amounted to NIS 1,140 million, compared to NIS 1,293 million in the corresponding period in 2010, a decrease of 11.8%. Disregarding adjustments to fair value of derivative financial instruments, the effect of tax hedging, gains and provisions for impairment of bonds, interest collected on problematic debts and gains on sale of loans, profit from financing operations before provision for doubtful debts amounted

to NIS 1,167 million, compared with NIS 1,164 million in the corresponding period in 2010, an increase of 0.3%.

INCOME FROM FINANCING ACTIVITY BY LINKAGE SEGMENTS

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

For the year ended December 31							
2011				2010			
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	56.0	3,016	63.0	50.7	2,844	58.9	172
CPI-linked shekels	9.2	(221)	(4.6)	10.2	(48)	(1.0)	(173)
Foreign Currency	34.8	1,364	28.5	39.1	1,323	27.4	41
	100.0	4,159	86.9	100.0	4,119	85.3	40
Options		31	0.6		66	1.4	(35)
Other derivative financial instruments (not including hedged derivatives and ALM)		1	0.0		(3)	(0.1)	4
Financing commissions		181	3.8		177	3.7	4
Other financing income (expenses), net		413	8.6		471	9.8	(58)
Total		4,785	100.0		4,830	100.0	(45)

* According to the average balance of the assets.

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

NET INTEREST INCOME ACCORDING TO LINKAGE SEGMENTS (INCLUDING ALM)

In the non-linked shekel segment, net interest income amounted to NIS 3,016 million in 2011, compared with NIS 2,844 million in 2010, an increase of 6.0%. Income from this segment constituted 63.0% of total net interest income in 2011, compared with 58.9% in 2010.

The average balance of assets in this segment decreased in 2011 by 23.2% compared with the preceding year.

The interest margin of the segment increased from a rate of 1.92% in 2010 to a rate of 1.59% in 2011.

The increase in profit of this segment, stems from the rise in volume of operations and the increased contribution of the active capital, which were offset by the effect of decrease in interest margin, inter-alia in respect of an Income of NIS 25 million in respect of fair value adjustments of derivative financial instruments in 2011 compared to an income of NIS 35 million in 2010.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 1.58% in 2011, compared to 1.89% in 2010.

The CPI-linked Shekel segment recorded in 2011 net interest expense of NIS 221 million, compared with expenses of NIS 48 million in 2010. Its proportion of total net interest income in 2011 was a negative rate of 4.6%, compared with a negative rate of 1.0% in 2010.

The average asset balance in this segment in 2011 rose by a negligible rate of 0.9% compared with the preceding year.

Adjustments to fair value of derivative financial instruments created a negative gap of NIS 187 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 0.54% in 2011, compared to a negative rate of 0.21% in 2010. This compared to an actual negative spread of 1.53% in 2011 and compared to an actual negative spread of 0.46% in 2010.

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

The contribution of the active capital in this segment increased in 2011.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net interest income amounted to NIS 1,364 million in 2011, compared with NIS 1,323 million in 2010, an increase of 3.1%. Its proportion of all net interest income was 28.5% in 2011, compared with 27.4% in 2010.

In 2011, the average balance of assets in this segment decreased by a negligible 0.8% compared with 2010.

The interest margin of the segment increased from a rate of 1.08% in 2010 to a rate of 1.45% in 2011.

The increase in profits of the segment stems from an increase in the interest spread, among other things, due to an income of NIS 180 million in respect of adjustments to fair value of derivative financial instruments in 2011, compared with an expense of NIS 113 million in 2010, which was offset due to the decrease in the contribution of the active capital.

The interest rate spread, after elimination of adjustments to fair value of derivative financial instruments ALM, reached a rate of 1.29% in 2011, compared to 1.18% in 2010. On the other hand, a hedging operation performed by the Bank resulted in a decrease of NIS 95 million in earnings from financing operations in 2011, compared to an increase of NIS 79 million in 2010.

The overall margin (excluding the effect of derivatives) reached a rate of 2.11% in 2011, compared with a rate of 2.87% in 2010.

The interest margin, including the effect of other derivatives (in hedge transactions and ALM), reached a rate of 1.18% in 2011, compared with a rate of 1.48% in the preceding year.

Total interest margin, disregarding the effect of adjustments to fair value of ALM derivative financial instruments and the effect of tax hedging in respect of IDB New York reached a rate of 1.23% in 2011 compared with 1.51% in 2010.

The following is the composition of the income from financing activities, before credit loss expenses*, by segments of operations:

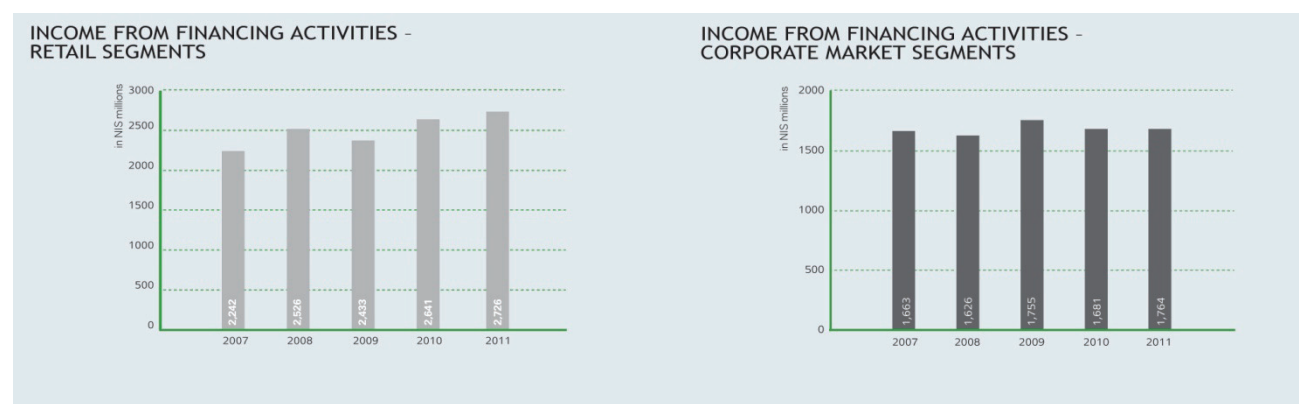
	For the year end December 31		Rate of change in %
	2011	2010	
	In NIS Millions		
Retail - household segment	1,565	1,386	12.9
Retail - small business segment	818	920	(11.1)
Corporate market segment	1,058	1,025	3.2
Middle market segment	706	656	7.6
Private banking segment	343	335	2.4
Financial management	295	508	(41.9)
Total	4,785	4,830	(0.9)

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

Financing income produced by the business segments, excluding the financial segment, has been mainly affected by changes in volume of activity. In addition, most segments experienced a decline of approx. 0.1% in the financial spread regarding credit operations, while the spread regarding deposits increased by 0.2%-0.3%, mostly as a result of the rise in the Bank of Israel interest rates.

Income has declined in the financial segment despite a growth in the volume of operations. This stemmed mainly from the decline in returns on the bond portfolios. In addition, other financing income in respect of the bond portfolio decreased by NIS 69 million, a change of NIS 174 million occurred in the tax hedge regarding IDB New York due to the transition from the

appreciation of the exchange rate in 2010 to a devaluation in 2011, while on the other hand, the effect of the adjustments to fair value of derivative financial instruments decreased by NIS 95 million.



Credit loss expenses in 2011 amounted to NIS 778 million, compared with a credit loss expenses of NIS 821 million in the preceding year, a decrease of 5.2%. In 2011, the credit loss expenses constituted 16.3% of the income from financing activities before allowance for credit loss expenses, compared with 17.0% of this income in the preceding year.

It should be noted that as from January 1, 2011, the Bank implements the directive of the Supervisor of Banks regarding "Measurement and disclosure of impaired debts, credit risk and allowance for credit losses", comprising a significant change compared with previous directives. The comparative data for prior periods were not restated. Accordingly the data for prior periods is not comparable with the data for the current period.

The balance of the allowance for credit loss, including the provision on a specific basis and the provision on a group basis, but not including provision for off-balance sheet credit risk, totalled NIS 1,975 million in 2011. The balance of this provision constitutes 1.67% of the credit to the public, compared with a balance of the provision (pro-forma) in the amount of NIS 2,068 million, constituting 1.73% of the credit to the public as of December 31, 2010.

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

	2011				2010			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
	In NIS millions							
On a specific basis	222	195	173	106				
On a group basis	30	31	15	6				
Total	252	226	188	112	274	169	261	117
Rate of credit loss expenses to credit granted to the public *	0.85%	0.75%	0.63%	0.38%	0.88%	0.54%	0.85%	0.39%

*On an annual basis

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 b (5) 1.

Operating and other income in 2011 amounted to NIS 2,690 million, compared with NIS 2,660 million in the preceding year, an increase of 1.1%.

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

	2011	2010	2009
	In NIS millions		
Account management	617	633	655
Credit cards	922	914	1,010
Revenue from the capital market	415	456	445
Gains on investment in shares, net	92	31	197
The handling of credit	258	254	221
Conversion differences	112	119	135
Foreign trade operations	57	58	57
Other	217	195	368
Total	2,690	2,660	3,088

Operating Commissions amounted to NIS 2,489 million in 2011, compared with NIS 2,547 million in the preceding year, a decrease of 2.3%. The decline stems mostly from the decline in ledger fees and in commission on operations in securities and other derivative financial instruments.

Income from credit card operating activities amounted to NIS 922 million in 2011, compared with NIS 914 million in 2010, an increase of 0.9%.

Income from capital market activity in 2011 amounted to NIS 415 million, compared with NIS 456 million in 2010, a decrease of 9.0%, as detailed in the following table.

Presented below are details regarding earnings from capital market operations in the years 2009-2011:

	2011	2010	2009
	In NIS millions		
Income from operations in securities and in certain derivative instruments	301	338	339
Distribution of financial products	82	81	55
Management, operational and trusteeship services to institutional bodies	32	35	49
Other	-	2	2
Total	415	456	445

For details regarding "Capital market move", see "Developments in the operations" in the section "Operations in the capital market" below.

Gains on investment in shares, net. For details see Note 25 to the financial statements.

Salaries and related expenses amounted to NIS 3,459 million in 2011, compared with NIS 3,218 million in the preceding year, an increase of 7.5% (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 %	
	2011	2010	2009	2011	2010
	In NIS millions			compared to 2010	compared to 2009
Salaries and Related Expenses - as reported	3,459	3,218	3,130	7.5	2.8
Awards	(174)	(91)	(179)		
Expense resulting from share based payment transactions	4	(7)	(2)		
The effect of changes in retirement rates on the provision for long-term service awards	-	-	(65)		
Waiver of wages in 2009	-	(16)	44		
Voluntary retirement program expenses	-	(7)	(6)		
Provision for a retirement plan at Mercantile Discount Bank	(22)	-	-		
The influence of the severance pay fund	-	94	80		
Salaries and Related Expenses - Disregarding certain components	3,267	3,191	3,002	2.4	6.3

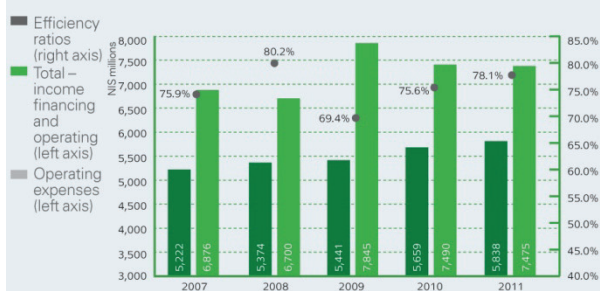
The rise in payroll expenses in 2011, compared with the preceding year, was mainly affected by the rise in payroll expenses of subsidiary companies and from provisions for awards based on the annual return.

The severance pay funds recorded in 2010 profits of NIS 158 million, used in part to cover the increase in severance pay liabilities in respect of prior years in the amount of NIS 94 million, the remaining profits in the amount of NIS 64 million recorded as "other income". 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.

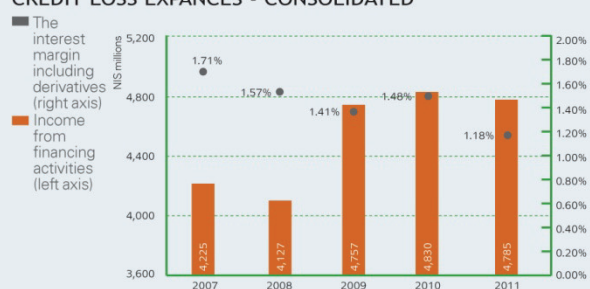
Salaries expenses, excluding related expenses, amounted in 2011 to NIS 2,317 million, compared with NIS 2,169 million in 2010, an increase of 6.8%.

The Bank's share in operating income after taxes of affiliated companies includes an amount of NIS 25 million in respect of the investment in FIBI. In 2010, included an amount of NIS 53 million in respect of the reversal of a part of the provision for taxes.

OPERATING EXPENSES TO TOTAL INCOME



INCOME FROM FINANCING ACTIVITIES BEFORE CREDIT LOSS EXPANES - CONSOLIDATED



COVERAGE RATIO



EFFICIENCY RATIO



DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2011 amounted to NIS 202,491 million, compared with NIS 185,576 million at the end of the preceding year, an increase of 9.1%.

Following are the developments in the principal balance sheet items:

	Dec 31		
	2011	2010	
	in NIS millions		Rate of changes in %
Assets			
Cash and deposits with banks	30,329	18,187	66.8
Securities	42,898	37,176	15.4
Credit granted to the public, net ⁽²⁾	116,383	118,666	(1.9)
Liabilities			
Deposits from the public	153,368	138,011	11.1
Deposits from banks	4,249	3,387	25.5
Subordinated capital notes	12,239	12,294	(0.4)
Equity attributed to the Bank's shareholders	10,745	⁽¹⁾ 10,824	(0.7)
Total equity	11,115	⁽¹⁾ 11,152	(0.3)

Footnote:

(1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

CREDIT TO THE PUBLIC

General. Credit to the public, net, as at December 31, 2011, amounted to NIS 116,383 million, compared with NIS 118,666 million on December 31, 2010, a decrease of 1.9%. The ratio of credit to the public to total assets reached 57.5% at the end of 2011, compared with 63.9% at the end of 2010.

As mentioned above, as from January 1, 2011, the Bank implements the directive of the Supervisor of Banks regarding "Measurement and disclosure of impaired debts, credit risk and allowance for credit losses", comprising a significant change compared with previous directives. The comparative data for prior periods were not restated. Accordingly the data for prior periods is not comparable with the data for the current period. Where practicable, pro-forma data as of December 31, 2010 have been presented as comparative figures for actual data as of December 31, 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.

COMPOSITION OF CREDIT TO THE PUBLIC BY LINKAGE SEGMENTS

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

	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of change in %
Non-linked shekels	64,043	55.0	65,359	55.1	(2.0)
CPI-linked shekels	18,407	15.8	19,160	16.1	(3.9)
Foreign currency and foreign currency-linked shekels	33,933	29.2	34,147	28.8	(0.6)
Total	116,383	100.0	118,666	100.0	(1.9)

(1) Restated with respect to retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1.

Credit to the public denominated in foreign currency and in Israeli currency linked thereto decreased by 0.6% compared with December 31, 2010. In U.S. Dollar terms, credit to the public in foreign currency and foreign currency linked Shekels decreased by US\$741 million as compared to December 31, 2010, a decrease of 7.7%.

The total credit to the public, which includes credit in foreign currency and Israeli currency linked to foreign currency, computed in dollar terms, decreased by 4.0% as compared to December 31, 2010.

DEVELOPMENT IN CRITICIZED EXPOSURE

	December 31, 2011			⁽²⁾ December 31, 2010		
	Balancesheet ⁽²⁾	Off balancesheet	Total	Balancesheet* balancesheet	Off balancesheet	Total
	in NIS millions					
Overall problematic credit risk in respect of the public include:						
Impaired credit risk	⁽³⁾ 5,618	137	5,755	⁽³⁾ 5,858	240	6,098
Substandard credit risk	757	17	774	960	5	965
Special mention credit risk	⁽⁴⁾ 1,644	442	2,086	⁽⁴⁾ 2,181	363	2,544
Total overall problematic credit risk⁽¹⁾	8,019	596	8,615	8,999	608	9,607
Total provision for problematic credit	839	58	897	1,030	46	1,076
Total overall problematic credit risk after allowance for credit losses	7,180	538	7,718	7,969	562	8,531
Of which ⁽¹⁾ :						
Commercial criticized exposure	7,210	593	7,803	7,772	608	8,380
Problematic credit risk in respect of "Private individuals"	809	3	812	1,227	-	1,227

(2) Pro-forma data.

(3) Include corporate problematic non performing bonds in an amount of 7 million NIS (2010: NIS 10 million).

(4) Include corporate problematic performing bonds in an amount of 85 million NIS (2010: NIS 102 million).

Problematic credit risk. As at December 31, 2011, the scope of the overall problematic credit risk in respect of the public, gross (including off-balance sheet components and before provisions for credit losses) amounted to NIS 8.6 billion, compared to NIS 9.6 billion according to the pro-forma data as at December 31, 2010, a 10.3% decrease. The problematic credit risk can be broken down into commercial criticized exposure (90.6%) and credit risk with respect to private individuals (9.4%).

Credit risk in respect of Israeli borrowers' activity formed 62% of total problematic credit risk, while the balance of 38% was in respect of the activity of foreign borrowers.

The total problematic credit risk, gross represents 7.3% of the portfolio of credit to the public, compared to 8.0% as of December 31, 2010 (pro-forma data).

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

	Balance as of December 31, 2011	Balance as of December 31, 2010 (pro- forma*)
On a consolidated basis		
	In NIS millions	
1. Non-Performing Assets:		
Impaired credit granted to the public not accruing interest income:		
Examined on a specific basis	3,072	3,310
Examined on a group basis	41	47
No-performing impaired bonds	69	27
Total non-performing assets	3,182	3,384
Assets received in respect of credit settlement	4	9
Total non-performing assets	3,186	3,393
2. Impaired debts restructuring of troubled debt accruing interest income	2,498	2,491
3. Commercial Criticized Exposure⁽¹⁾⁽²⁾:	-	-
Balancesheet commercial criticized credit risk in respect of the public	7,210	7,772
Off balancesheet commercial criticized credit risk in respect of the public ⁽³⁾	593	608
Total commercial criticized exposure in respect of the public	7,803	8,380
Balancesheet commercial criticized credit risk in respect of banks	260	400
Total commercial criticized exposure	8,063	8,780
4. Non impaired debts, in arrears for 90 days or more	557	885
Of which: Housing loans in respect of which provision exists according to period in arrears	313	406
Housing loans in respect of which no provision exists according to period in arrears ⁽⁴⁾	134	127

* Restated, see note 1f to the condensed financial statements.

Footnotes:

- (1) Balancesheet and Off balancesheet credit risk is presented before the effect of allowance for credit losses and before effect of collateral eligible for set-off with respect to the limitations on indebtedness of a single borrower or of a group of borrower
- (2) Balancesheet credit risk (credit, bond, other debts recognized in the balancesheet and assets in respect of derivative instrument) and off balancesheet credit risk that is impaired, substandard or under special mention, excluding balancesheet and off balancesheet credit risk due to private individuals.
- (3) As calculated for the purpose of the limitations on indebtedness of a single borrower or of a group of borrowers, except for guarantees granted by a borrower to secure a third party indebtedness, before the influence of collateral eligible for set-off.
- (4) Housing loans the minimum provision for which is calculated according to the period in arrears, in arrears over 3 months and up to 6 months, and other housing loans which are not impaired and which are in arrears for 90 days or more and the minimum provision recorded due to them is not computed according to the extent of arrears.

Impaired credit to the public. The balance sheet impaired credit to the public (interest accruing an non-accruing) amounted at December 31, 2011 to NIS 5.6 billion, compared to NIS 5.8 billion at December 31, 2010, a 4.1% decrease, which is mainly attributable to non-performing impaired credit to the public.

As of December 31, 2011, the impaired credit to the public comprised 3.2% of total credit to the public risk (both balance sheet and off-balance sheet) whereas in the economic sectors, hotel and food services amounted, construction and real estate, public and community services, respectively to a high rate of 19.5%, 8.7% and 6.9%.

Non-performing impaired credit to the public. The non-performing impaired credit to the public and which is examined on a specific bases, amounted at December 31, 2011 to NIS 3.1 billion, compared to NIS 3.3 billion at December 31, 2010 (according to the pro-forma data as of December 31, 2010), a decrease at a rate of 7.2%.

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 435 million on December 31, 2011, compared to NIS 465 million according to the pro-forma data as of December 31, 2010.

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, 2011 to NIS 560 million, compared to NIS 605 million according to the pro-forma report data as of December 31, 2010, comprising a decline in the current provision in the amount of NIS 45 million, a rate of 7.4%. This decline stems mainly from the change in the credit balances in respect of which the provision had been calculated.

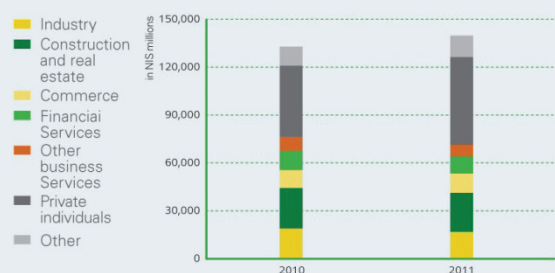
The balance of the group allowance for credit losses in respect of customers examined on a specific basis, and which are not impaired, amounted at December 31, 2011 to NIS 750 million, compared with NIS 757 million according to the pro-forma statements as of December 31, 2010, a decrease of NIS 7 million in the current provision, a rate of 0.9%. This decrease stems mainly from a change in outstanding balances of credit, in respect of which the provision had been included.

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 computed in accordance with the new directives:

	31.12.11	31.12.10
Ratio of impaired credit granted to the public not accruing interest income balance to total credit granted to the public	2.6%	2.8%
Ratio of non-impaired of credit granted to the public balance in arrears for 90 day or more to total credit granted to the public	0.5%	0.7%
The ratio of the balance of the allowance for credit losses in respect of credit granted to the public, to the balance of credit granted to the public	1.7%	1.7%
Ratio of the outstanding balance of allowance for credit losses in respect of credit granted to the public to the outstanding non-performing balance of impaired credit granted to the public	63.4%	61.6%
The ratio of commercial criticized exposure in respect of the public to the total credit risk in respect of the public	4.5%	4.7%
The ratio of credit loss expenses in respect of credit granted to the public to the average credit granted to the public	0.7%	*-
The ratio of net accounting write-offs in respect of credit granted to the public to the average credit granted to the public	0.7%	*-
The ratio of net accounting write-offs in respect of credit granted to public to the balance of allowance for credit losses in respect of credit granted to the public	43.0%	*-

*Not required at this point of time.

TOTAL CREDIT RISK IN RESPECT OF THE PUBLIC CLASIFIED BY ECONOMIC SECTOR CONSOLIDATED-BORROWERS IN ISRAEL⁽¹⁾



(1) As regards the absence of comparability between the data of the current period and that of prior periods, see note 1B(5)1.

CREDIT LOSS EXPENSES⁽¹⁾



(1) As regards the absence of comparability between the data of the current period and that of prior periods, see note 1B(5)1.

THE RISK CHARACTERIZATION OF THE CREDIT TO THE PUBLIC PORTFOLIO

Following are the rates of the credit loss expenses recorded for certain sectors (2010 – specific provision for doubtful debts), in relation to the outstanding balance of problematic debts (both balance sheet and off-balance sheet) in such sectors:

sectors	2011	*2010
Construction and real estate	8.2%	5.5%
Hotels, hotel services and food	** (0.3%)	** (2.7%)
Commerce	3.2%	11.7%
Industry	10.6%	8.6%
Communications and computer services	3.5%	0.3%
Financial services	10.5%	2.7%
Other business services	24.3%	31.7%

*This amounts was stated before 1.1.2011 in accordance with the prior directives

**Decrease in provision

The data presented above shows that the rate of the expense in respect of credit losses in relation to the outstanding balance of problematic debts in the industrial, financial services and other business services sectors was higher than the average rate of expense (9.0%) in the total credit portfolio. Compared with 2010, the rates of the expense in respect of credit losses on an industry level in relation to the balance of problematic debts in the construction and real estate, industrial, communication and computer services and financial services, have increased. On the other hand, the rates of the expense in the commercial and other business services sectors have decreased.

Following are the rates of the credit loss expenses in certain sectors (2010 – specific provision for doubtful debts) in relation to the consolidated balance sheet credit to the public in these sectors:

sectors	2011	*2010
Construction and real estate	1.3%	0.9%
Hotels, hotel services and food	** (0.1%)	** (0.6%)
Commerce	0.2%	0.5%
Industry	0.6%	0.6%
Communications and computer services	0.4%	-
Financial services	0.6%	0.1%
Other business services	1.6%	1.4%

*This amounts was stated before 1.1.2011 in accordance with the prior directives

**Decrease in provision

The data presented above shows that the rate of the expense in respect of credit losses in relation to the outstanding balance of credit to the public in the construction and real estate and the other business services sectors was higher than the average rate of expense (0.6%) in the total credit portfolio. Compared with 2010, the principal economic sectors (except for the commercial sector) recorded an increase in rates of the expense in respect of credit losses in relation to the outstanding balance of credit to the public.

The increase in the real estate sector stemmed in full from the rise in credit loss expense in respect of borrower activity overseas, due to a weak business environment in certain markets in Western, Central and Eastern Europe, reflected in the continuing standstill in the prices of income producing properties and a decline in the liquidity of those borrowers as a result of the continuing limited supply of financial resources. On the other hand, the expenses for credit losses in respect of local borrowers in the real estate sector declined significantly compared with 2010.

Following are the proportionate share of certain economic sectors in the total credit loss expenses (2010 – specific provision for doubtful debts):

sectors	2011	*2010
Construction and real estate	38.2%	28.1%
Commerce	3.2%	9.0%
Industry	13.2%	13.6%
Financial services	8.8%	2.0%
Other business services	15.2%	16.9%

*This amounts was stated before 1.1.2011 in accordance with the prior directives

The above data shows that the weight of the share of the construction and real estate and the financial services sectors in the total expense for credit losses has increased compared with 2010. On the other hand, the weight of the share of the commercial sector of the total expense decreased compared to 2010.

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

Economic sectors	December 31, 2011		December 31, 2010		Rate of change
	Total credit risk	Rate from total credit risk	Total credit risk ⁽²⁾	Rate from total credit risk	
	in NIS millions	%	in NIS millions	%	
Agriculture	1,401	0.9%	1,309	0.7%	7.0%
Industry	25,051	14.2%	27,603	15.1%	(9.2%)
Construction and real estate	33,630	19.1%	35,038	19.2%	(4.0%)
Electricity and water	2,424	1.4%	2,142	1.2%	13.2%
Commerce	19,240	10.9%	17,785	9.8%	8.2%
Hotels, hotel services and food	2,985	1.7%	3,280	1.8%	(9.0%)
Transportation and storage	4,125	2.3%	4,940	2.7%	(16.5%)
Communications and computer services	2,750	1.6%	3,154	1.7%	(12.8%)
Financial services	14,997	8.5%	18,609	10.2%	(19.4%)
Other business services	10,193	5.8%	11,866	6.5%	(14.1%)
Public and community services	2,370	1.3%	2,110	1.2%	12.3%
Private individuals - housing loans	20,094	11.4%	18,331	10.1%	9.6%
Private individuals - other loans	36,851	20.9%	36,103	19.8%	2.1%
Total	176,111	100.0%	182,270	100.0%	(3.4%)

The above data shows that compared with 2010, the weight of the share of the industrial and the financial services sectors in the total credit to the public portfolio has decreased, while the weight of the share of the commercial, private housing loans and other private loan sectors increased compared with 2010.

For additional details see Schedule E to the Management review and Note 4 to the financial statements.

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

The following is a review of developments in the balance of net credit to the public, by segment of operations:					
	For the year ended December 31				
	2011		2010		
	In NIS Millions	% of total credit to public	In NIS Millions	% of total credit to public	Rate of change in-%
Retail-household segment	37,033	31.8	36,268	30.6	2.1
Retail-small business segment	11,830	10.2	14,820	12.5	(20.2)
Corporate market segment	41,518	35.7	44,461	37.5	(6.6)
Middle market segment	22,488	19.3	19,455	16.4	15.6
Private banking segment	3,514	3.0	3,662	3.0	(4.1)
Total	116,383	100.0	118,666	100.0	(1.9)

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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 33.8% of total credit to the public as at December 31, 2011, compared with 32.0% as at December 31, 2010.

The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 50.8% of all credit as at December 31, 2011, compared with 50.6% as at December 31, 2010.

The 68 largest borrowers, in the credit brackets between NIS 200 million and NIS 2,000 million, were granted credit constituting 15.4% of total credit as at December 31, 2011, compared with 73 borrowers that were granted credit constituting 17.4% of the total credit as at December 31, 2010.

For details regarding credit levels in excess of NIS 800 million (additional details), 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 42,898 million as at December 31, 2011, compared with NIS 37,176 million at the end of 2010, an increase of 15.4%. It is clarified that the "nostro" portfolio to the Discount Group as of December 31, 2011, 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 6.9% of the total portfolio.

As of December 31, 2011, some 60.6% of the portfolio is invested in Government bonds, and 21.6% of the portfolio is invested in bonds of U.S. Government Supported Enterprises (GSE) (for details regarding the Bank's investments in bonds, according to economic sectors, see Annex to the Report of the Board of Directors, comprising an integral part thereof, Part "A", items 1-3).

Nostro portfolio 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.

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

Within the framework of the strategic plan for the Discount Group for the years 2011-2013 (see above), an allocation of risk assets has been approved for a controlled variety of investments within the "Nostro" investment portfolio.

COMPOSITION OF THE SECURITIES PORTFOLIO BY LINKAGE SEGMENTS

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

	December 31		Rate of change in %
	2011	2010	
	In NIS millions	in %	
Non-linked shekels	17,580	12,603	39.5
CPI-linked shekels	5,690	6,292	(9.6)
Foreign currency and foreign currency-linked shekels	18,965	17,588	7.8
Shares - non-monetary items	663	693	(4.3)
Total	42,898	37,176	15.4

Securities in foreign currency and in Israeli currency linked foreign currency increased by 7.8% compared with December 31, 2010. In U.S. Dollar terms, the securities in Israeli currency and in foreign currency linked Israeli currency increased by US\$8 million, an increase of 0.2% as compared with December 31, 2010.

Total securities, including securities in foreign currency and in Israeli currency linked to foreign currency expressed in U.S. Dollar terms, increased by 11.8% as compared with December 31, 2010.

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, 2011			December 31, 2010		
	Net adjusted cost	Fair value	Book value	Net adjusted cost	Fair value	Book value
	in NIS millions					
Bonds						
Held to maturity	5,895	6,115	5,895	6,752	6,785	6,752
Available for sale	33,006	32,976	32,976	27,440	27,550	27,550
Trading	3,378	3,364	3,364	2,187	2,181	2,181
Shares						
Available for sale	653	658	658	665	681	681
Trading	8	5	5	12	12	12
Total Securities	42,940	43,118	42,898	37,056	37,209	37,176

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 20 million as of December 31, 2011, is included in equity under "adjustments to fair value of available-for-sale securities" as a positive capital reserve (December 31, 2010: NIS 128 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 21 million as a negative capital reserve (December 31, 2010: NIS 1 million as a positive capital reserve).

The sale of securities from the held-to-maturity portfolio. For details regarding the sale of securities from the held-to-maturity portfolio by IDB New York, in 2011, see Note 3 D to the financial statements.

Corporate bonds. Discount Group's available for sale securities portfolio as of December 31, 2011, includes investments in corporate bonds in the amount of NIS 3,319 million (an amount of NIS 1,748 million is held by IDB New York and an amount of NIS 438 million, directly by the Bank), compared with NIS 3,381 million as of December 31, 2010 (an amount of NIS 1,650 million is held at IDB New York and an amount of NIS 723 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 BACKED SECURITIES

General. Discount Group's securities portfolio as of December 31, 2011 includes investment in mortgage backed securities in the amount of US\$3,382 million, which are held by IDB New York, compared to an amount of US\$2,945 million as at December 31, 2010, an increase of 14.8%. About 100% 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, 2011, the portfolio of mortgage backed securities (MBS) included unrealized net gains of US\$45 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, 2011 their market value increased by US\$44 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, 2011, 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\$171 million, compared to US\$420 million on December 31, 2010.

For details regarding exposure to loans Alt-A and to subprime loans sold in 2011, as well as 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", items 4 and 5, respectively).

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, 2011, and December 31, 2010, there were no unrealized accumulated losses in respect of available-for sale shares. As of December 31, 2011 and December 31, 2010, unrealized accumulated losses on available-for-sale mortgage backed securities were in immaterial amounts. (See Annex to the Report of the Board of Directors, comprising an integral part thereof, Part "A", items 6 and 7, 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:

Ratio of unrealized loss to amortized cost	Period of decline in fair value below amortized cost				Total
	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	
In NIS millions					
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
December 31, 2010					
Up to 20%	37	14	-	31	82
From 20% to 40%	-	-	-	166	166
Over 40%	-	-	-	26	26
Total	37	14	-	223	274
Of which: Government bonds	19	14	-	3	36

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 8).

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 2011, a provision for impairment of a non-temporary nature with regard to a number of securities amounting to US\$2 million (approx. NIS 8 million) [in 2010: US\$13 million (approx. NIS 46 million)].

For further details see Note 3 to the financial statements.

DEPOSITS FROM THE PUBLIC

Deposits from the public as at December 31, 2011, amounted to NIS 153,368 million, compared with NIS 138,011 million at the end of the preceding year, an increase of 11.1%.

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

	December 31, 2011		December 31, 2010		Rate of change in %
	In NIS millions	% of deposits from the public	In NIS millions	% of deposits from the public	
Non-linked shekels	84,116	54.9	71,592	51.9	17.5
CPI-linked shekels	10,913	7.1	11,609	8.4	(6.0)
Foreign currency and foreign currency-linked shekels	58,339	38.0	54,810	39.7	6.4
Total	153,368	100.0	138,011	100.0	11.1

Deposits from the public in foreign currency and in Israeli currency linked to foreign currency increased at the rate of 6.4%, compared with December 31, 2010. In dollar terms the deposits from the public in foreign currency and in Israeli currency linked to foreign currency decreased by US\$176 million, a decrease of 1.1% compared with December 31, 2010.

Total deposits from the public, including deposits in foreign currency and in Israeli currency linked to foreign currency, expressed in U.S. Dollar terms, increased by 8.1% as compared with December 31, 2010.

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

	For the year ended December 31				Rate of change in-%
	2011		2010		
	In NIS Millions	% of total Deposits from the public	In NIS Millions	% of total Deposits from the public	
Retail-household segment	65,503	42.7	57,534	41.7	13.9
Retail-small business segment	13,349	8.7	13,988	10.1	(4.6)
Corporate market segment	28,059	18.3	21,112	15.3	32.9
Middle market segment	6,747	4.4	7,982	5.8	(15.5)
Private banking segment	39,710	25.9	37,395	27.1	6.2
Total	153,368	100.0	138,011	100.0	11.1

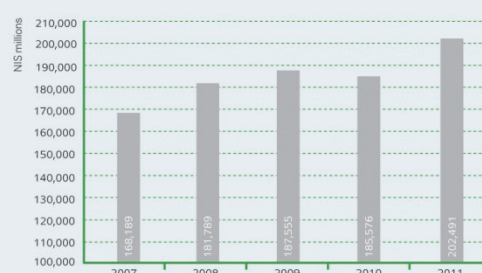
The ratio of total credit to the public, net, to deposits from the public was 75.9% at the end of 2011, compared with 86.0% at the end of the previous year.

DEVELOPMENT OF CREDIT TO THE PUBLIC AND DEPOSITS FROM THE PUBLIC - CONSOLIDATED



(1) As regards the absence of comparability between the data of the current period and that of prior periods, see note 1 B (5) 1.

DEVELOPMENT OF TOTAL ASSETS - CONSOLIDATED



CAPITAL RESOURCES

POLICY REGARDING CAPITAL FOR THE INTERIM PERIOD

The Basel Committee published in December 2009 draft recommendations in the matter of "Strengthening the resilience of the banking sector", and informed that it is its intention to publish a material part of the proposed changes as final recommendations as early as at the beginning of 2011, with effect as from December 31, 2012 (the recommendations were published in December 2010).

In his letter of June 30, 2010, the Supervisor of Banks informed that he is following developments in this respect and intends to examine the new recommendations in their final form with a view of modifying the existing directives applying in Israel, as the case may be.

In the interim period until the modification of the directives, the said letter requires banking corporations to take the following actions:

- To adopt until December 31, 2010, a target for the core capital ratio; this ratio is to relate to the core capital, less all deductions required by tier I, in accordance with Proper Banking Management Directive No. 202, "Measurement and capital adequacy - components of capital". The target has to be determined at a rate not lower than 7.5%;
- To submit to the Supervisor of Banks by the end of August 2010, a work plan designed to attain the said target;
- A banking corporation encountering difficulties, regarding the stated above, shall apply to the Supervisor of Banks in order to arrive at an agreed layout for reaching the target.
- To avoid the distribution of dividend, without prior approval from the Supervisor of Banks, if a bank has not attained the said target or if the distribution of the dividend will create such a situation.

The Supervisor of Banks informed on January 24, 2011, that the Bank may determine a core capital target of not less than 7.5% in effect until December 31, 2011 instead of December 31, 2010, on condition that certain terms determined by the Supervisor of Banks are fulfilled, including approval of a capital adequacy outline for maintaining a core capital target of not less than 7.5% until December 31, 2011, even if significantly different developments than those assumed at the base of the work plan occur. Furthermore, the Board of Directors shall receive a monthly report regarding compliance with the capital outline that had been determined, and that such report will also be submitted to the Supervisor of Banks. The Bank is required to form the said plan and submit it to the Supervisor of Banks.

The meeting of the Board of Directors held on March 2, 2011, approved a detailed outline for attaining a core capital target at the rate of between 7.5% and 8%, and in any case, a target that shall not fall below 7.5%, as well as a total capital adequacy ratio of not less than 13%, and this until December 31, 2011. The Bank attained the determined goals, as stated.

The resolution of the Board of Directors regarding the "Strategic plan for the Discount Group for the years 2011-2013" (see above), 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.

The core capital ratio as of December 31, 2011, computed in accordance with the above stated, reached a ratio of 8.1%.

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.

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.

PREPARATION FOR THE IMPLEMENTATION OF BASEL III IN ISRAEL

As abovementioned, in December 2010, the Basel Committee published new recommendations, "Basel III". The new recommendations are intended to improve the stability of banks in crisis periods.

Ambiguity exists at this stage with respect to the scope and format of the adoption in Israel of the Basel III recommendations, including: what will be the nature of the new capital instruments that will be recognized by the Supervisor of Banks, at what rate will the existing capital instruments be excluded from the capital adequacy calculations, and more.

To the Bank's best knowledge, the Supervisor of Banks is expected to publish during 2012 guidelines that will determine the format for the adoption of the Basel III recommendations as well as a gradual timetable for the implementation thereof.

On March 14, 2012, the Supervisor of Banks issued a draft 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%. For additional details see "Basel II" under "Exposure to risks and risk management".

CAPITAL MANAGEMENT

The capital management process is composed of the three 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, a preliminary 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.
- **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 2011, the optimal 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. At the end of 2011 and the beginning of 2012, the Bank withdrew excess capital from the subsidiary companies by way of dividend distribution. DMB distributed an amount of NIS 290 million, Mercantile Discount Bank distributed NIS 80 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.

Sensitivity of capital ratios to exchange rates. At the end of 2011 and the beginning of 2012 the Bank instituted a move, which significantly reduced the level of exposure of capital ratios to changes in exchange rates. This exposure is the consequence of the fact that the capital of the group is expressed in Shekel terms, while some 30% of the risk assets are expressed in terms of foreign currency (mostly U.S. dollars). Therefore, when computing the capital ratio, a change in the exchange rate affects the risk assets but does not affect the capital. The level of exposure was estimated by a movement of 0.07% in the core capital ratio with respect to each change of NIS 0.10 in the U.S. dollar exchange rate as against the Shekel. In consequence of the change in the accounting definition of the holding in IDB New York, taking effect on January 1, 2012, as detailed in Note 1 D 1.2 to the financial statements, changes in the value of the investment in IDB New York deriving from exchange rate differences will be included in a capital reserve and not in the statement of income.

The Bank's Board of Directors has decided to cancel the dollar hedging for the investment in IDB New York, and to finance this investment from shekel and not U.S. dollar resources, as was the case up to now. As a result of this change, changes in exchange rate will from now onward affect the Bank's capital and the foreign currency risk assets in a nearly identical manner, and therefore will not affect the Bank's capital ratios. All this, without affecting the Bank's current profit and loss. As a result of this move, the sensitivity of the capital ratio to changes in the exchange rate is expected to decrease to a negligible level.

CAPITAL ADEQUACY

- Total Shareholders' equity
- Capital adequacy ratio
- Core Tier I capital ratio



COMPONENTS OF CAPITAL

The Bank's capital resources as at December 31, 2011, amounted to NIS 11,115 million, compared with NIS 11,152 million at December 31, 2010, a decrease of 0.3%.

Equity attributed to the Bank's shareholders as at December 31, 2011, amounted to NIS 10,745 million, compared with NIS 10,824 million at December 31, 2010, a decrease of 0.7%.

The change in equity attributed to the Bank's shareholders in 2011 was affected, among other things, by the net tax cumulative effect of the initial implementation of the directive on January 1, 2011, regarding measurement of impaired debts and allowance for credit losses, in the amount of NIS 830 million, by earnings in 2011, by a decline of NIS 139 million in the "net adjustments for the presentation of available for sale securities at fair value, net of tax" item.

It should be noted that, in addition to that stated above, the balance of equity as of December 31, 2010, was reduced to the retroactive implementation of the directive regarding employee rights in the amount of NIS 417 million.

The ratio of total capital, to total assets as at December 31, 2011, stood at 5.5%, compared with 6.0% at the end of the preceding year.

Ratio of tier I capital to risk assets as of December 31, 2011, reached a rate of 8.8%, compared with 8.2% at the end of 2010.

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 8.1% as of December 31, 2011, compared with 7.7% at the end of 2010.

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, 2011, reached a rate of 14.1%, compared to a rate of 13.2% on December 31, 2010.

Innovative complex capital instruments constitute capital notes recognized as part of tier I capital (see Note 14 to the financial statements, item 7). The Bank's innovative complex capital instruments as of December 31, 2011 amounted to NIS 1,723 million, compared with NIS 1,680 million as of December 31, 2010. The innovative complex capital instruments are limited to 15% of the overall tier I capital. As of December 31, 2011, the innovative complex capital instruments amounted to 13.58% of the overall tier I capital (December 31, 2010: 13.40%). See above regarding the suspension of plans to raise funds by means of additional hybrid capital instruments.

Lower tier II capital. The Bank's lower tier II capital totalled NIS 6,343 million as at December 31, 2011, compared with NIS 6,267 million as of December 31, 2010. The extent of subordinated capital notes is limited to 50% of the tier I capital that was not allocated against market risks. At December 31, 2011, the said ratio was 50% (December 31, 2010: 50%). In view of the said restriction, capital notes in the amount of NIS 91 million were not included in the Bank's Lower tier II capital as of December 31, 2011.

Upper tier II capital. The Bank's upper tier II capital amounted to NIS 1,618 million as of December 31, 2011, including NIS 254 million of general provision for doubtful debts, compared with NIS 1,668 million as of December 31, 2010. The volume of the upper tier II capital is limited to 100% of the tier I capital. The balance of the upper tier II capital that the Bank is permitted to raise as of December 31, 2011, amounted to 4,725 NIS million. See above regarding the suspension of plans to raise funds by means of additional hybrid capital instruments.

Raising of Lower Tier II Capital. For details regarding raising Lower Tier II capital in 2011, see "Liquidity and the Raising of Resources at the Bank" below.

Rights Issue and Public Offering. For details regarding shares issue by way of rights issue and public offering done by the Bank, in December 31, 2010, see Note 13 D to the financial statements.

Possible future effect of the agreement with FIBI Holdings. In accordance with the agreement between the Bank and FIBI Holdings (see Note 6 E), 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, 2011, the difference would have reduced the core capital of the Bank by 0.48% and the comprehensive capital by 0.24%.

CAPITAL STRUCTURE

CAPITAL ADEQUACY DATA

	December 31	
	2011	2010
	in NIS millions	
1. Capital for Calculating ratio of capital		
Tier 1 capital less deductions	11,898	⁽¹⁾ 11,689
Tier 2 capital less deductions	7,173	⁽¹⁾ 7,090
Total capital for calculating capital ratio	19,071	18,779
2. Weighted credit risk balance		
Credit risk	120,256	⁽¹⁾ 125,628
Market risk	1,875	2,907
Operational risk	13,418	13,233
Total weighted credit risk assets balance	135,549	141,768
(3) Ratio of capital to risk assets⁽²⁾		
Ratio of original tier 1 capital to risk assets	8.1	⁽¹⁾ 7.7
Ratio of tier 1 capital to risk assets	8.8	⁽¹⁾ 8.2
Ratio of total capital to risk assets	14.1	⁽¹⁾ 13.2
Ratio of total minimum capital required by the Supervisor of Banks	9.0	9.0

Footnotes:

- (1) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the financial statement.
(2) For details regarding the capital ratio of significant banking subsidiaries and additional details, see Note 14 to the financial statements.

CAPITAL STRUCTURE

	December 31	
	2011	2010
	in NIS millions	
a. Capital elements		
Tier 1 capital		
Paid up regular share capital	4,093	4,075
Retained earnings	6,447	⁽²⁾ 6,620
Other capital reserves	214	-
Minority interests in the equity of consolidated subsidiaries	370	328
Total core capital	11,124	11,023
Innovative hybrid capital instruments	1,723	1,680
Amounts deducted from tier 1 capital:		
Goodwill	(142)	(149)
Intangible assets	(10)	(20)
Net losses on fair value adjustments of available for sale securities	(9)	-
Tier 1 capital less deductions from this tier's capital only	12,686	12,534
50% deductions from tier 1 capital (see B below)	(788)	⁽²⁾ (845)
Total tier 1 capital	11,898	11,689
Tier 2 capital		
45% of net gains of adjustment for presentation of available for sale securities at fair value	-	90
General provision for doubtful debts	254	254
Preferred shares	2	2
Innovative hybrid capital instruments	1,362	1,322
Subordinated capital notes	6,343	⁽²⁾ 6,267
50% deductions from tier 2 capital (see B below)	(788)	⁽²⁾ (845)
Total tier 2 capital	7,173	7,090
Total qualified capital	19,071	18,779
50% deductions from tier 1 capital and from tier 2 capital		
Investments in non-realistic companies with significant influence ⁽¹⁾	1,576	⁽²⁾ 1,538
Other deductions from tier 1 and 2 capital	-	152
Total deductions	1,576	1,690

Footnotes:

(1) Including amount in respect of the First International Bank of Israel Ltd of NIS 1,514 millions (31.12.10: NIS 1,548 millions)

(2) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the financial statement.

RISK ASSETS

	December 31			
	2011		2010	
	Risk assets	Capital requirements	Risk assets	Capital requirements
		9% ⁽¹⁾		9% ⁽¹⁾
	in NIS millions			
Risk assets and capital requirements in respect of credit risk caused by exposures of:				
Sovereigns	858	77	583	52
Public sector entities	1,189	107	991	89
Banks	3,546	319	3,925	353
Corporates	79,985	7,199	⁽³⁾ *86,261	⁽³⁾ *7,764
Secured by commercial real estate	1,991	179	*1,995	*179
Single retailer exposures	11,815	1,064	11,865	1,068
Small business loans	6,301	567	6,534	588
Mortgage	8,479	763	7,801	702
Securitization	15	1	37	3
Other assets	6,077	547	⁽²⁾ 5,636	⁽²⁾ 507
Total risk assets and capital requirements in respect of credit risk	120,256	10,823	125,628	11,305
Risk assets and capital requirements in respect of market risk according to the standard approach	1,875	169	2,907	263
Risk assets and capital requirements in respect of operational risk according to the basic indicator approach	13,418	1,208	13,233	1,191
Total risk assets and capital requirements	135,549	12,200	141,768	12,759

* Reclassified - from "Corporates" to "Secured by commercial real estate".

Footnotes:

- (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) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the financial statement.
(3) Restated, see footnote 5 in Note 14 to the financial statements.

LIQUIDITY AND THE RAISING OF RESOURCES IN THE BANK

GENERAL

The moderation in growth of the money supply M1 (cash in hand of the public and current account deposits in NIS) continued during the year, from 5% in 2010 to 2% in 2011. In contrast, the M1 money supply (M2 together with non-linked deposits of up to one year), accelerated to a rate of 10% (4% in 2010).

- The increase in the M1 money supply reflected a decrease of approx. 3% in current account deposits, mostly in the second half of the year, and an increase of approx. 11% in cash held by the public. The increase in cash held by the public, which also evidenced mostly in the second half of the year, occurred on the background of the growing economic uncertainty and the decline in the capital markets, which led to an increase in the demand for liquidity.
- The increase in the M2 money supply occurred practically in total in the period from January to September, on the background of the increase in interest rates and the decline in the capital markets. These resulted in the preference of bank deposits over more risky investment channels and contributed to a approx. 16% increase in time deposits of up to one year.

Concurrently to the increase in the quantity of money, an increase of approx. NIS 6.0 billion was recorded in 2011 in the monetary base (compared to NIS 11.5 billion in 2010). Most of the increase (approx. NIS 10.5 billion) occurred in the third quarter of the year offsetting absorption of NIS 5.4 billion.

The increase in the monetary base derived from the money supply by the Bank of Israel, which was partly offset by Government absorption.

- On the background of the strengthening of the local currency, the Bank of Israel purchased (mainly in the first half of the year) foreign currency in an amount of approx. NIS 16 billion (compared to approx. NIS 44 billion in 2010).
- Furthermore, as a result of the declining issuances of short-term loans (MAKAM), the operations of the Bank of Israel on the open market led to an additional supply of money of approx. NIS 17 billion, in contrast to absorption of approx. NIS 47 billion in 2010.
- With a view of reducing market liquidity (in view of the process of increased interest rates in the first half of the year), the Bank of Israel absorbed some NIS 28 billion by expanding Shekel deposits. This in contrast to the supply of about one half of that amount in 2010.
- Furthermore, Government activity led to additional absorption of approx. NIS 2 billion, in contrast to the supply of approx. NIS 1 billion in 2010. All of this absorption occurred in the first quarter of the year and was partly offset by Government money supply in the second and fourth quarters of the year.

THE BANK

Liquidity risk management policy at the Discount Group. The Bank's group management strategy is designed to minimize liquidity risk at the subsidiary companies and at the Group as a whole.

The Bank has defined a methodology for the assessment of liquidity risk, which includes identification of risk centers, risk assessors, authority and responsibility levels, etc.

The liquidity risk management policy determined that each subsidiary in the Group is responsible for independently managing its liquidity risk and for complying with the requirements of the law and of the Supervisor of Banks or the local Regulator. The monitoring and control over exposure to liquidity risk are performed independently by each of the Group companies and are under the responsibility of their boards of directors.

Notwithstanding, a uniform framework has been established – each subsidiary company shall maintain a "liquidity risk policy document" that includes an "action plan for crisis situations", and shall assess the risk by means of an internal model in a manner to be defined by the Bank's CRO. All this, taking into consideration the differences in economic environment and in the activity of the company.

The liquidity model at the Bank includes liquidity requirements, if existing, which stem from the increased risks in the activities of the subsidiary companies, reflected in deviation from determined risk limitations. Notwithstanding, the Bank does not allow subsidiaries to include in their liquidity models this possible assistance. Subsidiaries may include as a resource only contractual obligations of the Bank.

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 Group members and the Bank is based on the money price mechanism established at the Bank. As stated, many companies may not rely upon the transfer of liquidity where no liquidity framework had been defined by the other party. During the course of 2011, U.S. dollar term liquidity in immaterial amounts was transferred to the Bank by IDB (Swiss) 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.

Following are the changes in the composition of the Bank's deposits in 2011:

The non-linked segment. The volume of non-linked deposits from the public with the Bank reached at the end of 2011 an amount of NIS 71.9 billion, compared with NIS 61.3 billion at the end of 2010, an increase of 17.3%.

The CPI linked segment. The total of CPI linked financial resources amounted to NIS 12 billion at the end of 2011, compared with NIS 12.4 billion at the end of 2010, a decrease of 3.2%.

The foreign currency and foreign currency linked segment. The volume of non-linked deposits from the public with the Bank reached US\$8.2 billion at the end of 2011, compared to US\$8.6 billion at the end of 2010, a decrease of 3.7%. After eliminating exchange differences, the change between the currencies amounted to a decline of US\$224 million, a drop of 4.9%.

Raising of capital:

Issuances of lower tier II capital in 2011. In 2011, Mercantile Discount Bank raised lower Tier II capital in the amount of NIS 185 million.

Deduction of Capital Notes in 2012. An amount of NIS 1,306 million of capital notes issued in the past will be deducted in the course of 2011 from the tier II capital of the Group, used in calculating the ratio of capital to risk assets. The Bank and its subsidiaries raised at the beginning of 2012 funds in a total amount of NIS 326 million.

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, is generally included 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.

It should be noted that within the framework of the organizational change (see under "Human resources"), a certain movement of customers has occurred between the different segments, in particular, between the Small Business Segment and the Middle Market Banking Segment.

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).

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 2011 were conducted by four divisions: Banking Division, Corporate Division, Finance Division and the Customer Assets Division (since its establishment in October 2011).

The Banking Division conducts business with households, VIP customers, small companies and businesses, medium corporations (middle market), foreign residents, private banking customers and customers of direct banking. The division is also responsible for the Bank's investment consulting services - pension and securities consulting services.

The Corporate Division is responsible for operations with the large corporations through business managers, the Tel Aviv main

branch, the foreign trade department Diamond, Exchange Branch and the London branch. Likewise, the Division is responsible for operations with segments of specific customers, such as: diamond companies, hi-tech companies, construction (real estate project financing) and infrastructure companies, approved enterprises and large capital market operators.

The Finance Division The Division coordinates the management of market and liquidity risks 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, the central control layout, back office, Chief Economist and Investors Relations.

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 layouts 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") and for trusteeship services (through "Discount Trust").

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.

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 2011, the Bank operated a country wide layout of 149 branches and extensions, being organized within the framework of 6 areas. Mercantile Discount Bank ("MDB") operated 79 additional branches.

Changes in the Bank Branches. Three new branches were opened in 2011: "Discount Home – Savyonim", a "Discount Your Way" branch at the "Sharonim" shopping mall in Hod-Hasharon and a "Discount Your Way" branch at the "Grand Canyon" shopping mall in Haifa. Concurrently, the "Noah Square" branch in Givataim has been closed.

For details regarding the modification of the branch network, complementary services and the consultation layout, see "The household segment" hereunder. MDB opened 2 branches in 2011. For details regarding the intention of Mercantile Discount Bank to freeze its corporate credit portfolio, see below "Mercantile Discount Bank Ltd." under "Main investee companies".

Plan for 2012. The plan for 2012 includes the opening of one "Discount rapid" branch, three traditional branches, six mergers of branches and the transition of two branches into business branches.

TARGETS AND BUSINESS STRATEGY

In order to provide an inviting and pleasant customer experience, the branch appearance has been changed to suit the retail business by introducing a branch commercialization as well as installing closed circuit TV screens and audio systems. Within this framework, each branch was divided into two areas: the daily banking area - "Discount rapid" and the specialized banking area. In addition intensive action is taken to improve the work process more by removing the operational activity from the branch allotting more time to initiative and marketing activity. The retail segment focuses on the development of the consumer credit

field as a growth generator. Concurrently, with a view of improving the service experience of the customer, the Bank has deployed a line management system in the expert banking area at the branch.

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 2011, 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 the granting of structured credit facilities 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 requirement of the customer, his repayment ability, and the acquaintance with him over the years as regards structured credit lines, in which the interest rate decreases gradually in line with the increasing utilization of the credit facility. This activity supports the development of the consumer credit field at the Bank and allows full compatibility with the needs of the customer.

In the small business sector three principal kinds of customers were identified: business, business plus and extended business. The segments are defined in relation to parameters of volume of operations vis-à-vis the Bank, as measured mainly in the credit field.

SERVICE CONCEPT

In order to create a competitive advantage, a new service concept has been formed. This concept defines a system of values, the integration of which will improve the service experience. Absorption of the new concept began in May 2010 and continued in the course of 2011.

Conduct of the personal and humane 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;
- People oriented banking - familiarity and warm and humane relations on the part of the service providers;
- Service initiative - anticipating the customer's needs and customizing products or services to such needs;

- The integration of standards for handling customer approaches and the continued reduction in complaints;
- The allocation of resources based on the requirements of the customer and the Bank's priorities.

A customer focused support system was integrated at the Bank's service layouts. This system places the customer at the center and customizes the products according to his needs and preferences.

"DISCOUNT KEY"

In 2011, 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.

Over 308,000 "Discount key" savings deposits have been opened in the period of about one year and seven months since the launching of the campaign.

"LEAN ORGANIZATION" PROJECT - REMOVAL OF OPERATIONAL ACTIVITY FROM THE BRANCHES

Integration of the project at the branch layout is intended to achieve the following targets:

- a. The customer may choose between teller assisted banking services and self service banking;
- b. 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.

As of date of publication of the financial report all the Bank's branches have a self service banking area, where the customer is able to conduct most of his daily banking transactions, including cash and check deposits and effecting payments. Services of the ATM infrastructure have been expanded to include the withdrawal of foreign currency and making deposits using the ATM. Installation of the service allowing the depositing of cash using the ATM will be completed in 2012 at most of the Bank's branches.

Three back offices have been established in Tel Aviv, Jerusalem and Haifa, to which over 27 operating activities were transferred, including: clearing examination, establishment of authorizations for charging accounts and managing them, deposits through teller machines, etc. In addition, the back office is taking over from the branches the filing and maintenance of basic documents as well as the daily paperwork and their input on to the central computer system within 72 hours. The removal of basic documents has been carried out at about 80 branches. It is expected that in 2012 this process will be completed at 12 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.

Since the beginning of the project, some 200 employees have been moved to back office areas, while the total number of the Bank's employees has been reduced by 160 employees, as a result of the implementation of efficiency measures, which include improved processes and changes in performance concepts.

A similar project is being carried out since 2011 at Mercantile Discount Bank. One back-office operating unit was established (in Holon) in 2011, which is engaged in the technical examination of checks, in attachments and in registration for "Business +" for

about fifty branches. A second unit was recently established (in Nesher) and is currently beginning operations.

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 (and not the direct lines of the staff). 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. Development and improvement of the service channel via the Internet. Encouraging customers to use this channel results in significantly lower costs as compared with the cost of identical services provided at the branches. For details regarding the upgrading of the Internet site, see below "Technological changes that may effect the segment".

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 2011, 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, see Note 19 C 16 and 17).

The existing agreement with the Accountant General with respect to the teaching staff will expire in November 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.

ADJUSTMENT OF BRANCH LAYOUT

As part of the Bank's differentiation measures, unique concept branches are being established with a view of providing customer tailored service to the various needs of retail customers.

"Discount Rapid". Discount Rapid is located at the front of the branch and provides rapid response to daily banking services. The area reflects novelty, leadership and flexibility. Rapid banking centers include several information desks, ATM machine, Telebank machine and Internet stations. Most importantly, Discount Rapid is manned by professional bank personnel and is open during special hours, from 8:00 - 20:00. At the end of 2011, 35 "Discount Rapid" centers were in operation.

"Discount Your Way". These branches, located in shopping malls, serve as service and sales points to customers of these malls, and are tailored to the retail environment of the malls. Opening hours are adapted to customers' needs and convenience: 10:00 - 22:00. A "Discount Your Way" branch was opened in April 2011 at the "Sharonim" shopping mall in Hod-Hasharon. A "Discount Your Way" branch was opened in July 2011 at the "Grand Canyon" shopping mall in Haifa. At the end of 2011, 8 branches of the "Discount Your Way" line were in operation: at the "Avnat" shopping mall in Petach Tiqva, at the "Across the Park" shopping mall in Ra'anana, at the "Giva'tayim shopping mall" in Giva'tayim, at the "Malcha" Shopping Mall in Jerusalem, at the Renanim Mall in Ra'anana, at the Tel Aviv University campus, at the Sharonim shopping mall in Hod-Hasharon and at the

"Grand Canyon" shopping mall in Haifa.

"Household Discount". A branch designated at serving private retail customers only, based on an economic and efficient model for the penetration into residential areas and focused centers. These branches are located in large neighborhoods in cities and serve private customers until late hours. Business hours are adapted to the needs of customers living in the vicinity, the activity in hospitals, industrial areas, etc.: 8:00 - 20:00. The "Discount Home - Savyonim" Branch was opened in February 2011. 11 "Household Discount" branches operated at the end of 2011.

CONSULTING LAYOUT

Investment centers. Customers having deposits of over NIS 750,000 or customers active in the capital market are entitled to consultancy services regarding their funds at 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 2011.

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. As from March 2008, the Bank began providing 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 is considered a leader in this field and 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").

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 will provide the possibility of receiving a loan through the Internet and by SMS messages;
- Vehicle branch – it is planned to establish in the course of 2012 a branch specializing in the financing of vehicle purchases.

TARGETS AND BUSINESS STRATEGY

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

- The State employee tender - the Bank was successful in obtaining the tender for loans to State employees at the Accountant General's terms and additional banking services (see Note 19 C 16 to the Financial Statements);
- The teaching personnel tender - the Bank was successful in obtaining the tender for loans to teaching personnel at the Accountant General's terms (see Note 19 C 17 to the Financial Statements);
- Continued recruitment of private customers as part of new customers recruitment campaign.
- Discount outline - a joint marketing campaign with Discount Mortgage Bank, which focuses on turning the mortgage loan into a base product for the maintenance and the attracting of active customers through granting particularly attractive interest rates to customers who deposit their salary with the Bank (for further details see "Mortgage activity - Housing loans" in the Chapter "Further details regarding the activity in certain products").

POINTS OF EMPHASIS FOR THE COMING YEAR

- Continued leadership in personal and professional service;
- Strengthening the customer focused concept;
- Development of new and unique products and customizing them to customer needs;
- The continued attraction of State employees and teachers as customers, among other things, by way of a benefit basket especially structured for them and by the personal and people oriented service which they get from Bank employees;
- The continued positioning of the Bank as a leader in the pension consulting field;
- Emphasis on the preservation and fostering of customer loyalty and intensifying operations with new and existing customers;
- Intensifying operations on the liabilities side through capital market activity (for additional details regarding capital market activity, see "Operations in the Capital market" under "Further details as to activity in certain products");
- 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;
- The granting of mortgage loans through DMB, as a mechanism for attracting customers;
- As part of the overall proposal of value adapted to customer needs, the Bank operates service systems specializing in

investment consulting, pension consulting and credit;

- Discount Bank was the first bank to extend the range of branches within the framework of improving the service and to launch unique concept branches. The activity includes over 100 branches, which are also open for customer service on Fridays.

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

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

No material changes occurred in 2011 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

- Distribution of service stations and adaptation of business hours to the region and to the characteristics of the local population;
- Expansion of exposure and access to direct technological channels;
- Providing service and professional response to the customer compatible with his needs and preferences;
- The structuring of customer adapted products in the various banking channels;
- Flexibility and sensitivity to market changes, including regulatory requirements.

PRINCIPAL SEGMENT ENTRY AND EXIT BARRIERS

- Investment in branches layout all over the country;
- Investment in the establishment of advanced technological means, and in their maintenance and upgrading;
- Training of skilled service personnel engaged in providing a variety of banking products and activity;
- Maintaining the reputable service level, leadership, professionalism and reliability established over many years.
- The movement of customers from one bank to another requires the investment of efforts and impedes the attraction of new customers.

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

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

General. Most of the income from credit card issue operations is related to the household segment.

Income from financing operations amounted to NIS 1,565 million in 2011, compared to NIS 1,386 million in 2010, an increase of 12.9%. The said increase is explained by the increase in spreads relating to deposits, due to the rise in interest.

Net income of the segment in 2011 amounted to NIS 224 million compared with NIS 198 million in 2010, an increase of 13.1%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 9.3% in 2011, compared with 9.5% in 2010.

The credit loss expenses in this segment amounted in 2011 to NIS 146 million, compared with NIS 191 million in 2010, a decrease of 23.6%.

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, 2011							
in NIS millions							
Income from financing activities before credit loss expenses*							
- From external sources	(2,349)	278	10	211	(1,850)	-	(1,850)
- Intersegmental	3,511	(38)	-	(58)	3,415	-	3,415
Total income from financial activity	1,162	240	10	153	1,565	-	1,565
Operating and other income	449	779	232	42	1,502	-	1,502
Total Income	1,611	1,019	242	195	3,067	-	3,067
Credit loss expenses*	128	20	-	(2)	146	-	146
Operating and other expenses	1,527	691	180	135	2,533	1	2,534
Operating Income (loss) before taxes	(44)	308	62	62	388	(1)	387
Provision for taxes (tax savings) on operating income	(14)	86	17	23	112	-	112
Net Income (loss) Attributed to the shareholders of the banking corporation	(30)	159	57	38	224	-	224
Return on equity (percentage)	(3.8)	17.4	173.7	5.4	9.3	-	9.3
Average Assets	9,683	8,161	10	19,113	36,967	8	36,975
Average Liabilities	61,734	759	-	1,357	63,850	19	63,869
Average Risk-assets	10,079	12,188	438	9,370	32,075	11	32,086
Average customers' securities	-	-	34,235	-	34,235	-	34,235
Average other assets under management	1,036	-	1,328	1,326	3,690	-	3,690
Components of income from financial activities:							
Margin from credit activity	472	239	-	149	860	-	860
Margin from deposits activity	676	-	-	-	676	-	676
other	14	1	10	4	29	-	29
Income from financing activities before credit loss expenses*	1,162	240	10	153	1,565	-	1,565

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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, 2010							
in NIS millions							
Income from financing activities before credit loss expenses**							
- From external sources	1,303	283	10	160	1,756	3	1,759
- Intersegmental	(279)	(51)	-	(43)	(373)	-	(373)
Total income from financial activity	1,024	232	10	117	1,383	3	1,386
Operating and other income	471	787	264	48	1,570	-	1,570
Total Income	1,495	1,019	274	165	2,953	3	2,956
Credit loss expenses**	161	26	-	4	191	-	191
Operating and other expenses	*1,472	655	*156	118	2,401	1	2,402
Operating Income (loss) before taxes	(138)	338	118	43	361	2	363
Provision for taxes (tax savings) on operating income	*(56)	114	38	16	112	(1)	111
Net Income (loss) Attributed to the shareholders of the banking corporation	(82)	157	93	27	195	3	198
Return on equity (percentage)	*(11.4)	*20.6	*281.4	4.7	*9.4	-	9.5
Average Assets	9,286	7,858	9	16,327	33,480	36	33,516
Average Liabilities	57,006	748	-	1,531	59,285	161	59,446
Average Risk-assets	10,289	10,880	472	8,016	29,657	36	29,693
Average assets of provident and mutual funds	-	-	27	-	27	-	27
Average customers' securities	-	-	33,360	-	33,360	-	33,360
Average other assets under management	861	-	1,215	1,538	3,614	-	3,614
Components of income from financial activities:							
Margin from credit activity	505	238	-	114	857	1	858
Margin from deposits activity	481	-	-	-	481	2	483
other	38	(6)	10	3	45	-	45
Income from financing activities before credit loss expenses**	1,024	232	10	117	1,383	3	1,386

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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. Several bill proposals have been tabled before the Knesset, in which it is proposed to abolish Bank ledger fees, as well as obligating banks to pay interest on credit balances on current accounts. At this stage it is not yet possible to evaluate whether additional legislation and regulatory changes relating to banking services, commissions and/or interest in their respect, will take effect and what the applicable arrangements will be, if any, and how these may affect the banking services

consumption habits of customers. Accordingly, it is not yet possible to assess the implications this might have upon the Bank's results of operations in the future.

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.

For details regarding the intention of Mercantile Discount Bank to widen its retail activity, see below "Mercantile Discount Bank Ltd." under "Main investee companies".

RETAIL BANKING SECTOR - SMALL BUSINESSES SEGMENT

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

Net income of the segment in 2011 amounted to NIS 185 million compared with NIS 179 million in 2010, an increase of 3.3%.

The return on equity in 2011, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 18.3%, compared with 16.9% in 2010.

The credit loss expenses in this segment amounted in 2011 to NIS 113 million, compared with NIS 214 million in 2010, a decline of 47.2%.

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, 2011						
in NIS millions						
Income from financing activities before credit loss expenses*						
- From external sources	559	28	2	67	43	699
- Intersegmental	156	(10)	-	(10)	(17)	119
Total income from financial activity	715	18	2	57	26	818
Operating and other income	320	53	35	16	3	427
Total Income	1,035	71	37	73	29	1,245
Credit loss expenses*	129	-	-	(9)	(7)	113
Operating and other expenses	755	46	33	22	7	863
Operating Income before taxes	151	25	4	60	29	269
Provision for taxes on operating income	47	8	1	21	9	86
Net Income Attributed to the shareholders of the banking corporation	104	11	11	39	20	185
Return on equity (percentage)	13.8	19.6	205.4	39.6	19.9	18.3
Average Assets	10,891	312	4	1,018	1,256	13,481
Average Liabilities	12,205	901	-	694	50	13,850
Average Risk-assets	9,982	767	70	1,329	1,332	13,480
Average customers' securities	-	-	8,487	-	-	8,487
Average other assets under management	-	-	364	-	-	364
Components of income from financial activities:						
Margin from credit activity	560	18	-	44	26	648
Margin from deposits activity	131	-	-	8	-	139
other	24	-	2	5	-	31
Income from financing activities before credit loss expenses*	715	18	2	57	26	818

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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 31,2010						
in NIS millions						
Income from financing activities before credit loss expenses**						
- From external sources	1,614	13	3	110	37	1,777
- Intersegmental	(815)	1	-	(30)	(13)	(857)
Total income from financial activity	799	14	3	80	24	920
Operating and other income	334	60	47	20	*3	464
Total Income	1,133	74	50	100	27	1,384
Credit loss expenses**	172	-	-	43	(1)	214
Operating and other expenses	*782	65	31	19	10	907
Operating Income before taxes	179	9	19	38	18	263
Provision for taxes on operating income	*63	4	6	13	7	93
Net Income Attributed to the shareholders of the banking corporation	116	5	22	25	11	179
Return on equity (percentage)	*15.2	10.0	-	19.7	10.8	16.9
Average Assets	11,810	324	4	1,828	1,276	15,242
Average Liabilities	13,087	905	-	770	68	14,830
Average Risk-assets	10,895	753	87	1,819	1,517	15,071
Average assets of provident and mutual funds	-	-	10	-	-	10
Average customers' securities	-	-	9,186	-	-	9,186
Average other assets under management	-	-	347	-	-	347
Components of income from financial activities:						
Margin from credit activity	638	14	-	67	22	741
Margin from deposits activity	104	-	-	6	-	110
other	57	-	3	7	2	69
Income from financing activities before credit loss expenses**	799	14	3	80	24	920

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

SERVICE TO SEGMENT CUSTOMERS

The small business segment provides the full variety of services to the small and medium size business 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").

DEVELOPMENTS IN 2011

Credit centers. Until the middle of 2011, service for the business activities of customers having credit facilities exceeding NIS 500 thousand was provided by five regional credit centers, used as professional service offices for the branches, while the customer's account and his current operations continued to be conducted at the "mother branch". As stated, the centers were abolished in the middle of 2011, when middle market customers (characterized by a wider volume of operations and credit) were transferred to be serviced by six business centers, while customers with smaller businesses were transferred to be serviced by the branches.

POINTS OF EMPHASIS FOR THE COMING YEAR

- 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);
- The opening of a business dealing room 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. A focused activity is to be carried out to connect certain customers to this dealing room.

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

"Business +" website. In 2010, the Bank launched a designated website for business customers. The website presents comprehensive data regarding the accounts of the business and allows the carrying out of transactions at lower costs. The website has undergone an upgrade in 2011, and in 2012, focused activity with customers is to be performed, within the framework of which the option to conduct operations and receive service by means of the website will be presented.

SMS business packages. The SMS business package was launched in February 2011, allowing extension of current account services. Receiving messages 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.

In 2011, Mercantile Discount bank opened two additional branches in areas that have a high potential for providing banking services to the "small businesses" segment.

For details regarding the intention of Mercantile Discount Bank to widen its middle market activity, see below "Mercantile Discount Bank Ltd." under "Main investee companies".

CORPORATE BANKING SEGMENT

DEVELOPMENTS IN THE SEGMENT

Sale of credit portfolio. A credit portfolio of the corporate banking segment was sold in the second quarter of 2011 to various institutional bodies in a total amount of NIS 910 million. A gain in the amount of NIS 53 million was recorded in respect of this sale. For details regarding additional sales, see Note 4 to the financial statements.

Exposure to events in Japan, in the Arab world and in the PIIGS countries. An examination made shows that the Bank has no material exposure in respect of customers of this segment which might be impacted by the events occurring in Japan, in the Arab world and in the PIIGS countries during 2011.

REVIEW OF DEVELOPMENTS IN THE CORPORATE BANKING SEGMENT IN 2011

Expansion of the domestic economy continued in 2011, at a rate of 4.7%, similar to that of 2010. Growth, however, slowed down from quarter to quarter, the growth in the fourth quarter (3.2%) being the lowest since the middle of 2009. Growth rate of the business product slowed down in 2011 to 5.2%, compared to 5.8% in 2010, the last quarter of the year recording a growth rate of 3.5%.

Following are the factors affecting the development of the business product in 2011:

- A slowdown in growth of goods and services exports – about 5%, compared with 13% in 2010. The said slowdown reflects a sharp slowdown in the export of goods, 4% compared to 17%, and an accelerated growth rate of 7.5% in the export of services;
- A slowdown in private consumption 3.6% (compared to 5.3%), with a sharp slowdown in the consumption of durable goods, in particular the import of motor vehicles, and a slowdown in current consumption;
- On the other hand, accelerated growth was recorded in investments in fixed assets (excluding shipping and aviation) from 13% to 17%. The source of this growth is the investments in the economic sectors, particularly in machinery and equipment, which grew from 11% to 35%. In contrast, the rate of expansion slowed down regarding investments in construction. This was the result of the sharp slowdown in non-residential construction, while investments in residential construction continued to grow at a rapid rate of 13%;
- Public consumption (excluding defense imports) expanded in 2011 by 3.5%, following a growth at the rate of 2.2% in 2010. A growth of 2% was particularly noted in the purchases of the Ministry of Defense from the domestic business sector, in contrast to a contraction of 0.7% in 2010. Non-defense purchases grew by 3.4% in 2011, a similar rate to that of 2010;
- A slowdown from 12.7% to 10.7% was recorded in 2011 in the import of goods and services (excluding defense imports). This slowdown stemmed from a slowdown in the import of goods, which was setoff by a growth in the import of services (in contrast to contraction in 2010).

DEVELOPMENTS IN THE DEBT OF THE CORPORATE BANKING SEGMENT

A growth of 2.4% was recorded in 2011 in the indebtedness of the Corporate Banking Segment (excluding banks and insurance companies), which amounted at the end of December to NIS 779 billion (due to the application of the provisions regarding

impaired debts, comparison with the December 2010 data is not possible). The rates of change are in nominal terms and are affected by changes in the exchange rate and in the CPI. A significant moderation in the growth rate of the corporate debt occurred between the third and last quarters of the year – an increase of NIS 24 billion as compared with NIS 6 billion, respectively. Most of the slowdown is attributed to the debt to banks.

The growth in the outstanding debt during the year stems mainly from the rise in the debt to institutional bodies (about 12%), and to a certain extent also from the rise in the outstanding debt to the banks (1.8%). On the other hand, the debt of the Corporate Banking Segment to households and corporations (marketable corporate bonds) declined by 7%, alongside a decline in the debt to foreign residents (0.5%), this, despite the weakening of the Shekel as against the U.S. dollar.

As a result of the above developments, the weight of the share of the banks in the total debt of the Corporate Banking Segment declined during the period from 52.3% to 52.1%.

The volume of fund raising in 2011, through corporate bond issuance by companies of the segment (excluding banks and insurance companies), which comprises a significant part of the off-banking credit, amounted to NIS 25.5 billion, compared to NIS 23.3 billion in 2010. The volume of fund raising in the second half of 2011 amounted to NIS 7.2 billion, compared with NIS 18.3 billion in the first half of the year. The reduction in the volume of fund raising stemmed from the reduction in bond offerings by leading communications and real estate corporations, which raised funds through several large bond offerings in the first half of 2011, as well as from the rise in financing costs in the second half of the year.

DEVELOPMENTS IN SEGMENT MARKETS

Business activity in most economic sectors continued to grow in the course of 2011, with a significant moderation in the rate of growth in the second half of the year compared with the first, mostly in view of the continued decline in industrial exports.

Following are development directions in the principal economic sectors:

- Export inclined industrial sectors – an increase in the volume of industrial exports (excluding diamonds, in U.S. dollar terms), at the rate of 11% compared with 2010, which was based on the pharmaceutical, chemical, supervisory and control equipment industries as well as several traditional industries (mainly foodstuffs, machinery and equipment, metal, rubber and plastics). The high-technology industries recorded a growth of 6% in the volume of exports, compared with 2010, while a decline at an annualized rate of 11% and 25% was recorded in the second and third quarters, respectively, with a growth at an annualized rate of 40% recorded in the fourth quarter mostly due to an exceptional rise in the export of aircraft and to the recovery in exports of the pharmaceuticals and electronic components sectors, which recorded a sharp decline in the third quarter of the year;
- The electronics sector – a slowdown was recorded in the rate of growth of activity of this sector stemming from a moderation in growth of demand in the United States, the Eurozone and certain countries in South-East Asia, mostly with respect to electronic testing equipment, chips and equipment for the consumer electronic products market and the communications market;
- The chemical sector (forming a central part of the mixed technology sector) – recorded in 2011 a decline in production at the rate of 4% (following an impressive growth in 2010);
- The defense industries – a decline in the volume of operations compared with 2010, on the background of increased competition and the cutting-down of defense budgets around the world, which caused a downward trend in prices quoted in defense project tenders;
- Domestic industrial sectors – a significant moderation in the rate of growth of activity as from the second quarter of 2011, due to a slowdown in the rate of growth in the local demand. A decline in the volume of industrial production, in the rate of usage of machinery and equipment, in the number of workers employed and in the levels of inventories was noticed in the second half of the year, mostly as regards small and medium companies;
- Diamonds – an increase at the rate of 23% in the export of polished and rough diamonds (net) to an amount of US\$11.0 billion, compared with US\$8.9 billion in 2010. This increase stemmed from both an increase in quantities and a rise in prices

of rough diamonds and polished diamonds;

- The commercial sectors – a moderate increase in the volume of operations and stability in operating profit margins, due to an increase in the volume of demand on the domestic market, with moderation in the rate of growth starting with the third quarter. The main sectors affected from the increase in the volume of operations were motor vehicle importers, various goods and raw materials importers (petrol, iron, forage, wheat), electronic components and foodstuffs. Since the third quarter some of the food marketing chains reported a moderate decrease in turnover and a marked decline in operating profit margins, on the background of lowering prices as a result of increased competition and the social protest;
- The services sectors – an increase in the volume of activity in the operational and financial leasing sectors, vehicle rental and computer services. The communications industry recorded a significant decline in the volume of activity with a material decline in operating profit margins, due to an increase in competition and regulatory changes (mostly due to the decrease in connectivity fees). The investment house industry recorded a decrease in volume of operations on the background of the weakness on the capital market;
- The hotel sector – the number of hotel bed/nights remained stable compared with 2010 (21.9 million bed/nights), stemming from the stability in the number of foreign tourist bed/nights (10 million) and in the number of Israeli guests bed/nights (11.9 million). The nationwide average hotel room occupancy amounted to 66%, similarly to 2010;

ANTICIPATED DEVELOPMENTS IN THE SEGMENT'S MARKETS

A further slowdown in the business activity of most economic sectors is expected in 2012, on the background of the moderation in the rate of growth in foreign demand, including a decline on the rate of growth of the domestic activity. According to forecasts of the Bank of Israel of December 2011, the anticipated rate of growth for 2012 was reduced to a rate of 2.8%, compared with 4.7% in 2011.

Following are the main expected developments:

- The domestic market – moderation in the rate of growth of revenues and decline in profitability of companies, principally in the foodstuffs and communications sectors (due to the ramifications of the social protest and the regulatory changes expected to result in the decrease in prices in these industries) and in a number of traditional industries (metal, rubber-plastics and textiles), which are sensitive to the slowdown in the rate of growth of business activity;
- A significant moderation in the rate of growth of exports (according to the Bank of Israel forecast of December 2011, a moderate rate of growth of 1.2% is anticipated for 2012 in exports excluding diamonds and start-up companies), on the background of the slowdown in world trade, the significant exposure to certain markets in the Eurozone that experience a deep debt crisis, and the slow recovery rate of the markets in the U.S., due to the slow growth in private consumption, comprising about 70% of the product in the U.S.;
- Moderation in the level of the domestic demand, on the background of the anticipated slowdown in the private consumption of households compared with 2011, due to the decline in the consumption appetite of the population (a decline in economic security due to the weakness of the capital market, concern regarding a further economic slowdown following the Eurozone crisis, the slow recovery of the global economy and the rising geopolitical risks) as well as a certain increase in unemployment rates;
- A continued moderate growth of activity in the construction sector, mainly due to the significant increase in the number of new residential construction;
- Moderation in the rate of growth of investments in machinery and equipment and in inventory levels, on the background of the anticipated slowdown in non-financial activity.

EXPECTED DEVELOPMENTS IN CREDIT TO THE CORPORATE BANKING SEGMENT

Banking credit. An increase in the volume of credit is anticipated as a result of the following developments:

- Mitigated requirements by the Regulator in respect of the scope of the gradual increase in the adequacy of the core capital compared with earlier estimations;
- The need to recycle bank loans and bonds in considerable amounts, which are due for redemption in the course of 2012;
- An increase in investments and in working capital requirements of corporations, as a result of the continuing moderate growth in non-financial activity;
- A decline in the profitability of corporations and in their ability to produce cash by current operations (a decline in internal accumulation), to support the financing of current operations, investments and the distribution of dividends;
- A decrease in the rate of investments and in working capital requirements, due to the moderation in the rate of growth of non-financial activity;
- A decline in the volume of credit granted to holding companies in general and for the finance of acquisition of means of control (LBO) in particular, on the background of the increasing credit risk involved in such credit, which relies on dividend distributions in large amounts by the operating companies, in view of the apparent recommendations of the Concentration Committee regarding the "gap" companies and the moderation in the rate of growth in the non-financial activity.

Off-banking credit. The volume of off-banking credit is expected to grow significantly as a result of the following developments:

- The need for the recycling of bonds in a significant amount, due for redemption during 2012;
- The institutional bodies have certain flexibility in adhering to credit limitations (compared with capital adequacy requirements and large borrower group limitations at the banks) and therefore have a relatively greater ability to leverage their resources;
- An anticipated improvement in the terms of bond offerings by way of obtaining material collateral and financial covenants, while matching them to the credit terms offered by the banking industry;
- Increased demand on the part of mutual funds and institutional bodies for attractive investment products, including corporate bonds of a rating of "A" and above, carrying a suitable premium over government bonds having a similar average period to maturity;
- Enlarging the volume of direct loans to large and leading corporations by the institutional bodies, as a substitute to the acquisition of marketable bonds, which might lead to capital losses;
- A moderate growth only is expected with respect to foreign credit, on the background of the global slowdown and the slow expansion in banking credit in Western countries.

TARGETS AND BUSINESS STRATEGY

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 for the segment with respect to the year 2012:

- A minimal growth, practically down to stability in the volume of risk assets of the segment, while increasing the return on the existing credit portfolio by way of increasing the marginal spread and the operating commissions;
- Participation in the financing of large merger and acquisition transactions structured by the two large banks in Israel;
- Leading syndication transactions with institutional bodies;
- Intensifying the control and monitoring processes over current exceptional developments in the risk profile of customers;
- 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, and reducing exposure to holding companies, and in particular holding companies mostly operating abroad.

The Bank has defined preferred segments and/or areas of operation for the allocation of credit, which are typified by a reasonable level of risk and a growth potential, as detailed below:

- Industrial operations - electronics (principally in the industrial electronic equipment, chips and semiconductor sectors), chemicals, medical equipment, pharmaceuticals, defense industries, paper, food and beverages;
- Commercial operations - large corporations engaged in oil, gas and commodities trading, importers of motor vehicles, large food and electrical appliances marketing chains;
- Services - business services, software and computer services, public transportation, large and sector-leading leasing and car rental companies having a relatively low leverage level and which operate within the framework of a financially solid group;
- Expanding credit to large and medium operators on the capital market, where the credit is backed-up by solid financial assets.

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 2011". 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.

Amendment of Proper Banking Management Directive No. 313. On May 18, 2011, the Supervisor of Banks issued an amendment to Proper Banking Management Directive No.313 in the matter of: "Restrictions on indebtedness of a borrower and of a borrower group". This, among other things, in order to implement the lessons learnt from the recent global economic crisis, and with a view of updating the instructions as part of the measures taken to reduce the risk of concentration in the banking industry, and with the aim of matching the terminology to that of the capital adequacy instructions.

Among other things, the following instructions were determined in the Amendment:

- The exemption granted up till now to credit exposure to banking corporations has been abolished and a new restriction has been determined, "restriction on a borrower banking group", according to which the outstanding balance of indebtedness of such a group (net of certain amounts) shall not exceed 25% of the equity of the banking corporation, or NIS 250 million, the higher of the two.
- The restriction on a "borrower group" has been reduced from 30% of the equity of the banking corporation to a rate of 25% (it should be noted that according to the approval of the Supervisor of Banks, the Bank is already acting today according to this restriction).
- The restriction upon indebtedness of the "six largest borrowers" has been abolished and replaced by a restriction of 120% of the equity of the banking corporation (gradually, until the end of 2012) on the total net indebtedness of borrowers, borrower groups and borrower banking groups, the net indebtedness of whom to the banking corporation exceeds 10% of the equity of the banking corporation.

The Amendment will take effect on December 31, 2011. The Instruction includes transitional provisions for the treatment of deviations that might arise following the initial implementation of the restriction applying to borrowers whose net indebtedness

exceeds 10% of the equity of the banking corporation.

The said restrictions may have adverse implications on the manner and scope of the Bank's business segment operations insofar as they relate to these customers.

As of December 31, 2011 no deviations existed to the limitations as set in the said directive.

On February 14, 2012, the Supervisor of Banks issued an additional amendment to Proper Banking Management Directive No. 313 in the matter of "Restrictions on indebtedness of a borrower and a group of borrowers", with a view of clarifying certain matters in the Directive. It has been clarified within the framework of the amendment, that in measuring the total net indebtedness of borrowers, group of borrowers and banking group of borrowers, the indebtedness of a borrower who is included in more than one borrower group, should be included only in the group of borrowers having the largest indebtedness.

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, 2011, there were no deviations from the said limitations.

Amendment No. 44 of the Securities Law. An amendment published on January 12, 2011, determined that in cases where a company, being a reporting corporation, becomes insolvent or cannot meet its obligations, the bonds held by the controlling shareholders of the company will be redeemed only after the bonds held by all other bondholders have been redeemed.

This means that the right of the controlling shareholders to receive payment by power of their ownership of bonds issued by the corporation under their control, in circumstances where such corporation finds itself in difficulties, is impaired and turns into a deferred right. In such cases a controlling shareholder will be entitled to a payment by power of bonds issued by the corporation under his control only after (and actually only subject to) all other bondholders have been redeemed in full, unless otherwise explicitly determined within the framework of a compromise agreement or arrangement approved by a special resolution of a meeting of bondholders of the same Series, or within the framework of a compromise or arrangement approved in accordance with Section 350 of the Companies Law, or where the controlling shareholder is holding the bonds since their initial issuance.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Income from financing operations amounted to NIS 1,058 million in 2011, compared to NIS 1,025 million in 2010, an increase of 3.2%. The profit for 2011 has been affected by the gains on sale of the credit portfolio, see "Developments in the segment" above.

Net income of the segment in 2011 amounted to NIS 352 million compared with NIS 276 million in 2010, an increase of 27.5%.

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 9.8% in 2011, compared with 7.3% in 2010.

The credit loss expenses in this segment amounted in 2011 to NIS 281 million compared with NIS 222 million in 2010, an increase of 26.6%.

Following are the principal data relating to the operations of the corporate banking segment:

	Domestic operations				International operations				Total
	Banking and finance	Credit cards	Capital market	Construction and real estate	Total	Banking and finance	Construction and real estate	Total	
For the year ended December 31,2011									
in NIS millions									
Income from financing activities before credit loss expenses*									
- From external sources	1,468	16	2	867	2,353	103	9	112	2,465
- Intersegmental	(832)	-	-	(565)	(1,397)	(10)	-	(10)	(1,407)
Total income from financial activity	636	16	2	302	956	93	9	102	1,058
Operating and other income	158	55	47	31	291	46	2	48	339
Total Income	794	71	49	333	1,247	139	11	150	1,397
Credit loss expenses*	44	-	-	79	123	55	103	158	281
Operating and other expenses	389	45	33	65	532	33	8	41	573
Operating Income (loss) before taxes	361	26	16	189	592	51	(100)	(49)	543
Provision for taxes (tax savings) on operating income	125	7	3	65	200	20	(38)	(18)	182
Net Income (loss) Attributed to the shareholders of the banking corporation	236	10	13	124	383	31	(62)	(31)	352
Return on equity (percentage)	14.1	25.7	156.9	10.9	13.1	8.3	(62.9)	(11.8)	9.8
Average Assets	26,182	430	29	13,187	39,828	2,419	1,004	3,423	43,251
Average Liabilities	20,816	1,295	2	1,856	23,969	1,503	39	1,542	25,511
Average Risk-assets	21,493	516	114	19,258	41,381	5,022	1,307	6,329	47,710
Average customers' securities	-	-	85,998	-	85,998	-	-	-	85,998
Average other assets under management	-	-	412	-	412	-	-	-	412
Components of income from financial activities:									
Margin from credit activity	485	16	-	242	743	75	9	84	827
Margin from deposits activity	46	-	-	10	56	18	-	18	74
other	105	-	2	50	157	-	-	-	157
Income from financing activities before credit loss expenses*	636	16	2	302	956	93	9	102	1,058

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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

	Domestic operations				International operations				Total
	Banking and finance	Credit cards	Capital market	Construction and real estate	Total	Banking and finance	Construction and real estate	Total	
For the year ended December 31,2010									
in NIS millions									
Income from financing activities before credit loss expenses**									
- From external sources	78	11	2	252	343	408	9	417	760
- Intersegmental	453	-	-	69	522	(257)	-	(257)	265
Total income from financial activity	531	11	2	321	865	151	9	160	1,025
Operating and other income	84	49	34	27	194	66	1	67	261
Total Income	615	60	36	348	1,059	217	10	227	1,286
Credit loss expenses**	44	-	*-	38	82	87	53	140	222
Operating and other expenses	*340	60	18	*70	488	101	7	108	596
Operating Income (loss) before taxes	231	-	18	240	489	29	(50)	(21)	468
Provision for taxes (tax savings) on operating income	79	1	*6	84	170	38	(16)	22	192
Net Income (loss) Attributed to the shareholders of the banking corporation	152	(1)	12	156	319	(9)	(34)	(43)	276
Return on equity (percentage)	*8.5	(3.8)	*226.7	12.1	10.2	(1.6)	(55.4)	(6.6)	7.3
Average Assets	24,733	447	18	14,080	39,278	5,106	875	5,981	45,259
Average Liabilities	17,057	1,298	2	1,785	20,142	1,496	-	1,496	21,638
Average Risk-assets	25,566	519	74	18,582	44,741	8,542	875	9,417	54,158
Average assets of provident and mutual funds	-	-	230	-	230	-	-	-	230
Average customers' securities	-	-	80,484	-	80,484	-	-	-	80,484
Average other assets under management	-	-	182	-	182	-	-	-	182
Components of income from financial activities:									
Margin from credit activity	459	11	-	269	739	124	9	133	872
Margin from deposits activity	35	-	-	9	44	27	-	27	71
other	37	-	2	43	82	-	-	-	82
Income from financing activities before credit loss expenses**	531	11	2	321	865	151	9	160	1,025

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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. Within the framework of expanding the operations basket with the business customer and the focusing on activity that does not require capital, it was decided in 2010 on the establishment of a capital market department within the Corporate Division. 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').

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 2011, amounted to US\$72.7 billion, an increase of 23.9% compared with 2010. Export of goods amounted to US\$57.6 billion, an increase of 13.2% compared with 2010. The trade deficit amounts to US\$15 billion.

Details of imported goods according to purpose, shows an increase in most groups of imported goods. The developments in trading in goods in 2011, as compared with 2010, have been significantly affected by changes in world price changes.

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 2011 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 2011 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. 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 ever-increasing competition from the other four large banking groups as well as from foreign banks that operate in Israel (HSBC, Citigroup). It should be noted that competition on the part of the foreign banks has declined with the development of the world financial crisis.

The level of competition on the part of institutional bodies also increased in recent years, mainly insurance companies and pension funds.

Since the second half of 2009, the capital market has shown a continued recovery, and a considerable number of corporations reverted to raising off-banking resources.

The process of growing financial spreads and operating commissions continued during 2011, as a result of the weakness in the capital market, the need for an increase of the core capital on the part of the banking industry and the growing returns on bonds of leading corporations.

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, advances, execution and so forth.

MIDDLE MARKET BANKING SEGMENT

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Income from financing operations amounted in 2011 to NIS 706 million, compared to NIS 656 million in 2010, an increase of 7.6%.

The net income of the segment in 2011 amounted to NIS 148 million compared with NIS 116 million in 2010, an increase of 27.6%.

The return on equity in 2011, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 8.4% compared with 7.4% in 2010.

The credit loss expenses in this segment amounted in 2011 to NIS 165 million, compared with NIS 182 million in 2010, a decrease of 9.3%.

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, 2011										
in NIS millions										
Income from financing activities before credit loss expenses*										
- From external sources	339	6	2	158	4	509	55	774	829	1,338
- Intersegmental	(81)	(1)	-	(57)	(2)	(141)	207	(698)	(491)	(632)
Total income from financial activity	258	5	2	101	2	368	262	76	338	706
Operating and other income	76	19	11	14	-	120	66	3	69	189
Total Income	334	24	13	115	2	488	328	79	407	895
Credit loss expenses*	24	-	-	(12)	-	12	92	61	153	165
Operating and other expenses	257	16	10	28	-	311	167	31	198	509
Operating Income (loss) before taxes	53	8	3	99	2	165	69	(13)	56	221
Provision for taxes (tax savings) on operating income	18	2	2	33	-	55	24	(6)	18	73
Net Income (loss) Attributed to the shareholders of the banking corporation	35	3	4	66	2	110	45	(7)	38	148
Return on equity (percentage)	6.1	17.5	491.6	26.9	19.6	13.6	7.1	(4.1)	2.3	8.4
Average Assets	7,369	129	1	2,878	155	10,532	6,927	1,980	8,907	19,439
Average Liabilities	3,935	1,344	-	662	-	5,941	1,620	483	2,103	8,044
Average Risk-assets	8,281	254	24	4,051	150	12,760	8,549	2,192	10,741	23,501
Average customers' securities	-	-	10,546	-	-	10,546	-	-	-	10,546
Average other assets under management	961	-	287	-	-	1,248	-	-	-	1,248
Components of income from financial activities:										
Margin from credit activity	209	5	-	81	2	297	217	67	284	581
Margin from deposits activity	27	-	-	6	-	33	45	9	54	87
other	22	-	2	14	-	38	-	-	-	38
Income from financing activities before credit loss expenses*	258	5	2	101	2	368	262	76	338	706

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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 31,2010										
in NIS millions										
Income from financing activities before credit loss expenses**										
- From external sources	127	4	1	67	-	199	445	120	565	764
- Intersegmental	129	-	-	18	-	147	(225)	(30)	(255)	(108)
Total income from financial activity	256	4	1	85	-	346	220	90	310	656
Operating and other income ***	***87	16	18	12	-	133	***58	***10	68	201
Total Income	343	20	19	97	-	479	278	100	378	857
Credit loss expenses**	96	-	-	(5)	-	91	59	32	91	182
Operating and other expenses	*285	20	11	27	-	343	*153	30	183	526
Operating Income (loss) before taxes	(38)	-	8	75	-	45	66	38	104	149
Provision for taxes (tax savings) on operating income	*(14)	-	2	27	-	15	19	2	21	36
Net Income (loss) Attributed to the shareholders of the banking corporation	(24)	-	9	48	-	33	47	36	83	116
Return on equity (percentage)	*(3.6)	-	33.9	21.2	-	3.6	10.5	17.8	13.0	7.4
Average Assets	7,694	144	1	2,521	179	10,539	5,270	2,395	7,665	18,204
Average Liabilities	4,926	1,441	-	699	-	7,066	2,898	354	3,252	10,318
Average Risk-assets	9,400	253	33	3,305	233	13,224	6,323	2,751	9,074	22,298
Average assets of provident and mutual funds	-	-	16	-	-	16	-	-	-	16
Average customers' securities	-	-	8,541	-	-	8,541	-	-	-	8,541
Average other assets under management	957	-	404	-	-	1,361	-	-	-	1,361
Components of income from financial activities:										
Margin from credit activity	199	4	-	68	-	271	179	83	262	533
Margin from deposits activity	26	-	-	3	-	29	41	7	48	77
other	31	-	1	14	-	46	-	-	-	46
Income from financing activities before credit loss expenses**	256	4	1	85	-	346	220	90	310	656

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

***Restated

SERVICE TO SEGMENT CUSTOMERS

During 2011, a change has taken place in the customer service layouts, which included the merger of the credit centers with the business centers, creating 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. The change is intended to bring the decision-makers closer to the customer by way of decentralization of authority and the shortening of procedures for attending to the customer.

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. 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 2011, economic growth and private consumption recorded a certain slowdown as compared with 2010, as well as a standstill in residential real estate transactions. 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.

TARGETS AND POINTS OF EMPHASIS FOR 2012

- In view of forecasts indicating the worsening 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.
- The opening of a business dealing room providing dealing room services (purchase and conversion of foreign currency services and conducting hedge transactions) to customers of the Bank's Small Business segment and the Middle Market Banking segment. A focused activity is to be carried out to connect customers to this dealing room.

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 slowdown is also anticipated in investments in equipment and machinery. Furthermore, the continuing slowdown is expected in exports 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;
- 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 with the Bank financial assets in an amount exceeding US\$1 million in the case of Israeli customers and US\$0.5 million in the case of foreign residents (hereinafter : "private banking customers").

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 Pituch 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.

The service to Israeli and foreign resident customers grants them the advantage of a high level of access to the investment advisory services and the financial products areas, including in the global area.

During 2011, the Bank opened the new private banking center in Herzliyah, mostly serving Israeli customers, and the private banking center in the Mamilla Quarter in Jerusalem, mostly serving foreign resident customers. Together with the private banking centers in Tel Aviv and Haifa, customers of this segment have at their disposal four private banking centers, as described above.

The private banking centers offer, among other things, comprehensive banking solutions, while focusing on investment products and on the credit required to finance the varied investment channels of these customers.

During 2011, the Bank intensified operations with Israeli customers having a private banking profile.

During 2012, the Bank will focus on widening the Israeli private banking customer base and increasing the volume of operation of foreign resident private banking customers. Furthermore, the Bank is about to complete the move started in 2009, for the transfer to the retail segment (household) of customers who do not have a private banking profile.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2011 amounted to NIS 7 million compared with NIS 56 million in 2010.

Disregarding the profit from extraordinary operations, the loss amounted to NIS 1 million, compared with a net profit of NIS 47 million in 2010

The return on equity, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 1.7% in 2011 compared with 17.2% in 2010.

Following are the principal data relating to the operations of the private banking segment:

	Domestic operations			International operations			Total
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	
For the year ended December 31,2011							
in NIS millions							
Income from financing activities before credit loss expenses*							
- From external sources	73	1	74	455	-	455	529
- Intersegmental	92	-	92	(278)	-	(278)	(186)
Total income from financial activity	165	1	166	177	-	177	343
Operating and other income	67	43	110	98	47	145	255
Total Income	232	44	276	275	47	322	598
Credit loss expenses*	34	-	34	3	-	3	37
Operating and other expenses	117	38	155	358	46	404	559
Operating Income (loss) before taxes	81	6	87	(86)	1	(85)	2
Provision for taxes (tax savings) on operating income	29	3	32	(28)	(1)	(29)	3
Net Income (loss) Attributed to the shareholders of the banking corporation	52	11	63	(58)	2	(56)	7
	32.2	83.2	35.9	(26.8)	-	(26.3)	1.7
Average Assets	1,688	9	1,697	4,769	-	4,769	6,466
Average Liabilities	17,542	-	17,542	18,559	-	18,559	36,101
Average Risk-assets	2,594	175	2,769	2,486	-	2,486	5,255
Average customers' securities	-	13,270	13,270	-	12,272	12,272	25,542
Average other assets under management	-	2,105	2,105	144	-	144	2,249
Components of income from financial activities:							
Margin from credit activity	28	-	28	89	-	89	117
Margin from deposits activity	162	-	162	88	-	88	250
other	(25)	1	(24)	-	-	-	(24)
Income from financing activities before credit loss expenses*	165	1	166	177	-	177	343

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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

	Domestic operations			International operations			Total
	Banking and finance	Capital market	Total	Banking and finance	Capital market	Total	
For the year ended December 31, 2010							
in NIS millions							
Income from financing activities before credit loss expenses**							
- From external sources	222	1	223	(443)	1	(442)	(219)
- Intersegmental	(90)	-	(90)	644	-	644	554
Total income from financial activity	132	1	133	201	1	202	335
Operating and other income	49	35	84	85	57	142	226
Total income	181	36	217	286	58	344	561
Credit loss expenses**	1	-	1	*9	-	9	10
Operating and other expenses	*95	24	119	295	51	346	465
Operating Income (loss) before taxes	85	12	97	(18)	7	(11)	86
Provision for taxes on operating income	30	5	35	3	1	4	39
Net Income (loss) Attributed to the shareholders of the banking corporation	55	16	71	(21)	6	(15)	56
Return on equity (percentage)	*40.6	*139.6	*48.4	(13.2)	-	(9.5)	*17.2
Average Assets	1,985	7	1,992	4,591	-	4,591	6,583
Average Liabilities	18,597	-	18,597	18,006	-	18,006	36,603
Average Risk-assets	2,267	238	2,505	2,115	-	2,115	4,620
Average assets of provident and mutual funds	-	187	187	-	-	-	187
Average customers' securities	-	11,834	11,834	-	10,999	10,999	22,833
Average other assets under management	-	2,088	2,088	99	-	99	2,187
Components of income from financial activities:							
Margin from credit activity	28	-	28	87	1	88	116
Margin from deposits activity	113	-	113	114	-	114	227
other	(9)	1	(8)	-	-	-	(8)
Income from financing activities before credit loss expenses**	132	1	133	201	1	202	335

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

SERVICE TO CUSTOMERS

Private banking customers are offered an "enveloping" service package, which commits the Bank's and the Group's resources to providing an optimal response to customers' needs alongside a commitment towards taking the initiative in dealings with them. 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. Most of the staff has a command of foreign languages compatible with the language of the customer they serve. In addition, customers benefit from direct access to dealing rooms, direct banking via the Internet, as well as complementary services by the Bank's subsidiaries: trusteeship, portfolio management and investment banking, 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 both in Israel and abroad. The department also contributes to the Bank's involvement with Jewish communities abroad, while maintaining close contacts with organizations operating there.

A planning and business development unit acts to provide Israeli and foreign resident private banking customers with offers of value, particularly within the framework of 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 2011. 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 four principal areas of activity: trade in currencies, trade in interest rates, trade in Israeli and foreign securities and management of liquidity in Israeli currency and in foreign currency. The dealing room 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 four 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.

LIQUIDITY AND DEPOSITS

The liquidity desk engages in managing the Bank's short-term liquidity (up to one month), both in shekel and foreign currency terms, through the open tenders of the Bank of Israel, deposits and loans. The desk supplies interest rate quotations for deposits in foreign currency and in shekels by large customers ("super jumbo"), and looks after satisfying the Bank's needs (loans and transfers) with respect to any currency and at any point of time, including investment of surplus funds.

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 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.

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 Bank's President & CEO, makes decisions regarding 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 propensity. The asset and liability management increases or reduces the risks in accordance with the decisions of the assets and liability management committee by managing the available-for-sale portfolio and by off-balance sheet transactions.

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.

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.

In the dealing rooms field the Bank promoted during the last three years cooperation between the various dealing rooms of the subsidiaries, and has begun the implementation of a strategic plan for improving efficiency and increasing profitability supported by such cooperation.

MAIN DEVELOPMENTS IN THE SEGMENT

Developments in the "nostro" portfolio. For details regarding the Bank's "nostro" portfolio and developments therein, including particulars concerning the impairment of available-for-sale securities and concerning the Bank's investments in asset-backed securities, see above "Securities" under "Development of assets and liabilities", 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 loss of the segment, excluding the activity of the non-financial companies sub-segment, in 2011 amounted to NIS 131 million compared with a loss of NIS 119 million in 2010.

Total revenues, excluding non-financial companies segment, amounted in 2011 to NIS 191 million, of which NIS 82 million from domestic activity, compared with NIS 457 million in 2010, of which NIS 170 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 194 million, of which NIS 108 million from earnings on the sale of securities and from adjustments to fair value of trading securities, compared with NIS 215 million "Nostro" earnings in 2010, of which NIS 195 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 120 million in 2011, compared with NIS 45 million in 2010.
3. Income on international operations in the amount of NIS 116 million, compared to NIS 287 million in 2010.

The return on equity in 2011, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, reached a negative rate of 11.8%, compared with a negative rate of 10.4% in 2010.

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						
	2011			2010		
in NIS millions						
Income from financing activities before credit loss expenses**	90	202	292	147	365	512
Operating and other income	(8)	(93)	(101)	23	(78)	(55)
Total Income	82	109	191	170	287	457
credit loss expenses**	11	25	36	(1)	3	2
Operating and other expenses	644	150	794	*679	80	759
Operating Income (loss) before taxes	(573)	(66)	(639)	(508)	204	(304)
Net Income (loss) Attributed to the shareholders of the banking corporation	(143)	12	(131)	(202)	83	(119)
Return on equity (percentage)	(18.4)	2.6	(11.8)	*(25.7)	22.5	(10.4)
Average Assets	55,612	15,952	71,564	*50,597	16,159	66,756
Average Liabilities	24,302	8,700	33,002	*22,312	10,156	32,468
Average Risk-assets	12,450	4,344	16,794	*10,169	5,180	15,349

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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 strategic plan for the coming years in the financial management segment focuses mainly on areas of capital management, management of liquidity, of exposure to linkage bases and interest rate, on the management of the "Nostro" securities portfolio, including the establishment of a designated "Nostro" unit, on computer systems as well as on the integration of joint standards for risk management and implementation of controls, including by means of market and credit risk management systems, in cooperation with the Bank. During 2012 the Bank intends to intensify cooperation in the area of asset and liability management and in the activity of the dealing rooms of Group companies, both at the business and technological levels.

The above forward-looking statement is based on the Bank's plans as of publication of the financial report. The plan may not materialize, inter alia, as a result of implementation, technological and regulatory difficulties.

NON-FINANCIAL COMPANIES SUB-SEGMENT

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, 2011, the Bank was far from reaching the limitation.

The Banking Law (Licensing) (Amendment No. 15), 2010. An amendment to the Banking Law (Licensing) was published in March 2010, regarding the restriction according to which a banking corporation may not have an interest in more than one non-financial holding company. According to the Amendment, the restriction shall be changed as follows:

- In addition to the permitted holdings in one non-financial corporation, a banking corporation may have additional interests, either direct or indirect, in other non-financial holding corporations at a rate of up to 1% of a certain class of means of control;
- A banking corporation is permitted to hold more than 1% of a certain class of means of control of one insurer only, whose equity exceeds NIS 2 billion, who operates, directly or indirectly, in more than three economic sectors specified in the Act, and whose total investments in each of these sectors exceed NIS 20 million;
- The term "operating indirectly" (used in the definition of a non-financial holding company) shall be defined so that a corporation will be considered as operating indirectly in an economic sector, if it holds an interest of 5% or more in a certain class of means of control of a corporation active in that economic sector.

The said Amendment does not have a material effect on the Bank's business.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

The profit of the sub segment in 2011 amounted to NIS 67 million, compared with a loss of NIS 2 million in 2010.

The return on equity, calculated on the capital allocated to the sub-segment on the basis of the average balance of sub segment risk assets reached a rate of 76.4% in 2011, compared with a negative rate of 2.4% in 2010.

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

	For the year ended December 31	
	2011	2010
	in NIS millions	
Income (loss) from financing activities	3	(4)
Operating and other income	79	(7)
Total Income (loss)	82	(11)
Credit loss expenses	6	4
Operating Income (loss) before taxes	76	(15)
Bank's share in operating income of affiliated	-	4
Net Income (loss) Attributed to the shareholders of the banking corporation	67	(2)
Return on equity (percentage)	76.4	*(2.4)
Average Assets	718	624
Average Liabilities	721	721
Average Risk-assets	1,164	1,094

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

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 new 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 (In US\$ millions)*	Investment commitment	Invested For the year ended December 31, 2011*	Balance of commitment	Additional information and remarks
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	12.3	11.3	1.2	
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	5.7	
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	27.8	22.2	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	4.6	0.4	Venture lending of the Dovrat Group, which engages in the granting of loans and credit facilities to technology companies.
Stage One Ventures Capital Fund	49	18.8	18	0.8	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, which 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 Euroopportunities	Euro 100 million	Euro 11.3 million	Euro 10.6 million	Euro 0.7 million	Of the Rothschild Group.
Apax VII	Euro 11 billion	Euro 7.4 million	Euro 6.3 million	Euro 1.1 million	A European private equity fund in the Apax Group, and is expected to operate mainly in Europe.
Plenus III	120	15	10.9	4.1	A venture lending fund of the Dovrat Group, and is engaged in granting loans and credit facilities to technology companies.
Brack Capital Group real estate fund	110	5	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.
Fortissimo Fund II	109.9	20	11.4	8.6	"Turn around" fund for technology based developed companies.
Carmel Software Fund	171	0.5	0.5	-	

* 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, 2011 to US\$141.3 million. As of that date, the balance of DCMI's investment commitments amounted to US\$55.2 million.

In March 2012, DCMi signed an investment agreement in FIMI Opportunity Fund, according to which it is committed to invest in that Fund an amount of up to US\$70 million, but not more than 20% of the Fund's investment commitments. The Fund has not yet started operations.

Additional investment in funds. In addition to the investment in funds through DCMi, the Bank has made a direct investment in an additional fund:

FIMI Opportunity Fund I. The size of this fund is US\$114 million. The Bank's share in the fund is due to reach US\$23 million, of which US\$19 million had been invested by December 31, 2010.

Furthermore, MDB is committed to investments in six venture capital funds. As of December 31, 2011, the investment of MDB in these funds amounted to US\$3 million. As of December 31, 2010, the maximum commitment for the future investments in these funds amounted to US\$1.8 million.

Realizations in the first quarter of 2012. For details regarding realization, in respect of which DCMi is expected to recognize gross pre-tax gains of US\$9 million, see Note 19 C 15(b).

INVESTMENTS IN CORPORATIONS

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

Investment in activities abroad. In September 2007 an agreement for investment in two companies owned by Mayer Cars and Trucks Co. Ltd. (hereinafter: "the Mayer Group") was signed. The Bank, through DCMi, has committed itself to investing an amount of up to Euro 40 million in Mayer (Keshet) Real Estate Ltd. (hereinafter: "Mayer Real Estate") and an amount of up to Euro 30 million in Mayer Europe Ltd. (hereinafter: "Mayer Europe"). The Bank's said commitment was subject to the commitment of the Mayer Group to make a parallel investment of an amount of up to Euro 160 million in Mayer Real Estate and an amount of up to Euro 120 million in Mayer Europe. The investment in the said companies entitled DCMi to an equity interest of 20% and to the right to appoint one of five Directors in each of these companies. Up until December 31, 2010, DCMi invested an amount of Euro 11.5 million in the two companies of the Mayer Group. On May 8, 2011, an agreement was signed for the sale of holdings in the said companies of the Mayer Group. The sale was agreed at DCMi's carrying amount. An immaterial loss was actually recorded. Within the framework of the sale of the holdings, the Bank has been released of the said commitment to invest in companies of the Mayer Group.

Sale of investment in "KFS". For details regarding an agreement made in March 2009, for the sale of the investment in "KFS", see Note 19 C 18 to the financial statements.

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 income participating interest in profits. DCMi owns approx. 19.6% of the equity of Menif. For details regarding guarantees provided by DCMi, see Note 19 C 15.

Investment in Europort Ltd. In March and April 2007, Discount Israel Capital Markets and Investments Ltd acquired 13.34% of Europort Ltd., in consideration for US\$2 million. In August 2010, Europort and its shareholders entered into an agreement for the raising from them of additional capital in the amount of NIS 40 million, in four equal installments over a period of two years. In this respect, DCMi has committed to invest NIS 4.3 million, of which an amount of NIS 2.1 was invested until December 31, 2011. Europort is engaged in real estate investment and development, in income generating real estate and in housing for the elderly population. On December 31, 2010, DCMi held a 10.56% interest in Europort Ltd.

Realization of investments. For details of the realization of investments in 2009 in HOT, Bezeq and Harel, which had been in the Bank's direct possession, see Note 25 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 2.1 cards in his possession. ICC estimates the number of cards in Israel at December 31, 2011 was 7.2 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.

As stated, the credit card system is composed of four factors: Issuer- the entity issuing credit cards to its customers; Customer - the holder of a credit card; Trader - the entity accepting a credit card; Clearing agent - the financial institution through which the trader receives payment.

The trader enters into an agreement with the clearing agent. In this framework, the clearing agent, in consideration for a commission, undertakes to credit the trader related to it, in a manner secured in advance, with the consideration due to the trader for the transactions made with him by the customers holding the credit card of the brand that is being cleared. The commission collected by the clearing agent in respect of clearing services to the trader is the "Trader commission". The clearing agent, on his part, pays the issuer an issuance commission called "Cross commission". This commission is embedded in the trader commission collected by the clearing agent. Namely, the trader commission is composed of the clearing commission and the issuer commission.

THE OPERATIONS OF ICC

ICC operates in two sectors of activity in the credit card market, constituting together the core activity of a credit card company: (a) issuance of credit cards; and (b) clearing of credit card transactions. In addition, ICC engages in providing clearing services to various trading houses in Israel and abroad, in respect of Internet transactions ("international electronic trade").

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.

ICC issues a variety of credit cards in addition to the deferred charge card, which at present is the most common credit card in Israel, among which the following cards may be mentioned:

- (1) "Cal Choice" – a revolving credit card, in the framework of which, the customer receives at home a report of the transactions made by him during the previous month and details of the charges in their respect (formerly: "Active"). The customer has to notify ICC of the amount that he wishes to be charged with at the next charge date. If no such notice is received, his account will be charged with the minimum amount as specified in the credit card agreement, and the uncharged balance of his credit card purchases, together with interest thereon, will be added to the charges of the following month.
- (2) A VISA credit card, which is a virtual credit card ("a credit card without a card") which had been developed jointly with VISA International. Within this framework, the customer contacts ICC receiving a personal number and a code, with which he is entitled to transact business (in an amount not exceeding the predetermined limit) without having to use an actual plastic card.

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.

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, the granting of advances on account of future payments to trading houses with which the company is engaged in clearing agreements and factoring activity.

With respect to the clearing of international electronic trading transactions, ICC serves as a clearing agent since 2003. ICC has an appropriate clearing license from VISA, MasterCard and Diners. Within the framework of this operation, ICC is mainly engaged in the clearing of Internet website transactions effected on behalf of overseas trading houses which operate these websites. The transactions are document free. Operations in this field are based on a global trend of a steep rise in transactions effected on the Internet. It should be noted that this field of activity has declined significantly in its relative weight in the activity of ICC in the last two years and in its contribution to ICC's profits.

Following are quantitative data regarding the activity of ICC:

Number of valid cards ⁽³⁾	As of December 31,			
	2011		2010	
	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⁾	1,184	989	1,107	942
Off-banking cards ⁽²⁾	611	465	548	431
Total	1,795	1,454	1,655	1,373

Transactions turnover ⁽⁴⁾	For the year ended December 31,	
	2011	2010
	in NIS millions	
Bank cards	39,564	37,414
Off-banking cards	9,888	8,882
Total	49,452	46,296

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 from the operations in 2011 amounted to NIS 183 million, compared with NIS 161 million in 2010, an increase of 13.7%.

The return on equity was 19.1% in 2011, calculated on the capital allocated to the operations on the basis of the average balance of the operations risk assets, compared with 20% in 2010.

The credit loss expenses amounted in 2011 to NIS 21 million, compared with NIS 26 in 2010, a decrease of 19.2%.

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, 2011					
in NIS millions					
Income from financing activities before credit loss expenses*					
- From external sources	278	28	16	6	328
- Intersegmental	(38)	(10)	-	(1)	(49)
Total income from financial activity	240	18	16	5	279
Operating and other income	779	53	55	19	906
Total Income	1,019	71	71	24	1,185
credit loss expenses*	20	-	-	-	20
Operating and other expenses	691	46	45	16	798
Operating Income before taxes	308	25	26	8	367
Provision for taxes on operating income	86	8	7	2	103
Net Income Attributed to the shareholders of the banking corporation	159	11	10	3	183
Return on equity (percentage)	17.4	19.6	25.7	17.5	19.0
Average Assets	8,161	312	430	129	9,032
Average Liabilities	759	901	1,295	1,344	4,299
Average Risk-assets	12,188	767	516	254	13,725
Components of income from financial activities:					
Margin from credit activity	239	18	16	5	278
other	1	-	-	-	1
Income from financing activities before credit loss expenses*	240	18	16	5	279

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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, 2010					
in NIS millions					
Income from financing activities before credit loss expenses*					
- From external sources	283	13	11	4	311
- Intersegmental	(51)	1	-	-	(50)
Total income from financial activity	232	14	11	4	261
Operating and other income	787	60	49	16	912
Total Income	1,019	74	60	20	1,173
credit loss expenses*	26	-	-	-	26
Operating and other expenses	655	65	60	20	800
Operating Income before taxes	338	9	()	-	347
Provision for taxes on operating income	114	4	1	-	119
Net Income (loss) Attributed to the shareholders of the banking corporation	157	5	(1)	-	161
Return on equity (percentage)	20.6	10.0	(3.8)	-	18.5
Average Assets	7,858	324	447	144	8,773
Average Liabilities	748	905	1,298	1,441	4,392
Average Risk-assets	10,880	753	519	253	12,405
Components of income from financial activities:					
Margin from credit activity	238	14	11	4	267
other	(6)	-	-	-	(6)
Income from financing activities before credit loss expenses*	232	14	11	4	261

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

PUBLIC SHARE ISSUE BY VISA INTERNATIONAL

VISA International decided in 2007 on a structural change and the offer of its shares to the public. The public offering of shares on the Stock Exchange in the United States was effected in the first quarter of 2008. ICC is a member of the VISA Europe organization, which remained a not-for-profit organization. VISA Europe received part of the proceeds of the share issue of VISA International as well as blocked shares of Visa International. VISA Europe has distributed the proceeds to member companies of the organization, including the Bank and ICC. The said shares were locked-up (part of which were released in 2010 and the balance in March 2011).

For details regarding gains on realization of a part the VISA shares, see Note 25 A 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 the three way agreement for cross clearing, which was submitted for approval of the Antitrust Tribunal, 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. In the risk management field, the Supervisor applied to the credit card companies additional Proper Banking Management Directives, such as "the board of directors", "risk management", "fraud and embezzlement by employees", "banking insurance" and so forth. In the consumer field the instruction relates to several principal issues, including: rules for the issue of credit cards, their delivery, their renewal and cancellation, the information provided as part of the monthly statement, rules regarding point and stars drives, rules regarding the conversion of transaction in foreign currency into Shekels, and so forth.

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 Act entered into effect upon its publication, excluding the matter of opening the clearing market to competition, which will enter into effect at the end of nine months from date of the official publication of the Act as above.

In January 2012, ICC, LeumiCard and IsraCard were declared as issuers having a wide range of operations.

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. In complying with the Order, ICC is, among other things, obligated to employ extensive means in familiarizing itself with the customer in the process of attracting new customers.

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.

The amendment states that the board of directors of a credit card company is required to formulate a policy for the implementation of the directives of the Supervisor regarding this matter. The policy will refer, among other things, to limitations on the volume of issuance and clearing operations of the company in markets outside Israel, as well as to engagement with trading houses active in risk abundant businesses. In this respect, the risk abundant fields are: gambling, pornography, the marketing of "medical drug", "poison", "medical poison" and "preparation" as defined in the Chemists Ordinance (New version), 1981, and any other field defined by the Board of Directors as risk abundant. In September 2011, the board of directors of ICC approved the policy as stated.

On the issuance side - a credit card company is prohibited from approving a transaction made by means of a charge card issued by it, where suspicion exists that it comprises a gambling, lottery or a prohibited game transaction and where it is feared that the service acquired through the charge card is illegal in the country in which it had been rendered, or where the payment was made through a charge card held by an Israeli resident customer or by a foreign customer staying in Israel.

On the clearing side - it has been determined that a credit card company may engage in an agreement for the clearing of no document transactions with trading houses (in Israel or abroad), this only if according to information at hand the line of business of such trading houses is not in contravention of the law. Furthermore, credit card companies are prohibited from engaging with trading houses outside Israel active in risk abundant businesses, unless a legal opinion had been obtained according to which their line of business is not in contravention of the law, and which refers to the law applying to the parties to the transaction at all centers of their operations, and that all required measures had been taken in order to verify that such trading houses do not engage in no document transactions with customers who reside in countries that do not allow such transactions. It has also been determined that a credit card company has to apply the above mentioned requirements at least with respect to OECD member countries. In addition, a duty was imposed to monitor on a periodic basis compliance of the trading house with the duties imposed on it and to determine procedures that will assure that the company fulfills the requirements in this respect during the whole of the engagement period with the trading houses as stated.

ICC has adopted the Amendment and is implementing it in full.

For details regarding an additional amendment to Proper Banking Management Directive relating to the entire banking sector, see under on "Legislation and supervision" below.

Amendment of Proper Banking Management Directive No. 432. In March 2010, the Supervisor of Banks published an amendment to Proper Banking Management Directive No. 432, in the matter of "Charge cards". The amendment is intended to facilitate the transfer of customer accounts from one bank to another and will also enable customers to transfer their standing orders or continuing charge card transactions from the existing credit card to the new one. The amendment is intended to create a mechanism for the transfer of the charges, and for transferring the responsibility for such transfer of operations from the customer to the transferor issuer. The Directive also applies to the transfer of operations in continuing charge cards transactions, which are not incidental to the transition from one bank to another. The amendment became effective on September 1, 2010.

Credit Data Service Regulations (Amendment), 2009. An amendment of the Regulations imposing a duty of ICC to provide information to entities having a credit data service license. In this framework, ICC will be required to establish a reporting layout regarding credit data with respect to its customers, including positive information regarding its customers.

Amendment of Proper Banking Management Directive regarding Credit cards. On December 27, 2011, the Supervisor of Banks issued an amendment of Proper Banking Management Directive No. 470. The amendments are: additional details which an issuer will have to disclose to the customer in the monthly transaction report – adding the name of the supplier in whose place of business the transaction had been made (according to the name which he presents to his customers), providing additional information in cases where the transaction has no document; in cases where the customer's credit card has been cancelled or blocked and the issuer continued to charge the customer in respect of transactions effected prior to the cancellation or blockage of the card, the issuer is entitled to send the customer a detailed report of such transactions, soon after the date of the first and

last charge following the cancellation or blockage only, and at least once every six months.

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.

Standard for the protection of information relating to VISA card payments. The International VISA Organization (hereinafter: "VISA") determined a standard for the protection of information regarding credit card payments (PCI DSS) in 2004, under which trading houses, companies operating electronic sales stations and credit cards companies must attain a series of milestones in the implementation and integration of the provisions of the standard. According to the VISA regulations, the Organization is authorized to impose monetary sanctions on Organization members who do not comply with the said milestones. In view of certain difficulties arising in the adjustment of the provisions of the standard to the credit card market in Israel, which caused a delay in the implementation timetable of the standard, discussions have been held in recent months with VISA regarding the implications of the said delay. ICC together with other factors are endeavoring to solve the problem of adjustment of the standard to the Israeli credit card market.

Upgrading of the information systems. A new financial system was installed in April 2011 at ICC, which is expected to bring 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.

This project constitutes the infrastructure for continuing projects to be carried out in the upcoming years, in the area of implementing the GRC system for computerized compliance controls, and expanding the interface modules for performance of a detailed accounting recording and examination. Further to this Project, ICC operates a 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.

CRITICAL SUCCESS FACTORS

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

The issuance field:

- Authorization to issue brand name credit cards under a franchise granted by the international organizations;
- Cooperation with banking corporations;
- Consummation of agreements for the establishment of consumer clubs;
- Ability to offer customers attractive credit products;
- The ability to borrow funds from financial institutions at attractive terms.

The clearing field:

- Cross clearing agreements between credit card companies in Israel;
- The ability to attract trading houses and maintain relations with them by an extensive marketing layout.

As regards the clearing of international electronic trading transactions:

- Establishing a layout of engagements with Internet payments service providers;
- Advanced monitoring and control capabilities;
- An effective and efficient layout of risk management.

OBSTACLES TO MARKET ENTRY

Principal entry barriers into the issuance field:

- Activity as an issuer requires the existence of an extensive, complex, costly operating system, with sophisticated information and communications systems, including information security systems, customer service, etc;
- A massive and ongoing investment is required for country-wide marketing, distribution and sales channels in order to compete in the issuance field, especially through a distribution chain for credit cards is required in accordance with agreements with banks and/or customer clubs;
- High financial stability is required for purposes of issuing resources for financial activity, i.e. ability to borrow extensive funds at more preferable conditions compared to conditions offered to "regular" customers;
- Maintenance of control of the issuer by banking corporations is required for purposes of recognition and membership in international organizations that manage leading international brand names;
- 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 into the clearing field:

- Entry into the credit card clearing field involves, primarily, obtaining a license from the international organization to which the clearing activity is related. Receipt of such a license requires that the applicant have a banking connection and compliance with business and financial standards that will secure its activity, in addition to payment of membership fees to the international organization;
- An entity requesting entry into the clearing field should establish a communications network enabling on-line clearing of credit card transactions (or should acquire the services of Electronic Banking Services, which maintains such a system in Israel);
- The existence of a solid, credible information system for billing management.

ALTERNATIVE PRODUCTS

In addition to the classic alternatives to a credit card, e.g. checks, cash and bank transfers, additional instruments and services exist, constituting an advanced technology and which, in contrast to the above stated instruments and similarly to credit cards, are characterized by availability and convenience:

- Payment service through cellular phone;
- Internet transactions for transfer of funds without disclosing the credit card details of the customer/details of the customer's bank account ("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;
- Alternative products in the clearing field on the Internet are being developed all the time in view of the fact that the trade on the Internet is an activity being continuously developed.

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 or Diners credit cards. Additional customers in the clearing field are trading houses that look for advance payments services (the discounting of vouchers or invoices).

MARKETING AND DISTRIBUTION

The issuance field. The banks that are a party to the arrangement constitute ICC's "base recruiting level" for customers ordering credit cards through their banks. Consumer clubs serve as an additional "base recruiting level", through which ICC recruits off-banking customers. 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, who serve as liaison officers with the trading houses, even following the engagement by the primary clearing agreement.

In the field of clearing international electronic trading transactions, the engagement with traders around the world is made through a small number of "mediators" (Internet Payment Service Providers).

COMPETITION

The structure of competition. Competition in the field of credit card issuance is derived from the competition between the banks over customers. In addition, the competition is over the heart and pocket of the customer with the aim of convincing the customer to pay for the major part of his current consumption by means of the cards issued by ICC, and at the same time increasing the number of credit cards issued by it. In providing credit in the issuance channel, ICC competes with bank credit as well as with other entities providing off-banking credit. In the clearing field, competition is over traders to whom clearing services and complementing services are being provided.

The issuance field. Three credit card companies operate in Israel, all of which are owned or controlled by banks:

- ICC issues VISA credit cards and Diners credit cards (through Diners, exclusively). ICC also issues MasterCard credit cards.
- IsraCard, a group of private companies all of which are controlled by Bank Hapoalim Ltd., issues and clears Isracard (exclusively) and MasterCard, credit cards. IsraCard is a brand name owned by IsraCard, which issues credit cards under this brand name for use within Israel only. To the best of ICC's knowledge, as of date of the financial statements, the volume of operations of IsraCard in the issuance of VISA credit cards is rather limited 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 and MasterCard credit cards and Diners credit cards (through Diners, exclusively);
- IsraCard, which clears IsraCard (exclusively), "American Express" (exclusively), MasterCard and Visa;
- LeumiCard, which clears VISA and MasterCard credit cards.

In accordance with an agreement of October 30, 2006 between ICC, LeumiCard, IsraCard and the banking corporations controlling these companies, regarding the opening of the clearing market for VISA and MasterCard credit card by the three companies, the operational ability of ICC (and of LeumiCard) in respect of clearing MasterCard credit cards in Israel has increased. In June 2007 ICC began clearing MasterCard credit cards in Israel after activating the joint interface. Following the signing of the new agreement, Isracard joined the local agreement for cross clearing between ICC and LeumiCard with respect to the VISA brand name (for further details see Note 33 B 1).

As discussed in the Section "Regulations, legislation and arrangements" above, the "Isracard" credit card market is expected to open to competition in 2012. ICC is preparing to provide a response for such activity.

DEVELOPMENTS IN THE SEGMENT IN 2011

Amended cross clearing arrangement – reduction of the issuer commission rate. As a condition for the extension of the provisional permit for the arrangement between the credit card companies and the banks holding them (hereinafter: "the Appellants"), the Antitrust Tribunal has instructed the reduction of the cross commission rate to an average rate not exceeding 0.875%, starting with November 1, 2011.

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.

Within the framework of the amended arrangement, which is subject to the approval of the Tribunal, a gradual reduction in the average rate of the issuer commission has been determined, down to 0.7%, this, in several stages, the last of which will start on July 1, 2014. (For additional details, see Note 33 B 1 to the financial statements).

Exposure of credit card details issued by ICC. As a result of a cyber attack on January 2, 2012, on Internet websites of trading houses where customer details are retained, the details of customers holding various credit cards, including those issued by ICC, were exposed.

ICC has located the credit cards the details of which had been exposed on the Internet, and these cards were blocked for use on the Internet and by telephone. This, in order to avoid the misuse of such cards following the exposure of their details. ICC has also contacted the customers involved for the replacement of the said cards and has made arrangements for providing answers to customer queries in the matter.

The Management of ICC believes that this event is not expected to have a material effect on the company.

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 3 to the financial statements. For details regarding a joint issue agreement with the First International Bank ("FIBI") negotiations are being conducted lately with respect to its renewal terms, see Note 33 B 2 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 4.

Agreement for joint issuance with Yahav Bank. ICC and Yahav Bank signed an agreement on September 22, 2009, for the joint issuance of VISA, MasterCard and Diners Club credit cards. The agreement covers all operational arrangements and the granting of services to credit cards issued by ICC and distributed by Yahav Bank to its customers. Until date of signature of the agreement, Yahav Bank had issued Isracard credit cards only.

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 is expected during the first quarter of 2012.

Acquisition of factoring operations. In April 2009, the transaction for the acquisition of the factoring operations of Psagot Factoring Finance was consummated. The purchased operations were conducted under a new company (hereinafter: "ICC Factoring") jointly owned by ICC (75%) and a third party (25%). On November 30, 2010, ICC acquired the remaining shares in consideration for their par value only.

As from December 31, 2010, ICC Factoring has been merged into ICC. This move was made in order to extend the supervision and control over factoring operations. Completion of the merger is subject to obtaining all approvals required by the Companies Law and fulfillment of all conditions precedent included in the merger agreement.

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 proceedings at the Antitrust Court in the matter of a

binding arrangement for the cross clearing of VISA cards between ICC, FIBI, Discount Bank, Bank Leumi LeIsrael B.M. and Leumi Card Ltd., including the appointment of an expert by the Court and for details regarding an amended cross-clearing arrangement, see Note 33 B 1 to the financial statements. For details regarding a cross clearing tripartite agreement between the Commissioner, the credit card companies and the banks owning these companies, for the cross clearing of VISA and MasterCard charge cards, and for details regarding the reduction in issuer commission as from November 1, 2011 and thereafter, and the submission of an expert opinion regarding the computation of the issuer commission rate, 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 competition – see under "Regulations, legislation and arrangements" above;
- The signing by ICC of a special collective labor agreement – see under "Human resources" below;
- Change in terms of the joint issuance agreement with FIB – see Note 33 B 2 to the financial statements.
- A joint issuance agreement with Club 365 Ltd. – see above.

OPERATIONS IN THE CAPITAL MARKET

DISCOUNT INVEST

As part of the business strategy focusing on the customer and the variety of his needs, the Bank has recently 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.

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 subscribing to the TeleBank service, including foreign securities.

Customers having investments in amounts of between NIS 700 thousand and NIS 4 million, may 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 at the rate of only 0.2%.

Customers having financial wealth will 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 iPhone, Android and Blackberry 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 declined in 2011 by NIS 14.2 billion, from a level of NIS 156.6 billion at the end of December 2010 to a level of NIS 142.4 billion at the end of December 2011. Net negative deposits in all types of mutual funds were recorded in 2011, except for the shekel and monetary funds recording a growth in deposits.

The assets of funds specializing in bonds in Israel grew during the said period by NIS 24.3 billion, mainly due to declines in the assets of State bonds funds (NIS 9.2 billion), and of other bonds funds (NIS 17.5 billion). On the other hand, an increase of NIS 2.5 billion (8.3%) was recorded in the assets of the shekel bonds funds. Concurrently, assets of mutual funds investing in Israeli equities declined by NIS 4.2 billion (43%) while assets of funds investing in foreign equities declined by NIS 564 million (18.5%).

The decline in assets of funds investing in Israeli bonds (excluding the shekel bonds funds) and in equities derives largely from the decline in market prices of equities and bonds in Israel and the world over due to the debt crisis in the Eurozone countries, but also from the net withdrawal of deposits in these investment channels. In contrast, the increase in the assets of the shekel funds is explained by the flow of funds in their direction and by the rising prices in the shekel investment channel.

The growth in the assets of the other bonds and equity funds stems, to a large extent, from the rise in prices at the shares and bonds market in Israel, but also from the net inflow of funds to these channels. On the other hand, the decline in the assets of the Shekel funds is explained by the withdrawal of deposits therein.

The provident fund market. The provident fund market achieved in 2011 a negative return at an average rate of 2.98%. The said

decrease reflects the decreases in the various indices of the Stock Exchange in 2011.

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 2011 amounted to NIS 293,933 million, compared to NIS 305,988 million at the end of 2010, a decrease of NIS 12,055 million (3.9%).

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 2011 a net negative accumulation in the amount of NIS 5,024 million. This compared to a net negative accumulation of NIS 2,911 million in 2010. The said data reflects the effect of changes in regulation with respect to provident funds.

The basket certificate market. According to data published by the Tel Aviv Stock Exchange, 26 new basket certificates were issued in 2011, and a total of 432 basket certificates were traded at the end of December 2011, of which, 262 basket certificates based on domestic and international share indices and 170 basket certificates based on domestic bonds, short-term loans (MAKAM) and commodity indices.

Capital market. For details regarding developments in the capital market in 2011, see "Capital market" above under "Main developments in Israel and around the world in 2011".

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

The regulatory framework relating to the capital market operations, which was materially changed, among other things, due to the implementation of the recommendations of the Bachar Committee, 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. According to the plan, the measures to be adopted are expected to correct distortions created in the pension savings market and assist in reducing management fees.

Following the said plan, the Capital Market, Insurance and Savings Division at the Ministry of Finance published during 2011, among other things, the following documents:

- **Draft Memorandum of the Supervision over Financial Services Law** (Consultation, marketing and pension clearing system) (Amendment), 2011, in the matter of allowing the customer to choose a license holder that would recommend the pension savings by prohibiting the employer from subjecting a transaction (or the granting of benefits) to its being performed by a certain license holder. Furthermore, it is proposed to amend the prohibition imposed by Section 20 of the said Law, according to which a pension consultant who is a banking corporation may not engage with an employer or with a union of employers with respect to the rendering of pension consulting to an employee of that employer or to an employee of any member of an employers union. It is proposed within the framework of the amendment to the law to authorize the Commissioner to determine instructions regarding the engagement of a banking pension consultant with an employer.
- **Draft Regulations of Supervision of Financial Services** (Provident funds) (Distribution commissions) (Amendment), 2011, in the matter of applying a uniform distribution commission model to all pension savings products.
- **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, is

expected to become fully operative as regards pension consultancy, during 2012.

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.

Homogeneous interface. Towards the end of 2008 and at the beginning of 2009, the Ministry of Finance initiated steps for the coordination between the banks and other licensed operators operating on the pension market and the institutional bodies (product managers) with a view of creating a uniform interface for the communication of information between the institutional bodies and the licensed operators, and between them and the banks acting as consultants. As the first step in creating the said uniform interface, a circular was issued in August 2009 in the matter of "Uniform reduced structure for the transfer of data from an institutional body to a license holder", which came into effect on February 1, 2010.

In continuation of the regulation of information transfer interfaces, the Ministry of Finance issued on October 19, 2010, a second circular that was cancelled even before taking effect, in view of a third circular published on February 28, 2011 and which became effective on October 1, 2011 (hereinafter: "the binding circular letter"). During the preparations made by the Bank for the implementation of the provisions of the binding circular letter, discrepancies came to light between the various interfaces created by the institutional bodies, which do not enable the Bank to create a uniform interface for the purpose of obtaining and communicating information, as required by the binding circular letter. Such discrepancies had been brought to the attention of the Ministry of Finance, which issued clarifications on March 10, 2012, to settle the issues in dispute. The regularizing of additional event interfaces by the Ministry of Finance is continuing also in 2012.

Coding of pension savings products. As part of the effort to improve the efficiency of the uniform interfaces for the transfer of information between managers of the pension products and the other player in the market and the banks acting as consultants, it has been decided on the integration of a uniform coding system enabling distinctive identification for all pension savings products existing in the market (provident, pension and insurance), by means of a circular issued on December 29, 2010, which took effect on October 1, 2011.

Pension clearinghouse. In May 2010, the Bank joined together with other distribution entities and institutional bodies, as a shareholder in the 'Long-term Savings Clearing Company' (hereinafter: "the company"), which has submitted to the Ministry of Finance a detailed proposal for the establishment and operation of a pension clearing house.

On March 10, 2011, Amendment No. 3 of the Financial Services Supervision Act (Consultation, marketing and pension clearing system), 2005, (hereinafter: "the Pension Consulting Act") was published in the Official Gazette, which regularizes the operation of a central pension clearing system (hereinafter: "the clearing house") and the terms for the issue of a license to operate the clearing house. In accordance with that stated in the Amendment, the Clearing House will afford users, including the Bank, access to information regarding the pension savings of the customer as well as enabling the future monetary clearing with respect to pension savings, similarly to the stock exchange clearing system.

On July 4, 2011, the Treasury informed the Chairman of the Board of the company that it will not further the process of granting a license to the company to operate the clearing house, and that the company is entitled to participate in the process that the Commissioner will choose for the granting of the license, this in accordance with the authority conferred upon the Commissioner under the Pension Consulting Act.

On August 15, 2011, participation invitation papers were published at the preliminary stage of setting up the clearing house,

which is the initial stage of the tender to select the body that will setup the clearing house. The company decided not to participate in the tender and to proceed with the liquidation of the company. Also in 2012, the Treasury continued in regularizing the operations of the clearing house and the manner in which it will be used, by issuing draft regulations and circular letters.

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.

Draft Supervision over Financial Services Regulations (Provident Funds) (Investment principles applying to management companies and insurers), 2011. On March 14, 2011, the Finance Committee of the Knesset approved Regulations determining principles for investments by provident funds, pension funds and insurance companies. Among other things, the Regulations specify modes for the investment of funds managed by institutional bodies, and abolish the differences existing between the principles for investment applying to provident funds and pension funds and those applying to funds in respect of profit participating assurance policies. Furthermore, the Regulations changes certain of the existing investment limitations applying to the investments of an institutional body in a certain corporation, so that the limitation on the rate of holdings of an institutional investor in securities, in the granting of loans to and in deposits with a single corporation shall not exceed 5% of the fair value of the assets of the institutional investor. Nevertheless, in the case of an investment in a corporation that is a bank, the Regulations enable a 2.5% holding of isolated fund units in excess of the 5%, provided that the additional holding is to be made only in deposits. As regards cash and cash equivalents the rate of holdings in a bank is limited to 20% of the assets of the institutional investor. Additional restrictions, at a rate not exceeding 10%, have been determined with respect to groups of corporations. Similarly, in the case of an investment in a bank which is part of a particular group of corporations, it is proposed to permit an additional holding at the rate of 5% and, with regard to cash and cash equivalents, up to 25% of the assets of the institutional investor.

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

The Securities Authority issued on November 17, 2010, directives to license holders with respect to clarifying the needs and guidelines of the customer and the adaptation of the service to such needs and guidelines in accordance with Section 12 of the Act and recording of the details in accordance with Section 13 of the Act (New Version – 2010). The New Version replaces a previous version of the directives issued by the Securities Authority in January 2007, which, among other things, dealt with the duty to determine an investment policy for the customer, by way of determining several possible risk levels in accordance with the needs and guidelines provided by him, and to match several potential investment channels for each risk level.

The new directives focus on the manner in which the clarification of the needs is conducted and not on the substance of the clarification itself. Among other things, the new version of the directives allows, under certain conditions, performing an initial process of clarification of needs by a recorded telephone conversation, and among other things, determine the contents of the needs clarification with the customer, the manner of determining the investment policy regarding the portfolio, documentation requirements, the required process in case of refusal by the customer to provide information and the annual updating of the characteristics of the customer and his policy. The instruction regarding the recording of telephone calls entered into effect on November 17, 2010, while the remaining instructions entered into effect on May 31, 2011.

An Amendment to the Law came into effect on June 3, 2010 regulating the investment consulting business, the marketing of investments and the management of investment portfolios, (Amendment 14). It has been determined within the framework of

the Amendment that basket certificates shall be included in the definition of a financial asset, so that one who has any relation (as defined in the law) to basket certificates, shall not be allowed to act as an investment consultant, but only as an investment marketing agent. During the reported year the Bank has completed the disengagement of relations with companies issuing basket certificates and the sale of its holdings therein. For details as to the sale of the basket certificates operation, see Note 19 item 21.

The instructions relating to a "qualified customer", included in the amendment of the Regularizing Engagement in Consultancy Law (Amendment 13), came into effect on April 18, 2010, that enables foreigners qualified in their countries of origin to engage in investment consulting, investment marketing or portfolio management, to offer their services also in Israel without the need to apply for a license, subject to the provisions determined in the Law. The Regulations dealing with this subject were published on January 31, 2011, and became effective sixty days after their publication date. The provisions of the said Amendment pertaining to "foreign traders" entered into effect upon the said regulations becoming effective.

On February 22, 2012, the Finance Committee of the Knesset approved the Regulations regarding Engagement in Investment Consulting, Investment Marketing and Management of Investment Portfolios (Reports), 2012. The regulations impose reporting duties both on portfolio management companies and on a banking corporation engaged in providing advisory services and on portfolio managers and investment consultants personally with respect to events relating to them. Among other things, the Regulations impose on portfolio management companies the duty to provide the customer with a quarterly report in the format specified in the Regulations. Furthermore, a duty is imposed upon a banking corporation which provides investment advisory services, to submit to the Authority a monthly report that includes the data regarding all transactions effected in the customers' accounts by the licensed consultants employed by it during the month preceding the date of the report. The Regulations will enter into effect within six month of being published in the Official Gazette.

The Corporate Governance for Fund and Portfolio Managers (Legislation amendments) Act, 2011, was published in the Official Gazette on November 16, 2011. The Act will enter into effect six months after date of its publication in the Official Gazette, namely, on May 16, 2012. The Act amends the Mutual Investment Trusts Act, 1994, and the Engagement in Investment Consulting, Investment Marketing and Management of Investment Portfolios Act, 1995, in order to improve the corporate governance and internal control layouts in large portfolio management companies and in companies engaged in the management of mutual funds. Among other things, the Act imposes the following duties on portfolio management companies: appointment of an audit committee headed by an outside director, instructions regarding the duties of the board of directors, including approval of the internal control layout and the internal enforcement program, determination of procedures for risk management, confirmation of compliance with the license requirements of an investments portfolio management company. The Act authorizes the Securities Authority to impose monetary sanctions within the framework of the administrative enforcement procedures in the event of violation of certain duties specified in the Act.

New regulation concerning trusteeship. On January 23, 2012, the Finance Committee of the Knesset discussed the Securities Bill (Amendment No. 48) (Debt notes), 2011, as preparation for its second and third reading. The proposed amendment is intended, among other things, to strengthen the position and role of the trustee for holders of debt notes and to clearly establish his duty to supervise on a current basis the compliance of the issuer with his obligations towards the holders of the debt notes. In fact, the amendment represents the clarification of the role of the trustee in accordance with the concept of the Securities Authority, while determining that he must act with care, fidelity and diligence, without preferring one over the other or admitting considerations that do not stem from the holding of the debt notes in itself. In addition, in order to improve the possibility of supervision over the compliance by trustees with the qualifications required from them, it is proposed to authorize the Minister of Finance to issue regulations that will establish a register of trustees to be managed by the Securities Authority, as well as determine threshold entry terms and qualifications required from a custodian who wishes to be included in such register. Concurrently to the said legislation proceedings, the Securities Authority recently issued a preliminary version of the Securities Regulations (Reporting by a Trustee for Debt Notes), 2012, Securities Regulations (Reporting by the Issuer to the Trustee of Debt Notes), 2012, and the Securities Regulations (Qualification Terms and Registration of Trustees for Debt Notes), 2012, which are

intended to implement and detail the various issues of the said Amendment 48.

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.

New Regulations regarding Mutual Funds. On May 17, 2010, Amendment No. 15 Bill for the Mutual Investment Trust Law, 1994, was published. Among other things, the Amendment permits the offer in Israel of foreign mutual funds units in order to improve competition in the mutual funds market in Israel.

In addition, and concurrently to the above, in the matter of Amendment No. 14 to the Regularizing Engagement in Investment Consultancy, in Marketing Investments and in Management of Investment Portfolios Law, 1995 ("Regularizing Engagement in Investment Consultancy Law"), a Bill memorandum was published on November 16, 2010, for an additional amendment of the Mutual Investment Trust Law, in the matter of basket certificates and basket funds, 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.

The Securities Authority has announced that at this stage, the chapter dealing with opening the market to foreign mutual funds will be excluded from the Bill. The Authority intends to re-examine the subject of opening the market to public offerings by foreign mutual funds, in order to provide appropriate safety to investors.

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. To the extent that this Bill will be passed in its present format, it will widen the authority of the Israeli Securities Authority regarding areas of operation, which at present are not being supervised by it, and will bring about a change in the regulatory and supervisory structure in the capital market field, principally regarding everything relating to the formation of the council and the transfer of regulatory and supervisory authority to it.

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 December 29, 2011, the inter-office committee for the examination of custodian services in Israel published its final recommendations. This followed an interim report presented by the committee to the

Minister of Finance in August 2010. According to the report, custodian operations in Israel and abroad require comprehensive regularization by legislation. The report recommends a general framework of principles regarding the safekeeping of assets of the public by custodians in Israel or abroad while rigorously maintaining proper custody standards. These standards shall, among other things, relate to the definition of basic duties of providers of custodian services, which include securing the ownership rights in assets and cash of the customer and securing the rights related to the ownership of assets, the imposition of duties the purpose of which is to allow the separate identification of customer assets, continuous monitoring of the existence of the assets and of the registration of ownership rights thereto, the issue of instructions to the brokering agent regarding the process of appointment of a third party custodian and for the current supervision over him and for the establishment of an outside independent audit as to compliance with the requirements of the report. The committee recommends that the legal relationship between the brokering agent and the custodian shall be established in accordance with an agreement signed between them, which, among other things, will determine the responsibility arrangements in case of damage to the customer's assets. Moreover, the committee recommends that a Regulator supervising the work of the custodian or a brokering agent shall verify the establishment, supervision and enforcement of the proposed recommendations. On February 13, 2012, the Bank of Israel issued a draft letter, which instruct banking corporations providing custodian services to customers, directly (as a custodian) and/or indirectly (as a broker), to act, as from January 1, 2013, in accordance with the recommendations of the Committee, with a recommendation for an earlier implementation.

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. With respect to a part of the said broker group, the provisions of the Bill apply also to a director, employee, spouse and dependent family member as well as a corporation under their control. Violation of the provisions of the Bill will result in criminal liability. The proposed Bill also states that financial brokers have to establish procedures ensuring their compliance with the provisions of the Bill, and that the Securities Authority shall be authorized to issue guidelines for such procedures that will constitute accepted standards regarding the matter.

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in 2011 amounted to NIS 98 million, compared with NIS 158 million in 2010.

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 31,2011								
in NIS millions								
Income from financing activities before credit loss expenses*								
- From external sources	10	2	2	2	1	17	-	17
- Intersegmental	-	-	-	-	-	-	-	-
Total income from financial activity	10	2	2	2	1	17	-	17
Operating and other income	232	35	47	11	43	368	47	415
Total Income	242	37	49	13	44	385	47	432
Operating and other expenses	180	33	33	10	38	294	46	340
Operating Income before taxes	62	4	16	3	6	91	1	92
Provision for taxes (tax savings) on operating income	17	1	3	2	3	26	(1)	25
Net Income Attributed to the shareholders of the banking corporation	57	11	13	4	11	96	2	98
Average Assets	10	4	29	1	9	53	-	53
Average Liabilities	-	-	2	-	-	2	-	2
Average Risk-assets	438	70	114	24	175	821	-	821
Average customers' securities	34,235	8,487	85,998	10,546	13,270	152,536	12,272	164,808
Average other assets under management	1,328	364	412	287	2,105	4,496	-	4,496

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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, 2010								
in NIS millions								
Income from financing activities before credit loss expenses**								
- From external sources	10	3	2	1	1	17	1	18
- Intersegmental	-	-	-	-	-	-	-	-
Total income from financial activity	10	3	2	1	1	17	1	18
Operating and other income	264	47	34	18	35	398	57	455
Total Income	274	50	36	19	36	415	58	473
Operating and other expenses	*156	31	18	11	24	240	51	291
Operating Income before taxes	118	19	18	8	12	175	7	182
Provision for taxes on operating income	38	6	*6	2	5	57	1	58
Net Income Attributed to the shareholders of the banking corporation	*93	22	12	9	16	152	6	158
Average Assets	9	4	18	1	7	39	-	39
Average Liabilities	-	-	2	-	-	2	-	2
Average Risk-assets	472	87	74	33	238	904	-	904
Average assets of provident and mutual funds	27	10	230	16	187	470	-	470
Average customers' securities	33,360	9,186	80,484	8,541	11,834	143,405	10,999	154,404
Average other assets under management	1,215	347	182	404	2,088	4,236	-	4,236

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

DEVELOPMENTS IN THE OPERATIONS

Distribution of mutual funds. The Bank has entered into distribution agreements with most of the companies managing mutual funds in Israel, for the purpose of distributing their mutual funds to its customers, in consideration for distribution commissions in respect of mutual fund units held by these customers, in accordance with the regulations in this matter. In addition, the Bank is in the early stages of preparation for the signing of distribution agreements with foreign mutual fund managers, once they are permitted by law to offer units of mutual funds in Israel managed by them.

It should be noted that as part of the reform concerning bank charges, banks were prohibited, for the most part, from charging commissions in respect of the purchase and sale of mutual fund units.

Pension consulting services. In February 2008, the Bank received a license for the granting of pension advisory services and in March 2008, the Bank has started providing this service to customers.

The Bank provides pension consulting services regarding provident funds, pension funds and further education funds by means of financial consultants stationed at branches and investment centers.

As part of the pension consulting supporting layout, a designated module has been established within the Bank systems for the management of relations with pension consulting potential customers, starting with establishing the initial connection with the customer (whether initiated by the Bank or by the customer) and continuing with the customer coming to the branch for a meeting with the pension consultant. A reporting module has also been developed for the control, and monitoring of the performance at the level of consultant/branch/region and the Bank as a whole.

The Bank has engaged in distribution agreements with most of the operators in the pension market for the purpose of distributing further training funds, provident funds and pension funds managed by them. The Bank is obliged to engage with all suppliers of pension products (of the provident funds and pension funds that do not comprise insurance products, as well as further training funds) who are interested to do so, in distribution agreements for products managed by them in consideration for a distribution commission of a rate and payment terms identical to those of an identical service. The rate of the distribution commission is determined in regulations and is payable in respect of the pension assets (which are not insurance products) of customers who had received consulting services from the Bank in respect of products for which the Bank has distribution agreements with companies managing these products. The distribution commission generally amounts to 0.25% of the assets to which the advisory services apply.

In the wake of the present financial crisis, public awareness of the importance of pension planning has grown and accordingly the demand for pension advisory services at the Bank branches has grown significantly. Concurrently, the crisis caused many customers to take a decision and transfer the provident fund management to another investment channel or to another management company, and in certain cases even to withdraw their funds.

As a result of the fact that no uniform protocol for communicating data and no central clearing house for the transfer of funds exist as yet, many complaints are received from customers regarding delays in performing transfer operations. These complaints are brought to the knowledge of the management companies and are monitored by the Bank.

New trading services in the capital market. In 2011 the Bank continued to launch new 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. The service was launched at the end of the second quarter and is being gradually offered to the appropriate customers.
- A new and advanced interface for securities operations on the Internet website – the disposition of the website to all customers of the Bank has been completed.
- A designated trading interface for securities operations of institutional bodies.

Sale of the remaining interest in the provident fund activities. For details regarding the sale of the remaining interest of MDB in the operations of provident funds, in 2010, see Note 19 C 19 to the financial statements. Net gains of NIS 28 million were recognized in respect of this sale, derived from the amount that is not in dispute between the parties.

Sale of the basket certificate operations. For details regarding the sale of the basket certificates operation, which had been required due to changes in legislation, see Note 19 C 20 to the financial statements. In respect of this sale, the bank recorded net gains of NIS 29 million.

Sale of the mutual funds management operations of MDB. The net gain derived from this transaction in 2010 amounted to NIS 5 million. (See Note 30 B to the financial statements).

Providing securities services to American customers. Following changes in the enforcement policy of the U.S. Authorities regarding bank accounts managed outside the U.S., the Bank has re-examined the provisions of the U.S. law relevant to this issue. In view of the findings of the examination, the Bank intends to terminate the provision of securities services to U.S. related customers (both existing and new), and to prohibit the use of American means of communication for the purpose of providing securities services to customers staying in the U.S. In continuation of the adoption of the said policy, 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.

Merger of the portfolio management companies. In November 2011, the authorized organs approved the merger of Mercantile Capital Markets Ltd. with and into Tachlit Discount Portfolio Management Ltd. (formerly Tachlit Investment House Ltd.), with effect as from January 1, 2012. The main object of the merger is 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.

The merger entered into effect on January 1, 2012, after all statutory approvals, which constituted conditions precedent for its

execution, had been received.

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS

Securities. On December 31, 2011, the balance of securities held for customers amounted to NIS 105.4 billion, including NIS 7.5 billion of non-marketable securities, compared to NIS 112.9 billion as at December 31, 2010, including NIS 9.6 billion of non-marketable securities, a decrease of 6.6%. For details as to income from security activities, see Note 24 to the financial statements.

In addition, the balance of securities held on behalf of customers at the MDB as of December 31, 2011, amounted to NIS 11.3 billion, compared with NIS 13 million in December 31, 2010, a decrease of 13.1%.

Investment portfolio management. On December 31, 2011, Tachlit was managing 1,495 investment portfolios, which together were valued at approx. NIS 2,553 million, as compared to 1,619 portfolios valued in total at approx. NIS 2,862 million as at December 31, 2010. The above data point to a decrease of 7.7% in the number of portfolios managed and to a decrease of approx. 10.8% in the monetary value of the managed portfolios. The decline in the number managed portfolios stems partly from the initiated closing of inactive portfolios, which did not produce income for Tachlit, and partly from regulatory effects.

In addition, MDB, through a subsidiary of that bank, manages investment portfolios for its customers. On December 31, 2011 the total monetary value of managed portfolios was approx. NIS 1,935 million, compared with NIS 2,306 million in December 31, 2010, a decrease of approx. 16.1%.

Pension advisory services. 2011 was the fourth year in which the Bank provided pension advisory services to its customers. As from the start of operations in March 2008 and until the end of the year, advisory services were provided to some 81 thousand customers. The accumulation of customer assets, to whom advice has been provided, amounted to NIS 8 billion, in the said period. In addition, MDB provided consulting services to some 4,100 customers, with accumulated financial assets in the amount of NIS 840 million.

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.

As stated above, following the new legislation for the implementation of the Bachar Committee recommendations, the Bank has become a financial and pension consultant independent of the providers of the products, and distributes a range of financial and pension products.

CAPITAL MARKET SERVICES

The Bank provides its customers with an array of investment consulting services, securities trading and operating in Israel and abroad. These are offered to private customers, institutional customers and capital market operators. The Bank offers varied services, which include: equity securities activity in Israel and abroad, bonds (including convertible bonds), short-term Government loans (MAKAM), options, foreign currency, structured deposits, basket certificates, derivatives in Israel and abroad, securities offerings and lending of securities, as well as providing professional and objective investment consulting regarding securities and financial assets.

Some of the Bank's customers maintain securities portfolios managed by various portfolio managers operating through the Bank, including through the subsidiary Tachlit 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.

Income received from pension consulting requires the existence of a valid pension consulting agreement between the consultant or the marketing entity and the customer. Accordingly, fierce competition over customers is expected, trying to create with them a long term relationship, since in the event that the customer will sign a pension consulting agreement with another entity, the producer of the pension instruments will pay the commission since that date to that other entity. In cases where the customer has not signed an agreement with the marketer or consultant, the producer of the pension instruments is not required to pay any commission at all. Accordingly, competition is expected against all the consulting entities on the one hand and the marketing entities as well as against the providers of the products (insurance companies, insurance brokers, pension funds, etc.) on the other hand.

At the present time all banks are active in this field.

GOALS AND BUSINESS STRATEGY

- Intensifying the activity in the field of pension consulting that began in March 2008 and the continued development of systems supporting this activity;
- Completing the preparations for operating as a "supermarket" for financial and pension products;
- Improvement in securities trading by means of the Internet, development of the activity of arbitrage player and capital market players;
- Continued cultivation and distinction of the status of the investment consultant.

For details regarding the intention of Mercantile Discount Bank to intensify its investment consulting activities and to make changes in the format of its pension consulting activities, see below "Mercantile Discount Bank Ltd." under "Main investee companies".

CONSTRUCTION AND REAL ESTATE ACTIVITY

MARKET DEVELOPMENTS

General. The growing activity in the construction and real estate sector continued in 2011 compared to 2010, this on the background of the continued growth in the residential construction field, alongside a moderate growth in non-residential and infrastructure construction. The volume of investment in residential construction grew at a rate of 13.4%, further to a growth of 12.7% in 2010. Notwithstanding, a slight slowdown in growth rate was recorded in the second half of 2011, amounting to an annualized rate of only 11%, compared with an annualized growth rate of 14.5% in the first half of the year.

The volume of investments in non-residential construction and other construction work increased at a moderate rate of 4% compared with 2010, when in the second half of the year an increase at an annualized rate of 6.7% was recorded, compared with the first half.

The following developments occurred in the various operating segments in 2011:

Residential construction.

- Prices of residential units - The first half of 2011 experienced a rise in prices in demand areas in the center of the country and in peripheral areas of between 3% and 5%, compared with the end of 2010, when in the second half of the year a decline in prices became apparent at similar rates, so that on an annualized level residential units prices recorded a moderate decline,

mainly in central areas;

- Demand for new residential units – A decrease of 6% in the quantity of new residential units in high² demand, compared with 2010, due to a decline in demand, which started in the first quarter of the year. The demanded quantity of new residential units in the fourth quarter of the year reflected a decline at an annualized rate of 15% compared with the third quarter, and a decline at an annualized rate of 39% compared with the second quarter of 2011. It is estimated that the said decline reflects a change in trend on the part of potential purchasers of residential units for investment purposes, alongside the "sitting on the fence" by potential residential units purchasers for personal use anticipating a further decline in housing prices.

Following are developments in the quantity of new residential units in demand by regions:

- Tel Aviv region recorded an increase at the rate of 6.5% compared with 2010;
- Jerusalem and Southern regions recorded significant declines at rates of 22.8% and 16.8%, respectively, compared with 2010;
- Central, Haifa and Northern regions recorded a decline at the rates of 6.4%, 3.2% and 0.5%, respectively, compared with 2010.

Inventory of residential units for sale. The inventory of new residential units at the end of 2011 continued to grow, being 33% higher than the inventory at the end of 2010 (approx. twenty thousand residential units compared with fifteen thousand residential units). About 55% of this inventory was located in the Tel Aviv and Central regions.

Demand for mortgage loans. The demand for mortgage loans continued in 2011, when since the second quarter of the year a moderation in the rate of growth became apparent as a result of the continued increase in residential units prices, the rise in interest rates and stricter credit terms. The increase in housing prices led, respectively, to a significant increase in the amount of the average mortgage;

Luxury apartments. A trend of a significant decline in demand on the part of local and foreign investors became apparent, principally in the Jerusalem, Tel Aviv, Nataniya and Ashdod areas, accompanied by a decline in prices.

Income generating real-estate - office buildings. Stability in demand for office space became apparent in Jerusalem, Tel Aviv and the satellite towns in the Dan Region coupled by stability in rental prices, principally due to low interest rates and the low supply of properties (rental prices in the Jerusalem area rose by 20%). Average return amounted to 7.8% to 8.0%.

Income generating real-estate - commercial buildings. A growth in demand on the part of institutional bodies and large and medium marketing chains became apparent for quality commercial properties in demand areas in the center of the country and in peripheral areas, mainly for shopping malls and open shopping centers, coupled by stability in occupancy rates and in rental prices.

Real-estate activity abroad. The beginning of investments by Israeli corporations in entrepreneurial and income generating real estate in certain Western European, U.S. and Canadian markets, due to the following developments:

- Selective use of business opportunities for the acquisition of income generating properties at low prices;
- A decrease in the rate of equity required by foreign banks for the finance of investments in income generating real estate;
- The beginning of the increase in value of income generating real estate in the U.S. and Canada and in certain Western European countries, after a long decline in value of properties, which became apparent since the crisis period;
- The continuing standstill in the development of assets in certain Eastern-European countries that had been purchased by Israeli investors before the outbreak of the crisis in 2008.

Concurrently, many corporations are still trying to develop the properties purchased in Eastern Europe. Furthermore, the rise in returns on income generating real estate in Germany and Western Europe has attracted new Israeli investors on the one hand, and led to a decline in the value of investments of long-standing investors on the other.

² The term "new residential units in high demand" replaces according to definitions of the Central Bureau of Statistics the previous term "apartments sold", and includes both apartments sold and apartments not for sale the construction of which has begun (construction for self use, acquisition groups and construction for rent).

DEVELOPMENTS IN THE ACTIVITIES OF FINANCING RESOURCES

Corporations of this segment raised funds in 2011, by means of corporate bonds issuance, in a total amount of NIS 7.5 billion, compared with NIS 8.9 billion during 2010. Beginning with the second quarter of the year, the volume of corporate bonds issuance declined, amounting to NIS 1.8 billion in the second and third quarters and to NIS 1.2 billion in the fourth quarter.

Most of the bond issuances were effected by large real estate corporations having a high credit rating, on the background of the need to recycle debts in significant amounts, and which in certain cases required the providing of collateral and financial covenants. As from the second half of the year, small and medium corporations having a high risk profile, were not included among the bond issuing corporations, and in the fourth quarter, only large and solid corporations presenting a low return on their existing bonds, were among the issuing companies.

The slowdown in the volume of bond offerings as from the second quarter of 2011, stemmed mostly from the following factors:

- A rise in returns on most of the corporate bonds in the segment, due to concern regarding a decline in profitability of the local real estate corporations having a high leverage rate, as a result of the anticipated moderation in the growth rate of local demand;
- A decrease in the volume of demand for bonds on the part of mutual funds on the background of significant withdrawal of funds on the capital market;
- Decline in the volume of demand on the part of institutional bodies, on the background of the increase in debt arrangements;
- Concerns regarding the deterioration in the financial condition of domestic real estate holding companies exposed to foreign operations, due to the standstill in the rate of growth in their business environment.

EXPECTED DEVELOPMENTS IN THE ACTIVITY

A further expansion in activity in the real estate sector is anticipated in 2012, with a moderation in the rate of growth of investments in residential construction and in the national infrastructure area, compared with 2010.

Residential construction - Central region. A drop in prices, at the rate of 4%-6% compared with the average price level at the end of 2011, due to a decline in demand for residential units, concurrently with an increase in supply of residential units due to the presently high level of inventories, including the expected increase in inventory of residential units under construction. Given the restriction on the supply of financing sources, a decline in the inventory of residential units under construction is anticipated in the continuation of the year, a fact that would cause the market to reach equilibrium at low price levels.

Residential construction in the periphery. A moderate decline in the level of demand that will be coupled by stable prices, mostly due to a price level that matches the purchase power of purchasers and a relatively low growth in inventories of new residential units.

Residential construction – luxury apartments. A significant decline in the level of demand on the part of foreign residents and local investors that will be followed by a decrease in prices, mainly in Tel Aviv and Jerusalem, in continuation to the downward trend, which began in 2011.

Income generating property - office space. A growth in demand for office space in demand areas in the center of the country, in the first half of the year, coupled by an increase in rental prices, as a result of the low supply of office premises in preferred areas and the low interest environment, producing an average annual return at the rate of about 8%. A decrease in rental fees is expected in the second half of the year stemming from an anticipated significant growth in the supply of office premises for rental, mostly in the center of the country.

Income generating property - commercial space. Stability in demand for quality commercial property, accompanied by stability in rental prices, as a result of demand on the part of institutional bodies and private entrepreneurs for commercial properties characterized by long-term stable rates of return of 8%.

Infrastructure. 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).

Financing of foreign operations. Moderation in the volume of investments by Israeli corporations in entrepreneurial real estate in the housing and income generating property areas abroad, due to the continued standstill in property prices in the U.S. and the decline in financing resources in certain markets in East and Central Europe.

The limited offer of financial resources continues in certain markets, which is reflected in selectiveness in the granting of loans including the lowering of the financing ratios.

Developments in finance resources. A significant growth is anticipated in the volume of demand for fund raising through bond issuance, in view of the forecasted standstill in bank credit to this sector, mostly in relation to the following aspects:

- The need for recycling of bonds and bank credit in considerable amounts due for redemption during the year;
- Low ability of the banking industry to increase credit to the construction and infrastructure fields, due to it reaching the limit of credit available for this sector, thus the supply of credit is anticipated to largely match the volume of redemptions.

Bond issuance will be effected by the large corporations in this sector, having a high credit rating and a relatively low return (4%-6%) on their bonds, and will be coupled by an increase in financing costs and improved credit terms (by means of providing material collateral and financial covenants).

DIRECTIONS OF BUSINESS DEVELOPMENT IN THE MARKETS ACTIVITIES

In view of the anticipated moderation in the rate of growth of investments in real estate during 2012 and the need to maintain a safety margin from the sector limitations, the Bank has defined the following fields of activity in preferred areas for the allocation of credit facilities:

- A limitation on growth of the credit portfolio of the segment in accordance with the growth rate of the Bank's total credit portfolio;
- Giving preference to the growth in credit for housing projects in the center of the country and in peripheral preferred areas, promoted by financially solid building contractors/entrepreneurs, with whom the Bank has previous positive experience;
- 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;
- Strengthening the differentiation in the ratio of equity required for closed project financing, to be determined on the basis of a minimum amount with the addition of a certain rate derived from the quality of the borrower, the rating of the demand area and characteristics of the project;
- Financing of income generating properties projects, mostly in the field of shopping malls and commercial centers in demand areas, by entrepreneurs having considerable financial strength, while securing in advance a significant part of the potential rental earnings;
- Financing projects in the national infrastructure field, in cooperation with other banks and/or institutional bodies, giving preference to projects in the electricity and transportation fields that include identified and secured long-term repayment resources having a high certainty level.

The above information comprises a forward looking statement. The above reflects the evaluation of the Bank's management while keeping in mind the information available to it at date of preparation of the financial statements, as discussed above in this Section and based on publications of various entities, such as the Central Bureau of Statistics, the Ministry of Housing, the Bank of Israel and others. The information may not materialize if the decline in the level of domestic demand will continue and/or intensify as a result of a deterioration in the political/security situation, a significant decline reaching a complete freeze in the availability of financing resources on the financial markets in Israel and abroad, intensified recession conditions in the global markets, continued fluctuations in interest and exchange rates globally and in the Israeli economy and other

developments in macro economic conditions that are not under the Bank's control.

CREDIT POLICY IN THE CONSTRUCTION REAL ESTATE ACTIVITY

The Bank's credit policy is based on the following principles:

- The greater part of the credit facilities made available to the real estate sector will be processed through 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;
- Preference for the financing of housing projects promoted by companies/ entrepreneurs with whom the Bank has a continuous positive record;
- The allocation of credit facilities to project financing will be conditional upon minimum equity capital invested by the promoters at the stage of purchasing land and at the financing stage, and upon minimum profitability rates of the projects that should not fall below the standards determined by the Bank in this respect;
- Release of surplus funds in a project shall be made subject to concurrent compliance with sales rates and minimum construction completion rates as well as a reasonable coverage spread for the conclusion of the project;
- The allocation of credit facilities secured by pledges on income generating projects and on rental income is conditional upon the existence of solid lessees and ability to service the loan.

SCALE OF OPERATIONS AND NET INCOME

General. In view of the increased activity in the field of residential construction in 2011, 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 income from the operations in 2011 amounted to NIS 160 million compared to income of NIS 231 million in 2010, a decline of 30.7%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 8.1% in 2011 compared to a rate of 12.1% in 2010.

The credit loss expenses amounted in 2011 to NIS 222 million, compared with NIS 161 in 2010, an increase of 37.9%.

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:

Domestic activity. The volume of income amounted in 2011 to NIS 521 million, compared with NIS 545 million last year, a decrease of 4.6%, attributed in full to the decline in profits from financing operations. On the other hand, an attractive marketing environment that had its effect on fair-sized demand for residential units, resulted in the stronger liquidity of local borrowers in the real estate sector and to a decline of 24% in the volume of expense for credit losses compared with the year 2010 (NIS 58 million compared with NIS 76 million).

In consequence thereof, net earnings from local operations amounting to NIS 230 million remained similar to that of the previous year (NIS 229 million) and reflected a return of 14.4% on the allotted capital.

International activity. Business performance has been affected by the weak market environment in certain of the West European markets of operation not yet recovered from the crisis, the principal expressions of which may be summarized as follows:

- A continuing standstill, sometimes even a further decline in prices of income producing properties and properties under development (land and properties designed for betterment).
- A considerable decline in liquidity of borrowers due to the continuing limitations in the supply of financing resources reflected in selectivity in the granting of long-term loans to potential purchasers and in the reduced financing ratios upon

the refinancing of existing properties.

In consequence thereof, the volume of revenues in 2011 amounted to NIS 90 million compared with NIS 109 million in the previous year, a decline of 18%. The deterioration in the liquidity situation of borrowers abroad resulted in an increase in expenses for credit losses to NIS 164 million, compared with NIS 85 million in the previous year.

As a result, a net loss of NIS 69 million was recognized in 2011 on the international activity, compared with earnings of NIS 2 million in the previous year (a negative return of 30% on the allocated capital).

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

	Domestic operations				International operations			
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	Total
For the year ended December 31, 2011								
in NIS millions								
Income from financing activities before credit loss expenses*								
- From external sources	67	867	158	1,092	774	9	783	1,875
- Intersegmental	(10)	(565)	(57)	(632)	(698)	-	(698)	(1,330)
Total income from financial activity	57	302	101	460	76	9	85	545
Operating and other income	16	31	14	61	3	2	5	66
Total Income	73	333	115	521	79	11	90	611
Credit loss expenses*	(9)	79	(12)	58	61	103	164	222
Operating and other expenses	22	65	28	115	31	8	39	154
Operating Income (loss) before taxes	60	189	99	348	(13)	(100)	(113)	235
Provision for taxes (tax savings) on operating income	21	65	33	119	(6)	(38)	(44)	75
Net Income (loss) Attributed to the shareholders of the banking corporation	39	124	66	229	(7)	(62)	(69)	160
Return on equity (percentage)	39.6	10.9	26.9	14.3	(4.1)	(62.9)	(30.3)	8.1
Average Assets	1,018	13,187	2,878	17,083	1,980	1,004	2,984	20,067
Average Liabilities	694	1,856	662	3,212	483	39	522	3,734
Average Risk-assets	1,329	19,258	4,051	24,638	2,192	1,307	3,499	28,137
Components of income from financial activities:								
Margin from credit activity	44	242	81	367	67	9	76	443
Margin from deposits activity	8	10	6	24	9	-	9	33
other	5	50	14	69	-	-	-	69
Income from financing activities before credit loss expenses*	57	302	101	460	76	9	85	545

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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

	Domestic operations			International operations				Total
	Small Businesses	Corporate Banking	Middle Market Banking	Total	Middle Market Banking	Corporate Banking	Total	
For the year ended December 31,2010								
in NIS millions								
Income from financing activities before credit loss expenses**								
- From external sources	110	252	67	429	120	9	129	558
- Intersegmental	(30)	69	18	57	(30)	-	(30)	27
Total income from financial activity	80	321	85	486	90	9	99	585
Operating and other income	20	27	12	59	***10	1	11	70
Total Income	100	348	97	545	100	10	110	655
Credit loss expenses**	43	38	(5)	76	32	53	85	161
Operating and other expenses	19	*70	27	116	30	7	37	153
Operating Income (loss) before taxes	38	240	75	353	38	(50)	(12)	341
Provision for taxes (tax savings) on operating income	13	84	27	124	2	(16)	(14)	110
Net Income (loss) Attributed to the shareholders of the banking corporation	25	156	48	229	36	(34)	2	231
Return on equity (percentage)	19.7	12.1	21.2	14.9	17.8	(55.4)	0.8	12.1
Average Assets	1,828	14,080	2,521	18,429	2,395	875	3,270	21,699
Average Liabilities	*770	1,785	699	3,254	354	-	354	3,608
Average Risk-assets	1,819	18,582	3,305	23,706	2,751	875	3,626	27,332
Components of income from financial activities:								
Margin from credit activity	67	269	68	404	83	9	92	496
Margin from deposits activity	6	9	3	18	7	-	7	25
other	7	43	14	64	-	-	-	64
Income from financing activities before credit loss expenses**	80	321	85	486	90	9	99	585

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

***Restated

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, 2011 amounted to 21.5% (18.44% at the end of 2010), which constitutes a deviation from the provisions of the said directive.

Amendment No. 70 to the Land Taxation Law. On March 7, 2011, the Knesset passed Amendment No. 70 to the Land Taxation Law, effective as from March 31, 2011. The Amendment, among other things, states that upon the acquisition of rights to real estate which is not an "entitling residential unit", in respect of which exemption had been applied for, the purchaser must pay directly to the Tax Authorities a part of the consideration for the purchase (7.5%-15% of the consideration amount in accordance with

the date in which the seller purchased the rights to the real estate), as an advance on account of the land betterment tax applying to the seller, this after having paid to the seller 40% of the consideration amount.

The amendment has implications regarding the manner in which the banking industry conducts business in the real estate field in general, and as regards the aspects of financing real estate transactions in particular (the financing of building projects and the acquisition of land, reliance on pledging real estate in favor of a bank, etc.), these from the legal, operational and business aspects.

Planning and Construction Procedures Enhancing Residential Construction (Temporary Provisions) Act, 2011. The said Act was approved in a second and third reading on August 3, 2011. It establishes a new and accelerated planning channel that bypasses the existing planning committees. A special national housing committee will be established in every district in the country which will be authorized to deal with residential construction plans for at least 200 residential units. According to this Act, only public entities such as Government offices or local authorities will be authorized to submit plans for approval of these special committees. The plans must be in regards land, which at least 80% thereof is owned by the State. The Act has been approved as a temporary provision for a period of eighteen months.

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.

Letter regarding "acquisition groups". On March 25, 2010, the Supervisor of Banks issued a letter, against the background of the significant increase in the volume of operations of property acquisition groups, turning it into a very material component in the field of residential construction beginnings. In his letter, the Supervisor of Banks points out the risks involved in the operations of acquisition groups compared to the risk involved in providing credit to "standard" residential construction operations, and which creates concern for a material deterioration in the quality of credit provided by banking corporations.

According to the letter, during the period of construction and until its completion, credit (both balance sheet and off-balance sheet) granted to an acquisition group, intended for the construction of ten or more residential units, shall be classified as indebtedness of a real estate corporation (even if the acquisition group is not so officially incorporated). Respectively, the said credit shall be averaged at the rate of 100% in computing the ratio of capital to risk assets (instead of a ratio of 35%, or 75%, according to the Basel II rules, had such credit been considered as a loan for housing purposes).

According to the said letter, the content thereof shall be implemented as early as possible, and no later than the financial statements as of June 30, 2010.

Following the said guideline, the Supervisor of Banks published on August 15, 2010, a clarification, according to which, despite the required change in the classification of such loans, the instructions for computing provisions for doubtful debts by the "extent of arrears" method will apply to them (if and when conditions for such computation arises).

Bank guarantees in accordance with the Sales Act (residential units) (Assurance of investments of residential units purchasers), 1974 (hereinafter: "Sales Act"). On November 21, 2010, the Sales Regulations (residential units)(Assurance of investments of residential units purchasers)(bank guarantee), 2010, which determines a uniform format for a bank guarantee according to the Sales Act (residential units)(Assurance of investments of residential units purchasers), 1974. The Regulations entered into effect in February 2011, following which, Proper Banking Management Directive No. 456, regarding the format of the guarantee under the Sales Act (residential units) was withdrawn.

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:

- 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;
- Competitive margins and commissions that are largely similar to those offered by competitive factors;
- The offering of competitive terms from the aspect of project financing terms, the required volume of capital infusion, flexibility in releasing surplus funds;
- 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;
- Identification and finance of projects in preferred areas in the center of the country and in the periphery.

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.

As from the second half of 2009, against the background of the improvement in business performance of corporations operating in the local market and the thriving capital market, the availability of part of the large and financially stable customers to off-banking financing resources has increased. 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.

STRUCTURE OF THE COMPETITION PREVAILING IN THE OPERATIONS AND CHANGES THEREIN

Most of the competition in this activity takes place within the banking industry. In times when equity and bonds can be raised on the capital market, the off-banking finance serves as an alternative resource for long-term financing required, generally, for construction and/or acquisition of income generating assets in Israel or abroad or as capital financing the construction of real estate projects abroad.

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 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 2011, the mortgage market continued to be typified by intense competition between the banks in this market. Notwithstanding, a decline in the volume of new mortgage loans became apparent in the last months of the year.

	For the nine months ended December 31		
	2011	2010	
	in NIS millions		Rate of change
Housing loans granted out of bank's own funds by the mortgage banks, excluding internal recycling of loans	44,720	47,050	(5.0)
Loans from State funds	140	468	(70.1)
Total credit granted by the mortgage banks, excluding credit from the State funds and internal recycling of loans	50,746	54,950	(7.7)

SECTORS OF OPERATION

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

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

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

DMB formed a subsidiary, Discount Mortgage Home Insurance Agency (2005) Ltd., which acts as an insurance broker. This subsidiary operates independently and sells insurance through a telephone service separate from that bank's telephone service.

BUSINESS STRATEGY

The merger of Discount Mortgage Bank with and into the Bank is planned to be executed in 2012. The merger will enable the Bank to market mortgages having an overall view of the customer, to have a mortgage product joining the basic product basket offered to the Bank's customers. The Bank will act towards putting at the disposal of customers an efficient and professional service layout also in this field.

SCALE OF OPERATIONS AND NET INCOME

The volume of housing loans granted. In 2011, the volume of housing loans granted amounted to NIS 4,068 million, compared to NIS 4,906 million in 2010, a decrease of 17.1%. The above amount includes some NIS 377 million of loans recycled in 2011, compared to NIS 370 million in 2010, an increase of 1.9%.

Net income from the operations in 2011 amounted to NIS 60 million, compared with NIS 38 million in 2010, an increase of 57.9%.

The return on equity, calculated on the capital allocated to the operations on the basis of the average balance of operations risk assets, was 7.9% in 2011, compared with 6% in 2010.

Credit loss expenses. In 2011 to NIS 9 million, compared with NIS 3 million in 2010.

Following are principal data relating to the mortgage activity:

	Domestic operations			
	Households	Small Businesses	Middle Market Banking	Total
	For the year ended December 31, 2011			
	in NIS millions			
Income from financing activities before credit loss expenses*				
- From external sources	211	43	4	258
- Intersegmental	(58)	(17)	(2)	(77)
Total income from financial activity	153	26	2	181
Operating and other income	42	3	-	45
Total Income	195	29	2	226
credit loss expenses*	(2)	(7)	-	(9)
Operating and other expenses	135	7	-	142
Operating income before taxes	62	29	2	93
Provision for taxes on operating income	23	9	-	32
Net Income Attributed to the shareholders of the banking corporation	38	20	2	60
Return on equity (percentage)	5.4	19.9	19.6	7.9
Average Assets	19,113	1,256	155	20,524
Average Liabilities	1,357	50	-	1,407
Average Risk-assets	9,370	1,332	150	10,852
Average other assets under management	1,326	-	-	1,326
Components of income from financial activities:				
Margin from credit activity	149	26	2	177
Other	4	-	-	4
Income from financing activities before credit loss expenses*	153	26	2	181

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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

	Domestic operations			Total
	Households	Small Businesses	Middle Market Banking	
	For the year ended December 31,2010			
in NIS millions				
Income from financing activities before credit loss expenses*				
- From external sources	160	37	-	197
- Intersegmental	(43)	(13)	-	(56)
Total income from financial activity	117	24	-	141
Operating and other income	48	*3	-	51
Total Income	165	27	-	192
credit loss expenses*	4	(1)	-	3
Operating and other expenses	118	10	-	128
Operating income before taxes	43	18	-	61
Provision for taxes on operating income	16	7	-	23
Net Income Attributed to the shareholders of the banking corporation	27	11	-	38
Return on equity (percentage)	4.7	10.8	-	5.7
Average Assets	16,327	1,276	179	17,782
Average Liabilities	1,531	68	-	1,599
Average Risk-assets	8,016	1,517	233	9,766
Average other assets under management	1,538	-	-	1,538
Components of income from financial activities:				
Margin from credit activity	114	22	-	136
Other	3	2	-	5
Income from financing activities before credit loss expenses*	117	24	-	141

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

LEGISLATIVE RESTRICTIONS

Capital adequacy limitation. Whereas the activity within the framework of Discount Layout (see below) is conducted by DMB, it may be hampered by the capital adequacy limitation of this bank. The ratio of capital to risk assets of DMB at December 31, 2011, reached a rate of 13.9%.

Restriction on the credit concentration. Proper banking Management Directives require an additional provision in respect of credit concentration as regards housing loans, in the event that the balance of housing loans in respect of which an allowance based on the extent of arrears has been recorded, net of such a provision, exceeds 1.5% of the total balance of housing loans. As of December 31, 2011, the said rate at DMB amounted to 0.7%, therefore no provision was required.

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

- **Letter of the Supervisor of Banks in the matter of developments in the risk pertaining to housing loans.** On July 11, 2010, the Supervisor of Banks published a directive regarding developments in the risks relating to housing loans. The directive stated that in view of recent developments in the housing market, banks are required to re-examine their loan portfolios and their credit policies in the matter of mortgages and to verify that their policy agrees with the risk appetite that had been defined by their business strategy. It was also determined that every banking corporation shall create a supplemental provision in respect of housing loans, at the rate of at least 0.75%, in respect of each housing loan granted as from July 1, 2010 and thereafter, the primary financing ratio thereof was higher than 60%.

DMB has performed an examination showing that the minimal supplementary provision as stated is adequate, considering the credit risk existing at present with respect to new credit granted by DMB at the financing level determined by the Supervisor of Banks.

Further to the said guidelines, with a view of improving credit risk management in this field, the Supervisor of Banks published on July 13, 2010, a Directive widening the reporting in the matter of housing loans, with effect as from June 30, 2011.

- **Letter of the Supervisor of Banks in the matter of leveraged housing loans.** On October 28, 2010, the Supervisor of Banks issued a directive regarding a change in the risk weight, within its meaning in Proper Banking Management Directive 203, on that part of a loan bearing a variable interest rate. The crux of the Directive is that in view of recent developments in the housing market, each new housing loan approved since October 26, 2010, the amount of which is in excess of NIS 800,000, and which its funding rate is over 60% of the cost of the property and the part of the loan bearing a variable rate of interest is in excess of 25%, shall oblige the lending banks to increase the risk weight applying to such loans to 100%.
- **Guidelines by the Supervisor of Banks regarding housing loans at variable interest rate.** The Supervisor of Banks issued on May 3, 2011, a guideline in the matter of housing loans at variable interest rates, applying to loans which were approved in principal or with respect to loans, which the banking corporation has approved their recycling, as from May 5, 2011 and thereafter. The guideline restricts that part of the housing loan carrying a variable interest rate to one third of the total housing loan provided by a banking corporation to a borrower. Namely, a banking corporation may approve a housing loan only if the proportion of the loan carrying a variable interest rate to the total loan does not exceed 33.3%. This restriction applies to new housing loans in all variable interest channels, in which the interest rate may change during a period shorter than five years. Furthermore, the guideline regularizes the duty of disclosure to borrowers who had taken in the past non-linked housing loans at a variable interest rate based on the prime rate, where this component of the loan comprises on third or more of the total. Under certain conditions, the said restrictions do not apply to loans in respect of which the interest component alone is payable (grace loans), loans granted to foreign residents and to loans granted for "any purpose" in amounts not exceeding NIS 100,000.
- **Group provision in respect of housing loans.** According to a letter of the Supervisor of Banks dated May 1, 2011, and further clarifications issued by the supervisor's staff, banking corporations are required to record a group allowance for credit losses in respect of housing loans, this in addition to an allowance for credit losses based on the extent of the default period. This is required in order to take into consideration the decline in the rate of coverage of the provision in respect of the housing loan portfolio, in view of the accelerated growth experienced in recent years in credit granted for housing purposes and which is not yet reflected in the provisions based on the extent of the default period. For further details, see below in the Chapter "Exposure to risk and the management thereof".

Directive in the matter of the treatment of problematic housing debts – Proper Banking Management Directive No. 314. For details regarding the Directive, see Note D item 4.3 to the financial statements.

Housing Loans Bill (Amendment No.12) (Additional loan and participation in the repayment of a loan), 2011. The Housing Loans Bill (Loans and participation in repayment of loans for purchasers of a first residential unit), 2010 and the Housing Loans Bill (Loans and participation in the repayment of a mortgage in development areas), 2010, passed on January 5, 2011, their preliminary reading by the Knesset. The Bills are intended to assist the homeless in purchasing their own residential unit and to provide incentive to the financially stronger population to relocate to peripheral areas. The assistance is intended to those purchasing their first residential unit in a condominium complex. Purchasers of residential units, who are entitled to a preferential mortgage by the Ministry of Housing, are to receive in addition a bank loan carrying interest of up to 3%. In the case of purchasers of residential units in areas of national preference, the State will subsidize the repayment of the mortgage so long as they continue to hold the residential unit, or transfer the mortgage to another property in a similar area. The said two Bills were combined on March 15, 2011 into one Bill under the name stated in the heading above and was submitted for its first reading by the Knesset.

It should be noted that an additional bill was submitted on March 30, 2011, the Housing Loans Bill (Amendment – A grant for the purchase of an entitled residential unit in national preference areas), 2011, which proposes to determine a grant and a standing loan to those entitled to a preferential mortgage who purchase a residential unit in areas of national preference. It is further proposed that those entitled to a preferential mortgage will pay only one half of stated rate of acquisition tax.

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

Most of the banks compete in the mortgage market: mortgage banks, mortgage banks that have been merged and turned into a division of a commercial bank, as well as commercial banks. In addition, some of the insurance companies also offer mortgage loans. Competition in this market is fierce and is clearly price directed. Competition is affected, among other things, by perceiving the mortgage banking industry as an anchor product in preserving existing customers and recruiting new customers.

MARKETING OF MORTGAGE PRODUCTS

DMB serves its customers in 75 points of sale, four independent branches (Tel Aviv Main Branch, Pal Yam Branch in Haifa, The Diamond Exchange Branch in Ramat Gan and the Modi'in Branch), and 71 branches located within the branches of Israel Discount Bank Ltd. or near them. DMB also operates a call center divided into two specialized units: a sales center dealing with approaches by customers interested in new loans, including close attendance to the customer during the process of granting the loan, and a customer relations center attending to existing customers.

DMB engages in the marketing and advertising of its many varied products, customizing them to the changing requirements of the public, to changing economic conditions and to market trends. Concurrently, DMB continues to expand its activity with varied populations, such as: purchase groups, foreign residents, students, VIP's and others.

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

A MORTGAGE MARKETING CAMPAIGN - "DISCOUNT LAYOUT"

The Bank in conjunction with DMB launched in July 2007 an attractive interest rate mortgage layout intended to enlarge the credit portfolio of DMB and its share in the mortgage market.

The Bank determines who is entitled to the Discount layout and issues them a confirmation entitling them to the interest terms of the layout.

The Bank provides DMB with financial resources in accordance with the terms of the marketed mortgages (back to back) less a predetermined margin (hereinafter: "the Deposit"). It has been agreed that in cases of early redemption or recycling of the loan, the Deposit made by the Bank would be concurrently redeemed or recycled. At the beginning of 2010, in view of the excess financial resources accumulated by DMB, it has been decided that DMB will be able to grant credit within the framework of the outline, also from its own resources.

DMB grants such entitled customers mortgages under attractive interest terms, subject to criteria determined by the Bank (as of 2011 - a monthly salary of NIS 4,000 and over or personal capital of a minimum amount of NIS 0.5 million).

The customer has to comply with these conditions for a period of at least five years. If the customer does not abide by the entitlement terms, the interest rate will be increased according to the bank's guidelines (and concurrently the deposit interest would be increased at the same rate).

The entitlement confirmation issued by the Bank allows the customer to refer to DMB for obtaining the attractive interest rate, but it does not oblige that bank to grant mortgage loans under the layout channel since it is DMB which bears the credit risk.

According to an agreement which has existed between the parties for several years, DMB pays the Bank a one-off commission in respect of referral of the Bank's existing customers.

The accounting treatment adopted by the Bank and by DMB with respect to the said campaign is in accordance with the accounting treatment applied to transactions of granting other loans for housing purposes and to transactions involving the receipt of other deposits from banks or other deposits made with banks.

Following are details in respect of the scope of operations of the "Discount layout" in 2011:

	CPI linked	Non-linked	Foreign currency linked	Total
As of December 31, 2011				
In NIS millions				
"Discount layout" housing loans - from resources provided by the Bank	1,687	1,242	49	2,977
"Discount layout" housing loans - from resources of Discount Mortgage Bank	121	-	-	121
Non-"Discount layout" housing loans	69	142	3	214
Deposits provided by the Bank	1,647	1,214	47	2,908

An additional amount of NIS 69.4 million was deposited at the beginning of January 2012, of which NIS 39.2 million in the CPI linked segment. NIS 28.5 million in the non-linked Shekel segment at variable interest rate and NIS 1.7 million in the foreign currency linked segment.

The average interest rate on loans granted within the framework of the "Discount layout" in the CPI linked segment was 2.49% in 2011. The average interest rate on loans granted within the framework of the "Discount layout" in the non-linked Shekel segment was variable interest of 3.60% in 2011.

The resources provided by the Bank to DMB bear interest at the rate charged on the loan less a predetermined economic margin.

INFORMATION SYSTEMS

In February 2007, the Board of Directors of DMB approved the "Sky" Project, which objective was the upgrading of the existing information systems. For details regarding the engagement of DMB with the Bank for receiving computer services, see "Main future projects" in "Information and computer systems" in the Chapter "Fixed assets installations". In view of the decision to merge DMB with and into the Bank, the aim of the activity had changed and was defined as operating the mortgage layout at Discount 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), 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 May 11, 2011, 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, the ICAAP, in which it had been determined, among other things, the volume of risks assets in respect of the operations of overseas extensions shall not exceed 30% of the risk assets of the Group (excluding operating risk; in accordance with the first pillar of the Basel II recommendations). In addition, specific limitations have been determined in respect of each of the Bank's overseas extensions.

On December 31, 2011, the calculated rate of the Bank's exposure with respect to overseas extensions stood at 19.34% of total risk assets.

The Bank monitors the development of the exposure rate in respect of its operations in overseas extensions.

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

Guidelines applying in Switzerland. In accordance with the requirements of the Swiss regulator (FINMA), published in October 2010, the Bank has begun to implement the guidelines relating to cross border activity.

SCALE OF OPERATIONS AND NET INCOME

Net losses in 2011 amounted to NIS 37 million, compared with a net profit of NIS 111 million in 2010.

The return on equity, calculated on the capital allocated to the international operations on the basis of the average balance of segment risk assets, amounted to a negative 2.2% in 2011, compared with a positive return on equity rate of 6.6% in 2010.

The credit loss expenses amounted in 2011 to NIS 339 million, compared with NIS 243 in 2010, an increase of 39.5%.

Following are the principal data relating to the international operations:

	Households	Corporate Banking	Middle Market Banking	Private Banking	Non- Financial Companies	Total
For the year ended December 31, 2011						
in NIS millions						
Income from financing activities before credit loss expenses*	-	102	338	177	202	819
Operating and other income	-	48	69	145	(93)	169
Total Income	-	150	407	322	109	988
credit loss expenses*	-	158	153	3	25	339
Operating and other expenses	1	41	198	404	150	794
Operating Income (loss) before taxes	(1)	(49)	56	(85)	(66)	(145)
Provision for taxes (tax savings) on operating income	-	(18)	18	(29)	(78)	(107)
Net Income (loss) Attributed to the shareholders of the banking corporation	-	(31)	38	(56)	12	(37)
Return on equity (percentage)	-	(11.8)	2.3	(26.3)	2.6	(2.2)
Average Assets	8	3,423	8,907	4,769	15,952	33,059
Average Liabilities	19	1,542	2,103	18,559	8,700	30,923
Average Risk-assets	11	6,329	10,741	2,486	4,344	23,911

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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, 2010						
in NIS millions						
Income from financing activities before credit loss expenses**	3	160	310	202	365	1,040
Operating and other income	-	67	***68	142	(78)	199
Total Income	3	227	378	344	287	1,239
credit loss expenses**	-	140	91	9	3	243
Operating and other expenses	1	108	*183	346	80	718
Operating Income (loss) before taxes	2	(21)	104	(11)	204	278
Provision for taxes (tax savings) on operating income	(1)	22	21	4	121	167
Net Income (loss) Attributed to the shareholders of the banking corporation	3	(43)	83	(15)	83	111
Return on equity (percentage)	-	(6.6)	***13.0	(9.5)	22.5	6.6
Average Assets	36	5,981	7,665	4,591	16,159	34,432
Average Liabilities	161	1,496	3,252	18,006	10,156	33,071
Average Risk-assets	36	9,417	9,074	2,115	5,180	25,822

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

***Restated.

TAXATION

Under an agreement made with the Israeli tax authorities, the income of the Bank's overseas banking subsidiaries is added to the Bank's chargeable income, such that the Bank pays tax on the pre-tax accounting income of its overseas subsidiaries to the extent of the difference between the tax notionally payable in Israel on that income at the tax rate applicable to the Bank in Israel and the tax payable to overseas tax authorities.

DEVELOPMENTS IN THE SEGMENT

Private banking services to U.S. customers. In 2011, the Brooklyn Branch was opened in addition to the branch in Staten Island opened in 2010, both of which are branches providing private banking services to customers in the U.S..

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). For details regarding a claim submitted by a former senior officer of IDB (Swiss), 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.

The Bank operates a branch in London, which 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 hotel

industry 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.

United States. IDB New York ("IDB Bank") is the largest of the Israeli banks operating overseas.

This bank maintains four branches in the State of New York, 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.

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 letters of credit 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.

Foreign trade finance – letters of credit and the finance of foreign trade continue to comprise a significant source of income for IDB New York. IDB New York is rated fifty among all banks in the U.S. in providing letters of credit. The automatic system for customer initiated issue of letters of credit, operated by IDB New York, is an Internet based system enabling the issue and amendment of letters of credit in a quicker, easier and more precise manner than in the past.

Retail 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, provided by IDB New York, 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 (DBLA), 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 investment management 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. private banking 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 the branches of IDB New York, including designated branches especially established in Staten Island (2010) and in Brooklyn (2011).

Investments and Trust Department. This department offers investment management and trust services to international private banking customers 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 MANAGEMENT POLICY AND OBJECTIVES

The Bank's activity as a financial broker involves risk taking, the principal of which are: credit risks, market risks and liquidity risks. Additional risks relate to these risks, such as operational and legal risks.

The risk management policy is intended to increase the profit expectancy as part of the means to attain the Bank's business targets. This, within the framework of the approved risk appetite, in accordance with the Bank's ability to bear such risk.

In order to address all risks, the Bank adopted a risk management policy that defines the kind of risk exposure to the Bank, the units responsible for the risk exposure or for hedging against exposure, and their authorization. In addition, tools and mechanisms have been defined, for the identification, measurement, evaluation, control, monitoring and reporting of exposure to risk. In this framework, infrastructure and policy documents regarding the various risk areas have been adapted and approved. The policy documents are being updated from time to time, where necessary, in respect of changes in regulations and accepted best practice.

DRAFT PROPER BANKING MANAGEMENT DIRECTIVE NO. 339 - "RISK MANAGEMENT"

On August 15, 2011, the Supervisor of Banks published a draft of Proper Banking Management Directive No. 339, "Risk Management" (hereinafter: "the Directive"), within the framework of updating the Proper Banking Management Directives and aligning them with the Basel working framework.

The Directive is intended to replace the core principles for risk management and control, and reflects a group approach to risk management, as expressed in the Basel recommendations, "Second Pillar Supplementary Guidance", issued in July 2009. This with the aim to support the ability of the banking corporation to identify and react to developing risks in a timely and effective manner. The draft Directive discusses and defines five principal milestones:

- Corporate governance framework – the corporate governance framework relies on three control circles/lines of defense: business units management, an independent risks management function and internal audit. The Directive details and defines the structure and functions of the organs that participate in the management of risk;
- Risk management approach – An integrated and firm-wide risk management approach includes core processes for risk management: processes for their identification, measurement and assessment, control and mitigation, monitoring and reporting, along the business lines and across the corporation, for all types of risks. In addition, the Directive deals with additional topics, including: a risk appetite framework and the appropriateness of the corporation's risk profile to the framework decided upon, use of forward-looking stress testing, as a supplementary tool to the risk management approaches based on quantitative models, and use of models for risk assessment and measurement;
- Organizational culture for risk management – The board of directors and management are responsible for the integration of

an organizational culture based on sturdy risk management, including by means of:

- Imparting knowledge and expertise both with regard to business operations, and also to the whole array of risks resulting therefrom;
- Defining reporting responsibility and accountability;
- Risk management considerations are to constitute a central element in strategic and current decision-making;
- Setting an appropriate remuneration policy that balances risk against reward;
- Communication of the risk profile – The risk profile will be communicated to the Board of Directors within the framework of the risk document (the Exposure Report), in order to enable the Board of Directors to monitor the activities of management and to ascertain that these are in line with the risk appetite and with the risk management framework approved by the board;
- Group risk management – The Directive regulates the framework required for group risk management, including: determining a group risk management policy, giving tools and powers to subsidiaries for the purpose of risk management, and setting requirements for reporting to the parent company.

The Bank is studying the draft Directive and its implications on the Group's risk management framework and processes.

DISCLOSURE IN ACCORDANCE WITH THE THIRD PILLAR OF BASEL II

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).

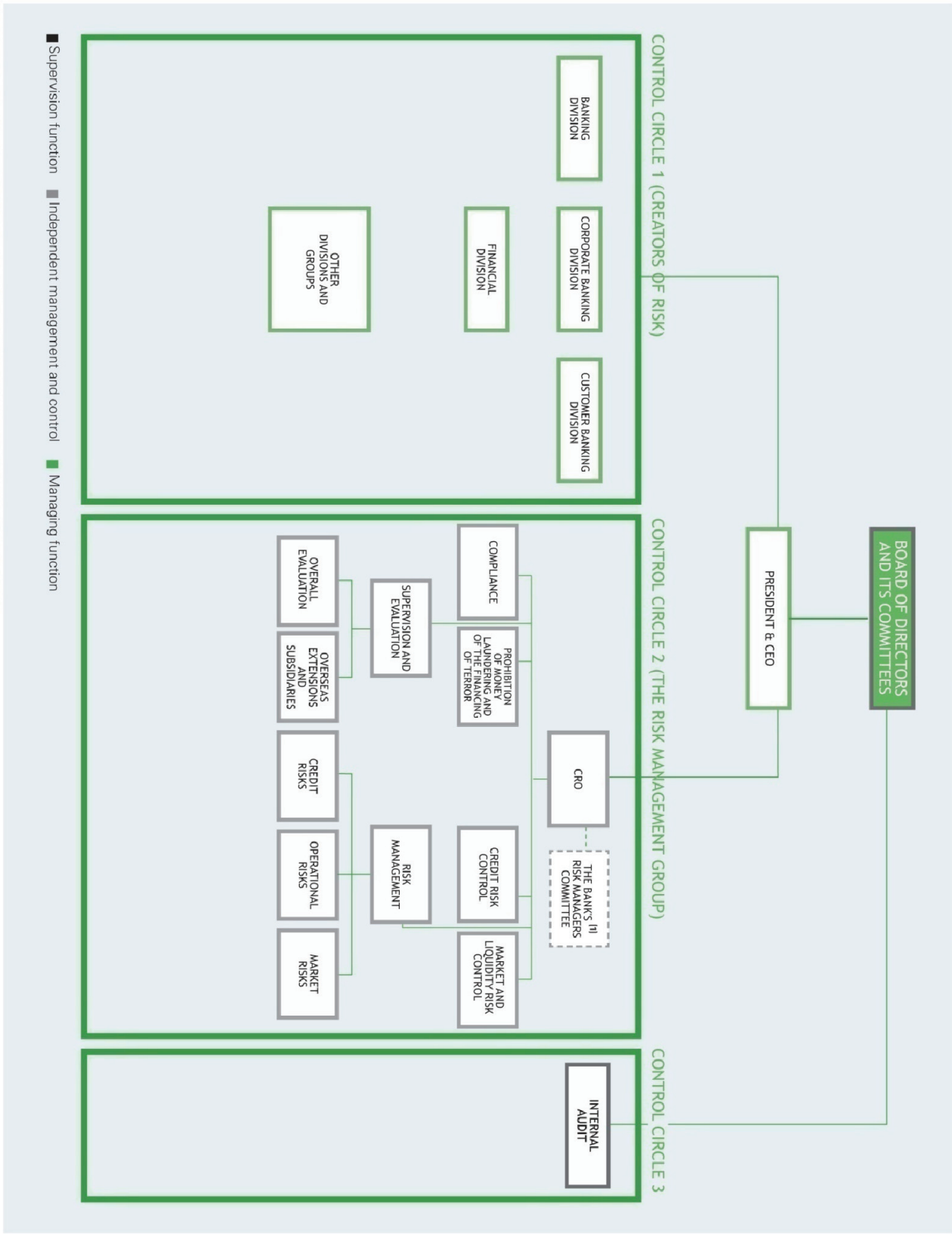
Furthermore, the said Annex includes a table relating the disclosure requirements according to the third Pillar to the data presented in the Report (Part "B", item 8).

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

Risk management model. The Enterprise Risk Management Model, which has been adopted by the Bank and the Group, is intended to create a balance between the separate circles related to risk management and to define the relations and affinities between them. The factors involved in risk management include: the Board of Directors, the Board's Risk Management Committee, the Bank's Management as well as the three circles related to risk management: the creators of risk, the factors responsible for the independent management of risk and the internal audit. The risk management model is included within the framework of a basic document dealing with Group risk management, which was approved by the Board of Directors in May 2010. The document determines the vision, principles guiding risk management, the functions participating in the core processes of risk management, and the work interface with subsidiaries in the field of risk management.

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

CONTROL CIRCLES DIAGRAM



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

The Board of Directors is assisted by its Risk Management Committee, and by various factors within the Bank's Management (risk management, legal counseling, internal audit and more).

The Risk Management Committee of the Board. The Committee discusses and submits recommendations to the Board of Directors with respect to any issue related to the risk management field at the Bank, including supervision and control over subsidiary companies and the Bank's overseas extensions, including procedures of the Board in this field.

The Committee supervises the implementation of the risk management policy both in the Bank and in the Group, including the examination of various issues which arise from time to time, such as: the implementation of new proper banking management directives published by the Bank of Israel, the determination of new limitations, management policy documents of the various risk, models and methodologies in respect of risk management, and suchlike. Generally, the committee convenes once a month. The risk management issues, which among other things include the policy, exposure and authorizations determined for their management and the nature of their monitoring and control, are tabled once every quarter for discussion by the Board of Directors within the framework of the exposure document. This document includes a report on the Bank's overall exposures to various types of risks in the past quarter. This document also relates to risks at the banking subsidiaries.

The Bank's Management. The Management is responsible for the realization of the risk management model and policy, the existence of control and supervision over the quality of risk management and the appropriateness of risk measurement and evaluation. Management acts through the Chief Risk Manager and the Risk Management Group and by a committee of risk managers of the Bank and of the Bank Group.

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

Mr. Yair Avidan, Executive Vice President	-	Chief Risk Manager and Chairman of the Committee;
Ms. Orit Alster, Executive Vice President	-	Credit Risk Manager;
Mr. Joseph Beressi, Senior Executive Vice President	-	financial reporting Risk Manager;
Ms. Esther Deutsch, Senior Executive Vice President	-	Legal Risk Manager;
Mr. Shai Vardi, Executive Vice President	-	IT Risk Manager;
Mr. Gilad Sokolov, Executive Vice President	-	strategy risks Manager;
Mr. Yigal Ronay, Executive Vice President	-	Market and Liquidity Risk;
Mr. Amir Rozin	-	Deputy Manager of the Risk Management Group.

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

The committee is engaged in forming the Bank's risk management policy in the various areas, in identifying new risk areas and risk centers and in initiating changes required in the risk management policy.

CREATORS OF RISK (THE FIRST CONTROL CIRCLE)

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

THE RISK MANAGEMENT GROUP - INDEPENDENT MANAGEMENT AND CONTROL (SECOND CONTROL CIRCLE)

- Chief Risk Manager (Head of Risk Management Group) - has the overall responsibility for risk management at the Bank and Group levels;
- Risk Management Group - The Group is responsible for managing the overall risks at the Bank and the Group within the framework of the second control circle, excluding legal risks and regulation risks, which are managed by the Legal Advisory Group and financial reporting risks, which are handled by the Accounting Group. In addition, the Group is responsible for managing and coordinating projects in the area of risk management at the Discount Group as a whole, including the implementation of the Basel guidelines.

The Group through which the Chief Risk Manager operates is responsible for assuring the understanding of risks facing the Group; the development of methodologies and of quantitative and qualitative tools for identifying and measuring exposure to risk; support of creators of risk in everything relating to managing the risks for which they are responsible; analysis and reporting exposure of the Bank and the Bank Group to the various risks, including supervision and control over overseas extensions and a subsidiary in Israel. Furthermore, the Group is responsible for the evaluation of capital adequacy, for verifying the effectiveness of risk management processes, and for the formation of recommendations relating to risk management, including the risk management policy, definition and updating of the risk appetite, the capital adequacy target, etc.;

- Independent risk controllers – The credit controller and the market and liquidity risk controller form part of the Risk Management Group and assist the Chief Risk Manager in supervising risks, including the efficiency and effectiveness of their management;
- The compliance officer-monitors the Bank's preparations towards the fulfillment of the duties imposed on it under the legislation and regulation in the field of consumer instructions, including verification of the Bank's compliance with consumer instructions relevant to new operations of the Bank. The compliance officer also verifies the correction of deficiencies identified in this field.
- Officer in charge of money laundering prohibition – is responsible for complying with the duties imposed on the Bank with respect to prohibition of money laundering and prohibition of financing of terror activities.

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

CREDIT RISK MANAGEMENT

GENERAL

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

The Bank is working towards adapting the risk management policy to the required format according to Basel II guidelines, the object of which is to assure the understanding of the risk management concept, the existence of effective processes of credit risk management, including compliance with determined exposure limits.

In this framework the Corporate Division has established a credit risk management unit. Within the framework of the unit, a department has been established, which integrates in the credit approval process and performs an independent review of applications for credit prior to their approval. This department also performs a validation process for the rating of borrower indebtedness. In addition, the unit includes an economic department dealing, among other things, in the formation of the Bank's credit strategies and policies as well as in forming methodologies for the analysis of credit transactions and in providing supporting tools for credit officers, and a business and operational control department engaged, among other things, in the development and assimilation of methodologies for a uniform business control at the Bank, in the early locating and identifying weaknesses in the credit portfolio and in the current control assuring that the management of credit files is in accordance with approvals and facility framework.

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

The credit strategy document outlines the mode of the Bank's operation as regards the granting of credit, within the framework for the implementation of the Bank's strategic plan, by detailing target markets and business targets, improving the management of the credit portfolio and its quality and the credit pricing policy that allows risk-matching pricing.

The credit policy includes principles and guidelines supporting the management of credit risk, including the policy regarding collateral, credit authority, the credit underwriting process and exposure limits. Risk indicators have been determined within the framework of the credit policy, the existence of which requires validation and updating of the documents. Furthermore, a policy and specific limitations have been determined with respect to exposure defined as significant. Furthermore, the policy document includes reference to the credit granting format for economic sectors and/or groups of population and/or transactions having unique risk characteristics.

The Bank is acting towards the integration of group credit risk management, that shall bind all subsidiaries. Each subsidiary in the Group will be required to approve a credit risk management policy, which in all material respects, is compatible with the guidelines of Discount Bank. In this framework, the risk appetite of the Group and its concept of credit risk management will, among other things, be integrated. As a first step in the move for the in the implementation of Group strategy and credit policy, the policy documents of the subsidiary companies are being reviewed by both the Corporate Division and by the Risk Management Group, while focusing on differences and aspects requiring coordination or matching with the group risk appetite.

Credit risk management is conducted by means of procedures and work processes that define the underwriting principles at the Bank, the management and control of the existing credit portfolio, credit granting authority and the ranking of the credit committees, work methodology, approval and control procedures, required collateral, the monitoring of credit portfolios and reporting by means of information systems. The role of all of these is to secure an appropriate management of the Bank's credit portfolio, reducing to the extent possible of the credit risk.

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

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

Hereunder is included reference, as the case may be, to the principal subsidiaries - IDB New York, Israel Credit Cards ("ICC") and Discount Mortgage Bank ("DMB"). 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.

ACTION TAKEN FOR THE AMENDMENT OF THE INSTRUCTIONS REGARDING CREDIT RISK MANAGEMENT

The Supervisor of Banks issued on October 6, 2011, a draft of the amendment of the instructions regarding credit risk management, within the framework of updating the Proper Banking Management Directives in line with the recommendations of the Basel Committee. The Supervisor has clarified that the updating of the Directives in this respect constitutes the regularization of the requirements and expectations of the Supervisor from the banking corporations, who are familiar with the

major part of which and who are already implementing them for quite some time. The update highlights these standards and where necessary, adds clarifications.

The following drafts have been issued, among other things:

- A new draft directive, Proper Banking Management Directive No. 310, regarding "principles for credit risk management", in which, among other things, were defined the risk management structure required from a banking corporation, and the distribution of authority as regards credit risk management among the various functions at the banking corporation. The draft is based upon the approach, according to which, for the purpose of an objective credit risk management, a high level involvement of a function independent of the business units is required.
Among other things, the draft requires that the formation of the credit policy, the classification and determination of provisions for credit losses will be the responsibility of the risk management function;
- Draft Proper Banking Management Directive No. 314 regarding "Proper evaluation of credit risk and proper measurement of debts", to replace the existing Directive, and which includes requirements concerning the measurement of credit risk, control over risk evaluation procedures and other relevant definitions;
- Draft amendment to Proper Banking Management Directive No. 319 regarding "Credit control". The amendment is intended to adjust the requirements to an advanced credit risk management system, and within the framework of which, the focus in the Directive has been shifted from technical-quantitative indices to qualitative requirements and to products required from the activity of the credit control unit.

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

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

The documents are discussed once a year, while determining strategy and credit policy for the following year. The policy is approved by the Bank's Management and Board of Directors. 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 that include: 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, the diamond industry, real estate and construction projects, the London branch, large capital market operators.

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).

The strategy document has been broadened to include the items detailed in the letter of the Supervisor of Banks dated December 10, 2009, regarding "Lessons learnt from the financial crisis regarding credit risk management". Among other things, a detailed credit strategy has been determined for holding companies, including guidelines for manner of financing.

In continuation of the process that started at the beginning of 2011, and within the framework of the credit policy document for 2012, the Bank has widened the process of adapting the strategy and credit policy documents to principles specified in the new Proper Banking Management Directive No. 301 regarding the "Board of Directors". Among other things, the adaptation related to the following matters: determining business targets and designated markets for the granting of credit, extending the desirable limits of the credit portfolio in compatibility with the risk appetite, including determination of new limitations regarding the level of exposure to the credit portfolio risks and limitations required for the individual transaction, definition of "material limitations" deviation from which requires approval of the Board of Directors, extending the principals for the granting of credit to employees and related persons and addressing compliance with regulatory and legal requirements.

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 and the restriction regarding large borrower groups the credit granted to exceeds a rate of 10% of the Bank's capital, impose an effective limitation on the group regarding the granting of credit to certain borrowers. The Discount Group complies with these limits. In addition, the credit policy of the Bank and of its subsidiaries include internal restrictions and lines of operation in addition to those promulgated by the Supervisor of Banks.

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

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

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

The credit exposure document relates to the following exposures: volume and composition of the Group credit portfolio (growth of credit, ratio of credit to the public to total assets), linkage segments base exposure, exposure to segments of operation, exposure to economic sectors, and exposure to large borrowers/large borrower groups.

In addition, the quality of the credit portfolio is examined in accordance with the distribution of the indebtedness rating of borrowers, the volume of problematic debt and the credit loss expenses. The concentration of the portfolio is also being examined.

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

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

The mortgage loans field. The activity of the Group in granting mortgage loans is mainly conducted through the subsidiary DMB. This activity is typified by a highly spread out credit portfolio, due to the focus of loans to households. DMB's policy in recent years dictated the focus on mortgage loan activity, both in financing the acquisition of residential units, including the construction of private houses, and in loans for other purposes secured by a residential unit owned by the borrower. This policy contributes to the distribution of the existing credit portfolio over a large number of borrowers, at a significant geographic distribution. DMB also finances groups of borrowers organized as "acquisition groups", mostly for residential purposes.

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

STRUCTURE AND ORGANIZATION OF THE CREDIT RISK MANAGEMENT FUNCTIONS

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

THE FIRST CONTROL CIRCLE

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

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

- The credit committees discuss and take decisions on matters of credit, both as regards new applications for credit and as regards existing indebtedness. Discussions of the committees include a review of borrowers including compliance with the credit terms, changes in credit profitability, developments in the financial condition of the borrower, evaluation of the level of exposure to changes in exchange rates, rating of the borrower, etc;
- **Credit risk management unit** at the Corporate Division, which includes the following units:
 - **"Second opinion" unit** – A department 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". In addition, the unit coordinates the handling of internal audit reports and audit reports submitted to the Bank of Israel, and the follow-up of findings of these reports.
 - **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; The analysis of credit risk applying to complex applications for credit 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.
 - **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 management and operation unit** is engaged in the preparation and updating of follow-up files for the credit committees. The unit is also responsible for relating groups of borrowers, in accordance with directives of the Bank of Israel in the matter, and for the current monitoring for the prevention of deviations from the limitations on a single borrower/group of borrowers; The unit is also responsible for the writing of a part of the credit and collateral procedures at the Bank.

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

- The duties of the credit risk management 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;
 - Development and application of internal models for internal credit rating of Bank customers, in order to quantify credit risk and support decisions;
 - Development of a statistical model for the computation of a group provision, according to the directive of the Supervisor of Banks concerning defective debts;
 - Follow-up of trend and developments in the field of risk management and their communication to all of the Bank's units.
 - The 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 also renders an opinion on the quality of borrowers rating. 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. It examines the procedures for approval of the credit granted, and its management, examines borrowers' files 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, stages of approval of the application in accordance with the credit authority, the actual granting of credit, following which the current control of the borrower's file.

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

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

In 2012 the Bank prepares for the change in the process of approval of credit, so that the involvement of the Board of Directors with the approval of credit will be limited and will mainly focus on approval of transactions that are inconsistent with the Bank's credit policy, as required by the new Proper Banking Management Directive No. 301. Within the framework of adapting the process of credit approvals to the Directive, the credit policy has established that transactions that "materially exceed" material limits, will have to be approved by the Bank's Board of Directors. Furthermore, limitations and principles have been fixed, any deviation there from requiring a change in the level of the approving authority or of the reporting level, as the case may be.

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

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

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

The consumer credit at the Bank is characterized by small amounts and a high distribution. The methodology and procedures regarding the examination of credit applications submitted by private customers, is intended to focus more on acquaintance with the customer, on socio-economic parameters and on his financial soundness in addition to the examination of the collateral. Furthermore, a private customer credit scoring system is also used, in order to determine the rating and credit recommendations for existing customers. Decisions on the granting of consumer credit are taken under personal authority or by the relevant credit committee, in accordance with the scope of credit.

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

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

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

The monitoring process of the credit portfolio includes:

- 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 provisions that reflect the expected loss to the Bank in respect of the "problematic debts". In determining the provisions, the Bank's Management relies on information at hand regarding the borrower, such as: his credit rating, financial soundness and/or owner guarantees, scope and quality of the collateral held, estimate of the present value of the future cash flows of the debtor, the risk level of the industry in which he operates, etc.

The Bank has prepared for the management of the credit portfolio and of the provisions for credit losses. The rating model of DMB is in its development stages, and a validation in its respect is concurrently being performed.

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

Credit underwriting and management processes at ICC. ICC operates according to procedures and work processes which define the

underwriting principles, management and monitoring of the credit portfolio. Procedures for the handling of credit and collateral and the relevant information systems are updated on a regular basis with a view of improving credit management.

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

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

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

Credit underwriting and management processes at DMB. The documentation and criteria required for the examination of applications for credit are defined in the procedures of this bank and include, among other things, a "getting to know the customer" policy, evaluation of the repayment ability of the customer in accordance with his characteristics (private and corporate), purpose of the transaction and the type of collateral offered in respect thereof.

DMB does not operate a grading model prior to the approval of credit. The rating model of DMB is in its development stages, and a validation in its respect is concurrently being performed.

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

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

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

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

CREDIT RISK MEASUREMENT AND REPORTING SYSTEMS

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

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

REDUCING 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.

Reducing the credit risk in respect of the concentration of borrowers/groups of borrowers. The Bank performs an ongoing follow-up of the situation of large borrowers/the six large borrower groups (and as of January 1, 2012, in accordance with the change in Proper Banking Management Directive No.313, with respect to 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 each borrower group, with a view of evaluating the credit risk at Group level.

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

Reduction in credit risk in respect of concentration according to economic sectors. The Bank performs industry surveys of various economic sectors as well as current surveys of the situation of the economic sectors in Israel in order to evaluate the credit risk at the industry level. Within the framework of the individual application for credit, an analysis of the economic sector of the borrower is performed and it is examined whether the application is in line with the credit policy according to economic sectors. The Bank complies with the Bank of Israel limitations and with internal limitations in respect of economic sectors, including the specific limitations regarding the real-estate industry.

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

METHODOLOGY AND TRAINING IN CREDIT MANAGEMENT

- Preparation of applications for credit and the financial analysis of the borrower's condition are performed according to the methodology and procedures developed by the Bank. A current analysis is performed on most recent financial statements of the Bank's business customers and a current follow-up of their business and financial condition is conducted. Furthermore, an economic and business analysis of credit applications is made, which focuses on the identification and evaluation of credit risk inherent in the customer's operations;
- Several methods developed by the Bank for the evaluation of the repayment ability of the borrower, of his needs for working capital and for evaluating the reasonableness of the credit exist. These methods are modified to the type of customer and structure of the transaction;

- Credit officers at all levels undergo training and study sessions with a view of preserving and updating the existing knowledge and their professional standards;
- With respect to material default events, the Bank performs an enquiry and a process of drawing conclusions, with a view of analyzing the reasons for the default and forming principles and guidelines that will prevent similar events in the future.

DEFINITION OF PROBLEMATIC DEBTS

The identification and classification of debts as "problematic debts" is performed according to classifications determined by Proper Banking Management Directive No. 314 and according to criteria specified in this Directive: "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.

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

As part of the Bank's preparation for the implementation of the instruction in the matter of "Measurement and disclosure of impaired debts, credit risk and provisions 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 provisions for credit losses.

QUANTITATIVE DISCLOSURE REGARDING CREDIT RISK

Segmentation of credit risk according to main credit exposure types

Gross credit risk exposure⁽⁵⁾⁽⁶⁾

	December 31 2011	Average in 2011 ⁽¹⁾	December 31 2010	Average in 2010 ⁽¹⁾
	in NIS millions			
Credit	157,532	152,220	146,493	147,177
Bonds	31,343	26,534	25,972	25,462
Others ⁽²⁾	7,715	7,756	⁽⁷⁾ 7,330	⁽⁷⁾ 8,287
Guarantees and other liabilities on account of clients ⁽³⁾	60,065	60,646	62,435	63,389
Transactions in derivative financial instruments ⁽⁴⁾	1,769	2,056	1,913	2,312
Total	258,424	249,212	244,143	246,627

Footnotes:

- (1) The average for the period is computed on a quarterly basis as from December 31, 2010.
- (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).
- (5) The gross credit balances as of December 31, 2011, are presented net of accounting write-offs and before allowance for credit losses. Such balances at December 31, 2010, are presented after deduction of provisions for doubtful debts.
- (6) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.
- (7) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the condensed financial statement.

DISCLOSURE AS TO CREDIT FILES MANAGED ACCORDING TO THE STANDARD APPROACH

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

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

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

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

REDUCTION OF CREDIT RISK

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

According to the Basel II guidelines, banking corporations may obtain relief from capital requirements with respect to usage of methods of reducing credit risks (CRM), subject to legal certainty. Legal certainty requires, among other things, that all documents securing a transaction, setoff documents, guarantees, etc. shall be binding on all parties involved and may be legally enforceable in all relevant judiciary fields. The Bank continues to act towards the improvement of processes and procedures in order to achieve the legal certainty required for the recognition of additional collateral.

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

- The business units evaluate and value the collateral in accordance with the collateral policy and procedures derived there from;
- The business control unit (within the first control circle) engaged in a sample testing of the value of collateral and is responsible for the development of control and warning reports with respect to the value of the collateral, validity of valuation, etc.;
- The credit control unit (within the second control circle) performs a sample check of customer files, which includes an examination of documents evidencing the collateral and whether they are in compliance with the Bank's policy and procedures;
- The internal audit department performs each year current audits of the business divisions. Such audits include an examination of collateral from the registration and reporting aspects, evaluation of the value of collateral, existence of insurance policies etc. The audit monitors the correction of deficiencies and the implementation of recommendations by the business factors until completion of the process;
- The legal department is involved in the management of collateral, in accordance with its type, as regards one or more of the following three aspects: preliminary legal advice, preparation of the collateral documents, examination and approval of the collateral.

The Bank is acting towards improving the said management and control processes.

The reduction of credit risk relating to banking corporations. The Bank's policy, as approved by the Board of Directors in February 2010, is to enter into transactions in financial derivatives only with banking corporations with which an ISDA agreement had been signed. This agreement leads to a reduction in credit risk by permitting the netting of liabilities and mutual demands stemming from over the counter derivative transactions in cases of insolvency of the counterparty.

The agreements are signed separately with each legal entity; with certain of the said banking corporations a credit support annex (CSA) to the agreement is signed, which regularizes with the counterparty the issue of collateral in respect of derivative transactions. The CSA includes a threshold amount that reflects the maximum exposure that each of the counterparties is ready to accept without receiving collateral.

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

MDB applies off-balance sheet netting with respect to transactions in derivative instruments with banks with which netting agreements had been signed that comply with ISDA rules. Most of banks active in derivative instrument transactions have signed the ISDA agreement. The Bank does not operate collateral under the CSA Annex.

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

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

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

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

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

As a condition for reliance on material collateral (pledge on fixed assets, such as: motor vehicles, residential real estate, commercial real estate, machinery and equipment), the Bank requires an insurance policy for the asset pledged.

The determination of the value for collateral of the various classes of collateral is derived from their nature, the extent of volatility attributed to their value, their quality, the extent of control and supervision that the bank has in their respect, their marketability, their liquidity and readiness of realization, including consideration for changes in their value resulting from situation of slowdown or growth in the business environment of the borrowers.

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

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

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

- "Eligible collateral" and guarantees available for netting - collateral used by the Bank for the reduction of risk assets in the credit field in accordance with Basel II instructions, which include:
 - Deposits pledged in favor of the Bank;

- Bank guarantees provided to the Bank as security for credit granted;
- Securities deposit and securities pledged in favor of the Bank (only securities defined as qualified under the rules of Basel II);
- "Other collateral" – all other collateral that are not defined as qualified. Other collateral serving the Bank for the purpose of hedging credit risks, include the pledge on fixed assets, such as: motor vehicles, residential property, commercial property, machinery and equipment, floating pledge, negotiable instruments that include credit card vouchers, documentary credit and including securities not defined as qualified as well as a pledge on contractual rights to the receipt of funds.

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

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

Bank procedures regarding pledges on real estate determine, among other things, the method of computing their value, the security spreads, the frequency of updating of the value and the authority for examination and approval of valuations in respect of the granting of credit. Furthermore, the Bank's procedures determine the rates of reliance applying to the different assets, such as: income producing property, stores, residential property, industrial buildings, land of various types, etc.;

- Fixed pledge - Bank procedures include guidelines for the evaluation of a pledge on fixed assets of various kinds. The procedures detail the frequency of updating the value of the pledge and the rates of reliance on the different assets in accordance with the type of the asset, its age, the level of marketability and possibility of realization. This includes: the value of motor vehicles is based on a suitable independent price list that is regularly updated, while the value of machinery and equipment is based on their purchase price or on an assessment by an appraiser;
- Floating pledge - Bank procedure determine guidelines for the valuation of a floating pledge, frequency of updating the valuation, rates of reliance on the various assets included in the pledge and computation of the Bank's share in the pledge. A floating pledge is formed based on updated information, knowledge of the borrower's business, type of active assets and the possibility of their realization. In cases where the information at hand for the purpose of determining the floating pledge is insufficient, the rates for reliance are reduced accordingly.
- Marketable securities - the value of marketable securities, at a holding rate lower than 5%, is based on market price, the rate of reliance for the security being determined by the securities research department. The value of securities held at a higher rate is assessed by the business factor at the Bank dealing with the customer. The Bank is preparing for the change in the process of determining the value for collateral, which is to be based on a statistical model based on consecutive parameters of market data (such as marketability, standard deviation, index related, etc.).
- Within the framework of the Bank's policy regarding the financing of acquisitions of means of control, rules have been determined for the valuation of the acquired shares for the purpose of securing such credit. A valuation of the acquired company is performed in accordance with the value of the transaction, market price, or according to a valuation assessment, as well as an examination as to the ability of the acquired company to pay dividends, being generally the source of funds for the repayment of the loan.

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).

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

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

- Exposure to foreign banks and financial institutions - the back office unit at the 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 2 of the aforementioned Note presents details of credit risk with respect to derivatives by counter party, on a consolidated basis.

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, 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 government debt situation of the PIIGS countries deteriorated significantly since the beginning of 2011, on the background of the slow economic growth and the difficulty in reducing the deficit of these countries. This was reflected in the downgrading of the credit rating of these countries, the increasing CDS spreads and returns on government bonds. Moreover, concern was growing regarding the possible bankruptcy of Portugal and Greece. The deterioration of the crisis affected the economies of Italy and Spain and caused a sharp rise in returns on government bonds of these countries. In order to confront the crisis, bailout packages have been devised for Greece and Portugal, and concurrently, the ECB began to purchase bonds of Spain and Italy in order to curb the spread of the crisis. In addition, in December 2011, the ECB started to provide banks with medium-term loans. Such loans reduced the concern regarding a liquidity crisis and led to the reduction in returns on bonds of the Italian and Spanish governments.

The S&P rating agency lowered the credit rating of nine European countries, including France, which credit rating decreased from "AAA" to "AA+".

An additional bailout package for Greece was approved in March 2012, in an amount of Euro 130 billion. The package includes a debt arrangement and a "haircut" of 53% for private investors. Approval of the package increased optimism in the markets.

On the background of this crisis, concern had emerged for the stability of several banks (outside the problematic countries) which are exposed to the debt of the PIIGS countries in general and to that of Greece in particular, and the credit rating of certain of these banks has been downgraded. Meanwhile, on the background of the exposure to Greek bonds, the French-Belgian Dexia Bank encountered difficulties, which required government intervention.

In 2011, exposure of the Discount Group to financial institution in the said countries has been consistently reduced and Discount Bank does not have a material exposure to financial institutions in the said countries. The Bank maintains a careful credit policy and an ongoing monitoring of banks operating in the PIIGS countries and is monitoring developments and volume of exposure to markets in general and to markets of the said countries in particular. 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.

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

- The credit facilities to foreign countries and banks are approved by the Bank's credit committees, in accordance with the recommendations of the financial institutions and at the Corporate Division. This recommendation is based upon mathematical models determining the maximum credit facility to states and banks. These models are based, among other things, on the rating of states and banks by the international rating agencies and on the banks' financial data, while taking into consideration the country in which the banks operate and the size of the economy to which the Bank is exposed;
- A reduction in the rating of a foreign bank and/or a deterioration in its financial data are weighted into the model, and where necessary, the Bank reduces its credit facility accordingly;
- The financial institutions 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. Allocation of credit facilities to the Bank's dealing room is in most cases directed towards banks incorporated in developed countries. Monitoring the Bank's compliance with limitations applying to credit facilities approved to the various institutions is conducted according to accepted practices at the Bank with respect to the monitoring of compliance with approved exposure limitations. The department, on a current basis, provides Management with reports regarding actual exposure levels at the Bank as well as regarding negative indications, if such are received;
- The Bank manages exposure to financial institutions in South America through IDB New York, which specializes in emerging markets;
- Deviations from credit facilities, if at all, are reported to the echelon in charge of the unit to which the credit facility had been allocated, in accordance with credit granting authority;
- The financial institutions unit at the Corporate Division received the Bank's exposure data regarding foreign financial institutions from the Finance Division, from various functions at the Bank and from the Bank's foreign subsidiaries and extensions. These data are consolidated at Group level and are reported to various factors at the Bank and to the Supervisor of Banks, as required.

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 86% of the exposure as of December 31, 2011, 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, 2011, include, inter-alia, the United States, Britain, Germany, Switzerland, Great Britain, France, Korea and Canada.

Losses in respect of impairment of securities in the amount of NIS 12 million are included in respect of exposure to foreign financial institutions.

Following are details of present credit exposure to foreign financial institutions⁽¹⁾, on a consolidated basis:

	Balance sheet credit risk ⁽²⁾⁽⁴⁾⁽⁵⁾	Present off balance sheet credit risk ⁽³⁾⁽⁴⁾	Present credit exposure ⁽⁴⁾
In NIS millions			
As at December 31, 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	52	-	52
As at December 31, 2010			
Present credit exposure to foreign financial institutions ⁽⁶⁾			
External credit rating ⁽⁷⁾			
AAA up to AA-	3,964	178	4,142
A+ up to A-	2,124	555	2,679
BBB+ up to BBB-	470	9	479
BB+ up to B-	308	-	308
Not rated ⁽⁸⁾	109	51	160
Total present credit exposure to foreign financial institutions	6,975	793	7,768
Balance of problematic bonds	24	-	24

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 condensed financial statements.
- (6) Credit exposure does not include exposure to financial institutions that have explicit and full government guarantees, and which do not include investment in mortgage backed securities (for additional details regarding mortgage backed securities, see Note 3 to the condensed 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, 2011 and 2010 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 234 million and NIS 6,254 million, respectively. For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.

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 is mostly done by Discount Mortgage Bank and 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 30%-35% of the borrower's income.
- Limitation on the volume of loans financing a substantial part of the value of the mortgaged property. Except in exceptional cases or Insurance Arrangements, the group does not approve amounts in excess of 75% of the value of the mortgaged property (the loans that are granted at a financing ratio of over 75%, are generally secured by EMI Insurance Company).
- The use of "safety factors" (durability tests) in the loan approval process. Namely, 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 four years).
- 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.

Quantitative data. The volume of the Group's housing loan portfolio as of December 31, 2011, amounts to NIS 19,671 million (December 31, 2010 - NIS 18,158 million). The volume of housing loans granted by the Group in 2011 amounts to NIS 4,068 million, of which NIS 377 million in respect of recycled loans (in 2010, NIS 4,906 million and NIS 370 million, respectively).

Following are data regarding certain risk characteristics of the Group's housing loans portfolio as of December 31, 2011:

	%
Rate of housing loans financing over 75% of the value of the Property	11.8
Rate of housing loans, the monthly repayment amount of each exceeds 35% of the income of the borrower	18.1
Rate of housing loans carrying variable interest rate of the total amount of the housing loan portfolio ⁽¹⁾	62.6

Footnote:

(1) Loans in which the interest rate change frequency exceeds five years were included in computing the ratio.

Increasing the allowance for credit losses created on a group basis. In view of the processes described above, in the housing market generally and in housing loans in particular, the Supervisor of Banks requested banking corporations on May 1, 2011, to assess whether any change had occurred in the quality of their housing loan portfolio, and reflect such assessment in the allowance for credit losses on a group basis as of March 31, 2011, made in respect of this portfolio.

Following the instruction of the Supervisor of Banks, the Group performed an assessment of the losses inherent in the housing loan portfolio, stemming from a possible impairment of the quality of this portfolio, in view of the processes described above.

As assessed by the Bank, the possible loss inherent in the Group's loan portfolio, derived from the said scenarios, amounts as of March 31, 2011, to NIS 20 million. The Bank included a provision in respect of such possible loss within the framework of the group allowance for credit losses - as part of the overall effect of the initial implementation of the new directives in the matter of "Problematic debts", which is accordingly reflected in the Bank's equity as of January 1, 2011.

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.

Following are data regarding significant exposure to groups of borrowers as of December 31, 2011:

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	3,093	391	3,484	131

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.

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 AND LIQUIDITY RISKS

General. Market and liquidity risks are presented in this review on a Group basis, including the Bank, Mercantile Discount Bank, Discount Mortgage Bank, IDB New York, IDB (Swiss) Bank, ICC and BLD, the severance pay fund for the Bank's employees.

Market risk. 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.

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.

STRATEGIES AND PROCESSES

Market and liquidity risk management policy. The market risk policy is intended to reduce the level of financial risk created by the Bank's current activity, alongside increasing the Bank's profits stemming from undertaking initiated and controlled exposure. The Bank has two policy documents on this subject, the one - market risk management policy, and the other - liquidity risk management policy. Both these policy documents have been approved by the Board of Directors.

The policy documents define the principles of risk management, the tools for measuring exposure and the limitations on exposure in relation to the Bank's overall activity, commercial operations, specific files and quantitative scope limitations on instruments that may be operated by the Bank. In addition, the document defines the responsibility of the various factors dealing with market and liquidity risk management, both as regards the determination of limitations as well as in the treatment of deviations from restrictions. Furthermore, the liquidity risk management policy document has defined a group of indicators for use in the identification of trends in the liquidity risk situation, and also includes a plan regarding preparations for a liquidity crisis situation.

The principal subsidiaries also have policy documents for the management of market and liquidity risks.

No deviations in applying the determined policy were recorded in 2011 (except for several specific deviations of negligible scope). For details, see below.

GROUP RISK MANAGEMENT

The Group risk management as defined in the policy document agrees with that stated in draft Proper Banking Management Directive No. 339 of September 2011. Accordingly, the Group's Chief Risk Manager is responsible for the supervision over the market risk management processes at the subsidiary companies and for verifying that they comply with the market risk

management policy of the Group. The market risk manager of each subsidiary is responsible for supporting the efforts of the Bank's Chief Risk Manager, including by way of communicating of data, reports, measurement results, collaboration of methodologies, etc.

The Boards of Directors of the banking subsidiaries have determined policies regarding the maximum exposure to market and liquidity risks, based on the Bank's policy. The subsidiaries manage their market and liquidity risk, each subject to the policy determined by its own Board of Directors. Notwithstanding, within the framework of the implementation of the Group policy for market and liquidity risk management, the Board of Directors has instructed the principal banking subsidiaries in Israel and abroad to modify, to the extent possible, their market risk management and measurement methodologies to those applied by the parent company, taking into consideration the specific characteristics of operations of each subsidiary.

The Bank applies the necessary steps for measuring and assessing the overall exposure of the Group to risks, as well as to absorb the group management concept at the Bank and at the Group's companies. 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.

The current management of market and liquidity risks is conducted separately at the Bank and at each of its main banking subsidiaries. Notwithstanding, the Bank frequently reviews, the inclination of the Bank, its banking subsidiaries and of the Group as a whole, to take risks and the actual market and liquidity risks. These reports are presented to the Board of Directors as part of the exposure document.

The data presented in this review, include, the Bank, MDB, DMB, IDB New York, IDB (Swiss) Bank, ICC and BLD.

Main changes in exposure policy and risk management procedures. As part of the process of reviewing the effectiveness of the limitations, and on the background of the increase in risk level in the financial markets, the Bank's Board of Directors has decided to toughen the group restrictions that limit exposure to market risk (in terms of VaR) and exposure to interest risk (in terms of a parallel scenario of 100 basis points). Furthermore, certain limitations at the Bank's level (on a standalone basis) have also been toughened. Furthermore, a group limitation was determined in terms of the maximum economic value erosion under stress test.

Two additional forums were established in the course of 2011, the aim of which is to improve the monitoring of market and liquidity risks: a Group forum for the management of market and liquidity risks, with the participation of representatives of the principal subsidiaries and a committee for the examination of the appropriateness of the liquidity risk management at the Bank. 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. For details, see "Capital Management" in the "Capital Means" section.

STRUCTURE AND ORGANIZATION OF THE MARKET AND LIQUIDITY RISKS MANAGEMENT FUNCTION

The organizational structure, by which the market and liquidity risks are being managed, is, as stated, composed of three control circles.

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

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

- **Risk manager committee.** This committee, the duties of which are defined in the risk management fundamental document, acts as a Management committee headed by the Chief Risk Manager. Membership of the committee is composed of risk managers of the first control circle, including the Head of the Finance Division – the manager of market risk. The role of the committee in the field of market risk management includes a periodic review of issues in this field, in accordance with the decision of the committee's chairman, and approval of new models or changes in existing models. In addition, the committee receives reports concerning the preparations for the implementation of new regulations in this field.
- **Asset and liability management committee (ALM committee).** This committee is headed by the 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 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;
- **Stress tests forum.** Headed by the Chief Risk Manager and meets at least once in each quarter. Presented to the Forum is the potential impairment under stress tests determined by the Bank and by the subsidiaries in the Group, and the Forum decides as to the stress tests that should be examined within the framework of market risk management.
The forum coordinates the stress tests regarding market risks and those regarding credit risks, and also reviews Group exposure in terms of stress tests. Representatives of the principal subsidiaries also participate in the forum;
- **The liquidity forum** is headed by the manager of the asset and liability management department and meets on a weekly basis. The forum performs an ongoing follow-up of the liquidity situation and of the implementation of decisions made by executive factors.

INTERNAL CONTROL MECHANISM REGARDING THE PREVENTION OF DEVIATIONS FROM THE POLICY

The Bank operates control mechanisms preventing deviation from the limits determined by the Board of Directors, which include three control circles as follows:

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 Bank's procedures requires those who accept the risk and the control factors to report to the Head of the Finance Division and to the risk management department in respect of any exceptional events, e.g. loss exceeding the predetermined limit, deviations from limitations and so forth.

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

In addition, internal limitations determined by the Head of the Finance Division, are monitored on an ongoing basis.

The second control circle. Headed by the Chief Risk Manager, is responsible for assuring the adequacy of the declaration in respect of the market risk appetite, the adequacy and effectiveness of the limitations, the formation of tools and methodologies for market risk management, and for performing an independent control over exposure and over market risk management processes at the Bank and the Group. The framework of the second circle includes the market and liquidity risks management unit and the market and liquidity risks control unit.

- **Market and liquidity risks management unit** 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.
- **The market and liquidity risk control unit** operates within the framework of the risk management department, the duties of which include a review of the effectiveness of the market and liquidity risks management processes applied by the first control circle, including: testing the adequacy of resources and of risk measurement processes, validation of models used for managing market risks and testing the reasonableness of stress tests.

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

Organizational structure at the principal subsidiaries. The Organizational structure at the principal subsidiaries includes the functions and control circles described above, with certain changes, as is obligatory due to their size and nature of operations.

CHARACTERISTICS AND SCOPE OF REPORTING AND RISK MEASUREMENT SYSTEMS

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

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

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

IDB New York. Measurement of the exposure to market and liquidity 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.

HEDGING AND/OR RISK REDUCTION POLICY

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.

MANAGEMENT AND MEASUREMENT OF MARKET RISKS

The Directive in the matter of risk management No. 339 published by the Supervisor of Banks specified basic principles for the management and control of the various risks. Within this framework, a duty has been imposed on the Board of Directors to discuss the Bank's policy with respect to risk management and to approve it, intensifying the Board's involvement in these matters. Among other things, the Board discusses the exposure document that summarizes the total market risks to which the Group is exposed. According to the said Directive, the Bank is required to manage exposure to market risks through an information system based on an internal model.

(1) BASE RISK EXPOSURE

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

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

As at December 31, 2011					
	Non-linked shekels	CPI linked shekels	Foreign currency ⁽²⁾	Non- monetary asset	Total
in NIS millions					
Assets	109,574	26,211	60,653	6,053	202,491
Liabilities	99,833	21,539	69,445	559	191,376
Balance sheet difference	9,741	4,672	(8,792)	5,494	11,115
Derivative instruments	(6,850)	(1,700)	8,550	-	-
Options	(52)	-	50	2	-
Total Difference	2,839	2,972	(192)	5,496	11,115
As at December 31, 2010					
Assets	*92,884	27,743	58,827	*6,122	185,576
Liabilities	*85,824	22,654	65,316	630	174,424
Balance sheet difference	7,060	5,089	(6,489)	5,492	11,152
Derivative instruments	(1,257)	(2,679)	3,936	-	-
Options	(241)	12	226	3	-
Total Difference	5,562	2,422	(2,327)	5,495	11,152

*Reclassified.

Footnotes:

- (1) The above presented data reflect the accounting positions, which differ from the economic positions in the various linkage segments, on the basis of which the daily exposure management is actually performed (see hereunder).
- (2) The base exposure is computed in accordance with generally accepted accounting principles, as stated in Note 17 to the financial statements. For current management purposes, certain changes have been implemented, which take into account the Bank's economic approach to base exposure. Exposure to foreign currencies is permitted within the limitations approved by the Bank's Board of Directors.

Exposure to base risks was, until the end of 2011, measured as a percentage of the economic available capital. The available economic capital is defined as the Bank's equity, less fixed assets and with the addition of investments in foreign subsidiaries

that are financed from foreign currency deposits, with the addition of adjustments required for the economic presentation of exposure to base risks.

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

Cancellation of the hedge of the investment in IDB New York. At the end of 2011, the Bank made a move which considerably reduced the level of exposure of capital ratios to changes in exchange rates. For additional details, see "Capital management" under "Capital resources".

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

Segment	Limitation	2011				2010			
		Period end	Range of exposure			Period end	Range of exposure		
			from	to	average		from	to	average
Non-linked Shekel	The balance	24%	24%	69%	59%	69%	68%	95%	79%
Linked Shekel	80%-(40%)	39%	28%	46%	36%	29%	2%	30%	19%
Foreign currency	25%-(25%)	37%	2%	37%	4%	2%	1%	5%	3%

* In 2012, these were replaced by limitations in terms of capital.

Actions taken to cancel the hedge were partly made in 2011, though the change of the accounting definition has been implemented as from January 1, 2012. As a result of the above, as of December 31, 2011, the Bank reports a deviation from the limitation applying to the foreign currency segment. This deviation is temporary and has been approved by the Bank's Board of Directors.

Capital sensitivity to changes in exchange rate. The capital's sensitivity to changes in exchange rate is presented in the following table, which provides details regarding the impact of changes in exchange rates of the major currencies on the Bank's equity as of December 31, 2011.

Segment	The Bank's capital sensitivity of changes in exchange rates ⁽¹⁾			
	in NIS millions			
	10%	5%	-5%	-10%
USD	323	169	(165)	(319)
EUR	(19)	(4)	5	5
GBP	5	3	(3)	(5)

Notes:

- (1) The theoretical change in the economic value of the Group (in terms of present value) as a result of the scenario
- (2) The theoretical calculation made in respect of the Japanese Yen and Swiss Franc indicated negligible changes in the economic value, and therefore is not presented in the table

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

(2) INTEREST RISK EXPOSURE

A. GENERAL

Interest risk is the risk of impairment of the Bank's capital and earnings as a result of changes in market interest rates. The risk derives from the exposure to future changes in interest rates and their possible effect on the present value of assets and liabilities 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)

December 31, 2011						
	Israeli currency		Foreign currency**			
	Non linked	CPI linked	US\$	Euro	Other	Total
In NIS millions						
Financial assets*	106,363	26,692	48,559	6,753	3,796	192,163
Amounts receivable in respect of derivative and off balance sheet financial instruments ***	78,844	2,398	44,946	13,069	8,345	147,602
Financial liabilities*	(96,630)	(21,789)	(55,009)	(8,930)	(4,231)	(186,589)
Amounts payable in respect of derivative and off balance sheet financial instruments ***	(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

December 31, 2010						
Financial assets*	90,554	28,781	45,919	7,237	4,874	177,365
Amounts receivable in respect of derivative and off balance sheet financial instruments ***	60,445	961	42,125	9,528	8,283	121,342
Financial liabilities*	(83,103)	(23,236)	(52,165)	(8,905)	(3,913)	(171,322)
Amounts payable in respect of derivative and off balance sheet financial instruments ***	(61,699)	(4,785)	(38,499)	(8,231)	(9,246)	(122,460)
Net fair value of financial instruments	6,197	1,721	(2,620)	(371)	(2)	4,925

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

December 31, 2011									
Change in interest rate	Fair value of financial instruments, excluding non-monetary items****						Change in fair value		
	Israeli currency		Foreign currency**						
	Non linked	CPI linked	US\$	Euro	Other	Offsetting effects	Total	Total	Total in %
in NIS millions									
Immediate parallel increase of 1 %	2,949	2,161	(1,166)	64	(65)	(2)	3,941	(305)	(7%)
Immediate parallel increase of 0.1 %	3,009	2,172	(986)	66	(64)	-	4,197	(49)	(1%)
Immediate parallel decrease of 1 %	3,090	2,184	(1,175)	68	(61)	(2)	4,104	(142)	(3%)
December 31, 2010									
Immediate parallel increase of 1 %	6,045	1,825	(2,904)	(370)	(1)	(2)	4,593	(332)	(7%)
Immediate parallel increase of 0.1 %	6,188	1,731	(2,610)	(390)	-	-	4,919	(6)	(0%)
Immediate parallel decrease of 1 %	6,381	1,599	(2,607)	(416)	1	(3)	4,955	30	1%

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

** Including Israeli currency linked to foreign currency.

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

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

Raising the discount rate by one basis point would have reduced the fair value of problematic debts by NIS 72 million. Raising the discount rate by 0.1 basis point would have reduced the fair value of problematic debts by NIS 5 million (compared to NIS 74 million and NIS 4 million respectively, as of December 31, 2010).

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.

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

December 31, 2011					
The change in interest rates	Unlinked	CPI linked	US dollar	Other foreign currency	Total
In NIS millions					
An increase of 100BP in interest rates	(200)	10	179	7	(4)
A decrease of 100BP in interest rates	222	(14)	(555)	(10)	(357)
December 31, 2010					
An increase of 100BP in interest rates	(102)	(36)	(87)	8	(217)
A decrease of 100BP in interest rates	120	25	(194)	(9)	(58)

The limitation determined by the Board for interest risk exposure in the various linkage segments relates to the maximum damage to economic capital resulting from concurrent movements in the yield curve of 1% in each segment.

The limit was set at 7.5% of the equity on the group's exposure to a change of 1% in the interest graphs in addition to the limits determined by the banking subsidiaries. In 2011, 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.

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:

December 31, 2011					
The change in interest rates	Unlinked	CPI linked	US dollar	Other foreign currency	Total
In NIS millions					
An increase of 100BP in interest rates	(166)	13	188	8	43
A decrease of 100BP in interest rates	190	(16)	(562)	(9)	(397)
December 31, 2010					
An increase of 100BP in interest rates	(99)	(34)	(76)	6	(203)
A decrease of 100BP in interest rates	116	23	(202)	(8)	(71)

No weekly cumulative change occurred in the past ten years, which had it occurred in the reported period would have adversely affected the "going concern" assumption used at the basis of preparation of the financial statements.

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

	As at December 31, 2011			As at December 31, 2010		
	Shekels		Foreign currency and foreign currency linked	Shekels		Foreign currency and foreign currency linked
	Non-linked	CPI linked		Non-linked	CPI linked	
Total Assets	185,207	29,090	125,468	150,999	29,742	117,966
Total Liabilities	182,120	26,918	126,481	144,802	28,021	120,959
Average maturity (years):						
Assets	0.96	3.44	0.84	0.99	3.83	1.05
Liabilities	0.70	3.81	0.72	0.66	3.98	0.69
Average maturity gap	0.26	(0.37)	0.12	0.33	(0.15)	0.36
IRR gap	2.82	0.45	1.93	3.00	0.76	2.13

(3) THE VALUE AT RISK (VAR)

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

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

	2011				2010
	At year end	Yearly average	Maximum	Minimum	At year end
	in NIS millions				
Estimate of VaR amount (in NIS millions, Group)	131	128	173	105	180

The weight of the VaR in relation to the shareholders' equity as of December 31, 2011 is 1.2%, compared with 1.7% at the end of 2010.

The decline in the Group VaR assessment stems mainly from a decrease in exposure to interest in U.S. dollar terms. This decrease was partly offset by changes in market data.

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. The tests that have been implemented to date confirm the model's validity.

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

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

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

(4) ANALYSIS OF THE IMPAIRMENT IN ECONOMIC VALUE UNDER STRESS TESTS

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

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

The Bank and its principal subsidiaries examine some sixteen extreme scenarios that include changes in interest graphs (corresponding and non-corresponding), changes in currency exchange rates and in the CPI and changes in the spreads of investments in corporate bonds. Following are details of the main extreme scenarios implemented at the Bank:

- Scenarios of extreme changes in market data as from the year 2000;
- Scenarios of changes occurring in the markets during the crisis of October 1998;
- Scenario of deterioration in the security situation in Israel;
- A scenario depicting a worsening security situation in the region having international implications;
- Scenario of a financial crisis in the U.S.A. and in Europe (a theoretical scenario updated and tested in view of the crisis in those markets in recent years, where the theoretical scenario is even more severe in certain parameters);
- Scenario of a global rise in prices;
- Scenario of a crisis in emerging markets;
- A global crisis scenario originating in the European government debts crisis;
- Scenario of an extreme event that includes severe assumptions as regards changes in interest rates.

At the end of 2011 a limitation was determined for the maximum erosion in the economic value of the equity capital under stress tests. It has been determined that the erosion in value shall not exceed 15% of the equity capital of the Group.

In the course of 2011, the Bank and the Group complied with this limitation.

(5) THE NET INTEREST INCOME (NII) MODEL AND THE EARNINGS AT RISK (EaR)

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

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 conduct 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 CRM. 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 granted by DMB within the "Discount Outline". The model operated by the Bank is based on historical data of early repayments, similar to the model operated by DMB.

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

(7) THE STANDARD APPROACH TO THE ALLOCATION OF CAPITAL TO MARKET RISKS

The Bank computes the capital allocation required in respect of the exposure to market risks in accordance with the standard approach, as prescribed by Proper Banking Management Directive No. 208. The allocation of capital to market risks is done as follows:

- Interest rate and shares risk - allocation in respect of the portfolios managed at the Bank for trading purposes, including the overall activity of the dealing room. Computation of the interest rate risk is performed in accordance with the "average period to maturity" method;
- Foreign exchange rate - allocation in respect of the Bank's overall activity;
- Option risks - allocation in respect of the Bank's overall activity, including embedded options. The computation is performed according to the "Delta plus" method.

Following are details of capital allocation to market risks according to the standard approach (Basel II guidelines):

	Capital allocation as of	
	December 31, 2011	December 31, 2010
	In NIS millions	
The Bank:		
*Interest rate risk	124	104
Foreign exchange rate	11	94
Share risk	-	1
Option risk	15	33
Total for the Bank	150	232
Allocation in risk terms	1,875	2,907

* Including the specific risk in the amount of NIS 6.2 million and NIS 4 million in the years 2011 and 2010, respectively.

The allocation to market risks in risk asset terms comprises 1.38% of the total risk assets as of December 31, 2011, compared with 2.05% as of December 31, 2010.

The decrease in the capital allocation to market risks stemmed mostly from the cancellation of the structured position and the tax hedging in its respect.

(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 range for this activity, and maintaining daily and sub-daily monitoring and control.

The Board of Directors has determined separate sets of limits pertaining to trading activities and to asset and liability activities. Limitations on trading activity were determined by the Board of Directors in terms of scope of activity, sensitivity to risk factors and theoretical losses incurred, including in extreme scenarios, and in terms of the value at risk (VAR). The management and control factors regarding these activities have also been determined.

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

For the purpose of 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.

Several deviations from limitations set by the Board of Directors were recorded in 2011. The deviations have been rectified within a short period of time.

(10) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

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.

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 or of 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.

Several deviations from the said limitations were recorded during 2011.

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 2011.

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. The total exposure and compliance with the Board of Directors limits are being measured and controlled on an ongoing basis by the middle office.

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

	As at December 31,	
	2011	2010
	in NIS millions	
Hedging derivatives	686	-
ALM derivatives	156,782	131,963
Other derivatives	19,078	44,826
Credit derivatives and SPOT foreign currency	2,274	5,164

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 J 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 a reduction in the earnings from financing operations by NIS 51 million in 2011, compared with a decrease of NIS 146 million in earnings from financing operations in 2010.

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

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

MANAGEMENT AND MEASUREMENT OF THE LIQUIDITY RISK

The liquidity risk is a risk where the Bank will have difficulties in honoring its obligations due to unexpected developments, and will be forced to raise funds or to liquidate assets in a manner that will cause it material losses. As this involves an uncertainty situation, in which the liquidity risk always exists, the Bank has determined the maximum exposure to liquidity risk that it is willing to take.

The current measurement of the exposure to liquidity risk is intended to provide decision makers with indicators that forewarn the intensification of this risk, allowing the Bank a period of time in which it may counteract the risk without having to sustain material losses.

Liquidity risk management. The Bank manages its liquidity risks subject to the policy 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.

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.

A forum dealing with the adequacy of the model began operations in 2011, 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.

A Business Liquidity Forum is run by the Bank convening at least once a week discussing the liquidity situation and examines the application of decisions made by management factors.

Limitations on the exposure to liquidity risks. The limitations determined by the Board of Directors in the approved new 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 2011.

Draft Amendment of Proper Banking Management Directive No. 342. On August 1, 2011, the Supervisor of Banks issued a draft amendment to the Directive regarding "Management of liquidity risk". The draft is intended to include in the Directive pertinent emphasis in the matter of management and assessment of liquidity management, based on the experience gathered since the issue of the existing Directive and lessons learnt from audits conducted in this respect at banking corporations. This as an interim period measure until the complete update of the Directive in accordance with the two documents of the Basel committee, mutatis mutandis, and at a date to be determined: the one, a document of September 2008, dealing with the principles for the proper management and supervision over liquidity risk; and the other, of December 2010, forming part of the Basel III documents.

The draft includes, among other things, new indices for the quantitative measurement of liquidity risk and the monitoring thereof.

The bank is studying the draft Directive.

For additional details, see "Liquidity and the raising of resources in the Bank".

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".

OPERATIONAL RISKS

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

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

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 are studying the directive and the new principles therein, including the implications of implementing these

principles. Subsequently, the Bank Group will take action to implement and integrate the operational risk management principles. 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.

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.

This structure of risk management enables the separation between those who take the risks at the various divisions and Groups who directly create the exposure to the risk and manage it, and those who engage and the factors engaged in the independent management of the risk.

Concurrently, the control entities – the officer in charge of money laundering prohibition, internal audit and compliance officer are independent entities who report directly to Management and/or to the Board of Directors.

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

Operational risk management policy. In April 2011, the Board of Directors approved an update of the policy document, including a declaration regarding the operational risk appetite and monitoring thresholds. The Bank will act towards the adoption of the update at Group level.

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;
- Existence of an organizational and operational structure at the Bank supporting operational risk management;
- Full reporting of failure events, including "almost failed" events, and the existence of an effective process for drawing conclusions.

In addition, the policy states that:

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

- The Bank's Management on the one side and the Board of Directors on the other will examine, improve and intensify, where required, the core principles in the field of operational risk management, the risk tolerance declaration, definition of authority framework for taking on risks, definition and maintenance of the organizational structure supporting operational risk management;
- The limitations on the exposure to operational risks at the Bank and Group levels, will enable effective, responsible and cost saving operational activity;
- The Chief Risk Manager is responsible for the development of methodology and models and for forming work tools and evaluation methods for the assessment of the operational risks of the Group in order to create quality, effective and active risk management at the Bank. The Chief Risk Manager is also responsible for reporting to Management and to the Board of Directors;
- In each Division or Group, the officers taking the risk, from the lowest managerial level to top management level, are those in charge of the risk and responsible for its ongoing management by identifying the risk, evaluating its level, monitoring the risk, determining and effecting plans to reduce the level of the residual risk, as well as reporting to their superiors and to the Risk Management Department;
- The Risk Management Group is responsible for the implementation of operational risk management by defining optimal work processes and procedures in this field;
- An examination, analysis and self evaluation of the operational risk management and their scale (RCSA) are to be performed periodically with respect to each risk center, taking into consideration the changes occurring in new processes, new operations and products. The evaluation is to be performed in accordance with the risk evaluation methodology used by the Bank during the operational risk survey, while giving special attention to the control environment.

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

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

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

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

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

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

Current management of operational risks. The Bank examines on an ongoing basis exposure to operational risks and implements measures for the reduction in the material risks level. The risk centers managers (the reviewed units) are taking steps towards the implementation of the risk reduction plans and update on a quarterly basis, the information regarding the progress of implementation of the new controls. The performance status regarding the implementation of the reduction plans is reported to management and the Board of Directors on a quarterly basis. 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, etc.

Operational risk management system. The Bank has completed the establishment of an operational risk management system, which went into operation on March 1, 2011. The system has been fully integrated at the Bank and at certain of the subsidiaries. Integration at the remaining subsidiaries will continue in 2012.

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, including events where no damage had been suffered by the Bank or which are considered "almost suffered". Such data base will enable the analysis of failure factors, the treatment of risk centers identified and the establishment of risk indicators that would allow, in the future, the monitoring of risks prior to their materialization. The Bank is at the final stages of the project for the modification and integration of the operational risk management system that will serve the Bank Group. The system has been fully integrated at the Bank and at certain of the subsidiaries. As stated, integration at the remaining subsidiaries will continue in 2012.

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

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

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

Operational risk survey. The performance of a Group operational risk survey began in the last quarter of 2011. The survey will be performed with the assistance and escort of an outside consulting company, and is expected to be completed in the first quarter of 2013.

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. The IT risks are operational risks applying to information systems in the process of production, cross company IT processes as well as new activities.

The Head of the IT and Planning Division is responsible for the management of IT risks at the Bank and at the subsidiary companies. He acts as chairman of the group IT risk management committee and reports to the Management and to the Board of Directors, at determined intervals, on cases where the limit for risk tolerance concerning IT had been exceeded at the Bank and at the subsidiary companies within the Group, which receive services from the IT and Planning Division, as well as on risks at a "very high"/"high" level of exposure, events of material failure, the action taken to rectify such cases and more.

In order to manage IT risks and with a view of minimizing exposure of the Bank and of the subsidiary companies to the realization of risk in the information system, the Bank's Management has appointed an IT risk manager, who reports directly to the member of Management acting as Head of the IT and Planning Division.

The responsibility of the IT risk manager 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 shall not exceed the maximum risk appetite and exposure limits determined in accordance therewith and to periodically perform a self evaluation of the risk and effectiveness of the risk management process.

The core processes for risk management. The core processes are constructed in three principal stages, as follows:

- Stage I - identification of IT risks – a process intended to assure that risk factors to which the IT group is exposed and their characteristics, are properly identified and understood;
- Stage II - measurement and evaluation of exposure to identified risks and devising a plan for containing the exposure;
- Stage III - management of identified risks and exposure, monitoring of the risks, application of measures to contain the risk, reducing exposure and adoption of measures minimizing the damage caused by the realization of the risk.

The IT risk management policy, approved by the Bank's Board of Directors in 2011, is based upon the methodology adopted by the Bank in the field of operational risk management, with required adjustments to the requirements of the IT field.

In accordance with the methodology adopted by the Bank, the said policy document defined three control circles:

- First control circle – headed by member of management acting as head of the IT and Planning Division, responsible for IT risk management at the Bank and at the Group, advising also the Board of Directors in determining the risk tolerance level and the IT risk management policy;
- Second control circle – headed by the Chief Risk Officer, responsible for: an independent evaluation of the IT risk exposure profile and verification of the effectiveness of control over IT risks;
- Third control circle – headed by the Internal Auditor.

The process allows efficient focusing on areas identified as having the highest risk for the Bank and the Group, forming multi-annual work plan as well as the timely adjustment of the risk management strategy and the risk map in accordance with changes taking place at the Bank and at the Group and /or in the operating environment of the Group.

Due to across the board implications on the Whole Group and as a result of the uniqueness of the knowledge required to manage this risk, a designated function in the risk management group, is being formed to address the subject at the Bank and at the Group.

The widening of and intensifying the activity in the matter of the second control circle is planned for 2012.

Operational risks survey. Within the framework of the survey to be performed in 2012 (see above "Operational Risks"), the various risks inherent in the IT field will also be identified and thoroughly examined.

The survey is the responsibility of the Chief Risk Officer, and the Head of the IT and Planning Division is responsible for the management of the identified risks in the IT field, to constantly update the risk map of the Bank and the Group in this area, and to act towards the implementation of suitable risk minimization plans.

The central risk sources to be examined within the framework of the survey are:

- Across the board processes – risks inherent in organization wide work processes that are the responsibility of the computer units in the IT and Planning Division, and which may hinder the attainment of goals (time-schedules, costs, quality of development, contents).

- Production systems, infrastructure components – risks that might disrupt the operation of systems supporting business and/or operating processes at the Bank, including information protection risks, banking communication risks and more.
- New activities regarding IT – risks deriving from the adoption of new technology and/or new work procedures in the IT field.

ENVIRONMENTAL RISKS

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

These risks may be included within the framework of the other risks (such as: credit, market, operating, legal and liquidity risks). Environmental risk may derive from an impairment of collaterals when realized. Furthermore, the risk might be realized in an indirect manner as a result of deterioration in the financial condition of another party due to environmental costs resulting from regulations regarding environmental protection. 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 letter also clarifies that the identification and evaluation of environmental risks comprise a part of the proper process of identifying and evaluating risks involving banking corporation and accordingly banking corporations are required to include management of environmental risks within the overall risks managed by them, including by way of integrating procedures for the identification of material risks upon the granting of credit and by combining the evaluation of environmental risks with the periodic evaluation of the quality of credit granted to customers.

The Bank's credit policy for 2012 in the matter of environmental risk was updated in December 2011. The said policy applied the directives of the Supervisor of Banks in this matter, the aim of which is to manage and reduce the Bank's exposure to credit risks deriving from environmental risk. In this framework, the Bank defined the process according to which it evaluates the level of environmental risk relating to customers (from the aspect of interpretation into credit risk), with separate treatment given to customers identified as having high potential for environmental risk.

LEGAL RISKS

Legal risk is defined in Proper Banking Management Directive No. 339 as a risk of loss a loss resulting from the lack of ability to enforce the performance of an agreement by legal means.

According to Proper Banking Management Directive No. 350 of February 14, 2012, the legal risk forms part of the operational risk, and it includes (though 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 has reviewed the definition of the legal risk in light of its definition in the Basel II documents, and is preparing to form an updated policy document.

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. The Bank manages compliance risk related to the consumer regulatory provisions (as regards regulation with respect to prohibition of money laundering and the finance of terror, see below "The officer in charge of money laundering prohibition"), in accordance with Proper Banking Management Directive No. 308 – through the compliance officer.

Consumer provisions are the set of Acts, Regulations, Orders and Regulatory Instructions that regularize bank activity in Israel with respect to everything relating to bank and customer relations, within the framework of the duties imposed on a bank vis-à-vis its customers.

The activity of the Bank and of its subsidiaries is subject to a number of Consumer provisions, both in the banking field and in other fields.

Entry into new activities, frequent changes in legislation and the many consumer regulatory directives that apply to the Bank and to its subsidiaries, in areas of existing or new operations, require modification of the infrastructure supporting the duties derived from them. 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 goodwill risks.

Policy document regarding management of compliance risk. On October 5, 2011, the Board of Directors approved a Group policy document in the matter of management of compliance risk, which establishes 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. An infrastructure of a detailed procedure system 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 and the procedures are enforced on a regular basis by means of various control and supervision systems. 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), at the Banking Division, Corporate Division and at the Customer Asset Division, as well as at the divisional/group level at the other relevant divisions/groups. Also in place are additional control functions, such as the internal audit, compliance officer and the officer in charge under the Money Laundering Prohibition Order (see below).

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 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. An interface exists between the compliance function at the Bank and the compliance functions at the subsidiary companies, 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. The interface with the subsidiary companies in Israel was intensified during 2011. In addition, action has been taken to tighten the interface with the compliance functions at the Bank's overseas extensions (IDB New York, IDB (Swiss) and the London Branch).

For the purpose of her work, the Compliance Officer is assisted by the coordination committee that meets once in every quarter. The compliance officer monitors the Bank's preparations for the implementation of the duties imposed on it under the consumer regulations, including verification of fulfillment of the said duties relevant to Bank's new operations, as well as monitors the rectification of various deficiencies in complying with the consumer instructions. The compliance officer submits quarterly reports that include a summary of her operations, to the Bank's President & CEO as well as to the CEO's of the subsidiaries in which she 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 her 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 of the infrastructure supporting the fulfillment of such 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.

During 2011, the Bank continued to act towards the correction of deficiencies found by an audit with respect to money laundering carried out at the Bank by the Supervisor of Banks.

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 approved by the Bank's Board of Directors in July 2010. 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.

RISK FACTORS TABLE

Banking corporations in Israel are required to include in their report a table indicating risk factors, classified as follows, according to their impact on the business of the banking corporation: high impact, medium or low impact. This table contains an evaluation of the effect of risks on the Group.

Considerable difficulties exist in evaluating the risks and their impact. Evaluation of the effect of a risk requires assumptions regarding the intensity of the future event and the probability that such an event will in fact occur. Reliable implementation of such evaluation requires utilization of advanced models, which are usually not available at this stage.

The risk evaluation and its effect, as presented in the table below, is therefore, a subjective assessment by the Bank's Management formed 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 and taking into consideration the existing control layout, which is reflected in the risk management quality evaluation. This method serves the Bank 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. Overall impact of credit risk	Medium-High	A risk of the impairment in the value of the Bank and its profitability as a result of a decline in the ability of borrowers to honor their obligations. The Bank manages the risk by determining a credit policy and exposure limitations relating, among other things, to the type of borrowers, market sectors, segments of operation, collateral, credit control, etc. The rise in risk evaluation (from "Medium" in the 2010 Annual Report to "Medium-High") stems from the rise in the level of uncertainty and the economic risk.
1.1. Quality of borrowers	Medium	A risk of the impairment in the value of the Bank and its profitability and collateral risk as a result of the quality of borrowers being in effect poorer than previously estimated and/or the collateral provided by the borrowers having a lower value than previously assessed. The Bank manages the risk, among other things, by way of monitoring and control over the borrowers, examination of the propriety and value of the collateral in accordance with the policy of collateral reliance, with adaptations to the Bank's credit policy.
1.2. Industry concentration risk	Low-Medium	A risk of the impairment in the value of the Bank and its profitability as a result of a decline in the business activity of a particular sector of the economy. The Bank adopts a conservative policy as regards industry concentration of credit. The highest segment concentration at the Bank is in the construction and real estate segment, which is typified by high concentration, which is mitigated by a large distribution and the quality of borrowers and collateral. The rise in risk evaluation (from "Low" in the 2010 Annual Report to "Low-Medium") stems from considerable weight of the real estate sector in the portfolio of the Bank and the risk involved in this sector.
1.3. Borrower/groups of Borrowers	Medium	A risk of the impairment in the value of the Bank and its borrowers concentration risk profitability as a result of a decline in the business activity of a borrower/large group of borrowers. Directives of the Bank of Israel determine limits for the concentration of indebtedness of borrowers and groups of borrowers. The Bank has not deviated from these limits and maintains ongoing control in this regard. The Bank analyses and monitors the activity and financial stability of the said borrowing groups. 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.
2. Overall impact of market risks	Low-Medium	A risk of the 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 overall exposure to market risks, as assessed by the VaR model and various stress tests as adjusted to Basel II, does not deviate from the exposure limits determined by the Board of Directors and is being controlled on a current basis.
2.1. Interest rate risk	Medium	A risk of the impairment in the value of the Bank and its profitability as a result of future changes in interest rates and their possible impact on the present value of the Bank's assets and liabilities. Exposure to interest rate risks, which is assessed by means of accepted tools, does not deviate from determined exposure limits and is monitored on an ongoing basis.
2.2. Inflation rate risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of changes in inflation due to the difference between assets and liabilities, including the impact of future transactions. The Bank's exposure to inflation risk is not material in relation to its volume of operations and its shareholders' equity, does not deviate from the set limits and is controlled on a current basis.

RISK FACTORS TABLE (continued)

The risk	Risk Factor Impact	Risk description
2.3 Exchange rate risk	Low	A risk of the impairment in the value of the Bank and its profitability as a result of exchange changes due to the difference between assets and liabilities, including the effect of future transactions. The Bank's exposure to exchange rate risk is not material in relation to its volume of operations and its shareholders' equity, does not deviate from the set limits and is controlled on a current basis. The decrease in risk evaluation (from "Low-Medium" in the 2010 Annual Report to "Low") stems from the fact that the risk is no longer expected to affect capital adequacy.
2.4. Share price risk	Low	A risk of the impairment in the Bank's value of the Bank and its profitability as a result of changes in the market price of securities held by the Bank. The Bank owns a considerable amount of securities held as investments and not for trading.
3. Liquidity risk	Low	A risk to the Bank's income and equity resulting from the inability to provide for its liquidity requirements and/or an uncertainty existing as to the availability financial resources. The risk involved therein is that the Bank would not be able to meet its obligations as a result of unexpected developments, and shall be obliged to raise funds or realize assets in a way that would cause it material losses. Exposure, as measured by an internal model, the examination of the volume and stability of deposits as well as by additional indicators, is low and is controlled on a current basis.
4. Operating risk	Medium	A risk of loss as a result of the improper or failure of internal processes, human error and the absence of proper examination and control processes, failure of the Bank's systems or as a result of external event, such as physical damage. The Bank monitors on an ongoing basis both the exposure to operational risks and the events of realization of such risks, and applies controls regarding the various procedures. The rise in risk evaluation (from "Low-Medium" in the 2010 Annual Report to "Medium") stems from organizational changes integrated in the Group, including the merger of Discount Mortgage Bank. This, despite the increased quality of management.
5. Legal risk	Low	A risk of loss as a result of the inability to enforce compliance with an agreement by legal means definition of the legal risk includes also, among other things, legal claims 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 Bank is subject, and which impose various duties upon the Bank. The Bank has not suffered material losses as a result of this risk and believes that the legal controls applied by it are appropriate.
6. Compliance, Money Laundering and Financing of Terror risks	Medium	A risk whereby the banking corporation 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 the Bank in the area of Bank/customer relations and/or the provisions of the law and regulation regarding prohibition of money laundering and the finance of terror. The Bank operates ongoing monitoring and control tools, which are believed to reduce this risk. The rise in risk evaluation (from "Low-Medium" in the 2010 Annual Report to "Medium") stems from a renewed examination of all risk components.

RISK FACTORS TABLE (continued)

The risk	Risk Factor Impact	Risk description
7. Reputation risk	Low-Medium	A risk for impairment in the Bank's business position as a result of impairment in the Bank's image, resulting from various publications, whether correct or incorrect, in the eyes of customers, correspondent banks, investors, regulatory authorities and others. 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. Materialization of the risk to reputation may be expressed in material damage to the Bank and the Group and may develop even to liquidity difficulties. The Bank takes action to minimize this risk through ongoing supervision and control over the implementation of instructions and procedures as regards customers, suppliers and employees.
Additional risks relevant to the Bank:		
8. Strategic risk	Medium	The risk of a significant damage over a period of time to the profitability of the Group, to its liquidity or reputation, due to material changes in the business, economic and competitive environment, in which the Group operates. The rise in risk evaluation (from "Low" in the 2010 Annual Report to "Low-Medium") stems from the changing business environment, in particular in view of the intensified capital adequacy requirements.
9. Risk environment	Medium-High	A risk stemming from factors and events outside the Bank: economic, social, political and geopolitical events, both in Israel and abroad, which might affect the Group risk profile. This, by 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.

BASEL II**GENERAL**

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

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

THE IMPLEMENTATION IN ISRAEL OF THE BASEL COMMITTEE RECOMMENDATIONS

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

The Basel II instructions are comprised of three pillars:

- First pillar - minimum capital requirements - defines the manner of computing the capital to risk components ratio. Its aim is to expand and improve the measurement framework for computing the minimum capital requirements in respect of credit risk, market risk and operational risk³. The process of computing capital adequacy according to the first pillar is based upon a rigid set of guidelines that does not allow the banking corporation subjective considerations.
- Second pillar - Supervisory evaluation (SREP - 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"). As part of the ICAAP, banking corporations are required to re-evaluate their capital needs, both in respect of risks treated within the framework of the first pillar and in respect of material risks not so treated and to determine in a subjective manner what is the adequate level of capital required in respect of such risks (capital adequacy evaluation). The additional risks included in the second pillar are composed of risks, not treated within the framework of the first pillar, the scope of exposure to such risks and the capital allocation in their respect can be computed on a quantitative basis (such as: credit concentration risk, interest rate risk regarding the banking book⁴) and qualitative risks which are examined within the framework of the overall examination of capital adequacy (such as: reputation risk, compliance risk, strategic-legal risk, etc.). Furthermore, within the framework of the second pillar banking corporations are required to prepare extreme scenarios for the examination of the capital position. This process of evaluation of the capital adequacy shall be performed regularly and on an annual basis. (For details regarding the supervisory review procedure over the ICAAP, see "The supervisory review process" hereunder).
The Supervisor of Banks has stated that the overall minimum ratio of capital shall not fall below 8% in respect of the first pillar and an additional 1% in respect of the second pillar.
- Third pillar - "market discipline" - Banking corporations are required to provide proper disclosure and to expand public reporting with respect to risks involved in the Bank's operations in a manner that would enable the public to better understand the overall risks to which the Bank is exposed, the manner in which they are being managed, and the volume of capital allotted in their respect.

The supervisory review process. On June 20, 2010, the supervisor of Banks published a document in the matter of the supervisory review process that focuses within the framework of the said review process, in a manner which together with Proper Banking Management Directive No. 211 "Evaluation of the appropriateness of capital adequacy", completes the adoption of the second pillar of Basel II by the Supervisor of Banks. Among other things, the document provides details of the measures which the Supervisor of Banks may take during the process of the supervisory review.

This process is designed to ensure that banking corporations allocate adequate capital in order to support all risks inherent in their business, and furthermore, encourage banking corporations to develop and use improved techniques for risk management in order to monitor and manage their risks.

The Supervisor will evaluate to what extent banks have succeeded in assessing their capital requirements in relation to their risks and will intervene where required.

The Supervisor is aware of the relation existing between the total amount of capital held by the banking corporation in respect of exposure to risk and the soundness and effectiveness of the risk management processes and its internal controls. However the increase in the total amount of capital will not be considered as the only option for handling increased risks facing banking corporations. Other means for risk management should also be considered, such as strengthening the risk management process, imposing internal limitations, increasing provisions and reserves and improving internal controls.

³ Allocation of capital in respect of operating risks was not required under Basel I.

⁴ Within the framework of the second pillar, banks are required to assess not only the interest rate risk applying to the trading portfolio but also the interest rate risk applying to the banking portfolio. This risk measures the exposures created in the course of the bank's asset and liability management by the ALM unit, except for the shekel trading portfolio being managed by it.

The central principles of the supervisory review process are as follows:

- A banking corporation shall establish a process for the evaluation of its total capital adequacy in relation to its risk profile as well as a strategy for preserving its capital level;
- The Supervisor shall review and evaluate the internal capital adequacy assessments and the strategies of the banking corporations as well as their ability to monitor the supervisory capital ratios and to ensure compliance with them. The Supervisor shall exercise the required supervisory measures in cases where he is not satisfied with the results of the said process;
- The Supervisor expects the banking corporations to maintain higher capital ratios than the minimum supervisory ratios and is empowered to require them to maintain capital over and above the minimum required level;
- The Supervisor may intervene at an early stage in order to prevent a decline in the capital level below the minimum level required to support risk characteristics of a particular banking corporation, and shall demand speedy corrective action in cases where the capital level is not maintained or does not revert to its required level.

Basel II - tightening banking corporations' corporate governance. For details regarding the new Proper Banking Management Directive No.301, including the reference included therein to issues of risk management and corporate governance, see below "Group management" under "Issues regarding corporate governance". For details regarding the adoption of a corporate governance code, see "Corporate governance code for the Discount Bank Group" under "Issues regarding corporate governance" hereunder.

THE IMPLEMENTATION OF THE REQUIREMENTS OF BASEL II AT THE DISCOUNT GROUP

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

In 2009, the Bank engaged an international corporation specializing in credit rating, for the execution of a project, within the framework of which the Bank, with the assistance of the said corporation, is developing several internal models for the rating of credit. The first stage of the development of the models and their integration was completed in 2011. The products of these models will be used to improve the credit management procedures and will serve as foundations for future use by the Bank in computing capital requirements in respect of credit risk based on internal credit rating models, within the framework of the implementation of "the advanced approaches" for measuring capital adequacy.

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

The Bank is in the midst of preparations for the transition to calculating the capital allocation in accordance with this approach. On May 1, 2011, the Bank submitted to the Supervisor of Banks the findings of a review performed by the independent auditors with respect to the propriety of the reporting to the Supervisor of Banks with respect to the capital adequacy as of December 31, 2010.

Second pillar. Preparation by the Bank in 2011, for the implementation of the second pillar, included:

- Submission to the Supervisor of Bank's staff (on May 15, 2011) of the ICAAP report, on the basis of the data as of December 31, 2010;
- During June and July 2011, discussions were held with the Supervisor of Banks, and in September a letter was received from the Supervisor of Banks summing up the supervisory review and evaluation process. The Bank has made arrangements to implement the main points of the remarks and instructions received within the context of the 2011 ICAAP report, which is planned to be submitted to the Supervisor of Banks by the end of April 2012;
- Continued formation of the Internal Capital Adequacy Assessment Process (ICAAP), including the improvement of processes and methodology, in view of the insight and feedback gained in the SREP process;

- Formation and updating of the risk management policy documentation;
- Continuation of the implementation of the work plan for the elimination of gaps found by the review performed by the Bank, compared to the risk management principles required in the documents published by the Basel committee (BIS), and gaps found during the formation of the ICAAP process.

Third pillar. The Basel II guidelines broaden the disclosure requirements, both qualitative and quantitative, in the matter of management of exposure to credit risks, market risks and operating risks.

Qualitative and quantitative disclosure regarding the various risks is presented above in the Chapter "Exposure to risks and risk management". Additional qualitative and quantitative data is presented in this Chapter as well as in additional parts of the annual report. A table relating the disclosure requirements stated in the provisional instruction to the different parts of the Annual Report, in which the required information is presented, appears in an Annex to this report (part B, section 8).

BASEL III

In December 2010, the Basel Committee published new recommendations, "Basel III". The new recommendations, are intended to improve the stability of banks in crisis periods. 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; that capital instruments of Tier II should include a loss absorption mechanism; and that the differentiation between the upper Tier II capital and the lower Tier II capital be abolished. The recommendations state gradual transitional arrangements during the years 2013 to 2019.

Ambiguity exists at this stage with respect to the scope and format of the adoption in Israel of the Basel III recommendations, including: what will be the nature of the new capital instruments that will be recognized by the Supervisor of Banks, at what rate will the existing capital instruments be excluded from the capital adequacy calculations, and more.

To the Bank's best knowledge, the Supervisor of Banks is expected to publish during 2012 guidelines that will determine the format for the adoption of the Basel III recommendations as well as a gradual timetable for the implementation thereof.

Draft guideline in the matter of the minimum core capital ratios. On March 14, 2012, the Supervisor of Banks delivered to all banking corporations a draft guideline stating his intention to determine a higher minimum core capital ratio than that required at the present time. According to this draft, 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.

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.

The Bank is studying the anticipated demands of the Supervisor of Banks, as contained in the draft guideline, and intends to make the necessary preparations in order to comply with the requirements to be determined.

The Bank's core capital ratio as of December 31, 2011, stands at 8.1%.

IMPLEMENTATION OF A FRAMEWORK FOR MEASUREMENT AND CAPITAL ADEQUACY

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 banking corporations and auxiliary corporations of the Discount group: MDB, DMB 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 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.

EFFECTS OF EXTERNAL FACTORS

MAIN DEVELOPMENTS IN ISRAEL AND AROUND THE WORLD IN 2011

DEVELOPMENTS IN GLOBAL ECONOMY

General. During 2011, the global economy continued to expand, though at a more moderate pace compared to 2010, when the slowdown in growth encompassed both the developed countries and the emerging markets. The slowdown derived mostly from the developments in the debt crisis in the Eurozone, the Earthquake in Japan at the beginning of the year and the geopolitical events in the Middle East and in North Africa. Added to these were the contractionary monetary policy in the emerging countries and the restrictive fiscal policy in certain of the developed countries.

The product of the United States grew by 1.7%, the fourth quarter of the year experiencing accelerated growth. A growth at the rate of 1.4% was recorded in the Eurozone, and the economic growth of the developing countries grew by 6.42%. The total of the global product expanded in 2011 by 4%, compared to a growth of 5.1% in 2010. On the background of the moderate growth rate

in the U.S. and in the Eurozone, the unemployment rate remained at a high level. However, while in the U.S. the unemployment rate declined during the year, the rate of unemployed increase in the Eurozone. Moreover, the slow growth rate and the high debt burden in the U.S. caused the S&P rating agency to lower the perfect rating of the State to a level of "AA+". On the background of the same factors, the credit rating of Japan was also lowered in the reviewed period.

At the center of economic events in 2011, were the intensified debt crisis in the PIIGS countries and the spreading of the debt problem to the strong countries in the Zone. On this background, the credit ratings of the PIIGS and additional countries in the Eurozone were lowered, and the rating of strong countries, such as Germany and France was put under surveillance. Concurrently, the financial position of banks also gave rise to concern, principally, the European banks exposed to debts of the PIIGS countries. In the meantime, the CDS level (insolvency insurance) rose sharply, both as regards countries in the center of the crisis and as regards the strong countries in the Zone.

With a view of containing the crisis and preventing the spreading thereof, bailout packages have been devised for Portugal and Greece and concurrently, it has been agreed to enlarge the bailout fund (EFSF), to strengthen the capital base of banks as well as a "haircut" for holders of Greek bonds. Furthermore, the ECB had purchased bonds of the problematic countries, and concurrently supplied liquidity to the financial system. In return, the countries involved were required to continue programs for the reduction in their debt. However, both the bailout plans and the plans for the reduction in the debt encountered difficulties in the execution thereof. The inability to implement these plans led to the resignation of the Prime Ministers of Greece and Italy and the formation of new technocratic governments headed by experienced economists. The political changes in the said countries, alongside the wish of leaders of the Eurozone to reach a fiscal union and the measures taken by the European Central Bank, led in the fourth quarter to certain stability in the concerns regarding an overall financial crisis in the Eurozone, including the fear of disintegration, following the sharp rise in the level of concern in the third quarter of the year.

Global prices of commodities in 2011, were, to a large extent, affected by the earthquake in Japan and by the geopolitical events, as well as by the economic slowdown, the exchange rate trend of the U.S. dollar and the regulatory restrictions in the area of commodity trading. As a result, a rise of 11% in the commodities index (CRB) was recorded until the middle of the second quarter of the year. However, the index fell by 18% in the second half of the year, so that in total for the period prices of commodities fell by 8%.

In 2011, the monetary policy around the world was not uniform and was affected by the rise in inflationary environment, the crisis in the Eurozone and the need to support the continuing recovery in the developed countries, the concern for the overheating of the developing economies and the signs for a global economic slowdown. In consequence, the interest rate in the Eurozone had been raised until July by 0.5%, but was lowered in continuation to the level as of the end of 2010 (1%). In the U.S., the interest rate remained unchanged (0-0.25%), the Governor of the Central Bank even noting that it is expected to remain at this level until the middle of 2013. At the same time, the FED purchased long-term bonds (on account of the short-term bonds) with the aim of supporting the economy, among other things, by means of a low interest rate on mortgage loans. In contrast, the monetary policy typifying the developing countries throughout most of the year had a contracting effect. As a result thereof, the interest rates in those countries had been raised several times while increasing the reserve ratio. Notwithstanding, since the middle of the third quarter, on the background of the global economic slowdown, the restrictive monetary process was stopped, with a reduction in the reserve ratio and in interest rates.

Financial markets. Trade on the equities markets in 2011 was mostly conducted on the background of developments in the Eurozone debt crisis, the monetary and fiscal policies in the leading economies and in particular in the United States and in the Eurozone, the geopolitical events in the Middle East and in North Africa and the earthquake in Japan. All this, alongside the apprehension regarding a global economic slowdown. In consequence of the above factors, leading stock markets in the world have recorded volatile trading activity. Whereas in the first half of the year, both the S&P500 Index and the DAX Index recorded increases, both these indices recorded sharp decreases in the third quarter, which were partly setoff in the fourth quarter. In total for the year, the S&P500 Index remained unchanged while the DAX Index fell by 16%. This, compared to increases of 13% and 16%, respectively, in 2010. At the same time, the Japanese Nikkei Index and the Chinese Index fell in 2011 by 17% and

22%, respectively.

Trading in U.S. and German government bonds also recorded inconsistent trend. Whereas in the first quarter, a certain increase in returns was noted, returns dropped sharply later on in the year and in particular in the third quarter, on the background of the intensified debt crisis in the Eurozone, which led investors to a flight to safety, alongside a global economic slowdown and remained at low rates also in the fourth quarter.

Trade on the currency market was conducted in 2011 on the background of the quantitative expansion in the United States, the rise in interest rates in the Eurozone and the demand for relatively safe assets. These led to the weakening of the U.S. currency as against the Euro and the Swiss Franc in the first half of the year. In continuation of the year, on the background of the intervention of the central bank of Switzerland in the foreign currency trading and the intensifying debt crisis in the Eurozone, the U.S. dollar strengthened against the said currencies. In total for the year, the U.S. dollar strengthened against all leading currencies in the world, except for the Japanese Yen, when against the Euro it strengthened by 3%. The Japanese Yen strengthened in 2011 against all leading currencies, on the background of aversion to risk in the world, alongside local demand for foreign currency, stemming from the need for reconstruction in the country following the earthquake.

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY

GENERAL

Expansion of the domestic economy continued in 2011, at the rate of 4.7% (in 2010 – 4.8%). This, with a slowdown in growth from quarter to quarter. The growth rate in the fourth quarter (3.2%) was the lowest since the middle of 2009. A contraction in private consumption and in foreign trade was recorded in the last quarter of 2011. A slowdown was also recorded in investments in fixed assets. In contrast, the expenditure on public consumption grew at a quick pace.

The unemployment rate declined in 2011 to an average level of 5.6%, compared to 6.6% in 2010. This with approx. 90 thousand new employees being absorbed and stability in the high level of participation of 57.4%. The rate of unemployment in the last quarter of the year reached a low level of 5.4%, compared to 6.4% at the end of 2010.

MAIN DEVELOPMENTS IN ECONOMIC SECTORS

The growth rate of industrial production slowed down in 2011 to a rate of 2%, compared to 8% in 2010. The production of hi-tech industry recorded a standstill, following a growth of 9% in 2010. A moderate slowdown was also recorded in the rate of growth of employee positions in the industry.

A slowdown was also recorded in the turnover of the commercial and services sectors, a rate of 3.2% in 2011, compared to 7.7% in 2010. This slowdown mainly stemmed from an intense slowdown in the turnover of the wholesale and retail trading, alongside a slowdown in the turnover of the business services and real estate sectors.

DEVELOPMENTS IN THE ACTIVITY OF THE ISRAELI ECONOMY WITH OVERSEAS MARKETS

The direct investments in Israel by foreign residents in 2011 amounted to US\$11.4 billion, an increase of 121% compared with 2010. In contrast, foreign residents liquidated financial investments in marketable securities in an amount of US\$ 5.4 billion, compared to investments of US\$9 billion in 2010. All the said liquidations were recorded in the second half of the year and stem mostly from sales of short-term loans (MAKAM) in the amount of US\$6.9 billion, in contrast to investments of US\$9 billion in 2010. The said liquidations were partly offset by investments in government bonds. The decline in investments in MAKAM occurred on the background of the Bank of Israel instructions and taxes imposed by the Ministry of Finance. Furthermore, liquidation of investments in Israeli equities in the amount of US\$0.7 billion was recorded in 2011, similarly to the volume of liquidations in 2010. The liquidation of investments in equities reflected investments in equities on the Tel Aviv Stock Exchange, which were set off by liquidation of investments in Israeli equities abroad.

Direct investments abroad by Israeli residents recorded in 2011 a decline of 60% compared with 2010, amounting to US\$3.3 billion. The said decline may be explained by an exceptional investment (made by a pharmaceutical company) in the third quarter of 2010. Furthermore, financial investments in marketable securities also declined by 66% to a level of US\$3.1 billion. The decline in financial investments stemmed mostly from a decline of 44% in investment in foreign equities alongside a sharp rise in liquidation by banks of investments in bonds and bills.

DEVELOPMENTS IN FOREIGN EXCHANGE RATES AND INFLATION RATES

In 2011, the trade in the Shekel against the U.S. dollar and the Euro was conducted mostly on the background of the trading trends in these currencies in the world. This, alongside the effect of local factors, with contrasting directions of effect. On the one hand, interest rate differentials between Israel and the developed countries, the good condition of the economy, the surplus on the current account and the reduced purchases of foreign currency by the Bank of Israel, all supported the appreciation of the local currency. On the other hand, the geopolitical events and the regulation concerning foreign investors caused the weakening of the Shekel, as well as in reducing the surplus on the current account down to a negligible level. In total for the year, the Shekel weakened as against the U.S. dollar by 7.7%, against the Euro by 4% and against the nominal effective rate by 5%. Especially outstanding is the weakening of the Shekel against the dollar by 12% in the second half of the year. This, similarly to the strengthening of the U.S. dollar against most of the leading world currencies.

The rate of the rise in the Consumer Price Index (CPI) during the year 2011 amounted to 2.2%, compared to inflation at the rate of 2.7% in 2010. The entire rise in the CPI in 2011 took place in the first half of the year, while in the third and fourth quarters of the year the CPI remained unchanged. The main factors for inflation in 2011 were the rise in cost of housing and the cost of energy. Their effect was partly offset by the decrease in the price of fruit and vegetables.

FISCAL AND MONETARY POLICY

Fiscal policy. The Government deficit (excluding the granting of credit) amounted in 2011 to NIS 28.6 billion, comprising 3.3% of the product. This, compared to a deficit of NIS 30.2 billion (3.7% of the product) in 2010. Notwithstanding, compared with the targeted deficit planned in the Budget Act for 2011, this reflects a deviation of NIS 3.5 billion. Deviation from the target derives mostly from a negative difference of 2.6% in revenues, while the expense side amounted to 99% of the planned expenses.

Monetary policy. The nominal interest rate in Israel rose in 2011 by 0.75% to a level of 2.75%, however, the monetary policy adopted by the Bank of Israel this year was not consistent. During the first half of the year, on the background of the continued fast growth, the rise in inflation and in inflationary expectations stemming from the capital market and the continued rise in housing prices, the Bank of Israel has increased the interest rate four times, to a level of 3.25%. Concurrently, with a view of counteracting the strengthening of the Shekel, the Bank of Israel continued to purchase foreign currency and has adopted several regulatory measures. Furthermore, with a view of facing the continued rise in housing prices and due to the concern regarding the stability of the financial system in the mortgage loan field, the portion of a mortgage loan bearing variable interest has been restricted.

Later on in the year, on the background of the slowdown in the domestic economy and the actual decline in inflation and in inflationary expectations deriving from the capital market, the Bank of Israel adopted an expansionary monetary policy. As a result, the nominal interest rate was reduced by 0.5% in the last quarter of the year.

THE CAPITAL MARKET

Most of 2011 was typified by a downward trend in prices of shares on the Tel Aviv Stock Exchange, excluding the fourth quarter, in which a rise was recorded in most of the leading indices. The decrease in prices occurred mostly on the background of the geopolitical events in the region, to which was added in the third quarter the effect of the sharp decline in world equities markets, the social protest and the conclusions of the "concentration committee" as well as the slowdown in economic activity.

On the other hand, trade in the fourth quarter of the year was affected by the positive trend in stock exchanges in the U.S. and Germany. In conclusion for the year, the general share index fell by 22% (an increase of 3.7% in the fourth quarter), this in contrast to a rise of 13% in 2010.

The decrease in share prices covered all leading indices in the Stock Exchange, the TA25 and TA100 indices recording a decrease of up to 20%, the banks index decreased by 34% (a decrease of 8.5% in the fourth quarter), the blu-tech 50 index decreased by 9% and the real-estate 15 index by 23%. On the background of the said developments, the market value of shares and convertibles (excluding index products) fell by 26% compared with the end of 2010, amounting at the end of December to NIS 600 billion.

Bonds trade in Israel in 2011 was mostly affected by the monetary policy of the Bank of Israel, the increase in aversion to risk due to an increase in economic uncertainty, the geopolitical events in the region and the debt arrangements by certain of the large corporations in Israel. This, alongside the inflationary developments during the year, the decline in return on U.S. government bonds comprising a benchmark for the local market, and the implementation of the Hodek Committee. In total for the year the comprehensive return on bonds of all classes index rose by 2.5%. This, in continuation to a rise of 8% in 2010.

The rise in the index reflected a rise of 5% in the government bonds general index (6.3% in 2010), which was partly offset by a decline of 1% in the comprehensive return on non-government bonds index (compared to an increase of 11% last year). As to the differentiation between bonds in accordance with linkage bases, CPI-linked government bonds recorded a rise of 4.3%, while the shekel bonds rose by 5.2%. As to non-government bonds, the CPI-linked bond index fell by 1.8%, while the foreign currency linked bond index rose by 8%. At the same time, the Tel-bond shekel index rose by 5%, and an increase was recorded in the return spread between corporate bonds and government bonds.

A noticeable slowdown took place all along 2011 in the raising of capital by means of corporate bonds. Whereas in the first half of the year the volume of bond issuance was maintained at the same level of that of the second half of 2010, the volume of bond issuance in the second half of the year fell by 30%, on the background of the deteriorating economic environment, the last quarter of the year recording a particularly low level. In total for the year, capital raising through corporate bonds amounted to NIS 40.6 billion, a decline of 5% compared with 2010. Of this amount, bond issues to financial institutions amounted to NIS 5.7 billion, compared to NIS 3.2 billion in 2010.

The daily trading turnover in shares and convertibles in 2011 fell to NIS 1.7 billion, compared with NIS 2 billion in 2010, the trading turnover in the fourth quarter of the year being especially low, amounting to NIS 1.4 billion. At the same time the daily trading turnover in MAKAM fell by 1.5% amounting to NIS 1.2 billion. On the other hand, the daily trading turnover in bonds increased by 15% compared with 2010, amounting to NIS 3.8 billion.

THE ASSET PORTFOLIO HELD BY THE PUBLIC

The value of the financial assets portfolio in the hands of the public increased in the last quarter of 2011 by 2%, in contrast to declines in value in the three earlier quarters of the year. Notwithstanding, the value of the portfolio dropped by 1% in 2011, amounting at the end of December to NIS 2.5 trillion. The entire decline in value of the portfolio during the year derived from a 30% decrease in the value of equities in Israel, the major part of it is attributed to falling prices. The said decline was partly offset by a rise in the value of foreign equities (in the fourth quarter) and a rise in the value of linked and non-linked assets.

Following are the changes in the composition of the portfolio recorded in 2011:

1. The equity securities component decreased from 26.9% to 21.5%;
2. The non-linked assets component increased from 31.9% to 35%;
3. The CPI linked assets component increased from 30.3% to 31.7%;
4. The foreign currency linked assets component increased from 10.9% to 11.7%.

PRINCIPAL ECONOMIC DEVELOPMENTS IN JANUARY-MARCH 2012⁵

In January 2012, the International Monetary Fund updated downwards the growth and international trade forecasts for 2012, to 3.3% and 3.8%, respectively.

Most of the indicators for economic activity in the U.S. published in the reviewed period, were positive and indicated the continued improvement in the employment market. The Governor of the Central Bank also noted the improvement in the rate of recovery of the U.S. economy. A part of the published indicators respecting the Eurozone presented a slight improvement, however they still indicated the weakness in the Eurozone economy. Furthermore, the credit rating of several of the Eurozone countries, including France, has been lowered, and concurrently, the credit rating of the EFSF bailout fund has also been lowered.

In the meantime, progress has been made in solving the debt crisis in Greece, which, among other things, included the approval of a bailout package of €130 billion, and an agreement between the banks and the Greek government regarding a "haircut" for private investors. In addition, the ECB had also issued a tender for medium-term loans, thus providing support for the banks and liquidity for the Eurozone. These developments have moderated the concern of investors with respect to the intensification of the Eurozone debt crisis. Notwithstanding, the concern regarding a further outbreak of the crisis has not vanished, particularly with respect to Spain and Portugal. This was expressed in the increase in the CDS spreads and the increase on return on bonds of those countries. This, in contrast to Italy where returns on bonds and CDS spreads recorded a decrease.

The annualized inflation rate in the U.S. declined in January and February 2012 (compared with that of December 2010), while in the Eurozone the annualized inflation rate remained unchanged. China recorded a rise in inflation in January and a decrease in February.

In the reviewed period, the U.S. central bank left the interest rate unchanged, and announced that it is expected to remain at this level until the middle of 2014. The interest rate in the Eurozone also remained unchanged. In China, on the background of the concern for economic slowdown and despite data indicating an improvement in industrial production, the central bank reduced the reserve ratio. Furthermore, China announced the reduction in the economic growth target for 2012 and the following years.

Trading on world equity markets was conducted mainly on the background of the calming down in the Eurozone, the supply of liquidity by the ECB and positive macro-economic data in the U.S. In consequence thereof, the S&P 500 index rose by 12%, and the German DAX index rose by 20%. Concurrently, a moderate rise in returns on German government bonds and a steep rise in returns on U.S. government bonds was recorded concurrently with the rise in returns in Germany. At the same time, the U.S. dollar weakened against most leading currencies in the world and in particular against the Euro, at the rate of 2%, while against the Japanese Yen the dollar strengthened by 7.8%. On the background of certain optimism in the world, the expansionary monetary policy of the central banks and the weakness of the U.S. dollar, the CRB commodities index rose by 3.5%. In particular, the price of oil rose by 6%, on the background of the tension with Iran in addition to the above factors.

In Israel, the combined index of the Bank of Israel rose in January-February 2012 by 0.2%, a rate similar to previous months. The inflation rate in each of the months of January and February remained unchanged and the annual inflation rate amounted to 2% and 1.7%, respectively. Prices of residential units (which are not included in the CPI) returned to rise following a three month period of declining prices.

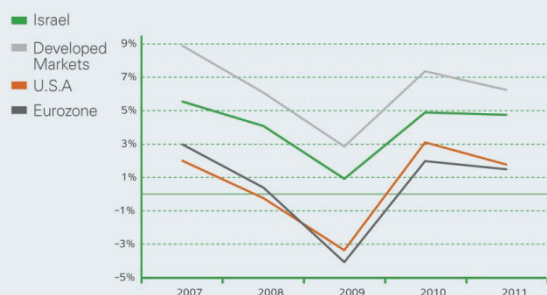
Thus, following the unchanged interest rate for the month of January, the Bank of Israel reduced the interest rate for February by 0.25%, principally on the background of the slowdown in the domestic economy. The interest rate for March remained at the same level, of 2.5%.

During the reviewed period, the Shekel strengthened as against the U.S. dollar at the rate of 2%, while against the Euro and against the nominal effective exchange rate it maintained its stability. An upward trend was recorded in share prices on the Tel

⁵ All the data in this chapter refer to the period from January 1, 2012 to March 21, 2012.

Aviv stock exchange, similarly to the positive trend in the world. Notwithstanding, the rise in the leading indices in Israel was more moderate compared to the leading markets in the world, the TA 25 and TA 100 indices rose by rates of up to 4.3%. The long-term non-linked Government bonds recorded a rise in returns. Concurrently, a rise of up to 3% was recorded in the Tel-Bond 20 and 40 indices, reducing the margin as against Government bonds.

PRODUCT GROWTH - ANNUAL GROWTH RATE



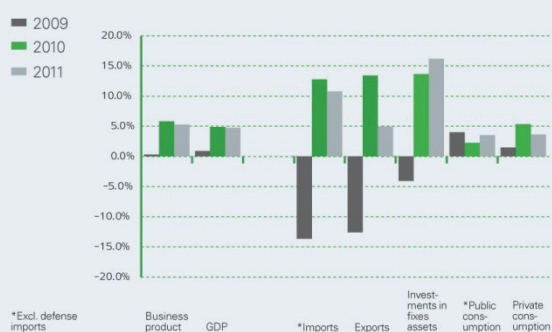
QUARTERLY UNEMPLOYMENT RATE



CENTRAL BANK INTEREST RATES IN SELECTED COUNTRIES



GROWTH IN ISRAEL



EXCHANGE RATE - CPI, JANUARY 2008=100 POINTS



ANNUAL CHANGE RATE IN THE CPI



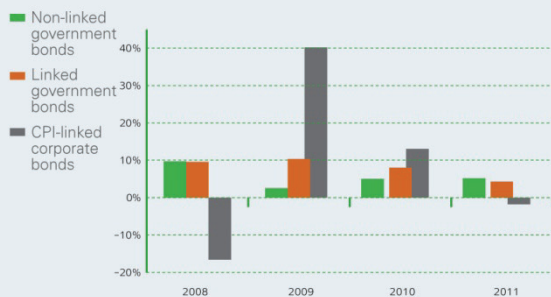
RETURN ON LONG-TERM GOVERNMENT BONDS



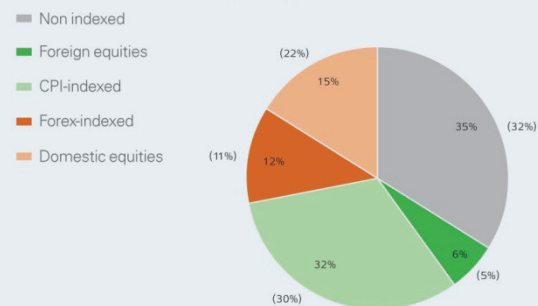
LEADING SHARE INDICES IN SELECTED COUNTRIES - JANUARY 2008 = 100 POINTS



ANNUAL RATE OF CHANGE IN SELECTED BOND INDICES



DISTRIBUTION OF THE PUBLIC'S PORTFOLIO BY ASSET TYPES 2011 (2010)



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 and on its own behalf (for example: investment consulting and customer portfolio management, pension consultation, mutual investments funds, the overall activities of provident funds and restrictions on insurance business activity).

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

The Bank and its subsidiaries are taking steps towards complying with the duties imposed upon them under the said provisions of the law.

Within the framework of the legislation passed in the wake of the Bachar Committee, a monetary sanction has been prescribed by most of the laws applying to the Bank's operations, 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.

BANKING LAWS

THE BANKING ACT (LEGISLATION AMENDMENTS)

On March 12, 2012, the Knesset approved the Banking Act (Legislation amendments) Bill, 2012, intended to regularize the activities of a bank that does not have a core controlling interest therein. The amendment included also provisions relating to the appointment of directors in banking corporations that have a core controlling interest, which apply also to the Bank.

ANTITRUST

THE ANTITRUST ACT - CONCENTRATION GROUPS

The Antitrust Act (Amendment No.12), 2011, was published on July 25, 2011. The Act states the terms for a determination by the Antitrust Commissioner ("the Commissioner") regarding the existence of a concentration group, and grants him the power to issue directives to all or part of the members of the concentration group. In addition, the Act, at the request of the Commissioner, empowers the Antitrust Tribunal to instruct the severance of ownership relations (sale of holdings) between members of the concentration group.

According to the Act, the Commissioner shall consult with the Governor of the Bank of Israel and with the Supervisor of Banks regarding the existence of a concentration group, and shall inform them of his intention to issue a directive under the Act, designed to prevent significant harm or fear of a significant harm to the public or to business competition between members of the group or in the industry, to the extent that the matter falls within their area of responsibility.

The Governor or the Supervisor is empowered to block the issue of such a directive based on considerations concerning the stability of the banking corporation or the banking industry. It has been determined that the instruction concerning the blocking of the directive of the Commissioner based on notices of the Governor or the Supervisor, will apply until January 1, 2014. The Minister of Finance, with the approval of the Financial Committee of the Knesset, is authorized to extend the said period by further periods of two years each.

ANTITRUST ACT - MONETARY SANCTIONS

On December 19, 2011, the Knesset passed the first reading of a Bill tabled by the Government – the Antitrust Act (Amendment No. 14) Bill, 2011, which adds to the Antitrust Act provisions that determine the authority of the Antitrust Commissioner to impose monetary sanctions of up to NIS 30 million, in respect of various violations of the provisions of the Act and the mechanism for imposing such sanctions.

The Bill is to be discussed by the Economic Committee of the Knesset as preparation for its second and third readings.

EXEMPTION FROM A BINDING ARRANGEMENT WITH RESPECT TO THE HOLDING AND JOINT ACTIVITY WITHIN THE FRAMEWORK OF ABC AND CBC

Following a new and comprehensive examination the Antitrust Commissioner decided, on November 5, 2008, to grant a conditional exemption from a binding arrangement in respect of the arrangement regarding the joint holdings and operations of the five large banks in Automatic Bank Services Ltd. ("ABS") and Bank Clearing Center Ltd. ("BCC"). The exemption is in effect for three years from date of the Commissioner's decision.

The exemption reiterates the terms that have been determined in the past and adds additional terms. Among other things, the exemption stipulates that interested parties in the Bank and or members of the Bank's management and or executives in charge of trading, accounting and/or retail operations at the Bank may not act as directors of ABS and BCC. Furthermore, anyone appointed as director of ABS or of CBC, prior to accepting office, must sign an undertaking to uphold the conditions of the exemption.

As part of the conditions of the exemption, ABS is permitted to act towards establishing an overseas backup site for the banking industry's data, which would provide backup services to any bank in Israel wishing to receive such service.

In September 2011, the banks submitted to the Antitrust Commissioner requests for an extension of the said exemption. The representative of the Antitrust Commissioner has expressed her opinion that the processing of the requests will not be completed by November 5, 2011, date of expiry of the existing exemption. On November 9, 2011, the Commissioner decided to extend the exemption and its terms for a period of four months from date of the decision, in order to enable the Antitrust Authority to complete the process of examining the application for exemption. The Commissioner decided on March 7, 2012, to extend the said exemption period for two months as from the date of the decision.

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, subject to changes made to certain of the terms detailed in the previous announcement and the addition of new terms. The announcement will be in effect for two years since the date thereof, unless another announcement is made before the end of the said 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, and various regulations and orders have been enacted under it. Concurrently, the Supervisor of Banks issued Proper Banking Management Directive No. 411. This set of regulations imposed upon banks the duty of identifying, verifying, reporting and maintaining records with respect to bank customers and the accounts maintained by them. Furthermore, criminal sanctions and the authority to impose sanctions as well as the forfeiture of funds have been determined with respect to violation of the law and related regulations.

The addition of predicate offenses. A new Prohibition of Money Laundering Order (Amendment of the First Addendum to the Act), 2011, was issued and became effective on July 13, 2011, which added to the list of predicate offences specified in the First Addendum to the Prohibition of Money Laundering Act, an offence under Section 3 of the Trading with the Enemy Ordinance, 1939 (hereinafter: "the Ordinance").

The meaning of adding this offence to the list of predicate offences, is that in the event that it is committed with the intention of obscuring the source of funds produced by the offence, or with the knowledge of the use made of the funds produced by it, or in the event of an act made in connection with such offence with a view of preventing the reporting thereof or causing an incorrect report – this will also constitute an offence under the Prohibition of Money Laundering Act.

At present, Iran, Syria, Lebanon and Iraq are considered enemy countries. Regarding Iraq, permits exist and are issued from time to time, according to which it will not be treated as enemy country.

As regards Iran, legislative measures have been taken with a view of promoting and intensifying the actions adopted in the campaign against the nuclear program of Iran, which among other things include the issue of a Trading with the Enemy Order (Enemy for the purpose of the Ordinance), 2011, and an amendment of Proper Banking Management Directive No.411, within the framework of which Iranian entities have been marked by name as being an enemy within the meaning of the Ordinance. The Bank is required to determine a policy with respect to operations with published lists of entities supporting Iran, and also to perform a review of the extent of exposure to operations involving such entities.

In addition, the Foreign Affairs and Security Committee of the Knesset approved on September 11, 2011, the Regulations for prohibition of investing in corporations maintaining business relations with Iran. These Regulations deal, among other things, with the publication of a list of corporations in which financial institutions are not allowed to invest.

These Regulations have not yet been published in the Official Gazette and therefore have not as yet entered into effect.

Amendment of Prohibition of Money Laundering Order – closed system accounts. The Prohibition of Money Laundering Order (Identification, Reporting and Maintenance of Records Duties by Banking Corporations for the Prevention of Money Laundering and the Finance of Terror), 2011 (hereinafter: "the Banking Order"), was issued and became effective on December 13, 2011. According to this Order, identification documents, verification of documents, declaration of beneficiary and face to face identification will not be required with respect to accounts considered as closed system accounts, namely an account of an individual containing a deposit or mutual investment fund units in an account with another bank (hereinafter: "the source account"), which at the end of the day return to the source account.

Entry into effect of provisions regarding "Know your customer" under Proper Banking Management Directive No.411. Two sections of Proper Banking Management Directive No. 411 took effect on January 1, 2011. These sections deal with the duty of determining a policy in the matter of "know your customer" when providing services to a person who is not registered as an account holder or as an authorized signatory of an account and as regards the duty to perform control over operations of customers made otherwise than through a bank account.

For details regarding an additional amendment of Proper Banking Management Directive No. 411, with respect to credit card

companies only, see above "Credit card operations" under "Further details as to activity in certain products".

Circular of the Supervisor of Banks regarding illegal gambling on the Internet. The Supervisor of Banks issued on January 29, 2012, a circular regarding the risk involved in money transfers involving bank accounts listed by the Money Laundering Authority. The circular requires a board of directors of a banking corporation to adopt a policy with respect to the risks involved in the transfer of money the source or destination of which are the said accounts, including reference to control and due diligence reviews intended to identify such money transfers. Banking corporations are required to make the necessary preparations until March 31, 2012.

Portfolio managers. The Prohibition of Money Laundering Order (Identification, Reporting and Maintenance of Records Duties by Portfolio Managers for the Prevention of Money Laundering and the Finance of Terror), 2011 (hereinafter : "the New Order regarding Portfolio Managers"), was issued on November 30, 2011. This Order replaces a previous Order in the matter. The principal changes in the new Order regarding portfolio managers involve the duty to perform a process of "know your customer", the duty of checking the customer with the published list of terrorist factors, identification and monitoring the operations of "a foreign public figure", the current control over customer accounts, verification of details of beneficiaries and controlling interests, the addition of a list of operations that might be deemed to be irregular and requiring reporting, as well as the duty to determine a policy in the matter of money laundering and the finance of terror.

The new order entered into effect on May 31, 2011.

Proposal for the amendment to the Prohibition of Money Laundering Law. In July 2007, a Bill for the amendment of the Prohibition of Money Laundering Law was published and passed its first reading by the Knesset. Various amendments are included within the framework of the Bill, among which, extension of the list of predicate offenses (the addition of several offenses under the VAT Law as predicate offenses), change in the level of punishment in respect of the offenses specified in the Law, extension of the term "control" (with respect to corporations) over and above the definition specified in the Securities Law, erosion in secrecy and in the confidentiality pertaining to the identity of the reporting entity (in a manner that might expose the identity of the bank officer who reported the transaction), the addition of various segments as reporting entities and extension of the jurisdiction of the Money Laundering Authority.

In July 2009, the continuity rule was applied to this Bill, and the Knesset Constitution, Law and Justice Committee is presently discussing this Bill.

The Knesset approved on March 5, 2012, a division of the Bill into two parts, one to be prepared for a second and third reading and the other part of the Bill to be further discussed by the Constitution, Law and Justice Committee.

The part of the Bill which is to be further discussed by the Committee, includes most of the instructions which were in dispute in discussions held until now, including: the change in level of punishment, definition of the term "control", limitations on disclosure in reporting, etc. The part to be passed for the second and third reading relates to dealers in precious stones, providers of currency services, the definitions section etc.

In addition, the Constitution, Law and Justice Committee of the Knesset approved on December 19, 2011, an additional proposed Bill for the amendment of the Prohibition of Money Laundering Act, within the framework of which it is proposed to widen the offence regarding "operation involving assets with the knowledge that it is prohibited", in a manner which for the purpose of existence of the mental basis, the turning of a blind eye is enough, and in a way that it would apply to assets of a value of NIS 50,000 and above.

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 Constitution, Law and Justice Committee of the Knesset has not yet held a discussion regarding this proposal for the amendment of the 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.

PROHIBITION OF THE FINANCING OF TERROR ACTIVITIES

The Prohibition on Terror Financing Law, 2005 (hereinafter: "Prohibition on Terror Financing Law"), came into effect at the beginning of August 2005. This Law specifies directives prohibiting the finance of terror activities, and various regulations and orders have been enacted under it imposing on banking institutions additional duties of identification and examination of customers based on published lists of terrorist organizations and activists. Furthermore, criminal sanctions and the authority to impose sanctions as well as the forfeiture of funds have been determined with respect to violation of the law and related regulations.

The Bank's preparations. Implementation of the legislation regarding prohibition of money laundering and the finance of terror as well as implementation of the policies adopted in respect of these matters, requires the Bank for preparations involving its computer system, with respect to training and study courses for employees and managers at the Bank, and for the formation of work procedures. The Bank continues its actions for the integration of the directives regarding prohibition of money laundering and the finance of terror, as well as the integration of its policies regarding these matters among all relevant bank employees. In this framework, the Bank develops and improves on a current basis computerized control systems for the identification and location of unusual activities and of customers and operations involving risk, and for reporting of such cases to the authorities, as required. For this purpose, the Bank performs on a current and computerized basis, scanning actions for the locating of such activities and customers and reporting of such to the authorities. Considering the many changes that are taking place in the primary and secondary legislation regarding the prohibition of money laundering and regarding the prevention of financing of terror, the preparations and assimilation is a continuous activity, both by the Bank and its relevant subsidiaries.

In the wake of legislation amendments and directives of the Supervisor of Banks, which were issued during the year, the Bank's Board of Directors has approved a policy in the matter of "know your customer" as regards passerby/third party, limitations and restrictions as regards operations with entities in risk countries, prohibition on transacting business with the enemy, prohibition on operations with entities declared as assisting the nuclear program of Iran and related programs, issued by the Israel Money Laundering and Terror Financing Prohibition Authority and prohibition on the transfer of funds, the origin or destination of which are bank accounts connected to illegal gambling on the Internet.

Group policy regarding money laundering. On July 5, 2010, the Board of Directors approved a Group policy paper on the subject of prohibition of money laundering and avoidance of terror finance. The policy paper 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. Following the approval of the policy paper, subsidiaries have been approached with the request to adopt and implement the Group policy, mutatis mutandis with the nature and volume of their business operations.

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".

THE COMPANIES LAW AND CORPORATE GOVERNANCE

AMENDMENT NO. 16 TO THE COMPANIES LAW - CORPORATE GOVERNANCE

On May 15, 2011, Amendment No. 16 to the Companies Law in the matter of the implementation of corporate governance rules, as formed by the Ministry of Justice and the Securities Authority, was published in the official Gazette. The purpose of the Amendment is to improve corporate governance in Israel and to modify it to reality in Israel and to principles accepted in this

respect around the world. The Amendment is intended to improve efficiency of decision making mechanisms in public companies in Israel, to increase transparency in decisions and strengthen the mechanisms of supervision and control over the manner of management of such companies.

Special emphasis has been put within the framework of the Amendment on the changing principles of independence of the Board of Directors in general and of the outside Director in particular, as well as the strengthening of the position of the institutional bodies and the minority shareholders in public companies regarding the process of appointment of outside Directors, with a view of weakening the power of the controlling shareholder in the company to influence its management and direct its activities in view of his personal goals.

This refers to a series of amendments, several of the outstanding of which deal with changing the majority required to approve transactions in which the controlling shareholder has a personal interest; change in the majority required for the initial appointment of an outside Director; extension of the maximum tenure of office of an outside Director and determining directives concerning the independence of the outside Director; emphasizing the duty of the Director to apply independent judgment; determination of directives prohibiting the possibilities of the dual appointment of the Chairman of the Board also as President & CEO of a public company; gender equality in a public company and qualifications in this respect; directives regarding the audit committee - its composition, the manner of taking decisions and extension of its duties and areas of responsibility; authorizing the Securities Authority to impose monetary sanctions on an individual or on a corporation in case of violation of certain directives of the Companies Law and determining recommended corporate governance instructions.

The amendments to the Law entered into effect within sixty days from date of publication.

Most of the requirements included in the Amendment Bill with respect to corporate governance, are already being applied by the Bank virtue of the Proper Banking Management Directives applying to it, and which are compatible with the principles of corporate governance approved by the Bank (see in "Issues regarding corporate governance" hereunder).

AMENDMENT OF PROPER BANKING MANAGEMENT DIRECTIVE REGARDING THE "BOARD OF DIRECTORS"

In December 2010, the Supervisor of Banks issued an amendment of Proper Banking Management Directive 301 regarding "Board of Directors". As a general rule, the amendments to the Directives are to take effect no later than January 1, 2012.

The amendments are based upon the recommendations of the Basel II Commission in the matter of "fortification of corporate governance at banking corporations", the applying practice and the regulatory updates on the matter in Israel and abroad.

The amendment to the Directive is the result of seeing the importance of a proper and high level performance of the Board of Directors as part of appropriate corporate governance and the proper management of the banking corporation. As part thereof, the Directives regarding the duties, composition and manner of operation of the Board of Directors have been amended.

Some of the said amendments have already been properly addressed in the framework of the principles included in the corporate governance code adopted by Discount Bank. Notwithstanding, following certain of the amendments, the Bank and the group companies to which Directive 301 applies, will be required to make modifications as well as certain changes to the composition and structure of boards of directors of the Bank and of Group companies.

COMPANIES ACT (REHABILITATION OF COMPANIES) BILL, 2011

On May 30, 2011, the Knesset passed the first reading of the Companies Act (Rehabilitation of companies) Bill, 2011. The purpose of the Bill is to establish by legislation and create legal certainty with respect to various issues involving the rehabilitation of companies, whether or not these had taken effect by Court decisions. The Bill is comprehensive and in part changes the existing legal position. It is not possible, at this stage, to assess the effect of this Bill on the Bank, if enacted.

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 had 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. The Bank is studying the implications on the new Law and is preparing to implement it.

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. The Board has appointed an officer in charge of enforcement and which shall be subject to the Chief Legal Counsel, and instructed the monitoring of the formation of the enforcement plan and its implementation in practice. Following the approval of the said action plan, the Bank and the group are taking steps towards its due implementation.

PUBLIC COMMITTEES

REPORT OF THE COMMITTEE FOR ECONOMIC AND SOCIAL CHANGE

On September 26, 2011, the Committee for Economic and Social Change, headed by Prof. Trachtenberg, submitted its report to the Prime Minister.

The report by the Committee proposes guiding principles for the economic and social policy of the Government. In addition to such principles, the Committee's report deals with four areas directly related to the roots of the social protest in Israel: housing, cost of living and competition, social services and the taxation mix. The Committee has formed specific recommendations in respect of these areas.

The Committee's report touches many and varied areas and the adoption of its recommendations in full may lead to a deep change in fundamental concepts of the Government's economic policy, to significant structural changes and to wide scope economic effects. At this stage, it is not possible to assess which of the Committee's recommendations will be adopted by the Government and will reach the legislation stage, and thus to assess the effect thereof.

The Government has adopted the taxation chapter of the Committee's report and has completed legislation proceedings in this matter (for additional details, see Note 29 H to the financial statements).

Furthermore, in recent months, the Government took a series of decisions following the report of the Committee, including: decisions regarding implementation of the recommendations of the Committee regarding antitrust issues, regarding the examination of manufacturing and marketing costs of products controlled by the Government, regarding the increasing of competition and reduction in the cost of living, regarding increasing the rate of participation in the country's workforce and the rate of employment, regarding improvement in the country's public transport system, and more.

RECOMMENDATIONS OF THE COMMITTEE FOR THE INCREASE OF COMPETITION

The Committee for the examination of competition in the market, appointed by the Prime Minister, the Minister of Finance and the Governor of the Bank of Israel, completed its report in February 2012, and on February 29, 2012, submitted its principal recommendations to the Government.

The Committee had examined three principal aspects: the terms for the allocation of public assets, financial and non-financial holdings and controlling interests by way of a pyramidal structure of holdings.

Among other things, the Committee recommends to prohibit a controlling interest or holdings above a defined level in a significant financial corporation, by a significant non-financial corporation or by the entity controlling a significant non-financial corporation. In addition, the controlling interest in a significant banking corporation shall not be allowed to control a significant financial corporation which is not a banking corporation. It should be noted that, according to the recommendations, both the Bank and the First International bank may be considered significant financial corporations.

The recommendations proposed by the Committee are to apply to all public corporations, and include duties relating to transactions with interested parties, the formation of a platform enabling investors to vote via the Internet and the encouragement of institutional investors to act as "gatekeepers".

The Committee also recommends to extend the authority of the Antitrust Commissioner and to impose restrictions upon the share of an individual issuer, a group of borrowers, the five largest issuers and the five largest borrower groups in the assets

managed by any investment fund (the "systemic risk").

Implementation of the Committee's recommendations involves a legislation process, and accordingly it is not possible to determine at this stage what would be the substance of legislative changes, if at all, and also assess their effect.

UNIFORM CONTRACTS

VERDICT IN THE COURT OF LAW FOR UNIFORM CONTRACTS

On May 5, 2009, a verdict was handed down at the Court of Law for Uniform Contracts, with regard to depriving conditions in a residential loan contract of the First International Bank of Israel ("FIBI"). A decision in the motion to postpone the implementation was also given on October 1, 2009.

The Court ruled that the loan agreement includes clauses that are discriminating clauses that should therefore be eliminated and also directed the amendment of other clauses.

Although the verdict was given in reference to a housing loan agreement, it includes statements which may also affect other contracts in use in the banking system. On January 10, 2010, 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 the Bank had appealed. Among other things, the parties agreed that the ruling of the Court in the matter of the invalidity of the waiver of alternative housing by kinsmen of the borrower will be cancelled. It was further agreed that the ruling of the Court in the matter of charging fixed commissions throughout the period of the loan will be cancelled, and the Bank will be entitled to update the amount of the commissions from time to time, subject to any law. The rulings of the Court in the matters of guarantors and charges in case of early redemptions remained in dispute. On December 5, 2010, the Supervisor of Banks instructed banking corporations to amend the contracts signed with new customers in accordance with the rulings of the Court not under appeal. The Supreme Court ruled on November 29, 2011 that "the notice of the parties is admitted and the parties shall continue the proceedings with respect to matters remaining in dispute in front of a composition of the Court".

DECISION ON AN APPEAL AGAINST THE RULING OF THE UNIFORM CONTRACTS COURT

On February 18, 2010, the Supreme Court gave a ruling in the appeal submitted by Bank Leumi against the decision of the Uniform Contracts Court from June 10, 2004, in the matter of the uniform contract of Bank Leumi with its customers regularizing the terms of opening a current account with the bank. It has been ruled that it is the Bank's prime interest and, in a direct manner, of the public in general to maintain the Bank's economic stability, while strictly collecting customer debts and preventing exposure to liquidity crisis. This interest of the bank and of the public, constitutes a major consideration in the overall circumstances in which the uniform contract between the bank and its customers is to be examined, and a significant component in the balance required for the purpose of determining whether a certain term in the agreement constitutes a discriminating term or not. Among other things, it has been ruled that there is no flaw or discrimination in the section that entitles the bank to cancel or reduce a credit facility in cases where the bank may face a risk of not being able to collect the debt, due to a deterioration in the repayment ability of the customer, and the bank does not have to give prior notice, but may inform the customer at the time of cancellation or reduction. The Bank is studying the implications of the said Court ruling upon the terms of engagement with its customers.

Requirements by the Supervisor of banks. On July 21, 2010, the Supervisor of Banks instructed the commercial banks to amend the current account agreement in accordance with the ramifications of the Supreme Court ruling in the matter of the "general terms for the management of accounts/deposits" agreement of Bank Leumi. As required, the Bank has amended the agreement accordingly.

In his approach, the Supervisor of Banks instructed banks to adjust by January 15, 2011, the housing loan agreement in

accordance with the contents of the ruling given by the Court of Uniform Contracts in the matter of discriminating terms in the housing loan agreement of FIBI, with respect to all those matters which had not been appealed against.

Furthermore, the Supervisor of Banks instructed the commercial banks to peruse all agreements used in practice by them, and to confirm to the Supervisor by the end of 2011, that such agreements have been amended in accordance with the contents of the said rulings, respectively.

The Bank has perused the principal contracts customary at the Bank.

U.S. LEGISLATION

DODD FRANK

In the wake of the global financial crisis, a wide reform was approved by the United States on October 21, 2010, which was established within the framework of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd Frank Reform"). The Reform deals with regularizing the activities of banks and other financial institutions in the U.S., as well as with regularizing the activities of financial institutions operating outside the U.S. and which provide financial services to U.S. citizens or which operate through U.S. brokers, such as U.S. custodian services.

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 above may, among other things, be expressed in reporting duties and registration requirements of the Bank with the U.S. Securities and Exchange Commission (SEC), or with a parallel supervising authority in charge of SWAPS activities that are not based on securities (CFTC).

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 apply already in the course of 2012.

The Bank is studying the implications of the Dodd Frank Reform.

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.

If no change occurs, these provisions will enter into effect on July 21, 2012, however, within the framework of these provisions, in their present version, banks are given a period of two years, until 2014, in order to prepare for the implementation thereof. Under certain circumstances, an extension of that date may be applied for. It should be noted that the final Regulations have not as yet been published and changes may apply also with respect to the effective dates.

Only after the publication of the final Regulations it would be possible to assess the extent of effect they will have upon the Group and its activities.

For details regarding changes in U.S. tax legislation, see under "Taxation" below.

VARIOUS LEGISLATION MATTERS

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.

LEGISLATION AND REGULATION WITH RESPECT TO THE PROTECTION OF THE ENVIRONMENT

In June 2009, the Supervisor of Banks issued a letter in the matter of environmental risks management by banking corporations. For further details, see "Environmental risks" under "Exposure to risks and risk management" above.

Concurrently, various legislative and regulatory initiatives were brought up. A private Bill in the matter of polluted lands was tabled for the second time in June 2009, within the framework of which the financing entities may be held responsible for soil pollution and among other things, for the prevention and discontinuation of the pollution. In August 2011, the Knesset passed the first reading (published in the Official Gazette) of a bill tabled by the Government – Prevention of Soil Contamination and Remediation of Contaminated Soil Bill, 2011, designed to regularize all aspects regarding soil contamination in Israel. The Bank believes that legislation and arrangement initiatives regarding the environment, both governmental and private, are expected to continue also in the future.

ABUNDANCE OF LEGISLATION INITIATIVES

The year 2011, 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 2011 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, a mortgage bank and financial services companies. Total investment in the consolidated and affiliated companies as at December 31, 2011, amounted to NIS 10.4 billion, compared with NIS 10.2 billion on December 31, 2010.

Following is the distribution of net income (loss) by the Group's structure:

	Contribution to Group's results		Contribution Disregarding the effects of coverage of investment(1)	
	2011	2010	2011	2010
	In NIS millions			
Banking Activity:				
Commercial banks:				
In Israel - the Bank (including branches overseas)	(70)	232	168	65
Mercantile Discount Bank	136	107	136	107
First International Bank	101	180	101	180
Overseas - Bank offices	330	(37)	93	130
Discount Mortgage Bank	39	29	39	29
Other Activities:				
Israel Credit Cards	163	130	163	130
Other financial services	92	27	92	27
Total operating income	791	668	791	668
Income (loss) from extraordinary operations	61	36	61	36
Net income	852	704	852	704

Notes:

- (1) The Bank in Israel created a surplus of liabilities in foreign currency, constituting coverage for the Bank's investment in Discount Bancorp, Inc., and IDB (Swiss), with the aim of preventing exposure to fluctuations in the exchange rate of the shekel against the U.S. dollar and the Swiss Franc.
- In the 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 "income from financing activities before provision for doubtful debts". This income and expenditure is taken into account in the calculation of provision for taxes. Income and expenses arising from exchange rate differentials on overseas investments are presented under the item "Bank's share in operating income of investee companies, net of tax effect".
- This method of treatment has an effect on the presentation of the Bank's after-tax operating income and on the contribution of the overseas units to net income. In 2010, the shekel was revalued in real terms as against the U.S. dollar by 6.0%, compared with an appreciation of 0.7% in 2009. In 2010, the shekel was devalued in real terms against the Swiss Franc by 3.3%, compared with a devaluation of 2.9% in 2009. The said net revaluation, in 2010, resulted in a decrease in the Bank's net operating income after tax in Israel by NIS 238 million, compared with an increase of NIS 17 million in net operating income in 2009. Concurrently, there was a decrease/increase in the positive contribution by overseas extensions to the Bank's results.
- (2) Including a reversal of a part of the provision for tax in respect of the Bank's share in the earnings of the First International Bank, in the amount of NIS 53 million and NIS 10 in 2009 (see Note 6 D to the financial statements).

MAIN INVESTEE COMPANIES

At the end of 2011, 24.1% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 19.8% were assets of overseas consolidated companies and branches. The contribution to the net income by the consolidated

companies in Israel amounted to NIS 477 million in 2011 (NIS 321 million in 2010). The contribution to the net income by overseas consolidated companies amounted to NIS 330 million in 2011 (a loss of NIS 37 million in 2010), and the contribution to the net income by affiliated companies amounted to NIS 109 million in 2011 (NIS 186 million in 2010).

The total contribution by both domestic and overseas investee companies to the Bank's net results amounted to NIS 916 million in 2011, compared with NIS 470 million in 2010, an increase of 94.9%.

Disregarding the effect of the coverage of the investment in overseas subsidiaries, net of the tax effect, the contribution of both domestic and overseas investees to the Bank's net results in 2011, would have been NIS 678 million, compared with 637 million in 2010, an increase of 6.4%.

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.

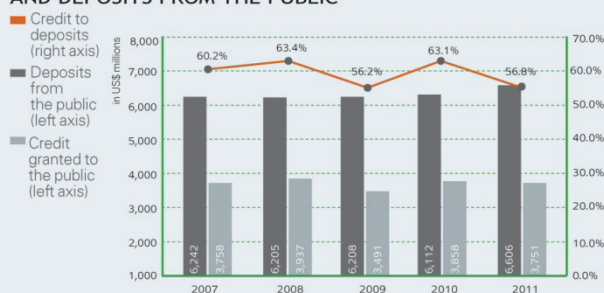
	In US\$ millions		Rate of
	December 31, 2011	December 31, 2010	change in %
BALANCE SHEET ITEMS			in %
Total assets	9,488	9,319	1.8
Total credit granted to the public	3,751	3,858	(2.8)
Total deposits from the public	6,606	6,112	8.1
Total equity	788	767	2.7
Ratio of capital to risk assets	16.5%	14.7%	
INCOME STATEMENT ITEMS for	2011	2010	
Net income attributed to the Bank's shareholders	46	51	(9.8)
Return on equity	5.9%	6.9%	

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 327 million in 2011 (after deducting a provision for additional taxes of NIS 26 million that applies to the Bank in Israel), compared with income of NIS 24 million in 2010 (after deducting provision for additional taxes of NIS 35 million that applies to the Bank in Israel).

The said contribution is comprised of Bancorp's net income in 2011 (after deducting the provision for tax as aforesaid) of NIS 133 million adding exchange rate differentials on the investment of NIS 194 million, compared with net income of NIS 141 million (after deducting a provision for taxes as aforesaid) and disregarding exchange rate differentials on the investment of NIS 165 million in 2010.

Alongside the exchange rate differentials on the said investment, the Bank in Israel recorded financing income/expenses in 2011 and financing expenses/income in the preceding year, in respect of the surplus foreign currency liabilities that the Bank created as coverage for the investment in Bancorp.

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 2011, MDB operated through 79 branches, compared with 77 branches at the end 2010.

	In NIS millions		Rate of change in %
	December 31, 2011	December 31, 2010	in %
BALANCE SHEET ITEMS			
Total assets	25,039	22,570	10.9
Total credit granted to the public, net	15,716	15,082	4.2
Total deposits from the public	20,981	18,736	12.0
Total equity	1,764	1,808	(2.4)
Ratio of capital to risk assets	13.2%	13.1%	
INCOME STATEMENT ITEMS for			
	2011	2010	
Net income attributed to the Bank's shareholders	162	141	14.9
Return on equity	9.6%	8.1%	

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 2011, as compared with 2010: an increase in the income from financing activities before credit losses expenses (an increase of NIS 9 million, which is approx. 1.3%); a decrease in credit loss expenses (a decrease of NIS 72 million, 66.7%); a decrease in operating and other income (a decrease of NIS 16 million, 4.5%), an increase in operating and other expenses (an increase of NIS 53 million, 6.9%), a decrease in the effective tax rate and a decrease in income from extraordinary operations of NIS 8 million.

The increase in operating and other expenses stems mainly from an increase of 8.4% in payroll expenses, due to the current updating of the provisions for employee benefits resulting from the implementation of the Bank's remuneration agreement, a provision of NIS 22 million in respect of the voluntary retirement plan and the initial implementation of the directives of the Supervisor of Banks regarding employee rights.

Distribution of dividend. The General Meeting of Shareholders of Mercantile Discount Bank, held on February 26, 2012, resolved to distribute a dividend in the amount of NIS 80 million.

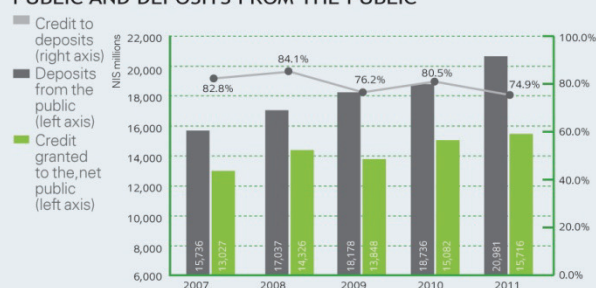
Business focusing and increasing efficiency at Mercantile Discount Bank. In December 2011, the Board of Directors of Mercantile

Discount Bank approved a plan formed with the assistance of an outside expert. The plan focuses on two principal areas, as follow:

- A. Business focusing – the execution of business and organizational processes that will enable Mercantile Discount Bank to maximize its business advantages, as follows:
 - Intensification of the middle market and retail operations – in the course of 2012, Mercantile Discount Bank plans to focus on the expansion of its retail and middle market operations. The change in the mix of the credit portfolio will be accompanied by organizational measures, as follows: changing the structure of the credit layout; converting the professional staff from corporate operations to middle market operations; changing the credit authority and widening the authority of region and branch managers; strengthening the control and supervision structure over credit operations.
 - Intensification of the investment consulting operations – in the course of 2012, Mercantile Discount Bank intends to develop the investment consulting field, and among other things, approach customer segments having a low exposure to this field (subject to an examination of all aspects involved in this operation).
 - Changing the mode of operation of the dealing room – in the course of 2012, Mercantile Discount Bank intends to change the mode of operation being conducted in its dealing room and to base it upon services in this field provided by the Bank. Execution of this move is subject to an examination of the regulatory, operational and other aspects (including control aspects).
 - Changing the mode of operation in the pension consulting field – in the course of 2012, Mercantile Discount Bank intends to change the mode of operation in the pension consulting field and to base it upon services provided by the Bank's pension consulting layout. Execution of this move is subject to an examination of the regulatory, operational and other aspects.
- B. Increasing efficiency - manpower and operating procedures aspects intended to increase the efficiency of the expense structure of Mercantile Discount Bank, as follows:
 - A planned reduction in manpower – in the course of 2012, Mercantile Discount Bank plans to adopt efficiency measures that will include a material reduction in the number of employees, principally in the bank's head office. Such measures include a voluntary retirement plan formed at the beginning of 2012. The plan involves the payment of enlarged severance payments to employees included in the plan. The financial statements of Mercantile Discount Bank as of December 31, 2011, include a provision in the amount of NIS 22 million in respect of the additional liability expected as a result of the implementation of this plan.
 - Review of the branch layout – in the course of 2012, Mercantile Discount Bank intends to reexamine its branch layout. In this context, the bank will review the disposition of its branches in the light of the Group branch disposition as well as the potential for increased efficiency and savings in expenses embedded in the possible merger of branches. Until the completion of this process, Mercantile Discount Bank intends to halt at this stage, any future plans for expansion of branches (except in cases of signed agreements).
 - Merger of the collection units – as part of the planned efficiency measures, Mercantile Discount Bank plans to merge the collection units of the Retail Division and the Corporate Division.
 - Possible further action – Mercantile Discount Bank intends to intensify cooperation with the Bank with respect to operational issues, with a view of using the infrastructure existing at the Bank, thus reducing costs in these areas.

For details regarding a request to approve an action as a class action filed, among others, against MDB and the Bank, regarding payments received in respect of foreclosures executed through magnetic media, see Note 19 C item 11.3 to the financial statements. For details as to the motion for a declarative ruling in the matter of charging the debtor's account with violation interest, see Note 19 C item 11.8 to the financial statements.

MERCANTILE - DEVELOPMENT OF CREDIT TO THE PUBLIC AND DEPOSITS FROM THE PUBLIC



MERCANTILE - NET INCOME AND RETURN ON EQUITY



DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank ("DMB") is a fully owned and controlled subsidiary of the Bank.

DMB operates 81 sales stations, 4 independent branches (Tel Aviv main Branch, Pal-Yam Branch in Haifa, the Diamond Exchange Branch in Ramat Gan and the Modi'in Branch), as well as 77 branches operating within the branches of Discount Bank or adjacent to them.

	In NIS millions		Rate of change in %
	December 31, 2011	December 31, 2010	in %
BALANCE SHEET ITEMS			
Total assets	18380.2	17418.0	5.5
Total credit granted to the public, net	18217.2	17099.6	6.5
Total deposits from the public	543.0	678.0	(19.9)
Total equity	862.9	1120.5	(23.0)
Ratio of capital to risk assets	13.9%	18.3%	
INCOME STATEMENT ITEMS for	2011	2010	
Net income attributed to the Bank's shareholders	45.3	30.4	49.0
Return on equity	4.0%	2.8%	

The business results of DMB for 2011, were affected, inter-alia, by an increase in income from financing activity (an amount of NIS 17.3 million, which is approx. 14.3%), by a decrease in the credit loss expenses (an amount of NIS 16.6 million), from a decline in operating and other income (an amount of NIS 5.8 million, comprising approx. 12.5%), and from a rise in operating and other expenses (an amount of NIS 6.7 million, comprising 5.7%).

Shareholders equity. The decline in capital stemmed from the distribution of dividend (see below).

The ratio of capital to risk assets. On November 21, 2010, the Board of Directors of DMB resolved that the total capital adequacy ratio of this bank shall not fall below 13%.

Distribution of dividend. The General Meeting of Shareholders of Discount Mortgage Bank held on December 29, 2011, resolved to distribute a dividend in the amount of NIS 290 million, which was distributed on the same day. The Bank will reinvest in Discount Mortgage Bank the required amount in case this will be required in order to maintain the capital adequacy.

See Note 19 C article 11.9 to the financial statements for details of the uncertainties relating to DMB. in the matter of charging

commission in respect of life assurance and property insurance of borrowers, article 11.10, regarding the charging of a premature redemption commission in the case of realizing a life assurance policy of a deceased borrower, article 12.1 in the matter of insuring property for amounts exceeding its reinstatement value and Section 11.11 in the matter of charging an early repayment commission on commercial loans.

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

The Board of Directors of the Bank and of its subsidiary DMB approved on November 23, 2011, the merger of DMB with and into the Bank (hereinafter: "the merger" or "the merger transaction").

The merger will enable the Bank to add the mortgage to the variety of products and services offered at the Bank branches, as a one-stop shop with the emphasis on providing a response to all the needs of the customer. The bank intends to gradually develop the point of sale of mortgages from 80 centers to some 130 centers, including in peripheral areas.

The merger will enable the Bank to offer valuable and varied propositions to customers in accordance with their needs, and to shorten the process of customer service. The move will lead to savings in expenses due to the reduction in duplicity and the merger of Head Office units as well as contribute to the increase in income due to utilization in full of the potential existing in the business activity.

A specialized mortgage department is to be established in the Banking Division, manned mostly by the professional and experienced staff of DMB, who will transfer to the Bank.

The merger process will be performed gradually in the course of 2012. Business continuity will be maintained all along the move, through the gradual and controlled transfer of all MDB's operations to the Bank. At the end of the process, new mortgages would be granted at Discount Bank branches and the overall service of existing customers would be provided by the professional staff at the branches and at the new mortgage department.

Based on Management's assessment, the financial statements include a provision in respect of the anticipated merger expenses. A part of that stated above includes plans and assessments considered forward-looking information. These plans and assessments are based upon information and data in the hands of the Bank's Management updated as of date of publication of this report. These plans and assessment may change as a result of changes in the economic environment, changes in regulations having a material effect, which might bring about changes in the pace of performance of the existing plans, or might require changes in the focuses of such plans. All these, in addition to the conditions precedent, as detailed hereunder, that may not materialize.

The principal terms of the merger agreement are detailed in the merger report issued by the Bank on November 24, 2011 (Ref. No. 2011-01-33729).

Conditions precedent. No certainty exists at this stage that the merger will in fact materialize, as it is conditional upon the fulfillment of certain conditions precedent, including: an approval in writing of the merger by the Supervisor of Bank, to the extent required; a ruling by the Income Tax Authorities that the merger is exempt from tax under the provisions of Chapter E(2) of the Ordinance; obtaining approvals by third parties, as the case may be, if and to the extent required according to the terms of any agreement to which the Bank and/or DMB are parties thereof, as well as obtaining additional approvals if required under any law; fulfillment of all conditions for the merger in accordance with the provisions of Chapter I of Part VIII of the Companies Act; and obtaining a notice from the Bank regarding the completion of computer processes required for the operation of the merged bank.

Once the merger is completed, DMB shall cease existing, without liquidation, and for all intents and purposes, the Bank will be considered as if it is DMB.

DMB being a wholly owned and controlled subsidiary of the Bank, the said merger will have no effect upon the consolidated financial statements at date of the merger.

Tax implications of the merger. As stated, completion of the merger is subject to the ruling of the Income Tax Authorities that the

merger is tax exempt under the provisions of Chapter E(2) of the Ordinance, and as such will not be liable to tax, except for Acquisition Tax at the rate of 0.5% in respect of the real estate assets of DMB, which will be transferred to the Bank in the framework 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.

The merger project is being conducted as a cross-organization project, led by the Banking Division with the assistance of outside consultants. Work teams, in which representatives of DMB participate, conduct various aspects of the merger, focusing on the risk management of the said merger aspects.

ISRAEL CREDIT CARDS LTD.

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2011, 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 issues and operates "VISA", "Diners" and "MasterCard" credit cards.

	In NIS millions		Rate of
	December 31, 2011	December 31, 2010	change in % in %
BALANCE SHEET ITEMS			
Total assets	8,723	8,646	0.9
Total equity	1,203	1,140	5.5
Ratio of capital to risk assets	16.7%	16.2%	
INCOME STATEMENT ITEMS for	2011	2010	
Total Income	1,130	1,104	2.4
Net income attributed to the Bank's shareholders	230	215	7.0
The contribution to the Bank's business results	163	130	25.4
Return on equity	20.6%	18.3%	

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%.

Distribution of dividend. On March 15, 2009, the Board of Directors of ICC adopted a policy according to which ICC will not distribute dividends out of retained earnings that had accumulated or that will be accumulated by ICC until December 31, 2009. On December 31, 2010, ICC distributed a dividend of NIS 150 million, out of earnings of 2010 (the Bank's share is NIS 108 million).

The contribution of the Bank's investment in ICC to the Bank's net results in 2011, amounted to NIS 162.8 million, compared with NIS 130 million in 2010.

Issue of capital notes to the Bank. On December 31, 2010, ICC issued to the Bank subordinate capital notes in the amount of NIS 30 million.

Capital adequacy and corrective measures. In a letter dated June 16, 2010, the Supervisor of Banks informed the Bank and ICC that following the materialization of risk events, ICC is requested to take immediate action in order to comply with capital adequacy requirements and to adopt corrective measures. ICC acted and is acting to implement in full the Supervisor's requirements.

Audit at ICC regarding the implementation of the Prohibition of Money Laundering Law. During the second half of 2008 and the first half of 2009, the Audit Department of the Bank of Israel performed an across the board audit in the matter of the implementation of the Prohibition of Money Laundering Law. An audit report was received by ICC on June 20, 2010, in which were detailed deficiencies found during the audit, which prima facie constitute violation of various provisions of the Law, including directives of the Supervisor of Banks applying to ICC. 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. In 2011, ICC instituted a long line of measures intended to rectify the deficiencies and implement the recommendations included in the audit reports. ICC intends to advance in 2012 the treatment of certain issues discussed in the audit report, including the issue of completion of the documentation pertaining to existing customers. For details regarding the police investigation and the seizure of documents and computer material of ICC, see "Clearing of international electronic trade transactions" under "Credit card activity".

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 a lawsuit and a motion to approve it as a class action suit, in respect of the charge of an issuer commission, see Note 19 C, 12.7.

ICC - NET INCOME AND RETURN ON EQUITY

■ Return on equity
(right axis)

■ Net income
(left axis)



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, 2011, 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, see "Material agreements" below and Note 6 E (1) to the financial statements.

	In NIS millions		Rate of change in %
INCOME STATEMENT ITEMS for	2011	2010	in %
Net income attributed to the Bank's shareholders	485	482	0.6
The contribution to the Bank's business results	104	180	(42.2)
Return on equity			
Ratio of capital to risk assets	13.1%	12.4%	

The Bank's share in FIBI's net profit for 2011 is net after provision for taxes amounting to NIS 25 million, in respect of the Bank's investment in FIBI.

In 2010, the Bank's share in FIBI's profit included an amount of NIS 53 million in respect of the reversal of the provision for taxes, as stated.

Distribution of Dividend. On September 6, 2010, the Bank received a cash dividend of NIS 212 million (the said dividend was distributed out of retained earnings as of December 31, 2005).

Unifications of share capital. 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 26.45% in the voting rights. In accordance with the provisions of the agreement with FIBI holdings, the Bank deposited with a Trustee shares which grant it voting rights in excess of 11.09%.

The distribution of the dividend and the unification of the capital have been made in accordance with the said agreement with FIBI Holdings.

An opinion in the matter of the provision for impairment in value. For details regarding an opinion received by the Bank according to which the Bank is not required to perform a provision for impairment of its investment in the shares of FIBI, see Note 6 E (3) to the financial statements. The opinion is available for perusal, with the consent of the provider thereof, via the MAGNA site on the Israeli Securities Authority website and via the MAYA site on the Tel Aviv Stock Exchange website⁶.

For details regarding a lawsuit and a motion for its approval as a class action suit, filed among others against FIBI with respect to the rate of the cross-commission, See Note 19 C item 12.8 to the financial statements.

For details regarding a legal action filed against FIBI in the matter of life assurance commissions and property insurance in contravention of the law and regarding a request to approve it as a class actions, see Note 19 C 13 to the financial statements.

For details regarding a motion for approval of an action as a class action suit filed against FIBI in the matter of the ruling of the Antitrust Commissioner that restrictive arrangements have existed between the banks, see Note 19 C to the financial statements, item 12.3. For details in the matter of the ruling of the Antitrust Commissioner that restrictive arrangements have existed between the Banks, see Note 19 C item 14 to the financial statements.

ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

Israel Discount Capital Market and Investments Ltd. (hereinafter: "DCMI"), a fully owned and controlled subsidiary of the Bank,

⁶The English translation of the opinion is available on the Bank's website.

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 %
	December 31, 2011	December 31, 2010	
BALANCE SHEET ITEMS			
Total assets	787	710	10.8
Total equity	62	(18)	-
INCOME STATEMENT ITEMS for	2011	2010	
Net income attributed to the Bank's shareholders	74	22	241.3
The contribution to the Bank's business results	75	9	733.3

Differences between net income of Israel Discount Capital Market and investments Ltd. And between its contribution to the Bank's results is derived differences in implementation of generally accepted accounting principles.

During 2011, DCMI, through a subsidiary, participated in 49 public offerings of securities (of which one with underwriting) with a total volume of approx. NIS 16.7 billion (56 public offerings with a total of approx. NIS 15 billion in 2010), and in one private transaction of securities with a volume of approx. NIS 1 billion (2 private placements with a total volume of approx. NIS 1 billion in 2010). Of the said issues in 2011, one private transaction of a total amount of NIS 1 billion was made by the Discount Group, compared with 3 public offerings in a total amount of NIS 1.2 billion and one private placement in the amount of NIS 200 million in 2010.

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 F (3) to the financial statements), which the Bank distributes regularly.

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 F (2) to the financial statements.

Distribution of dividend. The Bank's Management believes that it would not be possible to distribute a dividend in 2012.

FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2011, the investment in buildings and equipment amounted to NIS 3,080 million, compared with NIS 3,125 million at the end of 2010, a decrease of 1.4%.

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, 2011, was approx. 167 thousand square meters, compared with 161

thousand square meters at the end of 2010. Of this area, approx. 109 thousand square meters were freehold property and approx. 58 thousand square meters leasehold property (2010: 104 thousand square meters were freehold property and 57 thousand square meters leasehold property). At the end of 2011, some 82 thousand square meters served the Bank's branches and the balance served the head office, similar to 2010.

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

Concentration of the offices of Mercantile Discount Bank's management. Management of MDB and its central Head Office units operated until the beginning of 2011 in five different locations. In order to improve the efficiency of management's and head office work, MDB signed an agreement in September 2009, for the purchase of a part of an office building in central Tel Aviv, in consideration for NIS 110 million. During 2010 the office space in the building had been modified to the needs of MDB, and upon completion of the work at the beginning of 2011, various Head Office units were relocated to the new building.

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 security technology.

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 Mercantile Discount Bank.

Over the years the Bank has developed efficient, stable and effective computer solutions with respect to all business areas in which the Bank operates. 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 programs, see Note 7 H to the financial statements. For details regarding the engagement for providing computer services to Discount Mortgage Bank ("DMB"), see "Main future projects" below.

LOCATIONS OF THE OPERATION

The Bank's mainframe systems are located at two different locals, in various cities in the Greater Tel Aviv area. The fact that the two systems are located at a distance from one another adds to the survivability of the 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. 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, the secondary location begins operations without losing any entry.

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

DATA PROTECTION

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

The principal risks involving data protection are: improper use of the information by system users and unauthorized changes in the data maintained therein; harming the system environment, the operation of the system and its impact upon the Bank's business; sensitivity of the information and violation of privacy and confidentiality of the data and its owners (Bank customers). The protection of data at the Bank is conducted mostly in accordance with provisions of the Law including the Computer Law, the Protection of Privacy Law, and the Supervisor of Bank's Proper Banking Management Directives. The principal procedure as regards the management of information systems at banking corporations is Proper Banking Management Directive No. 357, and the Bank's activity with respect to data protection is conducted in compliance with the guidelines of this Instruction.

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

The Bank operates a data protection center the purpose of which is to identify risks and breaches in the data protection system. Furthermore, as part of the internal audit operates a unit which specializes in the field of information systems, which conduct a current audit of these matters.

PRINCIPAL PROJECTS EXECUTED IN 2011 AND ARE EXPECTED TO CONTINUE DEVELOPMENT IN 2012

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 project 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. The project began in 2007.
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. In the course of 2011, the project provided the Bank with several new tools for use in the trading field.
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 has been prepared for IT in the Group, deriving there from a new multi-annual planning process put into effect during the fourth quarter of 2011 and until the first quarter of 2012. This process will serve for the formation of a new work plan for IT projects, with effect as from the beginning of the second quarter of 2012.

The Bank's budget for 2012 in respect of projects for the development of information systems, including for information system development projects, amounts to NIS 234 million. This, compared with NIS 309 million in 2011.

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

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

In the first stage, the services are being provided with the support of the existing systems of Discount Mortgage Bank. The plan was that services in the second stage will be provided on the basis of the computer systems of Discount Bank. Completion of the transition to the full use of the Discount Banks systems was planned for May 2012. The agreement relates also to the use of the backup site.

In view of the decision to merge Discount Mortgage Bank with and into the Bank (see above "Main investee companies"), the aim of the activity had changed and was defined as operating the mortgage layout at Discount Bank. Discount Mortgage Bank will continue operations using the existing systems until completion of the merger.

MAJOR SUPPLIERS

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

INTANGIBLE ASSETS

Trade marks and brand names. The Bank has exclusive intellectual property rights in the following trademarks that are duly registered with the Registrar of Trademarks, and in the label accompanying each of them: "Israel Discount Bank Ltd.", "Discount Bank", and "Discount". In addition, the Bank registers from time to time, for the purpose of its business and marketing operations, names of services and products such as: "Drive, you have the drive to live" and slogans such as "In Discount we take you personally", "Discount Banking from the heart", etc. In 2010, the Bank registered the "Key" and "Discount key" trademarks as well as the trademark of the key chart. In February 2011, the Bank registered the following trademarks: "Discount", "Discount taking you personally" and "Israel Discount Bank", which include the new logo.

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".

In addition, ICC is in the process of registering a number of additional trademarks.

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

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

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

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.

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

Data bases. The Bank and its subsidiaries have data bases regarding their various fields of operations relating mostly to their customers and employees. Thus, among other things, ICC holds three data bases of registered customers holding VISA, Diners (through Diners) and MasterCard credit cards, as well as of traders accepting these cards.

TAXATION

GENERAL

The Bank and most of its subsidiaries in Israel are considered a financial institution under the Value Added Tax Law, 1975, and as such are chargeable to payroll tax and to profit tax at the rate of 16.0% of the payroll expense and of the profit, respectively.

Final tax assessments have been issued to the Bank for the years up to and including the tax year 2007 (For details regarding an assessment under appeal for the 2008 tax year, see Note 29 C to the financial statements).

For details regarding changes in company tax rates and in the rate of "payroll tax" and "profit tax", see Note 29 G and H to the financial statements.

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.

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 provisions 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, are negotiating 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 is being signed these days.

Among other things, the agreement states that provisions 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 provisions 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.

THE NON-RECOGNITION OF IFRS FOR TAX PURPOSES

Amendment No. 188 of the Income Tax Ordinance was published on January 12, 2012, which stated that Accounting Standard No. 29 – "Adoption of international financial reporting standards (IFRS)" shall not apply in determining taxable income for the tax years 2010 and 2011, even though it is applied for the preparation of financial statements. The Bank believes that the said ruling will not have a material effect.

A QUALIFIED INTERMEDIARY (QI) 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 rules are expected to take effect in 2013. The complete binding guidelines under the FATCA have not yet been published and the Bank continues to follow the relevant publications.

Based on the information known at present, the Bank believes that the above rules are expected to have implications on its activities involving customers having connection to the U.S.

The provisions of the FATCA are intended to take effect in the course of 2013, 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 declared as "U.S. accounts". Duties for tax deduction, documentation and identification regarding such account 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).

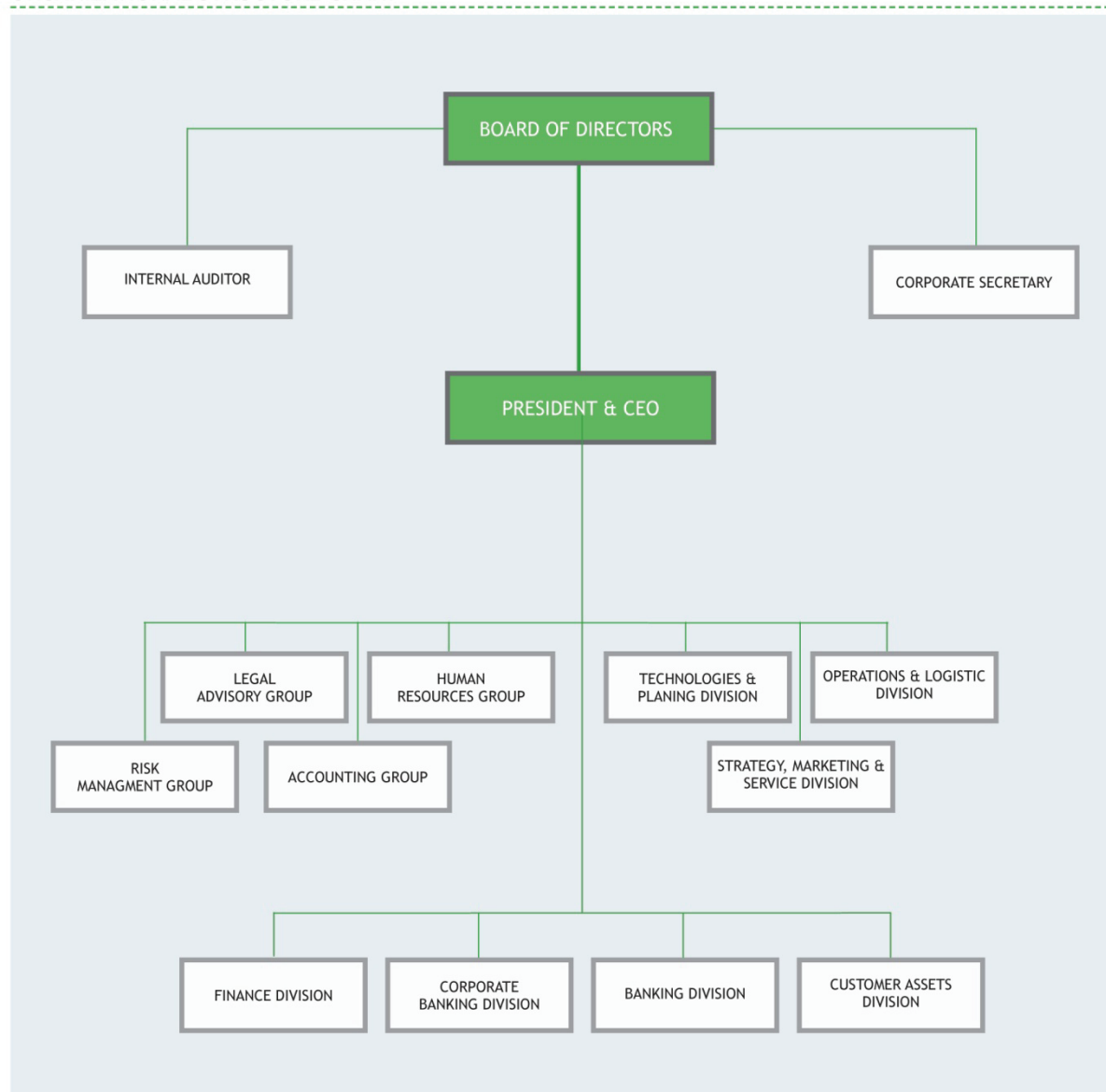
A financial institution that will not abide by the said regulations will be exposed to a significant sanction of deducting tax at the rate of 30% from payments to the bank and/or its customers due from U.S. sources.

The Bank is in the midst of the preparation process at the Group level, for the purpose of meeting the time schedule for the Directive becoming operative.

For further details regarding the Bank's provision for taxes, final assessments and reconciliation of the Bank's applicable statutory tax rate to the effective tax rate, see Note 29 to the financial statements.

HUMAN RESOURCES

ORGANIZATIONAL STRUCTURE CHART



A CHANGE IN THE ORGANIZATIONAL STRUCTURE

REORGANIZATION OF THE SERVICE LAYOUTS IN THE CORPORATE AND BANKING DIVISIONS

In 2011, the Bank's Management reorganized the service layouts to corporate and private customers of the Bank: a transition to three new and focused service layouts available to corporate customers, according to the volume of operations of the customer at the Bank.

Corporate customers having a credit facility of NIS 50 million and over are being served by the Corporate Division. Corporate customers having a credit facility of between NIS 5 and NIS 50 million are being served by the commercial department of the

Banking Division, operating in six commercial centers. Customers having a credit facility of up to NIS 5 million are being served by the Bank's branches.

The Corporate Division includes the large corporation department, serving the large Bank's business customers having a credit facility of NIS 50 million and over and a sales turnover of NIS 150 million and over, the real estate and infrastructure department and the special credit department. Concurrently, the Division continues to offer specialized services for the foreign trade layout, the Diamond Exchange branch, the Tel Aviv main branch and the London Discount branch.

Alongside the service layouts to corporate customers, the Bank strengthened the specialized service layouts for private customers.

The Banking Division includes the commercial department, transferred from the Corporate Division. This department provides services to commercial customers and to middle market customers, and merged two service layouts, the credit centers and the business centers, into one service layout that provides comprehensive service to this segment through a countrywide disposition of six business centers. The Bank's 149 branches have been divided into six regions, answering directly to the Head of the Banking Division, and handle private customers. Service for customers of the branches is expected to improve in view of the decision to increase the authority of Branch managers, a move that would reduce the time needed to provide response to customer requests. The specialized service layout in the branches had been strengthened by specialized credit officers and investment and pension consultants. Private customers active on the capital market will continue to receive specialized and suitable service in 10 countrywide investments centers.

Within the framework of the overall change some ninety Head Office employees were transferred to the service layouts at the Division and at the Bank. Furthermore, the Bank is acting to vacate redundant premises of the merging services layouts and offer them for sale.

Alongside the said preparations, the Bank has been preparing to reposition the private banking layout, which constitutes one of the Bank's central growth mechanisms in the coming years.

At a date proximate to the date of publication of this Report, the Bank had completed the establishment of the six regions, the consolidation of the service layouts of the credit centers with the business centers, the transfer of the commercial banking department to the Banking Division, the reorganization of the control and compliance layout at the Banking Division and the reorganization of the head office units of the Banking Division.

ESTABLISHMENT OF A CUSTOMER ASSET DIVISION

The Division was established in October 2011. It serves the segment of customers having a private banking profile at Discount Bank through two departments: the international private banking department – serving private banking customers who are foreign residents, by means of two private banking centers in Tel Aviv and Jerusalem; and the Israeli private banking department – serving local private banking customers who are Israeli residents, by means of private banking centers in Herzliyah and Haifa.

In addition, the Division is responsible for the investment and pension advisory services, by means of the consulting department, and for the initiation, development and management of financial products, by means of the financial products development and management department.

The Customer Assets Division is also responsible for two subsidiary companies – the Bank's portfolio management company - Tachlit Discount Portfolio Management and the Discount Trust company. Establishment of the Customer Assets Division is designed to support one of the central targets of the Discount Group – the development and intensification of activities in the capital market and private banking area.

ESTABLISHMENT OF THE STRATEGY, MARKETING AND SERVICE DIVISION

A Strategy, Marketing and Service Division was established in March 2011, entrusted with planning the Groups strategy and with supporting the business divisions by providing information services and management tools, marketing and advertising,

development and promotion of the direct channels, initiating actions for improvement of the service and the handling of customer complaints.

The establishment of this Division included the transfer of existing units – strategy, services and public approaches – and the establishment and reorganization of the marketing and advertising units, the planning of control and budgeting and the direct channels.

The establishment of the Division is intended to strengthen the Group synergy, improving efficiency of planning and the allocation of resources, improving the effectiveness of the marketing and advertising campaigns, and improving customer experience of the various channels.

LABOR FORCE AND PAYROLL COSTS

There were 5,871 employees in full-time positions in the Bank in Israel (not including the Bank's branches abroad) at the end of 2011, compared with 6,027 at the end of 2010, a decrease of 2.6%. The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas branches) dropped in 2011 and amounted to 5,979, as compared to 6,041 in 2010, a decrease of 1.0%.

There were 10,211 full-time positions in the Group in Israel and abroad at the end of 2011, compared with 10,221 at the end of 2010, a decrease of 0.1%. The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2011, was 10,240, compared with 10,219 at the end of 2010, an increase of 0.2%.

Following are the labor force data of the Group and the Bank, in terms of positions⁽¹⁾:

	As of December 31		Monthly average in	
	2011	2010	2011	2010
The Bank in Israel	5,871	6,027	5,979	6,041
Domestic subsidiaries	3,521	3,394	3,449	3,381
Group total in Israel	9,392	9,421	9,428	9,422
Overseas branches	33	37	35	35
Overseas subsidiaries	786	763	777	762
Group total overseas	819	800	812	797
Group total overseas and Israel	10,211	10,221	10,240	10,219

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⁾:

	2011	2010	Change in %
The annual average direct cost per employee position in the Bank in Israel	244	223	9.4
The total annual average cost per employee position in the Bank in Israel	363	340	6.8
The average annual overall payroll cost per employee of the Group in Israel and abroad	338	315	7.3

(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:

Main business segments according to segments of operation								
						<u>Financial Management</u>		
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non- Financial Companies	Other	Total
For the year ended December 31,2011								
Average number of positions in the segment	4,887	1,705	1,190	986	558	6	908	10,240
Of which: Management positions	625	302	285	222	116	3	216	1,769
For the year ended December 31,2010								
Average number of positions in the segment	4,636	1,845	1,152	953	544	6	1,083	10,219
Of which: Management positions	833	354	288	222	113	3	199	2,012

LABOR RELATIONS

General. Labor Relations at the Bank are based on the Labor Charter, collective labor agreements and employment arrangements that are consummated mainly in negotiations between the Bank's management and the employees' representatives.

Labor Charter. "Labor Charter for the Employees of Israel Discount Bank Ltd. ", which was signed in 1974 (hereinafter: "the Labor Charter") constitutes a wide base outlining and incorporating employment conditions, disciplinary provisions, arbitration procedures and additional procedures and regulations. During the last thirty years, dozens of collective labor agreements were consummated in addition to the Labor Charter. These other agreements include wage and other agreements intended to supplement and expand the Labor Charter, to change the Labor Charter or to cancel certain provisions of the Labor Charter.

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 come under the Clerks' Committee and authorized signatories and managers are organized under the Managers' Representative Committee. Most of the issues are agreed and signed between the Bank's management and the Employees' Representative Committee. A retirees' Committee also exists, under which the Bank's retirees are organized. The Bank assists the representative committee of the Bank's retirees 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, 2011, there were 4,375 tenured employees in the Bank (December 31, 2010: 4,002 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 as well as their maximum engagement period being five years with the possibility of extension for two additional years under special circumstances. 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 to two years. Temporary employment may be terminated at any time, at the discretion of management. On December 31, 2011, there were 1,657 temporary employees in the Bank (December 31, 2010: 1,902 temporary employees), of which, 329 employees engaged by the Bank (December 31, 2010: 248 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.

On February 1, 2009, the Bank signed an agreement with the representative committee of the employees enabling the Bank to employ, with the consent of the committee, and for an indeterminate period of time, persons who completed seven years of temporary employment with the Bank, at terms similar to those applying to them as temporary employees.

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 Bank management, part of the information technology staff and a defined and specified agreed list of position holders, mainly senior personnel. At present, the scope of personnel employed in accordance with personal employment agreements may reach approx. 80 positions. As of December 31, 2011, the Bank employed, in practice, 73 personnel (including members of management) under personal employment agreements (December 31, 2010: 65 employees engaged under personal contracts).

In addition, the Bank acquires services of manpower company employees and software houses. As of December 31, 2011, 6 manpower company personnel were employed by the Bank. These employees serve mainly as tellers hired as reinforcement following the transition to a shortened work week (as of December 31, 2010: 29 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, 2011, 613 software house personnel were employed in the Bank. These employees are engaged mainly in software development tasks (as of December 31, 2010: 838 software house personnel).

Following is a summary of employment data in the various categories and the changes therein:

	Employees	Tenured employees, personal contracts and members of management ⁽¹⁾	Temporary employees ⁽¹⁾	Manpower companies	Software house ⁽²⁾	Total
December 2009		3,987	1,893	14	747	6,641
December 2010		4,067	1,902	29	839	6,837
December 2011		4,448	1,657	6	613	6,724
Difference (December 2011 vs. December 2010)		381	(245)	(23)	(226)	(113)
Difference (December 2010 vs. December 2009)		80	9	15	92	196
Positions						
December 2009		4,041	2,025	13	827	6,906
December 2010		4,117	1,973	20	860	6,970
December 2011		4,502	1,640	2	560	6,704
Difference (December 2011 vs. December 2010)		385	(333)	(18)	(300)	(266)
Difference (December 2010 vs. December 2009)		76	(52)	7	33	64

Notes:

- (1) Including the positions of Bank employees the cost of which has been capitalized to fixed assets: 2011 – 370 positions, 2010 – 137 positions, 2009 – 126 positions.
(2) Including the positions of software house employees included in the Bank's manpower data: 2011 – 97 positions, 2010 – 54 positions, 2009 – 157 positions.

DEVELOPMENTS IN LABOR RELATIONS

NEW COLLECTIVE LABOR AGREEMENTS

Intensive discussions with representatives of the staff were held during the first half of 2011, which resulted in seven collective labor agreements, which were approved by the Board of Directors on June 13, 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 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.

RETIREMENT PLAN 2011

Concurrently, the Board of Directors has approved principles for a retirement plan designed for between 400 and 500 employees, at a budget of NIS 400 million, which, under certain circumstances may be increased by an additional amount of NIS 100 million (the said amounts comprise the additional cost, over the severance pay in accordance with the law).

A detailed retirement plan was submitted for approval of the Board of Directors on August 24, 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.

The plan's budget was set at NIS 850 million, gross, including severance pay in accordance with the law. In actual fact, the total cost of the plan, including severance payments according to the law, amounted to NIS 600 million.

Until March 21, 2012, 340 employees signed the retirement agreement at a total cost (in excess of the severance pay according to the law) of NIS 340 million. The outstanding balance of the provision for severance pay as of December 31, 2011, covers in full the said cost.

Reduction in the temporary workforce. The reduction in the temporary workforce was executed in two separate stages. In the first stage, performed in the period of October 2010 to November 2011, the temporary workforce was reduced by 275 employees. The second stage, performed in the first quarter of 2012, further reduced the workforce by 91 temporary employees and a further reduction of 21 temporary employees is anticipated during the year.

Reduction in the outsourcing workforce. The workforce of outsourcing personnel was reduced in 2011 by 150 workers. A further reduction of 70 outsourcing workers was made in the first quarter of 2012.

Transfer of outsourcing personnel. 100 outsourcing personnel were transferred in 2011 to the position of temporary computer staff. The transfer of some 300 additional outsourcing personnel to the position of temporary computer staff is planned for 2012.

EFFECTS OF THE COLLECTIVE LABOR AGREEMENTS AND THE RETIREMENT PLAN

According to assessments of the Bank's Management, the labor agreement for the years 2011-2012, the vacation redemption agreement and the change in status of part of the outsourcing workers, will lead to an overall savings of between NIS 140 and NIS 150 million, in the years 2011 and 2012. 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 in the long run.

The retirement plan is expected to create additional savings of between NIS 120 and NIS 150 million, in 2012 (the savings assessed now is slightly higher than that assessed upon the plan's launch, due to the fact that the termination of the plan has been moved forward from the initial date).

The reduction in the workforce of outsourcing personnel and the transfer of a number of them to the position of temporary workforce reduced expenses budgeted for software development by NIS 70 million. The continuation of this process in 2012 is anticipated, according to estimates of the Bank's Management, to further reduce the software development budget by an additional amount of NIS 50 million (it should be remembered that savings in the software development budget results, once development is complete, in the reduction of depreciation costs).

The above stated is considered forward looking information, as it reflects assessments of Management, at date of publication of this Report, regarding the following matters: the number and characteristics of outsourcing workers who will be accepted as "temporary computer employees"; the number of outsourcing personnel whose engagement will be terminated and their characteristics, the replacement coefficient between retirees who chose early retirement under the approved plan and new employees that will be engaged and their characteristics. The assessments of Management may not materialize if material changes occur in the said parameters.

Retirement plan at Mercantile Discount Bank. For details regarding the planned reduction in manpower at Mercantile Discount Bank, see above "Mercantile Discount Bank Ltd." under "Main investee companies".

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.

Part of the employees is entitled to global overtime payment and, for other employees, payable overtime is subject to approval by the employee's authorized superior. The Bank does not have a computerized system for determining the number of hours actually worked by the employees ("time clock"), except in respect of part of the temporary employees.

Most of the Bank's employees are entitled to recreation pay in an amount significantly higher than the amounts provided by law. Employees are also entitled to accepted provident and 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, 2013 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 shall not be deposited in a central severance pay fund, as hitherto was the practice, starting January 1, 2008 in

respect of new employees and starting January 1, 2011 in respect of other employees. For further details see Note 16 to the financial statements.

In accordance with the June 2011 agreement, 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.

SPECIAL REMUNERATION TO MANAGERIAL PERSONNEL

A managerial rank employee who has been promoted is entitled to a 5% salary increase (provided that at least 12 months have elapsed since the date of his last entitlement to such increase due to promotion and/or transfer). A managerial rank employee who has been transferred to another position is entitled to an increase of 2% to 7% of the salary according to the salary table (basic salary components), at management's discretion, taking into account the additional responsibility and/or the special managerial effort required for adaptation to the new position following the transfer, and provided that at least 12 months have elapsed since the date of his last entitlement to such increase due to promotion and/or transfer.

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, 2011, the staff of the managerial grade numbered 1,328 (December 31, 2010: 1,267 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 E 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.

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 2007-2011:

The year	The total number of retired employees (including early retirement)	The number of employees who has elected early retirement
2011	59	5
2010	62	13
2009	37	3
2008	86	28
2007	172	103

It should be noted that in addition to five employees who chose early retirement in 2011, 335 additional employees chose to retire in the first quarter of 2012, under the early retirement plan approved in 2011. Accordingly, most of the savings in this respect will be reflected in 2012, though the full effect of the savings from the early retirement will be reflected as from 2012 and thereafter.

LABOR RELATIONS OF THE PRINCIPAL SUBSIDIARIES

ICC. An approach made by the New Federation of Labor was received by ICC in April 2010, according to which, over one third of the staff of ICC elected to join the New Federation of Labor. The Federation of Labor declared itself as the representative employee union among the staff of ICC and requested that the management of ICC begin discussions with it regarding labor relations at 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.

The financial statements as of December 31, 2011, includes additional expenses in respect of the said agreement in the amount of NIS 20 million.

ICC believes that the pre-tax payroll expense for the years 2012, 2013 and 2014 will increase by an amount of NIS 30 million per year.

DMB. An approach made by the Federation of Labor was received by DMB in March 2010, according to which, over one third of the staff of DMB elected to join the Federation of Labor. In light of this, the Management of DMB has been asked to recognize the Federation of Labor as the representative organization. The parties conducted a verification of the facts in question, at the conclusion of which the Management of DMB recognized the Federation of Labor as a representative organization. On March 13, 2011, a collective labor agreement was signed for the first time with the representative committee of employees of DMB and the

New Federation of Labor. The agreement constitutes the rights and terms of employment of the employees of DMB (with the exception of salary additions), and is in effect for the period until December 31, 2013.

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.

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 December 19, 2011, the Intensification of Enforcement of Labor laws Act, 2011, was published in the Official Gazette, 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 Act imposes extensive responsibility on entities ordering services and on their general managers 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 Act enters into effect within six months of the publication thereof.

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 in this respect communication with the Employee Representative Committee. It should be noted that the Bank operates a computerized attendance reporting system with respect to a large part of the non-organized employees.

REMUNERATION POLICY IN A BANKING CORPORATION

A report issued in April 2008 by the FSF regarding the fortification of the capital and economic markets, referred to the negative influence which an inappropriate remuneration policy might have upon the volume and type of risks taken by banking corporation. Accordingly, the report contained a recommendation relating to the need to adjust the remuneration policies of companies operating in the financial sector to the long-term overall organizational profitability of the company.

On April 5, 2009, the Supervisor of Banks announced that as part of the adoption of the FSF recommendations and with a view of reducing risks emanating from inappropriate incentive structures, banking corporations and companies under their control are required to adopt no later than December 31, 2009, appropriate remuneration policies. The policy is to be determined by the board of directors based on wide overall organizational considerations (total payroll cost, desired wage differentials between various employee grades, etc.) and on the 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 taking 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 brought for approval of the Board of Directors at its meeting of January 11, 2010. The Board adopted the principles of the remuneration policy and directed the Bank's Management to submit a work plan for the implementation of the said principles.

The Board has determined that within the framework of the discussions of the remuneration plans and/or the update of the remuneration plans, the need for the uniformity of the parameters entitling the various employee populations to the right to an award, should be considered.

The Board noted that the remuneration policy document would be presented to the subsidiary companies, with a recommendation by the Bank that the principles of the remuneration policy should also be adopted by them. During 2010, the Human Resources Group in coordination with the subsidiary companies is to examine the agreements and/or remuneration plans existing at the Bank and/or at the subsidiaries with the principles of the remuneration policy, and if it transpires that an agreement and/or a remuneration plan are not in line with the principles of the remuneration policy, the Human Resources Group in coordination with the subsidiary companies, as the case may be, will act to make the necessary adjustments, to the extent possible.

It has also been decided that at least once a year, the remuneration policy document will be brought before Management and thereafter before the Board of Directors, for validation and re-approval.

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 G and H to the financial statements) and a remuneration plan for members of the Bank's Management (see Note 16) have been prepared in accordance with the principles of the remuneration policy adopted by the Bank. The remuneration plans formed in 2011 at ICC, Mercantile Discount Bank and at Discount Mortgage Bank, have also been prepared in accordance with the principles of the remuneration policy determined by the said subsidiaries.

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 having high potential and performance abilities for the manning of key roles at the Bank. In 2011, the Bank began to form the concept, the principles of the process and the identification of key roles.
 - 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.
 - (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. The development framework includes dynamic formation of knowledge and study, evaluation, personal experiences and movement between different roles. This is achieved through behavioral workshops, enrichment of knowledge, and involvement in cross-organization projects, unique evaluation processes, apprenticeship and personal consultation.
- Formation of leading leadership from within the middle level managers across the organization – initiating managerial manpower, which is innovation and change motivated. Special emphasis is given to the cross-organization apprenticeship as leverage for the integration of values and abilities within the Bank's organizational and managerial culture.
- "An executive training room" – a practical-implementation exercise environment, subject focused, for the maximization of the variety of the managerial capabilities and aptitude of department managers, branch managers, deputy branch/department managers and section managers.
- "Branch Managers Forum" – a professional forum that enhances the organizational positioning of the post and increases the managers' ability to lead changes. In addition, the forum serves as a colleague meeting place for joint learning;
- Development of an organic team – development programs at the organic level were launched in 2011 for the formation of a team, strengthening of the managerial role concept and the development of management expertise and apprenticeship among managers in the large corporations department and heads of team in international private banking.

(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). The training includes behavioral training for management role concept, grade adapted at the completion of banking/professional knowledge layer.
- "Advanced banking" – a classifying development channel for the formation of a cadre having the potential for managerial roles at the branches. Identification, development and preservation of seventeen employees having potential for a first managerial role in a branch. The channel includes behavioral and professional layers as well as apprenticeship process at the branches.

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;
- Sociometric and intelligence tests as part of executive training and within the framework of developing managerial teams and organic units;
- "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 manpower mix in a "desirable" profile, formation and integration of career tracks and training and preservation measures, adapted to a desired business behavior. The striving towards professionalism reflects the goal of producing human capital having knowledge and performance required to position the Bank in a leading role.

- Training of the managerial team at the branches, both from the professional/banking aspect and from the managerial/behavioral aspects, adapted to the needs of the Banking Division. Special emphasis was put in 2011 on the improvement of the professional level of branch managers and their deputies in the credit area. This, in addition to their training in matters of managing the separate investment consultant and management of pension advisory services.
- A comprehensive development policy for the investment consultant population – Implementation of a

professional/hierarchic advancement track, a training and qualification program at the various stages of the track, and preservation and remuneration mechanisms. An investment consultants forum operated in 2011 – a strengthening framework for discussion of dilemmas in the work environment, and the achievement of goals of investment consultants (at the branches and at the investment centers) and the relations between them and the branches.

- Pension consultants - advanced professional-banking training on the subject of pensions, focusing on the relations with the customers;
- Credit officers - instruction with respect to professional, business and conduct aspects;
- Bankers in service teams - integrative instruction for the position that includes a qualification component. In the passing year, some fifty bankers received designated training in new service teams, especially enrolled for these duties (qualitative enrollment). Instruction in the position by means of a study process for the focused improvement of performance, carried out during work at the branch as well as frontal learning, at the end of which, the employee undergoes a general professional proficiency examination;
- Tellers - Providing operating retail knowledge and skills relevant to the core duties of the teller as preparation for transition into service team banker with a focus on self study.

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. This means comprehensive coaching to the "custom made" principle, namely, a basket of development activities (for example: coaching and developing the managerial staff, role concept, formation of teams, processes and interfaces), training (developing and performing training) and intra-organizational communication from the organizational and personal aspects, adapted to the unique need of the project and of the designated professional teams and/or professional groups (according to occupation and/or hierarchy grade). The activities basket is the product of a comprehensive organizational diagnosis.

During 2011, a change management methodology was put onto operation within the framework of the integration of the business customer service layout –coaching the commercial center managers from the aspect of absorption in the Banking Division and formation of the team and interfaces, as well as within the framework of the capital market project – following-up the organizational change in the capital market group and in the brokers "Discounter" unit, diagnosing and forming training and integration program for the closing of gaps and removal of obstacles preventing the increase of the Bank's share in the capital market and structuring a communication program for the project. In addition, support is provided for the establishment of a risk management group, for the redeployment in the back-office area and in the business centers, for the establishment of new regional areas in the Banking Division and the opening of new concept branches as well as the formation of recommendations for involvement in the internal audit group.

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 elect it as their bank.

In 2011, the service field was transferred to the Strategy, Marketing and Service Division, considering its strategic importance to the organization and the aspiration of bestowing an overall view of the service concept both to the line divisions and the head office units.

In 2011, the Bank continued the training move for the integration of the service concept in the Banking Division, through in-depth activity in several branches under the leadership of the regional managements. In addition, the integration process was focused on combining the service contents into the various professional training sessions, while developing new training courses for new employees of the organization.

Concurrently, the Bank has started a move with respect to the Israeli private banking segment, with a view of bestowing upon

the employees the principles of the concept and the structuring of a theory of suitable responses adapted to the needs of this unique segment of customers.

Measurement of the customer's experience. Measurement of the customer's multi-channel experience continued also in 2011 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 standard response 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. A process of training, integration and constant measurement with respect to the service field had started and is continuing in 2012.

Handling complaints. The reduction in the number of complaints was defined as a system objective also in 2011. This, while maintaining the commitment and managerial responsibility all along the managerial backbone.

The focused effort in the years 2009-2011 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 significantly, from 346 complaints in 2009 to 251 complaints in 2011, a 27.5% decline. The rate of complaints found justified had dropped from 22% in 2010 to 21.2% in 2011 (38% in 2008, 25% in 2009). The grade awarded to the Bank by the Supervisor of Banks regarding the quality of complaint handling was 99% in 2011, compared to 93.5% in 2010 (89.3% in 2009).

INFORMATION MANAGEMENT

Information management constitutes an important layer in the management of employee professionalism, influences the quality of service at the Bank and forms a part of the work procedures therein. Also important is knowledge management concerning preparations for the "post retirement day" – preservation of organizational knowledge and accessibility of information to users by making it available at the "click of the mouse".

Information management is designed to provide an answer to several central challenges:

- Accumulation of professional knowledge, its preservation and its reuse;
- Knowledge sharing by all relevant factors in the organization;
- Turning covert knowledge into overt knowledge;
- Directing the required information to the user in the shortest possible time;
- Improving performance and attaining business goals.
- Shortening of reaction time and the transfer of required knowledge in the fastest and most efficient manner;

The organizational portal on the Intranet system at Discount Bank comprises a central tool in Information management.

Dozens of substance experts currently maintain and upgrade information communities and information sites. These sites and communities are connected to the core business activities and to central organizational processes, thereby supporting raising the level of employee professionalism and customer satisfaction. Outstanding examples are the expansion of the human resources group website to all Bank employees and the launching of a risk management website in 2011.

Statistical data indicate broad use by the employees of the information management tools, which enable beneficial sharing of professional and organizational knowledge.

Additional organizational and cultural processes, such as the selection of outstanding units and employees and activity in aid of the Bank's community and accessibility, are accompanied by designated sites planned to provide a response both as to current information regarding the process and as to the possibility of interactive staff operation.

The accumulated knowledge in the training programs (such as "enabling discussion" – a training program for the integration of risk management culture), activities of drawing conclusions, apprenticeship processes and the transfer of duties are also accompanied by designated know-how management tools. Additional applications provide the use of computerized forms, the distribution of procedures and circular letters and competitive data management.

The development of tools and framework for operational needs is performed while emphasizing aspects of cost saving and efficiency.

In addition, the activity of the organizational forum of leaders of the information communities - the forum for information sharing regarding methodology and tools, has continued alongside studying developments in this field at other organizations in Israel.

Drawing conclusions. Within the framework of promoting organizational learning and integrating risk management concept, the Bank cultivates a culture of drawing conclusions in order to expand organizational knowledge, information sharing, duplicating success and avoiding failure.

Two steering teams lead the integration in the Corporate Division and in the Human Resources Group. The teams form a policy in the matter of drawing conclusions and lead its implementation, namely, promoting the carrying out of enquiries, assistance in implementing the studied conclusions, distribution of the information derived from such enquiries to other relevant factors, identification of repeated patterns and performing learning inclusion.

A move was launched in 2011 for the integration of the concept and processes for the drawing of conclusions in the legal counseling layout, which were also included in banking training sessions (such as project management training) and in professional conventions.

ORGANIZATIONAL CULTURE

The Discount code of ethics. The process of integrating the code in the organization has been intensified in 2011, lead by managers according to the management chain.

Performance and commitment – management according to goals. With the aim of integrating an organizational-managerial culture of attaining goals and being performance based, a move of management by goals was launched in 2011 with respect to the Bank's Management and the senior executive echelon; defining measurable goals at the Head office and in the field, which are compatible with the business strategy and include also managerial and professional development of the staff and managers. By means of a supporting and guiding layout, the Vice Presidents and their reporters (regional areas/group managers) have defined effective personal goals and a goal language (establishment of a dialogue concerning performance, structured reporting formats, etc.). Implementation of this move, including motion and appreciation programs, will begin in 2012.

Integration of "the green bank" from the aspect of intra-organizational communication. A training program was put into motion in 2011, in the matter of communication and positioning of a cross-organization "green ambassadors" layer. These "Trustees of the environment" of Discount Bank led a training and integration layout for the nurturing of values and action benefiting the environment, including initiating activities within the work environment supporting an all-organizational action. Alongside the above operate the tenants of the "green buildings" – the buildings which the Bank renovates according to the green building principles. In Addition, twenty-five engineers and architects have been trained as green building reporters.

Intra-organizational communication - "Taking you personally". The Bank is investing in the development of open and two-sided communication with its employees, within the framework of realizing the promise of "taking you personally" with respect to both external and internal customers. The intra-organizational communication layout is designed to strengthen the employees feelings of kinship and commitment, while cooperating and providing answers to their questions and expectations.

In order to sense the employees' state of mind, challenges and questions, meetings at various levels are conducted, discussion groups and feedback processes, including:

- "Round tables" – "face to face" meetings of the President & CEO or of one of 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, including an "organizational feedback" (survey of employee viewpoints).

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 2011, 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); Group communication forum - periodic meetings for professional discussion of central issues and mutual learning, with the participation of representatives of companies in the Group; "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 2011 resources were invested in improving the measurement and evaluation tools, with a view of creating an infrastructure for an objective and relative measurement of production, creating true differentiation and instigating action.

TRAINING

In 2011, 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.

The knowledge gaps in various areas were filled in during the year according to the identification of needs conducted at the various units. Among other things, an answer has been provided for training needs derived from regulatory instructions that have effect on the banking industry and/or consumer instructions such as impaired debts, prohibition of money laundering "Red light" and compliance.

Short and applicable training of a varied and innovative mix, including distant learning. A part of the courses was provided by study flashes, their distinction being in their rapid arrival at the employee's "work desk" and in the uniformity and clarity of the message transmitted to a particularly large population.

In the course of 2011 strategic moves at the Bank were addressed at the training level, including:

- Integration of the customer focused initiating service concept within the managerial staff at the branches and the professional/managerial functions at the head office of the Banking Division (investment centers, the capital market department, credit centers, business customer department, credit risk management, the collection department, etc.) and within an in-depth process at three branches. Concurrently, the Bank continues the implementation of the concept of nurturing the customer experience at the security center and at the banking services department of the Operations and Logistics Division – theory and designated measurement processes, which express the reception experience of the customer. Furthermore, the contents of the various professional training programs at the Bank, classified according to professions, have been adapted to the service concept.
- Directing phone calls to the "TeleBank" – with a view of improving service to customers of branches, it has been decided to direct phone calls regarding General and personal banking to the "TeleBank" service. A pilot project for this plan was put into action in 2011 in three branches. The instructions outline for this pilot project included mapping of "moments of truth" in customer service, training for service representatives and team heads at "TeleBank", as well as field support for the pilot project branches.
- Improvement of the professional level of managers in the credit field – training courses and modular completion of knowledge to some 150 branch managers and their deputies with respect to consumer credit and business credit issues, having designated regard to those having or lacking background in credit matters. The training includes complex simulations, including simulation of credit committees.
- Training of all the managerial teams at the branches with respect to managerial and operational aspects.
- Transfer of Head Office staff to branch duties – as part of the preparations for the 2011 retirement plan, an "accelerated"

program had been formed and implemented for the transfer of staff of Head Office units to banking duties, service teams and teller functions.

- Strengthening the orientation of the staff to the Bank and the banking industry – improvement of knowledge and acquaintanceship of those employees making their first steps at the Bank with the banking contents world in general and with that of the Bank in particular. In 2011, the I.T. staff and new employees in Head Office units were trained for a more intimate acquaintance with the Bank (vision, strategy, values, structure and central projects), offering service in accordance with the Bank's service concept and the development of networking in the organization.
- A training layout regarding risk management subjects – advanced professional training, using various methods with a focus on "Distant learning". The training courses included increasing the knowledge of 207 compliance trustees (of branches, regional areas and divisions), risk center managers and reporters – including courseware for all bank employees in the matter of risk management and Basel, prohibition of money laundering, impaired debts and "red lights".

As part of improving professionalism, training courses continued also in 2011 for employees in core roles – credit officers, investment consultants, bankers in service teams, bankers in concept branches and tellers (renewed training).

Resources have been invested in specialized professional training programs in the I.T, project management (in the Finance Division, the Corporate Division and the IT and Planning Division) and group instruction areas.

Eighteen middle grade managers were trained in 2011 as intra-organization instructors. The aim of this move is to form internal capabilities for the teaching of organizational culture and integration of the change. The academic training was made available with the participation of the School of Social Work of the Tel Aviv University, while practical work was performed within the framework of workshop instructions of the Bank's service field.

Retail. A comprehensive move was performed in 2011 with respect to the training of the managerial staff and all officers at the international private banking department and in the private banking centers, regarding management of relations with customers and improvement of business performance.

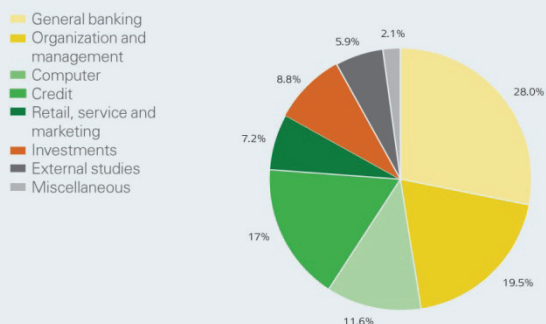
Scope of training. The number of training days in 2011 reached to 30,400 compared with 36,931 training days in 2010, a decrease of 17.7%. The data regarding the number of trading days relate to actual training days on the College premises, and does not reflect individual study activity that was implemented with respect to a variety of subjects and sectors. Thus, in 2011, 16,037 employees actually studied through self study.

INVESTMENT IN TRAINING

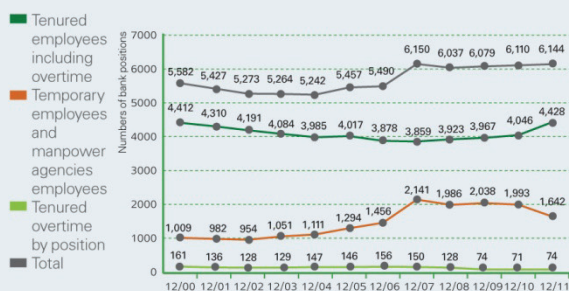
The Bank's investments in training and in the development of human resources amounted to NIS 15.6 million in 2011, compared with NIS 18.4 million in 2010. The amount includes the training of employees on various subjects of (developing and conducting training activities as well as training consultation). 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 training and in the preparation of training material. The cost in this respect is not included in the above amount.

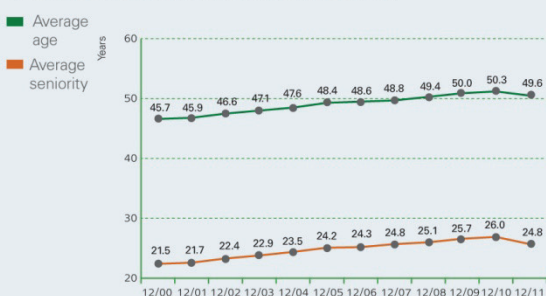
TRAINING DAYS BY TOPICS-(2011)



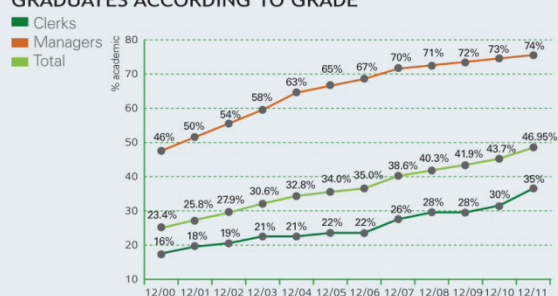
NUMBER OF BANK POSITIONS



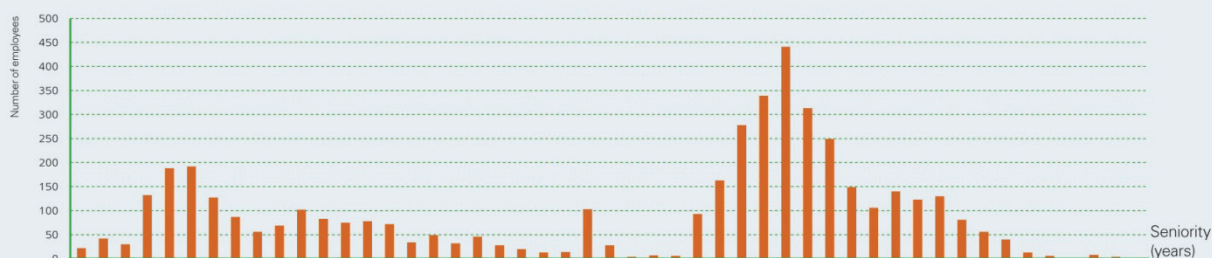
AVERAGE SENIORITY AND AVERAGE AGE



THE RATE OF UNIVERSITY GRADUATES ACCORDING TO GRADE



DISTRIBUTION OF TENURED EMPLOYEES BY SENIORITY - WORK FORCE AT DECEMBER 2011



DISTRIBUTION OF TENURED EMPLOYEES BY AGE - DECEMBER 2011



CONTROL OF THE BANK

GENERAL BACKGROUND

In consequence of the crisis on the shares market in October 1983, with respect to the "regulation" of this market, and as part of the measures taken to confront the situation that had occurred, The Government of Israel, on behalf of the State of Israel, entered into a series of agreements that created an arrangement to finance the acquisition from the public of the shares in each of the banking groups that were involved in the crisis. In accordance with the Bank Shares Arrangement (Temporary Provision) Law, 1993, (hereinafter - "the Bank Shares Arrangement Law"), the Bank's shares were transferred to the ownership of the State of Israel on October 31, 1993, which as from that date became the Bank's controlling owner, due to its holdings of the Bank's shares.

Up to January 31, 2006 the State held 559,870,403 of the Bank's Ordinary "A" Shares, comprising 57.09% of the Bank's outstanding capital and of the voting rights therein, this, after two offers for sale by the State of the Bank's shares made in 1996 and 1997 to the public and to the Bank's employees, in accordance with Prospectuses published by the State and the Bank, and after a private placement of the Bank's shares made to institutional investors in 2001.

According to the information provided to the Bank, on January 31, 2006, the transaction for the sale of a controlling interest in the Bank entered into on February 1, 2005 by M.I. Holdings Ltd. and the Government of Israel (hereinafter - "the Government") on the one hand, and the Bronfman-Schron Group (hereinafter - "the Buyers") on the other hand, (hereinafter - "the Agreement for the sale of a controlling interest in the Bank"), was completed. In the Agreement the Bronfman-Schron Group had purchased shares in the Bank which comprised 26% of its issued share capital (hereinafter "the control nucleus") and was granted an option for a period of three years from date of the closing of the transaction, which expired in the end of 2008, to purchase further shares which comprised up to an additional 25% of the Bank's issued share capital.

Arrangements with regard to cooperation between the buyers and the government, in respect of holding shares of the Bank and exercising the control in the Bank. In the Agreement for the sale of a controlling interest in the Bank arrangements and various undertakings have been prescribed with regard to cooperation between the Government and the Buyers, among other things, in everything connected to the exercise of voting rights attached to the Bank's shares held by the Government and to the Bank's shares owned by the Buyers, including provisions regarding the voting in general meetings of the Bank's shareholders and regarding the appointment of the Bank's Directors.

In May 2006, the State sold shares comprising 6.09% of the Bank's issued share capital and during 2010 the State sold the remaining shares held in the Bank (see below "The sale of shares of the state in the bank"). Upon the sale by the State of the remaining shares in the Bank held by it, all the arrangements regarding cooperation between the Bronfman-Schron Group and the Government have expired.

ENTITIES IN POSSESSION OF BANK SHARES

On December 31, 2011, 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 Philp Millstein, holds approx. 6.424% in Treetops;
- Rubinoff IDB Holdings LP, a limited partnership fully owned by Michael Rubinoff, holds approx. 3.207% in Treetops.

In addition to the Bronfman Group members the limited partnership Treetops Special Limited Partner LP (hereinafter: "SLP"), incorporated in the Cayman Islands, holds approx. 0.2% of Treetops, as limited partner (the limited partners in SLP are Matthew Bronfman (approx. 65%) and Michael Rubinoff, through Rubinoff IDB Holdings LP (approx. 35%). The SLP's general partner, is Treetops SLP Ltd., (a company fully owned by Matthew Bronfman, incorporated in the Cayman Islands) holds approx. 0.2% of SLP).

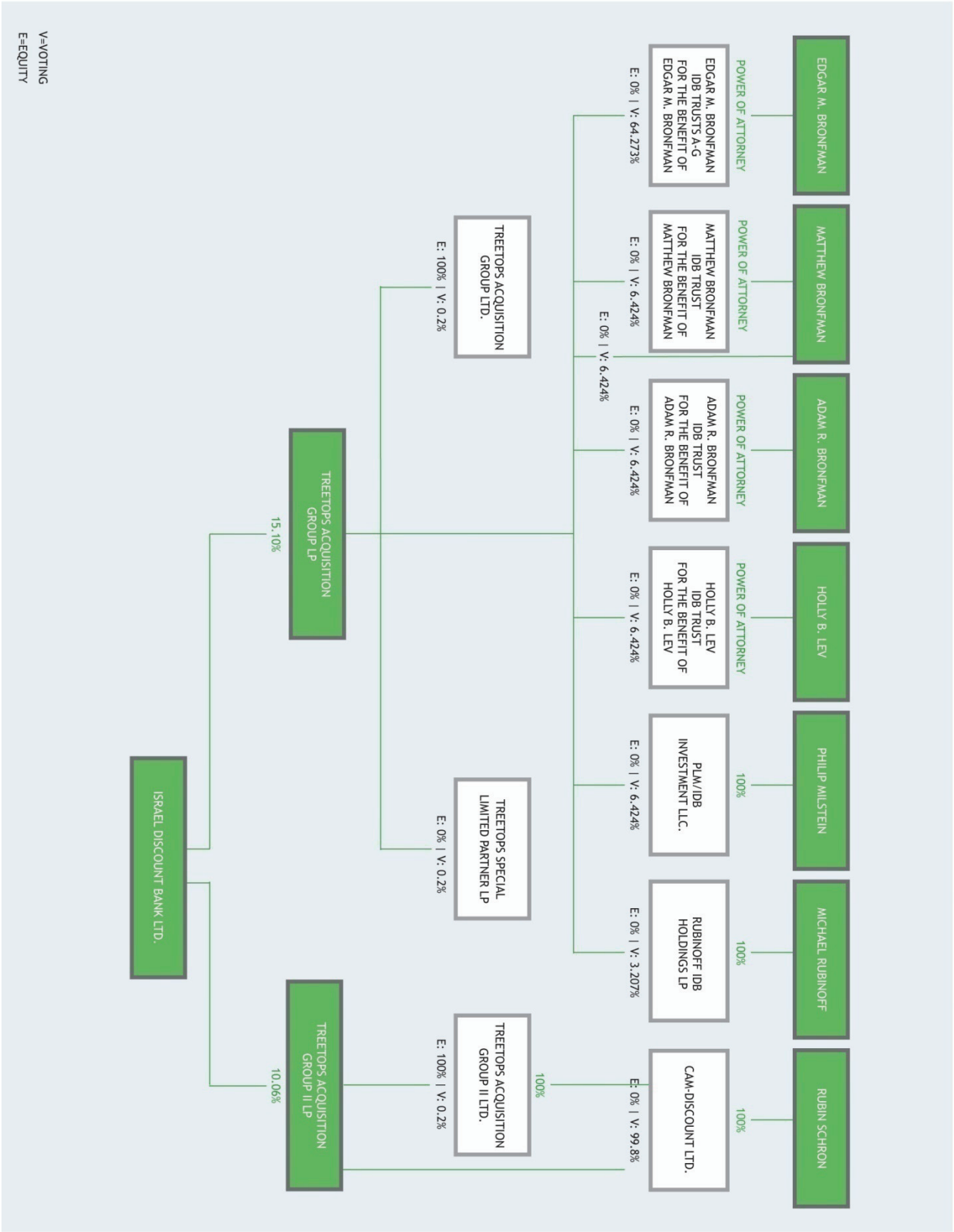
Treetops' general partner, that holds approx. 0.2% of Treetops, is Treetops Acquisition Group Ltd (hereinafter: "Treetops Ltd."), a company incorporated in the Cayman Islands. The means of control in Treetops Ltd. are held by the Bronfman Group members, in accordance with the ratio of their holdings in Treetops.

Treetops II is a limited partnership incorporated in the Cayman Islands. The limited partner of Treetops II is Cam Discount Ltd. (hereinafter: "Cam Discount"), that holds approx. 99.8% of Treetops II. Cam Discount is a company incorporated in the Cayman Islands, all the means of control wherein are held by Rubin Schron.

Treetops II's general partner, that holds approx. 0.2% of Treetops II, is Treetops Acquisition Group II Ltd (hereinafter: "Treetops II Ltd."), a company incorporated in the Cayman Islands, all the means of control wherein are held by Cam Discount.

For details regarding the arrangements between the buyers and the government and arrangements among the buyers, see this chapter hereunder.

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 Ruben 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 into shares, the Group shall maintain the minimum percentage holdings, computed on the basis of full dilution.
3. (a) For a period of five years subsequent to the date of the grant of this permit, the Group shall not directly or indirectly sell or transfer means of control in the Bank, if as a result thereof it is left with means of control of any type in a percentage lower than the minimum percentage. Any one of the Group's members may sell means of control from the additional percentage exceeding his or her share in the controlling interest, provided that a minimum of six months have elapsed since the last purchase affected by such Group member (in such regard, the exercise of the option from the government shall not be deemed a purchase act).
- (b) Five years from the date of the grant of this permit, the Group may sell or transfer its means of control, provided that it sells or transfers the entire means of control constituting the minimum percentage, to an individual or a Group that has duly received a permit for the control and holding of the aforesaid means of control.

In the Supervisor of Bank's letter annexed to the permit (hereinafter: "the letter annexed to the permit") it was stated that in the event that after five years from the date of the grant of the permit a decision is made by the Buyers to sell means of control in the Bank from the controlling interest such that after the sale none of the Group's members or the buyers require a permit for the control or holding of the means of control in the Bank, pursuant to the law, the following provisions shall apply:

- The two Buyers shall approach the Governor of the Bank of Israel, notify him of their decision and detail the manner of the sale planned by them;
- Before the sale of the means of control, as aforesaid, the Buyers shall make a preliminary with the Governor of the Bank of Israel, regarding the arrangements that shall be made, including the modification of the permit and the trust instrument, in order to allow them to effect the sale of the shares within a reasonable period of time (hereinafter:

"the transitional period"), taking into account, inter alia, the implications on the Bank's management and transfer thereof, business relations with the Bank, the market conditions and the quantity of shares being sold, and the format of holding and voting in respect of the Bank's shares constituting a holding of more than 5% of the means of control in the Bank during the transitional period (without such derogating from the Buyers' fundamental right to effect the sale, as aforesaid).

- (c) Notwithstanding the abovesaid, an additional member may be added to the Group and each of the Group's members may, at the end of five years as aforesaid, transfer or sell the means of control held by him and constituting his share of the minimum percentage, or part thereof, provided that the transferee or buyer cooperate on a regular basis with the rest of the Group pursuant to the Summary of Principal Terms entered upon by the Group as aforementioned, or another agreement approved the Supervisor of Banks, and that a permit was duly granted for the control and holding of the aforesaid means of control. Notwithstanding the above, an additional member may be added to the Group and a Group member may transfer or sell means of control as aforementioned also during the five year period from the grant of the permit, provided that the conditions set forth above had been fulfilled, and provided that the Group will continue being the leading factor both in regard to the percentage holdings as well as with regard to the cooperation between them.
- 4. (a) The Group's members and the entities through which the means of control are held shall act in accordance with the Summary of Principal Terms approved in advance and in writing by the Supervisor. The beneficiaries of the trusts from the Bronfman Group shall act in accordance with their undertakings to the Bank of Israel, which were approved in advance and in writing by the Supervisor. Rubin Schron, Matthew Bronfman and Michael Rubinoff were permitted to hold a higher share of the right to participate in the 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. (a) No dividend shall be distributed from the Bank's profits that accrued prior to September 30, 2004. If losses accrued after this date, no dividend shall be distributed until after these losses have been covered. In addition, no dividend shall be distributed from profits from the sale of the Bank's material assets for five years from the date of the grant of this permit.
Thereafter, dividend may be distributed from the sale of assets as aforesaid, subject to the Supervisor's prior written approval (The profits that accrued in the Bank prior to September 30, 2004, which are not available for distribution as aforesaid, amounts to NIS 2,704 million).
- (b) Notwithstanding the aforesaid, dividend may be distributed from profits from a sale of the Bank's material assets in the five years following the date of the grant of the permit, on the fulfillment of all the following conditions:
 - (1) The sale derives from legal requirements governing the Bank;
 - (2) The distribution of dividend from profits from a sale of such assets does not result in a reduction in the Bank's minimum capital ratio existing prior to the sale of the said assets;
 - (3) The Bank's board of directors approves the distribution after examining the Bank's needs and its business plans;
 - (4) The Supervisor gives his prior written approval to an aforesaid distribution, after examining the Bank's capital adequacy and the board of directors' decision and the basis thereof.
9. (a) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not engage in any business, in Israel or abroad, of receiving deposits - even from less than 30 people, or granting credit, or any other financial business in Israel that is such as to compete with the Bank's business.
- (b) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not be interested parties, directors or senior managers in corporations engaging in business of the type mentioned in sub-paragraph (a) above; in such regard, "interested party" means someone holding 5% or more of any type of the means of control.
10. 100% of the total balance sheet assets of each of the purchasers is to be financed from capital. Notwithstanding, the purchasers will be entitled to finance the acquisition of the controlling interest by way of a debt to the Government of Israel. Financing of the purchase of the means of control in the Bank, including the grant of guarantees for financing as aforesaid, shall not be provided, directly or indirectly, by the Bank or by banking corporations under its control.
11. The Bronfman and Schron Group shall reduce their liability to the Bank in order to comply with Proper Banking Management Directive No. 312 concerning a banking corporation's business with related persons, unless otherwise approved by the Supervisor, in advance and in writing.
12. The Group shall do the utmost to ensure that the memorandum, articles of association and all the 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. (For details regarding the process of a rights issue and a public offering of shares, see below Note D 13 to the financial statements).

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 outside director that the two groups would be entitled to appoint, when such office becomes vacant, whereas the Schron Group would be entitled to appoint the second outside director. 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.

EMPLOYEES AGREEMENT

On February 1, 2005, concurrently with the signing of the Agreement for the Sale of a Controlling Interest in the Bank, an agreement was signed between the New Histadrut Federation of Labor (hereinafter: "the Histadrut"), the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance (hereinafter: "the Employees Agreement"). On February 7, 2005, the 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 Employees Agreement was intended to settle several demands raised on behalf of the Bank's employees in connection with their rights in light of the sale of the controlling interest in the Bank by the State. The Employees Agreement determined, among other things, that the power of the Labor Charter as a collective labor agreement at Discount Bank, shall be extended for a period of five years, namely until December 31, 2009. At the end of this period, the parties shall act with regards to the power of the Labor Charter, in accordance with section 3 thereto.

Mercantile Employees Agreement. On May 22, 2005, the Histadrut, the Representative Committee of MDB Employees and the Accountant General at the Ministry of Finance signed an agreement, (hereinafter: "the Mercantile Employees Agreement"). On May 30, 2005, the Representative Committee of MDB Employees approved the Mercantile Employee Agreement. The Board of Directors of MDB approved the agreement on June 9, 2005, and the General Meeting of shareholders of MDB approved the agreement on June 20, 2005. The Finance Committee of the Knesset also approved the Agreement. The Mercantile Employees Agreement was intended to settle several demands raised by employees of this bank regarding their rights in light of the sale of the controlling interest in the Bank by the State. The Mercantile Employees Agreement determined, among other things, that the validity of the collective agreements at MDB (as the term is defined in the collective agreement dated December 21, 2004 and all its Annexes) will be extended for a specified period until December 31, 2009. At the end of this period, the parties shall act as regards to the validity of the collective agreements, in accordance with the terms of Section 5 of the labor agreement dated May 17, 1968. (the validity of the agreement was extended on January 1, 2010 until December 31, 2011).

REPAYMENT OF THE STATE'S DEBT WITH RESPECT TO THE AWARD TO EMPLOYEES

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An agreement with the employees stated, among other things, that the employees are to receive from the Government an amount of NIS 120 million in consideration for the waiver of their right to acquire the Bank's shares at a discount (hereinafter: "State's award to employees"). It was also provided that the employees will receive from the Bank an amount of NIS 130 million (hereinafter: "Bank's award to the employees").

It should be noted that in a conversation held between the 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 will amount to NIS 175 million, of which an amount of NIS 120 million was paid to the Bank in March 2006. The balance of the State of Israel debt to the Bank with respect to the award to Discount Bank employees amounts therefore to NIS 55 million and its payment is due on February 1, 2009.

According to information relayed to the Bank, concurrently with the signing of the agreement for the sale of a controlling interest in the Bank, an agreement was signed between the Bronfman-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).

The Bank's authorized organs approved towards the end of January 2009, the entry of the Bank into an agreement with the State of Israel for the granting of a loan in an amount equal to the amount of the debt of the State to the Bank, for a period not exceeding 13 months, under accepted commercial terms.

Soon afterwards, the Bank submitted to the Accountant General an agreement in this respect signed by the Bank. In response, the Bank was informed by a representative of the State that in view of personnel changes in the Department of the Accountant General, the State requires a short respite to study the matter.

Pursuant to the Accountant General's request of March 1, 2009, the Bank provided on April 27, 2009 certifications by the relevant corporations in the Discount Group, including the Bank, regarding awards granted to entitled employees, as well as the payments made to tax authorities in this respect. This was accompanied by a special confirmation (verification) rendered by the respective independent auditors of the said companies.

To the best of the Bank's knowledge, M.I. Holdings approached the Tax Authorities in December 2009, and presented its position, backed by a legal opinion, whereby the Bank should not have withheld tax and paid payroll VAT and National Insurance contributions in respect of the State's share in the payment to Bank employees (and therefore the Bank is entitled to a refund of the said tax payments from the Tax Authorities, and on the other hand the Bank has no claim against the State for the refund of the said tax payments), requesting the Tax Authorities to review the case.

The Bank has been informed of the refusal of the Tax Authority to discuss the matter with M.I. Holdings and of its proposal to bring up the matter within the framework of the discussions with respect to the Bank's tax assessment for the tax year 2006.

In an additional meeting with State representatives, held in November 2011, it was reported that an arrangement is being formed in the discussions held between the Bank and the Tax Assessing Officer regarding the tax assessment for the year 2006, on the background of the position of the Tax Authorities in the appeal against the Court's decision in the matter of Oil Refineries Ltd. (Tax Appeal 859-08 Chaim Nissim vs. Haifa Tax Assessing Officer). According to the arrangement signed in December 2011, the grant monies received from the Government shall be regarded as income while all payments of the Bank with respect to these grants shall be recognized as an expense. As a result of the said principle, which, as stated, is in formation, no benefit shall accrue to the Bank in respect of the refund of payments for VAT on payroll and National Insurance contributions.

Upon the formation of the principle for the arrangement with the Tax Authorities, the Bank has applied again to the Accountant General for the repayment of the debt together with interest and linkage differentials.

As of date of publication of the financial statements, the said debt has not yet been repaid and the agreement in its respect has not been signed.

THE SALE OF SHARES OF THE STATE IN THE BANK

The price of the transaction for the sale of the Bank's shares held by the State. Pursuant to a notice received by the Bank from the State of Israel, on January 14, 2010, the State sold shares comprising 5% of the Bank's issued share capital. The price of the

transaction was determined at NIS 8.871 per share. Pursuant to a further notice received by the Bank from the State of Israel, on July 29, 2010, the State sold shares comprising 8.33% of the Bank's issued share capital at an average price of NIS 6.789 per share. Pursuant to a further notice received by the Bank from the State of Israel, on October 28, 2010, the State sold shares comprising 11.7% of the Bank's issued share capital, the remaining Bank shares held by the State, at average price of NIS 7.255 per share.

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.

PROVISIONS 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 provisions for credit losses include a specific provision - an allowance for credit losses in respect of debts that had been examined on a specific basis and found to be impaired, and a group provision - 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 provisions 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 provisions reflecting the anticipated loss inherent in the credit portfolio. In determining the provisions 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 provision on a group basis, the Bank's Management assesses the amount of unidentified losses inherent in the portfolio, using a "credit loss provision coefficient" in respect of outstanding credit segmented according to economic sectors, determined within the framework of the "range of provisions" computed on the basis of the outstanding balances and provisions 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 provisions 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 that is being implemented as from January 1, 2011, see Note 1 D 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 provision, it is necessary to examine the probability of a loss and to assess its amount. These evaluations affect both the duty itself of creating a provision in respect of the claim and the mode and scope of the disclosure in the financial statements.

According to FAS 5 there are three levels for evaluating the loss: (1) Remote; (2) Reasonably possible; (3) Probable. The U.S. Standard also rules that if the loss cannot be assessed, no provision should be created in respect thereof, but the matter should be disclosed if it might be significant. For the purpose of assessing possible losses as a result of actions filed against the Bank, 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).

Furthermore, both the manner in which the Court interprets the said prerequisites and the weight that is given to each of them as well as the level of proof required (in view of the little experience and legal precedents), at this early stage, lack uniformity in the legal system, and accordingly it is most difficult to evaluate the prospects of such pleas.

When the Court's decision in the matter is given, a request for permission to appeal is usually submitted, which is also dealt with over a long period. Only afterwards, if the request for appeal is dismissed, the class action begins to be heard subject to limitations determined in the preliminary procedure.

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 follows:

- 1) Probable - probability of over 70%;
- 2) Reasonably possible - probability of over 20% and up to and including 70%;
- 3) Remote - probability of 20% or below.

The financial statements include appropriate provisions for claims in respect of which realization of the related risk exposure is probable.

According to the Directive only in rare cases a banking corporation is entitled to state in its financial statements that in its

Management's opinion, based on Counsel's opinion, it is not possible to assess the prospects that a risk exposure would materialize in respect of an ordinary legal action and an action approved as a class action. As to a motion for approval of a class action, the banking corporation is entitled to determine that it is not possible to assess the prospects of realization of the exposure to risk in four financial statements (including one annual report) to be published subsequently to the filing of an action together with a plea to have it approved as a class action suit. Such period is not to include the period in which the Court has stayed the proceedings in the matter. Note 19 to the financial statements states separately the outstanding claims, in respect of which a reasonable assessment of the exposure is not possible.

The financial statements include disclosure of material legal proceedings conducted against the Bank and Group companies, based on the following criteria: as a general rule, a material legal proceeding is one where the amount claimed is in excess of 0.5% of the Bank's equity capital, and if it is not possible to assess the prospects of the risk materializing; and of 1% of the equity capital if the prospects of the risk materializing are reasonably possible or remote.

The banking corporations have also been asked to provide disclosure regarding the total exposure in respect of claims that have been assessed, in whole or in part (in respect of the relevant part), as "reasonably possible". Disclosure as above is given in Note 19 C to the financial statements.

It should be noted that where the Bank is one of the defendants in an action, and the claimants have not attributed an amount to each of the defendants, the evaluation of the claim amount relevant to the Bank has been made to the best of ability, taking into account that consideration of the total amount might mislead and is incorrect in the circumstances, and that the evaluation does not necessarily represent the allocation as finally determined by the Court.

See Note 19 C to the financial statements for details of material legal actions pending against the Bank and against other companies in the Group. For details as to additional proceedings and claims settled during the year, see Section "Legal proceedings" hereunder.

IMPAIRMENT OF AVAILABLE FOR SALE SECURITIES

According to directives and guidelines issued by the Supervisor of Banks and to accepted accounting principles applying to banking corporations, unrealized gains or losses on adjustment to fair value of available for sale securities, net of the tax effect, are directly recorded as a separate item in shareholders' equity and are taken to the income statement in certain cases, including upon realization of the securities. Unrealized losses reflected as a capital reserve are losses of a temporary nature only. Other than temporary losses are taken directly to the statement of income.

The Bank's management is therefore required to examine and evaluate the nature of losses accumulated in respect of the said securities.

For the purpose of determining the nature of losses accumulated in respect of securities as above, managements of the Bank and/or of the relevant subsidiaries, base themselves on the security's various characteristics on which losses have been accumulated and on the company that had issued this security, such as: The 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, 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

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 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;
- Level 2 inputs: quoted prices on active markets for similar assets or similar liabilities; quoted prices on inactive markets for identical assets or liabilities; prices derived from evaluation models, where all significant inputs are observable in the market or are supported by observable market inputs;
- Level 3 inputs: unobservable inputs for assets or liabilities derived from evaluation models, one or more of their significant inputs are unobservable.

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 market (for details of the new directive, see Note 1 D 7 to the condensed financial statements).

The principal change in work procedures is the required reference to credit risk.

The Standard requires the banking corporation to reflect the credit risk and the nonperformance risk in the measurement of the fair value of the debt, including derivative instruments issued by it and measured at fair value. The nonperformance risk includes the credit risk of the banking corporation, but is not limited to that risk only. The Bank assesses the credit risk inherent in derivative instruments on the basis of the prices of the debt instruments of the counterparty traded on an active market, and on the basis of prices of credit derivatives based on the credit quality of the counterparty, for banks and customers in respect of whom indications exist for the credit quality based on active market transactions, and in accordance with internal models for the forecast of credit loss rate in case of default with respect to the rest of the population.

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 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.

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 guidelines included in the circular were applied as from April 1, 2011. The effect of the initial implementation was reflected by way of a retroactive application. The opening balance of retained earnings for the earliest period presented in these financial statements (December 31, 2008) has been restated, in respect of severance pay and jubilee award post retirement benefits (see hereunder), by an amount of NIS 392 million (net of tax). The comparative figures have been restated.

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 100 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).

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.

It should be noted that within the framework of the actuarial computation made, retirement of employees had been assumed in the framework of the approved retirement scheme in 2011. Also assumed were the scope of retirement and characteristics of retirees (seniority, gender and salary level), in accordance with assessments of the Bank's Management. The updated computation as of December 31, 2011, was based on the actual retirement scope and of the characteristics of the actual retiree population.

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 severance pay as of December 31, 2011, had been based:

	Increase in liability in NIS millions
Increase of 1 basis point in retirement rate of employees	27
Increase of 0.5 basis point in the real-term annual wage	104
Increase of 10 basis points in the rate of severance pay due	32

A decrease of 1 basis point in the discount rate will increase the Bank's liability for severance pay to employees by an amount of NIS 174 million.

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. In light of the fact that the rate of retirement used in the past in the actuarial calculation of the aforesaid liability did not take into account rates of retirement with respect to employees' early retirement, implementing the Supervisor's directives with regard to employee rights required also to restate the provision with respect to these liabilities.

Presenting the actuary's opinion for perusal. The opinion of the Actuary 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 2010 Annual Report (This Report)⁷.

DEFERRED TAXES

Deferred taxes are recorded in respect of temporary differences between the value of assets and liabilities in the balance sheet and their value for tax purposes.

Deferred tax assets in respect of timing differences are recorded only if it is probable that a tax savings will accrue upon reversal of the difference and deferred tax assets in respect of carry forward losses for tax purposes are recorded only if the realization of the tax asset in the foreseeable future is not in doubt.

Accordingly, when deferred tax assets are being recorded, the Bank is required to perform assessments and estimates as to the probability 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.

The balance of deferred tax receivable amounted on December 31, 2011, to NIS 1,417 million, compared with NIS 646 million on December 31, 2010. The increase in the balance stems mainly from the initial implementation of the Directive regarding impaired debts and of the Directive regarding employee rights.

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-

⁷ The English translation of the actuary's opinion is available on the Bank's website.

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, 2011 to NIS 959 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 net asset value of the Bank's investment in FIBI as of December 31, 2011, is NIS 1,558 million. The market value of the Bank's holdings in FIBI totaled on December 29, 2011 (the last trading date prior to the balance sheet date) NIS 900 million.

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 A-	Stable	December 6, 2011
	Subordinate capital notes ⁽¹⁾	il A+	Stable	December 6, 2011
	Upper tier II capital (Series 1)	il A-	Stable	December 6, 2011
	Hybrid tier I capital (Series "A")	il BBB	Stable	December 6, 2011
Midroog	Long-term deposits	Aa2	Stable	May 24, 2011
	Short-term deposits	P-1	Stable	May 24, 2011
	Subordinate capital notes ⁽¹⁾	Aa3	Stable	May 24, 2011
	Subordinate capital notes (tier I capital)	A-2	Stable	May 24, 2011
The international rating agency S&P	Issuer rating Short-term	A-3	Stable	December 6, 2011
	Issuer rating Long-term	BBB-	Stable	December 6, 2011
The international rating agency Moody's	Long-term foreign currency deposits	A-3	Negative	January 27, 2012
	Bank Financial Strength Rating	D+ (BFSR)		January 27, 2012
Mercantile Discount Bank				
Standard & Poor's, Ma'alot	Issuer rating (including deposits)	ilAA-	Stable	December 6, 2010 ⁽²⁾
	Subordinate capital notes	ilA+		December 6, 2010
Discount Mortgage Bank				
Midroog	Long-term deposits	Aa2	Stable	June 16, 2011
	Short-term deposits	P-1	Stable	June 16, 2011
	Subordinate capital notes	Aa3	Stable	June 16, 2011
Discount Bank Latin America				
The international rating agency S&P	Issuer rating (including deposits)	BB+	Stable	December 13, 2011 ⁽³⁾

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) Raising of the rating from "BB", following the raising of the rating of the State of Uruguay.

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:

Rating given by	Foreign currency - long-term	Foreign currency - short-term	Rating horizon	Date of rating/ ratification of rating
The international rating agency Moody's	A-1	P-1	Stable	December 2011
The international rating agency S&P	A+	A-1	Stable	September 2011
The international rating agency Fitch	A	F-1	Stable	May 2011

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 TO WHICH THE BANK IS A PARTY

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. Furthermore, the Bank manages various accounts of Lehman Group companies, some of which are for their customers.

On September 18, 2008, at the request of Bank Leumi, a temporary comprehensive attachment order was issued with respect to assets and rights existing in the Lehman Group accounts with the Bank in an amount of up to NIS 370 million. On March 12, 2009, the Tel Aviv District Court ruled a compromise agreement reached between the Bank and Bank Leumi, to have effect of a Court verdict. According to this agreement, the attachment on assets of the Lehman Brothers companies held by the Bank, executed by Bank Leumi will be approved, subject to the Bank's priority rights in these assets deriving from the right of set-off

to which the Bank is entitled.

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

On December 10, 2009, the Bank received notice of a motion for contempt of Court that had been submitted to the Bankruptcy Court in New York by Lehman Brothers Inc., against Bank Leumi and Israel Discount Bank. As part of the motion filed in New York, Lehman Brothers Inc. petitioned to apply the stay of proceedings order issued in New York to Bank Leumi and to Discount Bank and to instruct them to stop all proceedings against Lehman Brothers Inc. in Israel, to cancel the attachments on its funds and to allow the Trustee to perform receivership on all its assets in Israel. The Bank claimed that it is subject to proceedings in a Court of Law in Israel.

The provisional attachment order, given at the request of Bank Leumi, with respect to assets and rights existing in the accounts of the Lehman Brothers Group at the Bank, was removed by consent in August 2011. The motion for contempt of Court submitted to the New York Bankruptcy Court by Lehman Brothers Inc. was removed by consent in August 2011. The settlement of accounts with this company has been completed by consent.

On November 16, 2010, the Bank was served with a request by Lehman Brothers Commercial Corporation for Alternative Dispute Resolution procedures (ADR) regarding a settlement with respect to derivative transactions that were pending at date of the collapse of the Lehman Group. In July 2011, an alternative dispute resolution (ADR) process took place between the Bank and Lehman Brothers Commercial Corporation with regard to the accounting for the derivative transactions that were outstanding at the time of the Lehman Group collapse. The parties consented to the proposition of the mediator, according to which the Bank will pay an amount of US\$6.45 million for the final and full settlement of the mutual claims by the parties. The settlement amount (provided for in full in the Bank's books) shall be transferred following the completion of procedural matters.

The settlement with two other companies in the Lehman Brothers Group is not yet complete.

Legal proceedings against IDB (Swiss). On November 4, 2011, a former Vice President and Risk manager of IDB (Swiss), submitted to the Labor Court in Geneva a claim in the amount of SFR 2 million against IDB (Swiss). The claim raises various arguments against the bank concerning his dismissal from office and his rights in this respect.

As background to the case, it should be noted that in October 2010, the Claimant, while still a Vice President of IDB (Swiss), 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 Bank 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 2011

Two motions for approval of an action as a class action suit were submitted on August 4, 2008 to the Jerusalem District Court, one against the Bank, Discount Gemel Ltd. (hereinafter: "the Manager") and the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance (hereinafter: "the Commissioner"), and the other against the Bank, Bank Leumi Le'Israel BM, KAHAL - Employee Training Funds Management (1996) Ltd. (hereinafter: "the Manager") and the Commissioner.

The Plaintiffs claimed that they were members of the provident funds managed by the Managers as well having current accounts at the Bank. According to the Plaintiffs, the banks unlawfully took possession of the consideration monies received in respect of the "transfer of control over the assets of the provident funds, the management thereof and trusteeship thereon", this instead of passing on the consideration to the members of the provident funds proportionally to their share in the assets of the provident funds, the consideration monies being the profit generated by the assets of the funds. The Claimants argued that the provident funds management companies and the selling banks have violated various laws and fiduciary duties.

The amount of damages claimed is the amount of the consideration received in each of the transactions. The damages are

attributed both to the Bank that received the consideration, unlawfully as alleged by the Plaintiffs, and to the Manager. Accordingly, the amount of damages claimed in one of the actions is NIS 607 million and in the other action (relating to the Bank and Bank Leumi) NIS 260 million.

On March 27, 2011, the District Court dismissed the motion for approval of the action as a class action suit. On May 19, 2011, the Plaintiffs filed an appeal with the Supreme Court against the said decision. In May 2011, a motion was filed, with the consent of the parties, for the dismissal of the appeal, the Defendants waiving their claim for expenses. Concurrently, certain of the representatives of the Plaintiffs submitted a motion for replacement of the representative Appellants by other Appellants within the group. The appeal was dismissed on October 9, 2011, with no order for expenses, the motion for the replacement of the representative appellants was also dismissed.

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 with respect to commissions and in respect of the Supervisor's ruling that in accordance with Section 43(e) of the said Law, the said statement serves as prima facie evidence for everything determined therein in any legal proceedings, see Note 19 C 14 to the financial statements.
3. For details regarding 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.

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 m 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.

AN AGREEMENT FOR THE GRANTING OF LOANS AND SERVICES TO STATE EMPLOYEES

On May 10, 2007, the Bank signed an agreement for the granting of loans, overdraft and banking services to State employees following its success in the tender issued by the Accountant General. For further details see "Retail banking sector - household segment" in the Chapter "Activity of the Group according to principal segments of operating" and Note 19 C 16 to the financial statements.

ISSUES REGARDING CORPORATE GOVERNANCE

CORPORATE GOVERNANCE CODE FOR THE DISCOUNT GROUP

As part of the Bank's strategic plan for the years 2007-2011, the Bank has taken steps towards the adoption of the "Corporate governance code" for the Discount Bank Group. The purpose of adoption of the code is to maintain a policy of "best practice" of corporate governance principles at Group level, which will guide the Discount Group in its operations.

In April 2009, an ad hoc committee of the Board of Directors was established, which proceeded to promote and complete the corporate governance code.

The corporate governance code of the Discount group and the declaration of principles of corporate governance at the Discount Group were approved by the Board in its meeting of October 28, 2009. The Board's resolution specified that the said documents be examined once a year in order to determine whether they are in accordance with the Bank's business and the business and regulatory environments in which it operates.

This Code has, among other things, been prepared in light of the various laws and principles applying to the Bank, being a banking corporation and a public company, while adapting it to the characteristics and unique needs of the Discount Group. In addition, 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 basis.

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 Board of Directors over companies in the Group; reorganization and structural changes; the formation of a group risk management policy regarding various areas.

In August 2007, the Board of Directors adopted a legal opinion rendered by a prominent legal expert, according to which transactions between interested parties in the Bank and its subsidiary companies shall be approved in accordance with procedures determined by the Israeli Law with respect to approval of transactions with the Bank itself.

The actual implementation of a corporate governance code involves the formation of procedures intended to regularize the activity of the Board of Directors and its committees, approval of related party transactions, as well as work processes involving subsidiaries. The Bank is acting towards completion of forming corporate governance procedures in the matter of approving transactions with interested parties.

GROUP MANAGEMENT

Proper Banking Management Directives regulate, among other things, the Group conduct of the banking corporation as regards various issues. Proper Banking Management Directive No. 301 (in its original version) required the Board of Directors of a bank to determine a policy with respect to exposure to various risks (credit risks, market risks, operational risks, liquidity risks, legal risks, etc.) concerning its subsidiary companies and foreign extensions. Furthermore, the Bank's Board is required to determine a policy concerning everything relating to its involvement in determining employment and retirement terms for employees of the subsidiaries of the banking corporation and to verify that the subsidiaries' boards of directors discuss the said terms. The Board of Directors has to ensure that any new activity is approved by it only after it had studied the risks involved in the new operation, it had examined the mechanisms to be used by it in managing, measuring and controlling the risks, it had determined quantitative limits and verified that human resources, financing resources and mechanized and technological infrastructure are available in order to ensure proper absorption and management of the new operation and its compatibility with the banking corporation's existing operations. The Board of Directors must also set guidelines to ensure that corporations controlled by the banking corporation will provide the banking corporation the information it requires in order to maintain at the Group level an ongoing follow-up, supervision and control over the business of the Group and the scope of risks involved. These guidelines shall include the establishment of a central head office unit that will analyze the said information and will report to the management of the banking corporation the condensed data and its recommendations, in accordance with a reporting format approved by the Board. Proper Banking Management Directive No. 313 requires implementation of borrower and group of borrowers credit limits on a consolidated basis.

The new Proper Banking Management Directive No. 301 (hereinafter: "the new Directive"), published in December 2010 (see "Legislation and supervision" below), requires that the Board of Directors shall discuss, decide and form guidelines, as the case may be, regarding 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 the matter of supervision and control mechanisms over controlled corporations, it is required 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, for the first time, 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.

The new Directive entered into effect on January 1, 2012, except for several sections.

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. Among other things, it was determined that in certain of the areas – strategy, risk management, internal audit, legal consultation 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 concerning 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.

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" below.

THE INTERNAL AUDIT IN THE GROUP IN 2011

Details of the Internal Auditor. The Bank's Internal Auditor is Mr. Nir Abel, CPA (Isr.), who assumed office on May 18, 2011. (In the period until Mr. Abel assumed office, Mr. Rafi Bichler, deputy manager of the Internal Audit Group, served as acting Internal Auditor). 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.

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 accordance with the Internal Audit Law, 1992, according to the Banking Rules (Internal Audit) 1992 and according to Proper Bank Management Directives.

The work plan was designed on the basis of an overall risk survey, conducted according to new and accepted methodologies, and was influenced by local and international guidelines (including Basel II, COSO, SOX and Proper Banking Management Directive No. 307 regarding the internal audit function).

The senior management of the Internal Audit Group are involved in the preparation of the work plan. Prior to the work plan being submitted for approval, it is forwarded to the Bank's independent auditors, to the chairman of the Board of Directors, to the Chairman of the Board's Audit Committee and to the Bank's President & 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.

The work plan allows the Internal Auditor discretion for a 15% deviation as regards the use of human resources. A higher deviation requires prior approval of the Audit Committee.

The planned work programs for the 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.

The audit reports are graded on the basis of the audit findings.

During the reported period, no material transactions (within the meaning of Proper Banking Management Directives) were effected.

Audit of investee corporations in Israel and abroad. The internal audit work plan also relates to the Bank's investee companies in Israel and abroad. Where the 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.

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 118.7 positions (including overheads; not including 3 outsourcing positions), of which, 36.5 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 2011 engaged in internal audit at the Bank and in investee companies in Israel and abroad:

The Bank	63.5
Investee companies in Israel audited by the Bank's internal auditor	16.4
In overseas extensions	2.0
Investee companies in Israel where the audit is performed by an independent internal auditor *	20.5
Investee companies abroad where the audit is performed by an independent internal auditor	14.0
Total **	116.4

*of which: the internal auditor, overheads - two positions, and public access - two positions.

**Does not include 3 outsourcing positions.

Performance of the audit. The internal audit is carried out according to the provisions of the Internal Audit Law, 1992, Banking Rules (Internal Audit), 1993 and according to the professional standards of the Institute of Internal Auditors in Israel.

The Internal Auditor also acts in accordance with the instructions and guidelines of the Supervisor of Banks as reflected in Proper Banking Management Directives and in audit reports performed by the Supervisor of Banks.

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, including financial data. Access to information as stated above, in investee companies and foreign operations, is secured by the internal audit procedures of these entities and by guidelines of their boards of directors.

Reports by the Internal Auditor. All 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.

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.

With respect to each quarter, about 30 days following the end of the quarter, the Internal Auditor submits a comprehensive report regarding all activities of the internal audit in Israel and abroad, for that quarter. The quarterly report discusses the material findings included in audit reports submitted in the course of the reported quarter, a concise response to the findings by the audited entities, as well as follow-ups of previous quarterly reports and prior issues that had not yet been resolved.

The quarterly report is submitted to the Chairman of the Board, to the President & CEO, to all Board members and to the CRM, The quarterly report is discussed with the President & CEO and relevant members of the Management and afterwards by the Board's Audit Committee.

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.

Once a year, the Internal Auditor submits to the Chairman of the Board, to the President & CEO and to all Board members an annual report (in addition to the four quarterly reports). This report details the principal matters that were audited during the year, the manner in which the findings and recommendations were treated. A copy of the report is also delivered to the CRM and to the Auditors.

The quarterly and the annual reports were submitted and discussed as follows:

- Report on the activities of the internal audit in the fourth quarter of 2010, submitted on February 16, 2011, and discussed by the Audit Committee on March 27, 2011.
- Annual report on the activities of the internal audit in 2010, submitted on March 30, 2011, and discussed by the Audit Committee on April 13, 2011 and by the Board of Directors on May 3, 2011.
- Report on the activities of the internal audit in the first quarter of 2011, submitted on May 3, 2011, and discussed by the Audit Committee on June 29 and July 7, 2011.
- Report on the activities of the internal audit in the second quarter of 2011, submitted on July 31, 2011, and discussed by the Audit Committee on August 29 and September 12, 2011.
- Report on the activities of the internal audit in the third quarter of 2011, submitted on November 13, 2011, and discussed by the Audit Committee on January 1, 2012.
- 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.

The annual report regarding the activities of Internal Audit in 2011 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 set out for internal audit at the Bank.

Remuneration. Details of the payments to the Internal Auditor and of the components thereof are given hereunder under "Remuneration of the Chairman of the Board of Directors and Senior Executive Officers". In the opinion of the Board of Directors, such payments have no effect upon the Internal Auditor's professional judgment.

Proper Banking Management Directive regarding "Internal audit function". On December 25, 2011, the Supervisor of Banks issued a new Proper Banking Management Directive regarding the internal audit function. 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, including:

- Characteristics of the function - the attributes required in order for the internal audit function to fulfill its role in an effective and efficient manner;
- The duties of the internal audit function;

- The charter given to the function;
- The scope of the internal audit work, considering the structure of the banking corporation and the complexity of its operations;
- The work methods of the internal audit function, as divided to the central issues and processes in its work;
- Status of the Internal Auditor;
- The direct reporting mechanism of the internal audit function to the Board of Directors, through the Audit Committee.

The Directive will take effect on July 1, 2012. The Bank is preparing for its implementation.

The Audit Committee approved on January 25, 2012, a letter of appointment for the Internal Auditor in accordance with the requirements of the 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 - Discount Employees for the Community continued during 2011, in this context, volunteer Bank employees act out the Bank's vision of people oriented banking contributing their time and compassion.

The volunteer activity is varied and provides assistance and support to a wide range of components of the population in Israel: children and youth, students, servicemen, disadvantaged sectors, 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 2011 in the culture and arts field, providing sponsorship and donations.

In 2011, 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 2011, including the Lema'an Project, amounted to NIS 6,403 thousand, compared with NIS 7,292 thousand in 2010. 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 1,664 thousand in 2011, compared to NIS 1,355 thousand in 2010. Furthermore, direct current cost associate with the Visitor Center (tour guide personnel and building maintenance) amounted in 2011 to NIS 3,211 thousand, compared with NIS 4,203 thousand in 2010. 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 2011 to NIS 433 thousand, compared to NIS 445 thousand in 2010.

The social activity and involvement in the community was carried out by the Bank in the following areas:

DONATIONS

Donations are directed mainly to associations, clubs, education establishments, health organizations and others, that focus on children and personal welfare. Among the donations granted in 2011, noteworthy are those granted to following associations: Yad Ezer Lachaver, Warm Home for Children requiring Artificial Respiration, Yad Sarah, Ilan, Akim, The Institute for Advancement of Education in Jaffa, College for All, Alut - the Israeli Society for Autistic Children, the Israel Multiple Sclerosis Society, Variety, Reuth Medical Center, "Migdal-or" Association, Nachum Gutman Museum, The Foundation for Advancement of Druze Community Members, and more.

THE "LEMA'AN" PROJECT - DISCOUNT EMPLOYEES FOR THE COMMUNITY

The varied activity continued in 2011, while focusing on voluntary activities in the framework of various associations acting in aid of youth at risk and in distress and various associations.

Presented below is a selection of examples of the projects and activities within the framework of the "Lema'an" Project:

Unit volunteer activity. During the year, additional units at the Bank joined the volunteer activity within the framework of the unit, including:

Customer Asset Division – the Division's staff elected to act at four volunteer centers: Na'amat Home in Bat-Yam (children at risk), Edith Wolfson Medical Center, Club for the Blind in Bat-Yam and "Dancing on Wheels" Association.

"Yohana Jabotinsky" School in Beer Yaacov, dealt with within the framework of the "Discount Start-Up" Project, has been adopted within the framework of a unique volunteer project, jointly operated by the Lowland Region and servicemen of Squadron 916.

"Almog Club" in Holon (children at risk) – has been adopted by the staff of the Holon Branch. The branch has also harnessed its customers in this activity.

Senior Citizens Club in Holon has been adopted by the staff of the Industry Branch Holon.

"Branco Weiss" School – The staff of the Ramla Branch have adopted the school children, children at risk who are not able to integrate within the formal education system.

"Joy for the Children" Association – The Association has been adopted by the Nation Branch in Jerusalem. The Association provides medical and mental help to children suffering from chronic diseases such as Epilepsy, Muscular dystrophy, etc.

Sheltered Housing – the staff of the Bayit Vagan Branch have decided to adopt the occupants of the sheltered housing project situated near to the Branch.

Single Mothers Club – the staff of the Ibn-Gabirol Branch have decided to adopt the children of the club numbering fifteen children aged five to ten years.

Tz.V.A. Club – has been adopted by the staff of the Migdal Ha'Emek Branch, who renewed their voluntary activities.

"Mikveh Israel" School – the staff of the Operations and Logistics Division have elected to adopt the youth studying at the school in Holon, which operates within the framework of the "Discount Start-Up" Project.

Battered Women's Home in Tel Aviv – The Home has been adopted by the staff of the Large Block Branch reinforced by the staff of the Tel Aviv Region.

"Purim" holiday activities. Volunteer Bank employees organized Purim celebrations at centers at which they are active, designed for the elderly population, the sick, servicemen, etc. Notable was the party organized at the Schneider Children Hospital in Petach Tiqva, with the participation of some sixty volunteers from the Bank's various units and branches as well as retirees. The event included clowns, giant dolls, inflated dolls, activity stations, rich refreshment buffet, distribution of Purim gift bags and visits to the children department (including oncology) accompanied by clowns and bank volunteers.

Hanukkah events at volunteering venues. Bank employees conducted Chanukah 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.

"Adopt a combat soldier" Project. Discount Bank continued in 2011 its support to the enterprise established by the Friends of the IDF. Within this framework the Bank continued its adoption of "Squadron 916" of the Israel Navy, which is entrusted with Israel's southern coastline.

The bank supports the Squadron with a monetary contribution as well as with voluntary work. The contribution is a yearly amount of NIS 100 thousand intended for financing activities for the welfare of the soldiers.

In addition to a monetary contribution, the Bank incorporates volunteer activity of the Ashdod Branch employees. Furthermore, naval servicemen participate in various events of the Bank.

"Our Children's Horizon" Project. During the summer months, for the fifth year running, the Bank employs young persons having

eyesight deficiencies who are active in the "Our Children's Horizon" Association. Prior to the beginning of their work, the youth are provided with training as preparation for their work at the Bank. Training was provided at two sessions at the Discount College, where candidates arrived with coordinators of the Association, and were provided with tools regarding qualification and expertise at work as well as training regarding data protection, coaching, self assessment and more.

Bazaar for the sale of products made by persons with special needs. In the past year, the Bank assisted in setting up a bazaar (on premises of the Bank) for the sale of items produced by persons with special needs cared for by various associations, such as: the "Enosh" Mental Health Association in Rishon le'Zion, "Meital House" (a framework for adult special education), and the Heletz School for special education to children. Income of the bazaar was dedicated to the continued activity of the said Associations.

"Discount Fund" at the "Ezra LeMarpe" Association. The Bank continued its support of the Fund, whose goal is to offer financial assistance, for the third year running. Approaches in the matter of health received by the Bank are referred to the Association for examination of the case and its various aspects. Where the case is found deserving of assistance it is awarded out of the Fund.

Assistance to needy families towards the Jewish New Year and Passover holidays. In line with the Bank's tradition, the Bank rallied once again to assist needy families. The Bank has purchased charged food cards in the value of NIS 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.

"Birthday Angels" Project. In recent months, several branches belonging to the lowland region have joined a project intended to adopt clubs for children in high risk situation in the geographic areas in which the branches operate. The main activity in this respect is the celebration of birthdays of children belonging to the club. The participating branches were provided with game sets for the children from the "Birthday Angels" Association and funds for birthday presents and refreshments from the Bank.

Promotion of Education in Yaffo Association. The cooperation with this Association continues, including volunteer work by Bank employees at the clubs of the Association and a financial contribution by the Bank. The Association provides a variety of education programs, welfare and enrichment to thousands of children in risk situations. The assistance is provided to families of a low socio-economic background giving them higher prospects of success in life.

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.

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.

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.

INVOLVEMENT IN AND CONTRIBUTION TO THE COMMUNITY BY THE PRINCIPAL SUBSIDIARIES

Following are descriptions of several prominent projects carried out by the principal subsidiaries:

Dreamnight at the Zoo. An international social project, originating in the Rotterdam Zoo in Holland in 1996, and operating today in some 23 countries around the world. Zoos that have joined the project open their gates at no entrance fee for a special evening. ICC has undertaken to lead this project in Israel. The year 2011 marked the sixth year of this activity, in the framework of which over one thousand children hospitalized all over the country and pupils of the ACUM Association and their families are invited to the Safari Park.

"Another lesson". In 2010, ICC joined the "Another lesson": Association, which directs publicly held knowledge towards enrichment classes held at different schools, tutored by employees of the public and business sectors. ICC employees joined the volunteer group of the Association and provided children of the "Hadarim" school in Or Yehudah a taste of the corporate business world in general and of the financial world in particular.

ACUM Association. ICC continued in 2011 its partnership with the Association. During the year, changing exhibitions of pupils of ACUM were exhibited in the premises of the company. As part of the monetary donation to the ACUM Association and the social-voluntary work of ICC and its employees, ICC initiated the project of renovating the clubs for ACUM children. In 2011, ICC assisted in the renovation of additional clubs.

ICC forest. Within the framework of cooperation with the Jewish National Fund (JNF), ICC donated trees for the rehabilitation of the Carmel forests. The number of trees donated was in relation to the number of ICC credit cards issued by employees of the JNF. On the first anniversary of the Carmel disaster, ICC employees volunteered for forestry work for the rehabilitation of the Carmel forests, in cooperation with the JNF.

Telephone center for the collection of donations. ICC has provided a designated telephone center in aid of the CHUM Association. In a fundraising radio broadcast, donors have been referred to representatives of the telephone service at centers in Givataim and in Upper Modi'in, who raised over NIS 2 million.

A start-up project in the Arab sector. In 2011, 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 2011.

"A computer for every child". MDB, through the "A computer for every child" Association (under the patronage of the Government of Israel) has donated this year as well, computer kits to children of low income families. The donation this year amounted to one hundred computer sets at a total cost of NIS 0.1 million.

Participation in an educational project. MDB Bank has been participating also in 2011 in a project conducted by "Yad Eliezer" Association, within the framework of which this bank has granted 400 scholarships to Yeshiva students, at a total cost of NIS 0.4 million, in consideration for their commitment to serve as tutors to children of disadvantaged families in the ultra-orthodox sector.

"Adopt a combat soldier" Project. Discount Mortgage Bank ("DMB") has also joined the project, adopting Regiment 405 of the Artillery Corps as from 2007. Accordingly, DMB is committed to make an annual donation of NIS 100 thousands for three years, starting with 2007. At the beginning of 2011, Discount Mortgage Bank has committed for three additional years. In addition to the monetary contribution, DMB employees participate in special events held by the Regiment and support the activities of the Regiment and its servicemen. DMB has decided to continue adopting the Regiment for an additional period of three years.

Volunteer activities at DMB. During the Jewish High Holidays, employees of DMB distributed pre-paid magnetic cards for the purchase of foodstuff to needy families all over the country. In addition, for the past two years DMB is engaged in a joint project with the Mishluma for the development of Jaffa (an agency of the Tel Aviv-Jaffa Municipality focused on the development of Jaffa). As part of the project, DMB operates on a weekly basis, a learning assistance station for the benefit of children of the Ethiopian community in Jaffa.

EMPLOYMENT OF HANDICAPPED PERSONNEL

As part of its personnel recruitment policy, the Bank offers disabled persons, who generally are not accepted by employers, the opportunity of being integrated into positions at the Bank suitable to their ability and according to the Bank's requirements. This offers such persons the opportunity to function as regular citizens who provide for themselves with self respect.

"HERZELILINBLUM" - BANKING AND TEL AVIV NOSTALGIA MUSEUM

The Herzelilinblum Museum of Banking and Tel Aviv Nostalgia forms an additional layer of the longstanding tradition of contribution to the community. 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 years old preserved building, one of the first houses of Ahuzat Bait. Great emphasis had been put on the restoration of the original house, "Schieff House", built originally as a dwelling house.

Visitors. Since its opening in May 2009, the Museum hosted some 110,000 visitors of various populations: organized groups, young people, servicemen, students and more. In 2011, the Museum hosted some 45 thousand visitors within the framework of 1,200 activities of all kinds.

Guided tours. The Museum offers to the general public various types of tours, such as: history focused tours; economic-banking focused tours; tours that include guided tours of the vicinity of the Museum (the Ahuzat Bait area); tours including various lectures; guided tours of changing exhibitions.

Conferences and events. The museum hosts conferences and various events initiated by the Bank. In 2011, over fifty events were held for corporations, business forums and organizations, for units of the Bank and their customers. Some sixty meetings of "A window to banking" – introduction meetings with the Bank for new and existing employees – were held during the year.

Children's workshops. During school vacations 216 workshops for children have been held: of which 174 workshops for children on economic subjects, 42 workshops of historical subjects and 14 workshops for children aged 4-6 years (jointly with the "Ein Dor" Museum).

Changing exhibitions. The Museum presents changing exhibitions, including works from the Bank's art collection. Among the more outstanding exhibitions held in 2010, the following may be mentioned:

"Inspiration". An exhibition of works of art created by senior executives in the economy, held in March 2011. This is a joint enterprise of the Economy Heads Forum, Discount Bank, Herzelilinblum Museum and the Globes newspaper. Proceeds of sale of the works were donated for the establishment of a social, educational and cultural center for solitary servicemen at the Servicemen House in Ramat-Gan.

From an orange to @ - this is no legend. An exhibition of nostalgic items dating to the beginning of manufacturing industry in Israel and up to "straight out of the oven" blue-white medical developments, presented in the "Medica" exhibition held in

November 2010 in Düsseldorf, Germany, presenting the story of Israeli industry.

In 2010, the State of Israel became a member of the OECD, known also as the "club of industrialized countries", which engraved on its flag economic cooperation and development.

This important event caused the Museum to organize an exhibition presenting the stages, achievements, and trends in the development of the industry and the economy in Israel. From "Jaffa oranges", the start of industry in Israel at the beginning of the twentieth century, and up to the "@" – a reminder of the Internet and hi-tech era.

One hall of the Museum shows in chronological order various milestones in the development of industry in Israel. Another hall shows the interaction and contribution of the economy and industry to education and co-existence with our neighboring countries as well as "blue and white" breakthroughs.

"Circles of Life" Exhibition. On the occasion of Independence Day and Remembrance Day for the Fallen IDF Soldiers, the Museum presented an exhibition of the "Circle of Life" works of the artist David Mei-Tal. The works reflect the circles of life relating to the artist's family, confronting bereavement and pain, and dedicated to the men of the Golani Brigade in memory of the artist's son, Lt. Colonel Amir Mei-Tal, a battalion commander in the Brigade who was killed in action in Lebanon on December 12, 1988, during the "Blue and Brown" operation. Present at the opening event were a number of the commanding officers of the Golani Brigade and soldiers of its Reconnaissance Group, the Deputy Chief of Staff of the IDF, Major General Moshe Kaplinski, the former Chief of Staff, Lt. General (Rtd.) Gabby Ashkenazi and the Bank's Management.

"Future currency". Some twenty artists present their vision as to how would money coins look in twenty years time.

"Soskin - the camera, the city and the home" exhibition. This exhibition was opened on September 22, 2011, and some 250 visitors participated in the opening event.

Mr. Avraham Soskin (1881-1963) was known as "the photographer of Tel Aviv" and as the one who photographed the historic event of the "Ahuzat Bait" land lottery in April of 1909, when the Tel Aviv landscape was only a shoreline and sand dunes. Soskin who began to photograph the country of Israel more than one hundred years ago, documented the establishment of the country, the building of Tel Aviv, the leaders of the Jewish community, the first settlers in towns and villages and more.

The uniqueness of the exhibition is in the focusing on the juncture between the "public" and "private" Soskin. Alongside his classical photographs, the exhibition presents also artistic experiments performed by him as well as a selection of his personal effects.

The Golani Race. In June 2011, on occasion of the annual Golani Race, the Museum was elected as one of the target points of the Race. 80 of the Golani Brigade soldiers reached the Bank's Museum to view a film depicting the heritage of the Golani Brigade.

Love Day tours. On the eve of Love Day, short forty minutes tours were conducted on the theme of "Tel Aviv love stories".

A White Night in Tel Aviv. Within the framework of the White Night events, the Museum has conducted 18 tours for some 500 visitors and a film about the photographer Avraham Soskin was screened on the front of the Museum building.

Cooperation with the Ministry of Education. Since the establishment of the Museum, dozens of schools have visited it, pupils from second to twelfth grades, each age group being allotted a suitable tour plan.

This year, the Museum has focused its activity in the educational field on planning unique tours for pupils studying civics and social studies at five unit level.

Three study programs have been devised for this purpose:

- 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.

Recognition of the Museum as a heritage site. By means of the Society for Preservation of Israel Heritage Sites, the Herzlilnblum Museum has been officially recognized as a heritage site in Israel, thereby joining about one hundred other such sites in Israel. Among others present at the unveiling of the preservation plaque fixed to the front of the building, were the Culture and Sports

Minister, Ms. Limor Livnat, the Chairman of the Board, the President & CEO and members of the Bank's Management.

"MA'ALEH" RATING FOR 2011

In June 2011, "Ma'aleh" published its rating for 2011. The Bank has been rated, for the third year in a row, under the "Platinum" category, relating to companies having the highest grades.

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.

85 corporations took part in the rating in 2011, the total financial turnover of which comprised 60% of Israel's business product.

"THE MARCH OF THE LIVING"

In May 2011, a delegation of Discount Bank employees participated for the ninth 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 70 of the Bank's staff. This continued a tradition started in 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.

ARTS

Discount's art collection contains some 1,700 original works and about 4,000 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 2010. Within in this framework the Bank lent the following works from its art collection.

On the occasion of the Israeli Independence Day, the Bank had sent on loan five video art productions, which were screened at the Israeli Consulate in Boston.

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.

Upon completion of the work, the tiles will be exhibited at the Ashdod Art Museum.

Guided public tours. Guided tours of the Bank's art collection, open to the public, are conducted on Friday mornings at the Discount Tower. Over sixty tours were made during 2011, in which over 1,600 guests 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>.

CULTURAL EVENTS

"Aida at the foot of Masada". Following the success of "Nabucco at the foot of Masada" in 2010, the Bank again sponsored, jointly with the Israeli Opera, two performances of the opera "Aida", which was staged at the foot of Masada in June 2011. Shuttles were organized to bring the Bank's customers and employees to the performance, where they enjoyed an exceptional and captivating artistic experience.

SPONSORSHIPS

During 2011, the Bank granted sponsorship to entities and activities promoting social, sporting, cultural, artistic and educational and business goals.

CULTURAL, ARTISTIC AND EDUCATIONAL SPONSORSHIPS

Testimony Theatre. This is the fourth year running in which the Bank sponsors the project of Testimony Theatre, which commemorates the stories of Holocaust survivors on the theatre stage, and afterwards in an inter-generation meeting between high school students and Holocaust survivors.

Sponsorship for the "SuperPartners" exhibition. In September 2011, the Bank sponsored an exhibition at the Tel Aviv Museum of Art, with the participation of the artists Shay Azouly and Reuven Israel.

Sponsorship of a film on the subject of condition of Holocaust survivors. Production of a sequence to the film "Restitution Moral", dealing with the condition of Holocaust survivors in Israel and abroad. The film was broadcasted on Channel 1 on Holocaust Day.

Sponsorship for a documentary film regarding "Start-up" Association. The production of a documentary film regarding the activity of "Industry Start-up" of the "Start-up" Association.

Teachers Organization. Sponsorship for the Israel Education Conference held at Airportcity with the participation of members of the Teachers Organization.

Armored Corp Memorial Association. Sponsorship for a seminar held by the Association on the subject of the battle heritage of the Armored Corp.

The Tel Aviv Soloists Ensemble. Sponsorship for a Gala Evening in honor of the tenth anniversary of the establishment of the Tel Aviv Ensemble.

SPORTS SPONSORSHIPS

Sponsorship of the Tel Aviv University Sports club. The Bank sponsors this club which offers a wide range of sport facilities to the Tel Aviv university students.

Sponsorship of the Basketball Association. Within the framework of the sponsorship, the Bank's customers enjoyed benefits when purchasing tickets for games of the Israeli basketball team.

Hapoel Jerusalem. Sub-sponsorship of the Hapoel Migdal Jerusalem basketball team.

ENVIRONMENTAL PROTECTION, SCIENCE, AND BUSINESS SPONSORSHIPS

The Arava research and Development Convention. Sponsorship of an Open Day at the Arava, comprising the largest agricultural exhibition in Israel, showing the latest innovations in the field of modern agriculture.

Herzliyah Conference. Sponsorship of the Herzliyah Conference focusing on the interaction between economics, society and governance. The Bank's Chairman of the Board, Dr. Yossi Bachar, participated in the global economy session.

Global entrepreneurship week. In an international event on the subject of entrepreneurship, the Bank joined the "Global entrepreneurship week" Association and a lecture was given on the "Herzelilblum Museum", being an example for a unique

entrepreneurship.

Conference on the provident funds pact. The conference has been held in Eilat with the participation of investment managers and directors of industry provident funds and representatives of units providing services for such institutions on behalf of banks and investment houses.

SPONSORSHIPS REGARDING HEALTH ISSUES

Association for fighting A-T disease. Sponsorship for the premiere performance "A good finish" at the Chamber Theatre in aid of the Association.

Friends of the Bnai Zion Medical Center Association. Sponsorship for a health day encouraging awareness of female health held in Haifa.

Edith Wolfson Medical Center. Sponsorship of a gala evening organized by the Friends of the Edith Wolfson Medical Center for the promotion of its pediatric department.

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,			
	2011	2010	2011	2010
For Auditing⁽³⁾:				
To the joint auditors	19,937	*19,351	7,607	7,598
For Other Services:				
Audit related services ⁽⁴⁾ :				
To the joint auditors	4,365	*5,280	3,825	4,784
Taxation Services ⁽⁵⁾ :				
To the joint auditors	3,307	*3,001	1,797	875
Other Services:				
To the joint auditors	1,975	2,133	1,424	1,173
Total	9,647	10,414	7,046	6,832
Total Auditors' Remuneration	29,584	29,765	14,653	14,430

* Reclassified.

Footnotes:

- (1) The auditors' remuneration includes payments to partnerships and corporations under their control and also includes payments pursuant to the VAT law.
- (2) Includes remuneration that has been paid and remuneration that has been accrued.
- (3) Auditing annual financial statements and reviewing interim financial statements. 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 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⁾	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 ⁽⁴⁾	Chairman of the Board	100%	⁽⁵⁾ -	1,884	1,629	836	40	4,389	(4,315)	74	-
Reuven Spiegel ⁽⁶⁾	President & CEO of the Bank	100%	-	2,238	1,889	2,032	317	6,476	1,277	7,753	-
Ehud Arnon	President & CEO of IDB New York	100%	-	2,108	1,376	177	36	3,697	-	3,697	-
Israel David	President & 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	-
Yoav 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 Corporate Banking Division	100%	-	919	552	806	81	2,358	-	2,358	-
Yair Avidan group	Executive Vice President, Chief Risk Manager and Head of Risk Management	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, 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 and 26, 2012. The award is brought for approval of the Board of Directors on March 28, 2012. The award will be brought for approval of the general meeting of the shareholders at a near date.

(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, for details see Note 22G and H to the financial statements. The amount of benefits and grossing-up includes payments in respect of rent amounting to NIS 164 thousand.

(7) On January 29, 2012, Mr. Harmelech gave notice of termination of his employment with Mercantile Discount Bank. His retirement will become effective on April 30, 2012.

(8) Mr. Hanegbi retired from office on September 30, 2011. As of December 31, 2011, employer/employee relations have not as yet been terminated.

Year 2010

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	Chairman of the Board	100%	-	⁽⁴⁾ 1,814	⁽⁴⁾ 500	2,007	-	4,321	6,414	10,735	-
Giora Offer ⁽⁵⁾	President & CEO of the Bank	100%	0.02%	2,415	-	1,236	146	3,797	(2,193)	1,604	-
Reuven Spiegel ⁽⁶⁾	President & CEO of IDB New York	100%	-	3,043	⁽⁷⁾ 5,788	**660	-	9,491	-	9,491	-
Jacob Tennenbaum	President & CEO of Mercantile Discount Bank	100%	-	1,728	1,330	947	-	4,005	-	4,005	-
Israel David	President & CEO of ICC	100%	-	1,292	644	2,198	-	4,134	376	4,510	-
Ilyse Baum	Executive Vice President and Chief Lending Officer of IDB New York	100%	-	1,860	**323	739	-	2,922	-	2,922	-
Noam Hanegbi ⁽⁸⁾	Senior Executive Vice President, Head of Retail Banking Division	100%	-	1,093	-	320	8	1,421	376	1,797	-
Shlomo Pitchon ⁽⁹⁾	Senior Executive Vice President, Internal Auditor	100%	⁽¹⁰⁾ -	1,080	-	320	12	1,412	313	1,725	-
Esther Deutsch	Senior Executive Vice President, Legal Adviser	100%	-	921	-	237	5	1,163	548	1,711	-

* The amounts of the remuneration are in cost terms to the Bank and do not include payroll tax.

** Reclassified.

(1) Including an adaptation award, severance pay, provident pay, further education fund, vacation pay and National Insurance contributions.

(2) Complementing provisions for related benefits following changes.

(3) The expense was computed according to the value assessed at date of allotment of the options warrants of capital plans. In the phantom option plans the benefit is adjusted at each reporting date.

(4) Remuneration, terms of employment and phantom option plans were approved by General Meeting of Shareholders of the dates November 10, 2001 and January 25, 2010.

(5) Retired from office on December 31, 2010.

(6) Appointed President & CEO of the bank on January 1, 2011.

(7) The amount includes awards in respect of the years 2009 and 2010, as well as retirement award upon his appointment as President & CEO of the bank.

(8) Until April 26, 2010, he acted as Head of the Operations and Information Division.

(9) Mr. Pitchon retired from office on December 31, 2010.

(10) Mr. Pitchon owns shares in the Bank in a negligible par value amount of NIS 22,727.

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 G and H to the financial statements. For details regarding the phantom option plan granted to Dr. Bachar, see Note 13 E 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 G and H to the financial statements. For details regarding the phantom option plan granted to Mr. Spiegel, see Note 13 E 1 to the financial statements.

Mr. Spiegel served as President & CEO of IDB New York until February 28, 2011. Mr Spiegel was employed by the subsidiary under a personal agreement. The period of employment was until June 30, 2012, following which the agreement was supposed to be automatically renewed each time for a period of one year which may be terminated by either of the parties with a prior notice of six months. Upon termination of his employment, Mr. Spiegel was entitled to a payment equal to one year salary. Mr. Spiegel's monthly salary was reviewed by IDB New York every year and could have been updated at the end of each year in accordance with the rise in the consumer price index in the US. Mr. Spiegel was entitled to social benefits (National Insurance contributions, pension within the framework of the pension plans in effect at the subsidiary, at the rate of 1.5% per each year of employment, on condition that he completes at least five years of employment), as well as to life assurance, medical care and loss of work ability insurance. Mr. Spiegel, as the other members of management of IDB New York, was entitled to an annual award on condition that IDB New York reaches 80% of the forecasted annual earnings in accordance with the annual work plan, in addition, a long-term remuneration plan for management members exists, whereby an additional award is paid for attaining the profitability target for three consecutive years. IDB New York provided Mr. Spiegel with an appropriate motor vehicle and he was also entitled to an annual home leave in Israel.

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.

Mr. Israel David, serves as President & CEO of Israel Credit Cards ("ICC") since April 1, 2010. He is employed by ICC under a personal employment agreement for a fixed period starting on April 1, 2010 and ending December 31, 2014. Thereafter, the agreement shall become a non-fixed term agreement until Mr. David reaches retirement. Mr. David is 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 is entitled according to the agreement to severance pay under the law. In addition, if ICC decides to terminate his employment, Mr. David will be entitled to adaptation award, as follows: if his employment is terminated before the end of the fixed period and before the end of two years since beginning of his employment, he will be entitled to an award equal to nine months pay with the addition of 23.33% in lieu of social benefits contributions; If his employment is terminated before the end of the fixed period but after the end of two years since beginning of his employment, he will be entitled to an award equal to six months pay with the addition of the said 23.33%; If his employment is terminated after the end of the fixed period, he will be entitled to an award equal to six months pay. The non-competition period is three months since the termination of employment, unless otherwise agreed by the parties.

Mr. Israel David is also entitled to remuneration within the framework of the 2011-2013 remuneration plan, approved in September 2011. The entitlement to an award in respect to a certain calendar year is conditional upon the fulfillment of

threshold conditions determined in the plan, which define quantitative targets regarding net earnings and off-banking credit cards, as well as attaining a minimum level of compliance with risk management limitations to be determined by the board of directors. The annual award payable to Mr. David will be composed of an award based on a formula, to be computed according to the attainment of four indices based on the performance of ICC (net earnings, market share, number of off-banking credit cards and financing income) and an additional index – any annual focusing index to be determined in each year by the board of directors of ICC. The said annual award will also include an additional award to be distributed at the discretion of the board of directors of ICC. When considering this award, the board of directors will take into account, among other things, a qualitative evaluation of the manner of ICC's risk management during the year of the award and whether the company has attained the goals set determined in this respect by the board of directors of the company as well as compliance with laws, regulations and company procedures. In a year of award, in respect of which Mr. Israel David will not be entitled to a computed award, no additional award will be distributed. The payment of the annual award in respect of a certain award year will be made in three installments. If in a certain award year, all threshold conditions are not fulfilled, then all deferred award installments that should have been paid at date of payment of the annual award in respect of that award year, shall be cancelled and shall not be paid.

Mr. Israel David will also be entitled to a long-term award, to be computed depending on the attainment of cumulative net earning goals of ICC over the period of the remuneration plan. Mr. David shall not be entitled to the long-term award if employer/employee relations with him will be terminated before January 1, 2014.

Mr. David served as Deputy President and Head of the Retail Banking Division (at present, the Banking Division) until March 31, 2010. Mr. David was employed under a personal employment agreement for an indeterminate period, which either of the parties could terminate giving a prior notice of four months. According to the agreement, Mr. David was 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, and in the event of the CPI falling, his salary was not changed until such time that the rise in the CPI offsets the rate of the fall. The salary of Mr. David has been updated as from April 2008.

Mr. David 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. David is entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. David is among management members entitled to awards according to the award plan, as stated in Note 16 G to the financial statements as well as to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 E (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 is considered for the purpose of the plan, as if his employment by the Bank had not been terminated. Mr. David received a retirement award as well as a prior notice in the amount equal to eight monthly salaries.

Mr. Ram Harmelech. Deputy CEO and Head of the Corporate Division at Mercantile Discount Bank, employed by Mercantile Discount Bank under a personal employment agreement for a determined employment period, the original termination date thereof is March 16, 2024. Notwithstanding the above, the agreement entitles each of the parties to terminate the engagement between them giving a prior notice of three months.

It should be mentioned in this respect that in January 29, 2012, Mr. Harmelech has informed of his decision to terminate his employment by Mercantile Discount Bank. His retirement is expected to become effective on April 30, 2012.

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.

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. 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 is employed under a personal employment agreement for an indeterminate period, which either of the parties may terminate giving a prior notice of four months. According to the agreement, Mr. Hanegbi is prohibited from competing against the Bank for a period of six months following the termination of employment, unless otherwise agreed by the parties. His salary is linked to the CPI, and in the event of the CPI falling, his salary will not change until such time that the rise in the CPI offsets the rate of the fall. Mr. Hanegbi is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. Hanegbi is entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. Hanegbi was among management members entitled to awards according to the award plan, which had been in effect until the year 2010, as stated in Note 16 I to the financial statements as well as to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 E (2) to the financial statements.

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 as well as to a retirement award equal to six months salary. 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.

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 equal to six months salary. 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. Giora Offer, acted as the Bank's President & CEO in the period from since March 2, 2001 to December 31, 2010. Mr. Offer was employed under a personal agreement. For details regarding the terms of employment of Mr. Offer, including entitlement to an

annual award, see Note 22 I to the financial statements. For details regarding Mr. Offer's stock option plan, see Note 13 E (3) to the financial statements. Mr. Offer waived 10% of his gross remuneration (excluding as regards provisions and related benefits) for a period of one year, starting February 2009.

Mr. Jacob Tennenbaum. The President & CEO of the subsidiary Mercantile Discount Bank (hereinafter: "MDB") is employed under a personal employment agreement. The period of employment is a determined period of five years ending in July 2011. Subsequent to that date (and provided the employment is not terminated prior to this date by either of the parties), the employment agreement shall continue in effect for an indeterminate period until Mr. Tennenbaum reaches retirement age, during which period either of the parties is entitled to terminate the agreement giving a prior notice of six months. In the event that MDB decides to terminate the employment of Mr. Tennenbaum in the course of the determined period, then MDB is obligated to pay to Mr. Tennenbaum until the end of the determined period, his full salary including the related benefits or his full salary excluding the related benefits but with the addition of 15%, as elected by MDB. Mr. Tennenbaum shall be prohibited from competing against MDB during a period of three month following the termination of employment, unless otherwise agreed by the parties. Mr. Tennenbaum is entitled to annual vacation, sick leave, recreation pay, appropriate motor vehicle, social benefits (severance benefits as determined by law, provident payments, loss of ability to work insurance and further education fund) as well as other benefits. Upon retirement from office, Mr. Tennenbaum is entitled under the agreement to severance payment in accordance with the law. In addition, he is entitled to a special award upon termination of his employment (whether by MDB or by himself), as follows: if termination of employment occurs within the five year determined period he is entitled to an award equal to a six months salary; if termination of employment occurs after six years he is entitled to an award equal to a nine months salary; if termination of employment occurs after seven years he is entitled to an award equal to a twelve months salary. Alternatively, if his employment is terminated following the sale of MDB, transfer of the control thereof or merger thereof, Mr. Tennenbaum will be entitled to a special award of twelve months salary. In the event that MDB offers shares to the public, within the framework of which shares and/or share options will be allotted to employees, then Mr. Tennenbaum will be entitled to a similar allotment at rates and under terms to be decided by MDB's board of directors considering his office as President & CEO. In 2009, Mr. Tennenbaum waived 7% of his annual remuneration.

Mr. Shlomo Pitchon, was employed by the Bank as Senior executive Vice President and acted as the Internal Auditor until December 31, 2010 (termination of employer/employee relations on March 31, 2011). Mr. Pitchon was employed under a personal employment agreement for an indeterminate period, which either of the parties may terminate giving a prior notice of six months. According to the agreement, Mr. Pitchon was 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, and in the event of the CPI falling, his salary will not change until such time that the rise in the CPI offsets the rate of the fall. Mr. Pitchon 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. Pitchon was entitled to severance payment in accordance with the law as well as to a retirement award equal to six months salary. Mr. Pitchon is among management members entitled to awards according to the award plan, as stated in Note 16 G to the financial statements as well as to option warrants in accordance with the option plan for senior executives at the Bank, as detailed in Note 13 E (2) to the financial statements.

Ms. Esther Deutch, employed by the Bank as Senior Executive Vice President, Chief Legal Advisor. Ms. Deutch 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. Deutch 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. Deutch 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. Deutch is entitled to severance payment in accordance with the law as well as to a retirement award equal to six months

salary. Ms. Deutch is among management members that were entitled to awards according to the award plan, as stated in Note 16 I to the financial statements. Ms. Deutsch 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. Ms. Deutsch is entitled to phantom options, as detailed in Note 13(e)(4) to the financial statements.

TRANSACTIONS WITH CONTROLLING SHAREHOLDERS

NEGLECTIBLE TRANSACTIONS

General - Amendment of the Securities Regulations - Immediate report regarding transactions with controlling shareholders.

According to law, the Bank must submit immediate and periodic reports with respect to any exceptional transaction entered into by the Bank. The Companies Law states that an "extraordinary transaction" is "a transaction not in a company's ordinary course of business, a transaction that is not undertaken in market conditions or a transaction that is likely substantially to influence the profitability of a company, its property or liabilities".

The Amendment of the Securities Regulations (Periodic and Immediate Reports), 1970, (hereinafter: "the Amendment") came into effect on August 6, 2008. Pursuant to this Amendment, a reporting corporation is required, among other things, to submit an immediate report with respect to "details regarding a transaction with the controlling shareholder, or in which the controlling shareholder has a personal interest in its approval, including principal details of the transaction or of the engagement, details of the Organ approving the transaction and a summary of the grounds for its approval; in this Section - "transaction" - excluding a transaction where other transactions of its kind, have been determined as negligible in the most recent financial statements".

The term "negligible transaction" originates in Regulation 64(3) of the Securities Regulations (Preparation of Annual Financial Statements), 1993 (hereinafter: "financial statements regulations") which deals with disclosure in financial statements of transactions of the corporation with an interested party therein. This Regulation determined the extent of the disclosure which is required regarding such transactions, and it also grants an exemption from providing the disclosure where a negligible transaction is involved.

Whereas the financial statements regulations do not apply to banks, where instead directives of the Supervisor of Banks as to preparation of financial statements apply, the Union of Banks referred to the Israel Securities Authority the question as to how the instruction regarding a "negligible transaction" should apply to banks. In its reply to the Union of Banks dated August 6, 2008, the Israel Securities Authority informed that it will not interfere in cases where no disclosure will be given in an immediate report to banking transactions that do not constitute extraordinary transactions, as defined in Section 1 to the Companies Law, provided the following are fulfilled:

- The upcoming quarterly financial statements as of September 30, 2008 (and thereafter the periodic statements) shall include a general description of the transactions, their characteristics and the criteria determined for defining the transactions as negligible or as such that are not extraordinary, providing details of the facts, reasons and explanations for such determinations;
- The audit committee of the corporation is to establish criteria for determining a transaction as unusual or negligible;
- Within the framework of describing the engagement with a controlling shareholder as regards office and employment, a general description shall be included as to his financing transactions with the bank (if any) and their characteristics.

Disclosure and reporting outline. The Securities Authority has issued a guideline to the Bank with respect to the disclosure to be included in a Prospectus of the Bank and thereafter in annual financial statements, in the following format:

- (a) With respect to banking transactions with controlling shareholders that are not considered extraordinary transactions, the Bank shall report in the Prospectus as well as in periodic reports the balances of credit granted and of deposits made in accordance with the format appearing in the following tables;

- (b) As from the annual financial statements for 2009, the Bank is required to disclose the highest balance during the period of deposits made by controlling shareholders;
- (c) As from the annual financial statements for 2009, the disclosure provided in the credit table should be given separately for the balance of credit granted to a controlling shareholder and the balance of credit granted to relatives of the controlling shareholder (on a cumulative basis). Disclosure as to credit granted to each reporting corporation related to a controlling shareholder shall be provided on a consolidated basis at the level of each such reporting corporation.

Criteria for extraordinary and for negligible transactions. For the purpose of implementing the guideline of the Securities Authority, as stated above, the Bank is required to determine criteria for the definition of a "negligible transaction" - with respect to non-banking transactions, "negligible transaction" - with respect to banking transactions and "market terms", as well as to the manner of approval and disclosure of debt transactions to which Proper Banking Management Directive No. 312 does not apply. Accordingly, the Audit Committee of the Board of Directors decided on August 27, 2009, as follows:

"Negligible transaction" - a transaction, other than a banking transaction that complies with the criteria detailed hereunder, is considered a "negligible transaction":

- (1) A transaction for the purchase of retail products from a controlling shareholder or a transaction for the purchase of retail products in which the controlling shareholder has a personal interest - a transaction in the ordinary course of business undertaken in market conditions the volume of which does not exceed NIS 2.5 million, provided that the total of the transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity as defined in Directive No. 312 of Proper Banking Management Directives (hereinafter: "regulatory shareholders' equity"). The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.
- (2) A transaction for the purchase of services from a controlling shareholder or a transaction for the purchase of services in which the controlling shareholder has a personal interest, provided that it is not an engagement with a controlling shareholder or his relative concerning the terms of his office and employment, in the ordinary course of business undertaken in market conditions, the volume of which does not exceed NIS 2.5 million, provided that the total of the transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity. The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.
- (3) Transactions for the rental of space from a controlling shareholder or transactions for the rental of space in which the controlling shareholder has a personal interest, that have been approved in any one calendar year in the ordinary course of business, undertaken in market conditions, the total of which does not exceed 0.1% of the regulatory shareholders' equity.
- (4) Reimbursement of expenses of a controlling shareholder in the ordinary course of business and under market conditions, incurred for the purpose of participating in events representing the Bank or in customer conventions of the Bank and its subsidiaries by their invitation - expenses of up to US\$100,000 per annum.
- (5) Any other transaction in the ordinary course of business undertaken in existing market conditions the volume of which is up to NIS 250,000, provided that the total of transactions of its kind in any one calendar year shall not exceed 0.1% of the regulatory shareholders' equity. The said amount shall not apply to individual transactions the volume of each is under NIS 25,000.

"Extraordinary transaction"

- (a) Regarding banking transactions that are debt transactions - a debt transaction shall be considered as material if in consequence thereof the total indebtedness of the controlling shareholders will exceed 5% of the regulatory shareholders' equity, or if the increase in the indebtedness of a single borrower of the group, following such transaction, exceeds 2% of the said equity. In the event that several debt transactions have been approved to the same single borrower during any calendar year, the said debt transactions are to be measured on a cumulative basis. For this purpose, measurement of the total indebtedness shall be made separately in respect of the Bronfman Group (on a cumulative basis), with respect to the Schron Group (on a cumulative basis) and with respect to any other corporation the volume of credit granted to it is not restricted in accordance with Section 5 of Proper Banking Management Directive No. 312, at the corporation's level on a

consolidated basis, so that the total indebtedness of each of those shall not exceed 5% of the said equity.

"Controlling shareholder group" - a controlling shareholder together with the private companies related to him, within the meaning 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 provision 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 J,K and O and Note 19 C (7) (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, 2011										
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 un favor of a third party		Indebtedness of a controlling shareholder regarding transactions in derivatives ⁽¹⁾⁽²⁾	
	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period	Balance at end of period	A high balance during the period
in NIS millions										
The Bronfman group	8	23	3	12	-	-	6	9	-	-
Reporting corporations related to the Bronfman group:										
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 period	A high balance during the period
Controlling shareholders, including reporting corporations related to the controlling shareholders									10	28

(1) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.

(2) There was no par value of the said transaction as of December 31, 2011, the highest balance during the period amounting to NIS 41 million.

Credit	December 31, 2010									
	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 un favor of a third party		Indebtedness of a controlling shareholder regarding transactions in derivatives ⁽¹⁾⁽²⁾	
	A high balance during the period		A high balance during the period		A high balance during the period		A high balance during the period		A high balance during the period	
	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period	Balance at end of period
in NIS millions										
The Bronfman group	3	45	2	12	-	-	10	15	-	-
Reporting corporations related to the Bronfman group:										
Isralom properties Ltd	7	12	3	10	-	-	-	-	-	-
Shufersal Ltd	-	2	41	46	38	39	-	-	0.9	1.1
Total of reporting corporations	7	14	44	56	38	39	-	-	-	-
Total for the Bronfman group	10	59	46	68	38	39	10	15	0.9	1.1
Schron group	7	7	-	-	3	3	-	-	-	-
Deposits									Balance of deposits	
									Balance at end of period	A high balance during the period
Controlling shareholders, including reporting corporations related to the controlling shareholders									201	337

(1) 10% of the balance of a future transaction with the addition of mark to market.

(2) The par value of the said transaction as of December 31, 2011, amounted to NIS 9 million, the highest balance during the period amounting to NIS 11 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). On June 16, 2011, the special meeting of the Bank's shareholders approved the renewal of officers liability insurance policy as detailed in the Immediate Report dated June 16, 2011, (Ref. No. 2011-01-185736). See also Note 19 C 7 (L) to the financial statements.

Amendment of the employment terms of the President & CEO. As detailed in the Immediate Report dated May 3, 2011 (Ref. No. 2011-01-137292), a certain amendment had been approved in the engagement terms of the President & CEO, as regards the provisions for provident contributions, which does not involve an increase in the cost of engagement of the President & CEO.

The information detailed in the said reports is presented here by reference.

Amendment of the Bank's By-Laws. On March 21, 2012, a special meeting of shareholders of the Bank approved the amendment of the Bank's By-Laws 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 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. This directive was applied for the first time in the financial statements for the second quarter of 2005.

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, 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 2010, the Bank conducted a process of validation and updating of existing processes and addition of new processes, by means of the SOX unit established within the Accounting 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 instructions of the Supervisor of Banks and on the date prescribed by these instructions.

CHANGES IN INTERNAL CONTROL

During the fourth quarter ended on December 31, 2011, 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 at MDB and at the Bank, as detailed below.

Changes in internal control at the Bank and at MDB. At the end of 2010, the Bank and MDB integrated an internal information system, developed by the Bank, used for the management and reporting of impaired debts, credit risk and provisions for credit losses (the "Chotam" system). This system implements the new Directives issued by the Supervisor of Banks in this respect and which became effective on January 1, 2011 (see also Note 1 B (5) to the financial statements).

Integration of the new system in the branches, Head Office units dealing with credit and at the units dealing with special credits was completed at the beginning of 2011. The new system replaced the previous local information system that was adjusted to the previous reporting requirements (which were in effect until December 31, 2010).

Following the initial implementation of the directives of the Supervisor of Banks and the integration of the system as above, a material change took place in 2011 in the process of identification, classification and computation of the allowance for credit losses.

For the purpose of the preparation of the credit data and the allowance for credit losses for the financial statements for the first quarter in their new format, and for the purpose of the evaluation of the effectiveness of the controls and procedures regarding their disclosure for the first quarter, the Bank has begun mapping the control environment related to the work procedures for

the identification and classification of problematic debts and of computing the allowance for credit losses. The mapping, as stated, is in an advanced stage but has not yet been completed. Key controls regarding these issues relating to the completeness of data and reasonableness of the results have been implemented during the preparation of the financial statements for the first, second and third quarters of 2011. Furthermore in the course of integration of the system, the Bank and Mercantile Discount Bank have adopted means of control designed to assure proper integration of the system. Notwithstanding, as stated, integration of the new system was completed at the beginning of 2011, with the usual mishaps and failures that accompany the putting into operation of such systems, and among other things, this required making manual corrections to the products of the system. The Bank will continue to act towards rectifying the deficiencies and completing the mapping of the control environment, as early as possible.

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 states (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 the management thereof" above.

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.

The Bank implements an emergency scenario drill routine on an ongoing basis. Such drill routine comprises a vital component of the examination of the Bank's readiness to face threat scenarios and to secure compliance with the targets of service levels.

In the course of 2011, the following principal moves were conducted:

- The Bank has actively participated in the national emergency exercise "Turning Point 5". As part of the exercise, the Bank has exercised the operation of the situation room, disposition and operation of a mobile branch, the operation of a core branch and the entry of employee into protected shelters;
- The GDPS system for the optimal management of the data update process and recovery of the Bank's central computer system has been put into operation and exercised;
- The electric and air-conditioning infrastructure of the central computer facilities have been upgraded;
- Thirty "core branches" have been qualified and equipped for operation in emergency situations.
- The crisis management ability of the situation room has been upgraded – a designated crisis management system has been acquired and installed;
- A project has been launched for the upgrading of the backup format of the dealing room to a "hot backup;"
- An analysis has been performed of the programs for the maintenance of business continuity at the subsidiaries abroad.

PROPER BANKING MANAGEMENT DIRECTIVE REGARDING "MANAGEMENT OF BUSINESS CONTINUATION"

On December 25, 2011, the Supervisor of Banks issued a new Proper Banking Management Directive (No.355) regarding the management of business continuation. The directive has been prepared within the framework of the updating of the proper banking management Directives and their modification to the Basel framework, and with a view of adopting and implementing proper procedures for the management of business continuation by banking corporations.

The directive clarifies the responsibility of the Board of Directors and of senior management for the integration of a framework for the management of business continuation and establishment of proper supervision. The framework for the management of business continuation includes work procedures in the areas of infrastructure, corporate governance and risk management, designed to ensure that banking corporations shall continue to provide principal banking services despite the occurrence of events causing severe operational disruption of their systems and activity.

The directive details the four principal components that have to be included in the framework for the management of business continuation: analysis of business implications, within the framework of which, the risks and potential effect on the banking corporation in the short, medium and long-run are identified and assessed; the recovery strategy, which defines targets for the level of service which the banking corporation shall endeavor to provide in case of disruption, while determining time schedules for renewal of such services; a plan for the continuation of business operations, which defines duties, areas of responsibility and authority to make decisions in case of disruption as well as the triggers for its activation; monitoring risks and exercise program.

According to the directive, the appointment, among other things, of a business continuation officer will be required as well as of a team to manage the crisis, which will be composed also of senior management members, the duties of the team being the management of the crisis and the taking of decisions in stress situations. The directive includes guidelines regarding location, infrastructure and the manner of operation of the alternative business locations of the banking corporation, which will be maintained in a ready condition to enable the banking corporation to maintain business continuity in case of damage to its principal locations.

The Directive will take effect on July 1, 2012, with the exception of the provisions regarding business continuation of suppliers and providers of services to vital processes and regarding the alternative site, which will take effect on December 31, 2012.

The Bank is preparing for the implementation of the Directive.

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 DIRECTORS⁸

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 Coordination Committee, Computer Committee, Credit Committee and the Remuneration Committee, member of the Strategy Committee and member of the Risk Management 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 Israel Credit Cards Ltd. (since March 2012), as Director and Deputy Chairman of the Board of Israel Discount Bank of New York (since January, 2010) and as Director of Discount Bancorp Inc. (since January, 2010). Also serves as CEO and Chairman of the Board of Amiad Av. Ltd. (since July 2007) and Chairman of the Board 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 General of the Ministry of Finance (November 2003 - January 2007), Head of the Tax Authority (provisional appointment) (January 2007 - April 2007), Chairman of the Advisory Committee of Klirmark Capital Ltd. (April 2009 - November 2009), 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).

Ilan Biran – Serves as Outside Director of the Bank since October 29, 2008, appointed for an additional period of office since October 29, 2011. Mr. Biran is a member of the Audit Committee, the Committee for the review of the financial statements, Credit Committee, Computer Committee and the Risk Management Committee.

Acts as an Outside Director under the Companies Law, 1999, having accounting and financial expertise as well as professional qualifications.

Mr. Biran has an academic education - Bachelors in Economics and Business Administration from Bar-Ilan University and holder of a diploma/strategic studies in strategy and economics from Georgetown University, Washington DC.

Serves as Chairman of the Board of Rafael Advanced Defense Systems Ltd. and Centriton Ltd. and as Chairman of the Management Committee, Kinneret College on the Sea of Galilee (R.A.).

Served as Chairman of the Board of Beit Shemesh Engines Holdings (1997) Ltd. (2006-2007), DBS Satellite Services (1998) Ltd. (2004-2006) and as Director in Delta Three Israel Ltd. (2004 - November 2008), as Director and Chairman of the Strategic Research and Development Committee of Israel Aircraft Industries Ltd. (2005-2007), as Director 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).

Eli Eliezer Gonen – Acts as Director of the Bank since November 10, 2010. Mr. Gonen is a member of the Remuneration Committee,

⁸ 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.

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), of Ma'ale Hachamisha Hotel (since February 2011), and of the Ghetto Fighters House - Itzhak Katzenelson Holocaust and Jewish Resistance Heritage Museum (since July 2008); 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) and in Hapoel Jerusalem - Management Company Ltd. Served 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 as General Manager of the Sheraton-Moriah Hotel Chain in Israel (1999-2009).

Ilan Cohen - Acts as Director of the Bank since November 10, 2010. Mr. Cohen acts as Chairman of the Strategy Committee and member of the Coordination committee, the Remuneration Committee and the Computer Committee.

Acts as an outside 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, as Director and deputy Chairman of Edmond de Rothschild Private Equity Management Ltd., as Director of Hadaka Hatishim Ltd., of P.O.C. Investment Company (1999) Ltd., of Tal-Ya Water Technologies 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 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 Committee for the review of the financial statements.

Acts as an outside 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 outside Director in Gav-Yam Ltd. (since 2006), outside Director in Excellence Nessuah Brokerage Services Ltd. (since 2010) and as consultant to New-Pharm Ltd. (since 2007).

Acted as Director of Otzar Hachayal Bank Ltd. (2006-March 21, 2012), as outside Director of Direct Investments House (Mutual Trust Funds) (2006-2010), 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).

Edith Lusky - Serves as Outside 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 Chairperson of the Committee for the review of the Financial Statements, as member of the Coordination committee, the Remuneration Committee, the Corporate Governance Committee and the Risk Management Committee.

Serves as an Outside Director in accordance with the Companies Law, 1999. Has financial and accounting expertise and professional qualifications.

Ms. Lusky has an academic education - Master of Economics and Bachelor of Economics and Statistics from Tel Aviv University. Acts as director of Netvision Ltd. (July 2011-December 2011) and in 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) and as a Director of Igud Leasing Ltd. (March 2007 - December 2008), and as a Director of Igudim Insurance Agency (1995) Ltd. (September 2005 - December 2008), Igudim Ltd. (September 2005 -December 2008) and Livluf Insurance Agency (1993) Ltd. (February 2004 - December 2008).

Jorge Zafran - Serves as Director of the Bank since January 31, 2006. Mr. Zafran acts as Chairman of the Corporate Governance Committee, a member of the Audit Committee, the Risk Management Committee, the Credit 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 Coordination committee, the Committee for the review of the Financial Statements, the Credit Committee, the Corporate Governance Committee and the Strategy Committee.

Serves as an Outside Director according to Directive No. 301 of the Proper Banking Management Directive and has accounting and financial expertise as well as professional qualifications.

Mr. Aish is a Certified Public Accountant 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 Outside Director and Chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd. (December 2003 - September 2007) and as Outside Director and Chairman of the Risk Management Committee of MDB (November 2000 - October 2006).

Joseph Ciechanover-Itzhar - Serves as Director of the Bank since June 3, 2009. Mr. Ciechanover-Itzhar acts as member of the Remuneration Committee and of the Risk Management 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., Director of Harel Insurance Investments and Financial Services Ltd. and of the Israel Museum. Deputy chairman of the Board of Hillel - The Israel Center for Jewish Campus Life (PBC), member and Treasurer of the Elie Wiesel - Foundation of Humanity. Chairman of the Dr. Jacob Isler Association for Assisting the Handicapped and Bereaved Families and member of 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).

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 Shryz 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). 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).

Yali Sheffi - Acts as Director of the Bank since November 10, 2010. Mr. Sheffi acts as member of the committee for the review of the Financial Statements, the Credit Committee, the Remuneration Committee, the Strategy Committee and the Computer Committee.

Acts as an outside 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).

Owner manager of a private business consulting company (since June, 2009), 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).

DETAILS REGARDING MEMBERS OF MANAGEMENT

Reuven Spiegl - serves 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.

Serves 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. (Director since March 2011) and as Director of Israel Discount Bank of New York.

Acted 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. (October 2011-December 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) and as head of the Retail Banking Division at Israel Discount Bank Ltd. (April 2001 to February 2006).

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.

Serves as Director of Israel Discount Capital Markets & Investments Ltd. (since September 1999), Badal Computer and

Management Services Ltd. (since February 2002), Nidbach Real Estate and Investments Ltd. and Discount Reinsurance International Limited, Guernsey (since March 2008) and of Diners Club Israel Ltd. (since July 2011).

Served as Chairman of the Board of Discount Gemel Ltd. (until December 2008) and as Director of Israel Credit Cards Ltd. (June 2010 – June 2011).

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 the board of Discount Mortgage Bank Ltd. ("DMB") (since March 2011) and Diners Club Israel (since January 2012).

Served as 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) and as Manager of the Jerusalem Region of Bank Leumi Le'Israel B.M. (2001-2006).

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.

Acted 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) and as Manager of the Bank's Legal Consulting Department (2000 - June 2006).

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) and manager of the Foreign Extensions Department at Israel Discount Bank Ltd. (February, 2001 - August, 2006). 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, 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.

Serves 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, 2006).

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 head of the Ofek project at the Israel Discount Bank Ltd. (2001-2006), 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 11, 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.

Acted as manager of the large corporations department at Israel Discount Bank Ltd. (January 2007 to March 2011), as manager of the special credit department at Israel Discount Bank Ltd. (January 2000 to December 2006) 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.

Serves as President & CEO of Badal Computer and Management Services Ltd. (since May 2010, Director since August 2004), and as Director of DMB (since 2006), 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).

Acted as deputy head of the Operations and Information Systems Division, 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).

Acted 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 Bachelor 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 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) and as lecturer in securities and finance at the College of Management (since 1994).

Acted as chairman of the board of REIT 1 (May 2008 - June 2011), as outside 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 Otzar Hachayal Bank (November 2000 - July 2006), and of the First International Bank (August 2006 - March 2011).

DISCLOSURE REGARDING THE PROCESS OF APPROVAL OF THE FINANCIAL STATEMENTS

General. On April 27, 2008, the Supervisor of Banks issued a provisional directive in the matter of "Disclosure in the Directors' Report regarding the Process of Approval of the Financial Statements". The directive adopts the guidelines of the Securities Authority on the subject issued in July 2007. According to the directive, banks must include in their quarterly and annual Directors' Reports information as to the process of approval of the financial statements.

Companies Regulations (Directives and terms regarding the process of approval of financial statements), 2010 [hereinafter: "Companies Regulations (Financial statements approval)"]. The said Regulations state, among other things, the matters in respect of which, the committee appointed to review the financial statements will form recommendations to the Board of Directors. Among other things, the Regulations further state that the chairman of the committee reviewing the financial statements will be an outside director, most of its members will be independent directors, all its members have the ability to read and understand financial statements and at least one of the independent directors will have accounting and financial expertise.

Overall control at the Bank. The Bank's Board of Directors is the organ entrusted with the overall control at the Bank. The committee for the review of the financial statements is the entity entrusted with the supervision, control and guidance of the process of the approval of the Bank's financial statements, and this Committee, at the conclusion of its work, submits its recommendations regarding the approval of the financial statements to the Board. The committee for the review of the financial statements is comprised of five Directors, which are Directors having accounting and financial expertise and independent Directors, as follows: Ms. Edith Lusky (outside director), chairman of the committee, Mr. Ilan Biran (outside director), Mr. David Levinson, Mr. Ilan Aish and Mr. Yali Sheffi.

Process of approval of the interim financial statements. Approval of the financial statements includes the following stages and organs:

Disclosure Committee. As part of the implementation of the Bank of Israel directives in the matter of disclosure in the financial statements, which are based on Section 302 of the Sarbanes Oxley Act (see hereunder), the Bank has formed a Disclosure Committee headed by the President & CEO with the participation of the following management members: Mr. Joseph Beressi, Senior Executive Vice President - Chief Accountant; Ms. Esther Deutsch, Senior Executive Vice President - Chief Legal Adviser and Legal Risks Manager; Mr. Yuval Gavish, Senior Executive Vice President - Head of the Banking Division; Mr. Yigal Ronay, Executive Vice President - Head of the Finance Division and Risk and Liquidity Manager of the Bank; Mr. Yair Avidan, Executive Vice President - Head of the Risk Management Group and the Bank's Chief Risk Manager; Ms. Orit Alster, Executive Vice President - Head of the Corporate Division and Credit Risk Manager; Mr. Shai Vardi, Executive Vice President - Head of Technologies & Planning Division. The Bank's Corporate Secretary and other entities at the Bank are also invited to attend the meetings of the Committee. The Internal Auditor and the Bank's independent auditors are also invited to attend the meetings of the Disclosure Committee as observers. The Committee convenes once in every quarter (or more if required) and discusses material disclosure matters in accordance with principles determined within the framework of the disclosure policy adopted by the Bank's Board of Directors.

The committee for the review of the financial statements. The committee for the review of the financial statements discusses the draft of the Bank's financial statements, including matters determined in the Companies Regulations (Financial statements approval), and is making recommendations to the Board of Directors in their respect, also discusses the Bank's financial statements on a stand alone basis (not consolidated).

Prior to the discussions by the committee for the review of the financial statements, the draft financial statements are provided to the Committee members for review together with additional documents intended to assist them in understanding and analyzing the financial statements, as well as extensive details regarding problematic debts and provisions for doubtful debts. The committee for the review of the financial statements discusses the statements in detail with the participation of senior

officers related to financial reporting (the President & CEO, the Chief Accountant and other entities at the Bank, where required). The independent auditors and the Internal Auditor are invited to attend the meetings as observers.

As part of the discussions, the Chief Accountant reports to the Committee on matters related to the financial statements or matters that might have an impact on the financial statements, such as new regulatory requirements that have been published or which are expected to be published. The Committee is authorized to discuss and decide on the disclosure of critical accounting policies.

Within the framework of discussing the financial statements, the Committee also discusses cases of borrowers where the recommended provisions in respect to their debt to the Bank exceed the amount determined by the Board, and recommends to the Board the provision to be made in their respect.

The committee for the review of the financial statements as well as the Audit Committee of the Board is also informed (if required) of significant deficiencies and weaknesses found in the formation or implementation of the internal control over financial reporting, and of fraud, if any, in which the Bank's Management or other employees playing a significant role in the internal control over financial reporting are involved.

The independent auditors report findings, if any, that came up during their audit of the financial statements as well as other matters which, in their opinion, should be brought to the attention of the committee for the review of the financial statements members.

At the conclusion of the discussion, the committee for the review of the financial statements presents its recommendations to the Board with respect to the approval of the financial statements, prior to the discussion which the Board will be holding in the matter.

The Bank's Board of Directors. Following the discussions by the committee for the review of the financial statements, an additional discussion regarding the approval of the financial statements is held by the full plenum of the Board. Prior to the meeting, the Directors receive an amended draft of the financial statements (which include the recommendations and decisions of the committee for the review of the financial statements) together with the documents provided to the members of the committee for the review of the financial statements for their discussion of the financial statements.

Senior officers involved in financial reporting are also asked to attend the full meeting of the Board are (the President & CEO, the Chief Accountant and other officers where required), as well as the Internal Auditor and the independent auditors of the Bank attending as observers.

The discussion includes a review of the financial statements by the President & CEO and by the Chief Accountant, and a report concerning the adoption of the recommendations of the committee for the review of the financial statements.

The independent auditors report any findings of their audit of the financial statements as well as other matters which, in their opinion, should be brought to the attention of the Board members.

During the discussion, Board members refer to management questions and requests for clarifications regarding items that have been included (or should have been included) in the financial statements to others involved in the financial reporting. At the end of the discussion, subject to satisfactory answers on the part of management, the Board approves the financial statements.

REPORT ON DIRECTORS HAVING ACCOUNTING AND FINANCIAL EXPERTISE

According to Section 92 (a)(12) of the Companies Law, the Board of Directors must determine the required minimum number of directors having accounting and financial expertise, as this term is defined in Section 240 of the Companies Law.

In accordance with regulations enacted under the said Section 240, the evaluation of the accounting and financial expertise of a director shall be made by the board of directors, and, among other things, the following should be taken into account as part of the overall considerations: the director's education, experience and knowledge of the matters detailed in the Companies Regulations (terms and tests for a director having accounting and financial expertise and a director having professional qualifications), 2005.

In March 2004 and February 2006, the Bank's Board of Directors has resolved that the minimum number of Directors having accounting and financial expertise acting on the Board, will be three.

Following this, and in view of the instructions of the Supervisor of Banks, it was determined in February 2006 that the minimum number of Directors having accounting and financial expertise, that it is fit and proper that they should be appointed members of the Audit Committee of the Board and of any other committee of the Board that is authorized to discuss the financial reports of the Bank, is one Director.

As stated in the disclosure regarding the process of approval of the financial statements, in accordance with the Companies Regulations (Approval of reports), a committee for the review of the financial statements has been established, which complies with the terms specified in the Regulations.

Furthermore, 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. Both the composition of the Board of Directors and of the Audit Committee is in agreement with these terms.

The Directors having "accounting and financial expertise", and the factual background providing the basis for attributing these qualifications to them, are as follows. It should be mentioned that according to the reporting requirements of the Bank of Israel, against each name of a director it is stated whether he is a member of the review of the financial statements committee of the board and/or a member of the audit committee of the board.

Dr. Yossi Bachar - is a Certified Public Accountant, Dr. of Business Administration (specializing in finance), Master of Business Administration (specializing in finance) and Bachelor of Economics and Accounting.

Served as Chairman of the Board of Mercantile Discount Bank Ltd. (as Director since January 5, 2010, and as Chairman since January 2010 – February 2012) Director General of the Ministry of Finance (November 2003 - January 2007) and as Head of the Tax Authority (provisional appointment) (January 2007 - April 2007) and as partner and manager of Luboshitz Kasierer Accounting Firm (formerly Arthur Andersen and later Ernst and Young) (April 1995 - November 2003).

Since January 2010, Dr. Bachar acts as Acting Chairman of the Board of the Bank, as Director and Deputy Chairman of Israel Discount Bank of New York. Dr. Bachar acts as member of the financial statements committee and as Director of Discount Bancorp Inc, since March 2012 serves as Chairman of the Board of Israel Credit Cards.

Ilan Biran - Bachelor of Economics and Business Administration and holder of a diploma/strategic studies in strategy and economics.

Serves as Chairman of the Board of Rafael Advanced Defense Systems Ltd., Chairman, manager committee Kinneret College on the Sea of Galilee (R.A).

Serves as Director General of the Ministry of Defense (1996-1999), Bezeq the Israel Telecommunications Corp. Ltd. (1999-2003) and as Chairman of the Boards of Beit Shemesh Engines Holdings (1997) Ltd. (2006-2007) and of DBS Satellite Services (1998) Ltd. (2004-2006) and as Director in Delta three Israel Ltd. (2004-2008) as Director and Chairman of the Strategic Committee of Israel Aircraft Industries Ltd. (2005-2007), as Director of Massad Bank Ltd. (2005-2007), as Director and member of the Finance Committee and of the Audit Committee of Netafim Ltd. (2004-2007), as a consultant at Venture Partner Consultant, The Challenge Fund - Etgar L.P. (until December 2009).

Mr. Biran serves as member of the Audit Committee and the committee for the review of the financial statements.

Eli Eliezer Gonen - 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), as Chairman of the Board of Ma'ale Hachamisha Hotel (since February 2011), and of the Ghetto Fighters House - Itzhak Katzenelson Holocaust and Jewish Resistance Heritage Museum (since July 2008); partner, director and joint general manager of Terra Holdings, Management and Investments in Hotels Ltd. (since September 2009) and Director of the International Convention Center I.C.C. Jerusalem -

Binyaney Haooma Ltd. (since 1998). Served as President of the Israel Hotel Association (2000 - December 2010) as Director of Tambour Ltd. (2002-2007), of Crystal Machinery and Electrical Appliances Ltd. (2004-2006), 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 - 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. Serves as Director and deputy Chairman of Edmond de Rothschild Private Equity Management Ltd., as Director of Hadaka Hatishim Ltd., of P.O.C. Investment Company (1999) Ltd. and of Tal-Ya Water Technologies Ltd. President & CEO of Ilan Cohen Investment and Entrepreneurship Ltd. and of Yield Investment Advisors Ltd.

Served as Director of the Alliance Israelite Association (2007 - November, 2009) and as Director General of the Prime Minister's Office (2004-2006).

David Levinson - Master of business administration from the Tel Aviv University and Bachelor of economics and statistics from the Hebrew University, Jerusalem.

Acts as outside Director in Gav-Yam Ltd. (since 2006), outside Director in Excellence Nessuah Brokerage Services Ltd. (since 2010) and as consultant to New-Pharm Ltd. (since 2007).

Acted as Director of Otzar Hachayal Bank Ltd. (2006-March 21, 2012), as outside Director of Direct Investments House (Mutual Trust Funds) (2006-2010), 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).

Mr. Levinson serves as a member of the Committee for the review of the financial statements.

Edith Lusky - Master of Economics and Bachelor of Economics and Statistics.

Served as Senior vice president and member of management of Union Bank of Israel Ltd. (2004-2008) 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.

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.

Ms. Lusky serves as Chairman of the Audit Committee and as Chairman of the committee for the review of the financial statements.

Ilan (Eilon) Aish - Certified Public Accountant, Bachelor of Economics and Accounting.

Serves as Joint Managing Director, Harvest Capital Markets Ltd.

Served as a partner in the accounting firm of Yigal Brightman & Co. (1984-1992) and in the accounting firm of Vulcan, Weinberg, Aish & Co. (1993-2000) and as consulting partner in the accounting firm of Goldstein, Sabu, Tevet (2001-2004).

Served as Outside Director and chairman of the Investments Committee of the Provident Fund of IBM Israel Employees Ltd.

(December 2003 - September 2007), and as Outside Director and chairman of the Risk Management Committee of MDB (November 2000 - October 2006). In addition acted as Director of Harisha Tuff Lanka (Private) Ltd., (April 2007 - December 2009), Chairman and General Partner in Tuff Industries (April 2002 - December 2008) and as Chairman of the Board of Tuff Merom Golan (2000) Ltd. (April 2002 - December 2008).

Mr. Aish serves as a member of the Audit Committee and of the committee for the review of the financial statements.

Joseph Ciechanover-Itzhar - has a Ph.D. in Philosophy and Jewish Studies from Boston University; studies at the Jewish Theological Seminary at Boston University. Has an L.L.M. from the University of California Law School, Berkley, and a Magister Juris from the Hebrew University Law School, and studies towards a Masters Degree at the Business Administration Department at the Hebrew University (no degree).

Serves as Director of the Azrieli Group Ltd., of Harel Insurance Investments and Financial Services Ltd. and of the Israel Museum, president of I.Y.Z. Investments Ltd. and of Atidim-Etgar Nihul Kranot Ltd. and as Deputy Chairman of Hillel - The Foundation for Jewish Campus Life in Israel (NPO). In addition, a member and treasurer of the Elie Wiesel Foundation for Humanity and Chairman of the Dr. Jacob Isler Fund for Assisting the Handicapped and Bereaved Families.

Served as Chairman of El-Al Israel Airlines Ltd. (1995-2002). Between the years 1985 and 1995 served as President and member of the Board of PEC - Israel Economic Corporation Ltd. and member of the Board and of the Executive Committee of IDB Holding Company Ltd. Served as Chairman of Israel Discount Bank Ltd. and was a member of the Advisory Committee of the Bank of Israel (1986-1991).

Acted as Director General of the Foreign Ministry (1978-1980), as Head of the Defense Ministry Delegation to the United States (1974-1978), as Legal Advisor to the Defense Ministry (1968-1974) and has served in various positions in public service (1957-1978).

Yali Sheffi - Certified public accountant, 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). Direct PhD. studies in mathematical economics, at the Hebrew University, Jerusalem (not completed).

Owner manager of a private business consulting company (since June, 2009). 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. 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 - Briteaman 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).

Mr. Sheffi serves as a member of the committee for the review of the financial statements.

CHANGES IN THE BOARD OF DIRECTORS AND MANAGEMENT

CHANGES IN THE BOARD OF DIRECTORS

The tenure of office as Director of Dr. Yitzhak Sharir ended with the General meeting of October 26, 2011.

Under Proper Banking Management Directive No.301, Messrs. Ben-Zion Granit, Ben-zion Zilberfarb and Zvi Streigold concluded their term of office as outside Directors.

The Chairman of the Board and the Directors thank Directors, who have ended their tenure of office, for their contribution to the Bank during their service.

The General Meeting of Shareholders held on October 26, 2011, resolved to appoint Mr. Ilan Biran for an additional term as Director in the status of outside Director as defined in the Companies Act, 1999, with effect from October 29, 2011. The Meeting

further resolved to appoint Mr. Ilan (Eilon) Aish for an additional term as outside Director in accordance with Proper Banking Management Directive No.301, with effect from November 1, 2011.

A Special Meeting of Shareholders held on March 21, resolved to appoint Mr. David Levinson as a Director at the Bank, in the status of outside Director under Proper Banking Management Directive No.301, in addition to the acting Directors. This appointment takes effect on March 21, 2012. Furthermore, it was resolved to appoint Ms. Edith Lusky for an additional term as Director in the status of outside Director as defined in the Companies Act, 1999, with effect from March 25, 2012.

CHANGES IN MANAGEMENT

On January 1, 2011 Mr. Spiegel took office as the Bank's President & CEO.

On January 11, 2011, Mr. Yuval Gavish, Senior Executive Vice President, took office as the Head of the Bank's Banking Division.

On March 21, 2011, Ms. Orit Alster, Executive Vice President, took office as head of the Bank's Corporate Division.

Mr. Nir Abel took office on May 18, 2011, as the Bank's Internal Auditor.

On July 3, 2011, Mr. Yigal Ronay, Executive Vice President, took office as Head of the Finance Division. Mr. Ronay replaced Ms. Dorit Ben-Simon, Senior Executive Vice President, who retired from office on June 30, 2011.

On August 12, 2011, Mr. Yosi Perets, Executive Vice President, took office as Head of the Human Resource Group. Mr. Peretz replaced Mr. Amnon Gideon, Senior Executive Vice President, who retired from office on August 11, 2011.

On August 28, 2011, Mr. Abraham Levi, Executive Vice President, took office as Head of the Clients Assets Management Division.

On October 1, 2011, Mr. Gilad Sokolov, Executive Vice President, took office as Head of the Strategy Marketing and Service Division. Mr. Sokolov replaced Mr. Noam Hanegbi, Senior Executive Vice President, who retired from office on September 30, 2011.

The Board of Directors, the President & CEO and Management thank Ms. Ben-Simon and Messrs. Gideon and Hanegbi for their endeavors and contribution during their term of office at the Bank and wish success to the new members of Management.

MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

In 2011, the Board of Directors held 36 meetings. In addition, 95 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 28, 2012

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:

	December 31, 2011			
	Net adjusted cost	Fair value	Cumulative other comprehensive income	
			profits	losses
In NIS millions				
Non governmental bonds and bills				
Various sectors*	325	310	8	23
Financial services ⁽¹⁾	3,128	2,829	22	321
Total non governmental bonds and bills	3,453	3,139	30	344
Government bonds and bills				
US government**	3,913	3,932	36	17
Israel Government	16,844	16,991	217	70
Other Governments	440	443	4	1
Total government bonds and bills	21,197	21,366	257	88
Government Sponsored Enterprises (GSE) Agencies				
Freddie Mac	3,014	3,061	53	6
Fannie Mae	5,291	5,359	73	5
Other	51	51	-	-
Total government Sponsored Enterprises (GSE) Agencies	8,356	8,471	126	11
Total available-for-sale bonds	33,006	32,976	413	443
	December 31, 2010			
Total non governmental bonds and bills	3,552	3,369	55	238
Total government bonds and bills	17,265	17,430	206	41
Total government Sponsored Enterprises (GSE) Agencies	6,623	6,751	140	12
Total available-for-sale bonds	27,440	27,550	401	291

*There is no segment in the said group the fair value of investments in its related bonds exceeds NIS 91 million.

**Including Ginnie Mae bonds in a fair value of NIS 3,538 million.

1. AVAILABLE FOR SALE BONDS - DATA ACCORDING TO ECONOMIC SECTORS (CONTINUED)

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

	December 31, 2011			
	Net adjusted	Fair	Cumulative other	
	cost	value	profits	losses
In NIS millions				
Banks and banking holding companies ⁽²⁾	3,052	2,758	22	316
Insurance	16	14	-	2
Other	60	57	-	3
Total financial services	3,128	2,829	22	321

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

North America ⁽³⁾	1,486	1,226	11	271
West Europe ⁽⁴⁾	642	608	1	35
Israel	742	745	10	7
Australia	105	102	-	3
Other	77	77	-	-
Total bank and other banking holding companies	3,052	2,758	22	316

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

Rating				
AA	4	4	-	-
AA-	29	29	-	-
A+ to A-	940	805	-	135
BBB+ to BBB-	206	155	-	51
BB+ to B-	257	187	-	70
Not rated	50	46	11	15
Total	1,486	1,226	11	271

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

England	289	266	-	23
Switzerland	146	141	-	5
Other*	207	201	1	7
Total	642	608	1	35

* 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, 2011				
Non governmental bonds and bills				
Various sectors	20	20	-	-
Financial services	114	120	6	-
Total non governmental bonds and bills	134	140	6	-
Total Government bonds and bills	5,033	5,241	208	-
Government Sponsored Enterprises (GSE) Agencies				
Freddie Mac	181	185	4	-
Fannie Mae	159	162	3	-
Other government agencies	388	387	-	1
Total government Sponsored Enterprises (GSE) Agencies	728	734	7	1
Total held-to-maturity bonds	5,895	6,115	221	1
December 31, 2010				
Total non governmental bonds and bills	313	323	10	-
Total government bonds and bills	4,785	4,845	76	16
Total government Sponsored Enterprises (GSE) Agencies	1,654	1,617	8	45
Total held-to-maturity bonds	6,752	6,785	94	61

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, 2011				
Non governmental bonds and bills				
Various sectors *	43	37	-	6
Financial services	65	49	-	16
Total non governmental bonds and bills	108	86	-	22
Total government bonds and bills	3,233	3,241	9	1
Total government Sponsored Enterprises (GSE) Agencies	37	37	-	-
Total trading bonds	3,378	3,364	9	23

December 31, 2010				
Total non governmental bonds and bills	**95	**90	1	6
Total government bonds and bills	**2,074	**2,073	3	4
Total government Sponsored Enterprises (GSE) Agencies	18	18	-	-
Total trading bonds	2,187	2,181	4	10

*There is no sector in the said group the fair value of investments in its related bonds exceeds NIS 18 million.

** Reclassified between government bonds and non governmental bonds and bills

4. EXPOSURE TO ALT-A LOANS AND TO SUB-PRIME LOANS

IDB New York held on December 31, 2010, a portfolio of held-to-maturity bonds, bonds of the RMBS ALT-A type, with a total balance sheet exposure of NIS 149 million.

The rating of all mortgage backed securities of the Alt-A type has been decreased during 2010 to below the investment rating. IDB New York recorded in 2010 a provision for impairment of an other than temporary nature in the amount of NIS 42 million in respect of these securities.

All securities of the RMBS type were sold in the first quarter of 2011 (see Note 3 D to the financial statements).

5. EXPOSURE TO COMMERCIAL MORTGAGE BACKED SECURITIES (CMBS)

IDB New York holds commercial mortgage backed securities (CMBS) with a total balance sheet exposure of NIS 57 million. 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, 2011, 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 issued by GNMA, FNMA and FHLMC agencies, due to the fact that all layers of the said securities reflect identical credit risk.

For details regarding the sale of some of the securities, in July 2011, see Note 3 D to the financial statements.

5. EXPOSURE TO COMMERCIAL MORTGAGE BACKED SECURITIES (CMBS) (CONTINUED)

Following are details regarding CMBS Exposure:

Maturity Date	As at December 31, 2011			As at December 31, 2010		
	Adjusted cost	Fair Value	Book Value	Adjusted cost	Fair Value	Book Value
in NIS millions						
2039-2040	17	17	17	17	18	17
2045-2047	5	5	5	12	14	12
2049-2051	35	38	35	39	44	39
Total	57	61	57	68	76	68

6. UNREALIZED LOSSES - SHARES AVAILABLE FOR SALE

On December 31, 2011, and December 31, 2010, there were no unrealized accumulated losses in respect of available-for sale shares.

7. UNREALIZED LOSSES - MORTGAGE 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:

the ratio of unrealized loss to the cost of the investment and the period of time in which the loss occurred.					
Ratio of unrealized loss to amortized cost	Period of decline in fair value below amortized cost				Total
	Up to 6 months	From 6 to 9 months	From 9 to 12 months	Over 12 months	
In NIS millions					
December 31, 2011					
Up to 20%	18	1	-	9	28
Total	18	1	-	9	28
December 31, 2010					
Up to 20%	16	1	-	-	17
Total	16	1	-	-	17

8. DETAILS REGARDING CERTAIN BONDS HELD BY IDB NEW YORK IN THEIR AVAILABLE FOR SALE PORTFOLIO

Presented below are details as of December 31, 2011 and December 31, 2010, 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 2011								March 9 2012
Securities Ratings								
Issuer's / Group's Name	Net adjusted Cost	Market Value	Unrealized Loss	Final Maturity	Moody's	S&P	Fitch	Unrealized Loss
in NIS thousands								
Securities with ratio of unrealized loss over 40%								
United Bancshares Inc	17,401	9,553	(7,848)	2037	NR	NR	NR	(6,691)
Barclays Bank	19,105	11,392	(7,713)	2026	Aa3	NR	A	(5,617)
International Bankshare Corp	17,752	10,126	(7,626)	2037	NR	NR	NR	(6,470)
Total securities with ratio of unrealized loss over 40%	54,258	31,071	(23,187)					(18,778)
Securities with ratio of unrealized loss from 20% to 40%								
Morgan Chase .P.J	246,619	177,126	(69,493)	2027	A2	BBB	A	(52,436)
Wells Fargo	212,100	157,265	(54,835)	2027	Baa1	BBB+	A	(44,500)
Bank of America	198,241	145,618	(52,623)	2028	Ba1	BB+	BBB-	(57,665)
Suntrust	78,770	55,469	(23,301)	2028	NR	BB+	BBB-	(22,612)
Huntington Bank	19,105	14,093	(5,012)	2027	Baa1	BB+	BBB-	(4,977)
First Maryland	18,547	14,206	(4,341)	2027	Baa2	BBB-	NR	(4,372)
Keycorp	3,794	2,828	(966)	2028	Baa3	BBB-	BBB	(857)
Total securities with ratio of unrealized loss from 20% to 40%	777,176	566,605	(210,571)					(187,419)

Notes:

NR - Non Rated

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

8. DETAILS REGARDING CERTAIN BONDS HELD BY IDB NEW YORK IN THEIR AVAILABLE FOR SALE PORTFOLIO (CONTINUED)

December 31 2010							
Securities Ratings							
Issuer's / Group's Name	Net adjusted Cost	Market Value	Unrealized Loss	Final Maturity	Moody's	S&P	Fitch
in NIS thousands							
Securities with ratio of unrealized loss over 40%							
Community Trust Bancorp	16,567	7,450	(9,117)	2037	NR	NR	NR
United Bancshares Inc	16,102	7,453	(8,649)	2037	NR	NR	NR
International Bankshare Corp	16,439	7,808	(8,631)	2037	NR	NR	NR
Argentina - Boden	25	7	(18)	2012	B3	B	B
Total securities with ratio of unrealized loss over 40%	49,133	22,718	(26,415)				
Securities with ratio of unrealized loss from 20% to 40%							
Bank of America	183,828	134,316	(49,512)	2028	Baa3	BB+	BBB-
Wells Fargo	196,948	154,044	(42,904)	2027	Baa1	A-	A
Morgan Chase .P.J	178,383	139,894	(38,489)	2037	A2	BBB+	A
Suntrust Capital	73,131	53,672	(19,459)	2027	NR	BB	BBB-
Huntington Bank	17,745	12,084	(5,661)	2027	Ba1	BB-	BBB-
Barclays Bank	17,745	12,084	(5,661)	2026	Aa3	NR	AA-
First Maryland	17,195	13,476	(3,719)	2027	Baa2	BBB-	NR
Other	3,524	2,474	(1,050)	2037			
Total securities with ratio of unrealized loss from 20% to 40%	688,499	522,044	(166,455)				

Notes:

NR - Non Rated

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

As of December 13, 2011, 97% 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 81 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 the following criteria:

- A five-year cumulative deferral of interest at the option of the issuer. If interest is deferred, all prior interest deferred is contractually due to the holder of the instrument after the deferral period ends.
- The debenture issued must also have a minimum stated maturity of 30 years (not to exceed 50 years for tax-deductibility) and be subordinate to all other forms of debt issued by the BHC.
- The issuer may not announce of an early redemption until the end of the first five years.
- TRUPS may not have voting rights.
- Restrictions - the FRB has restricted the maximum amount of cumulative preferred stock (TRUPS or regular perpetual preferred stocks) that will be eligible for inclusion as tier I (core) capital up to 25% of total capital. Any excess over 25% is treated as tier II (supplementary) capital.
- Deferral Provision - Dividend payments on a security may be deferred by the issuer for up to five years accumulated. If an issuer elects to defer interest payments on TRUPS it must also cease dividend/interest payments on preferred and common stock.
- Parent Guarantee - TRUPS have a parent holding company guarantee that only provides for payment of dividends or distributions, if the SPTV has sufficient funds to pay investors. If the BHC has defaulted on its junior subordinated note payment to the SPTV and as a consequence the latter does not have funds on hand to pay investors, then the BHC is not obligated to pay any amount owed on the TRUPS.

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.

During the fourth quarter, in light of the Bank of Israel's instruction, a provision for impairment due to securities of two issuers was registered, as a result of the Bank incurring unrealized losses amounting to over 40% of their value, over a number of sequential quarters. As shown in the above table, subsequent to the balance sheet date, the market price of some of the securities presented in the above table has increased. As of March 9, 2012, there are no securities carrying unrealized losses of over 40%.

During the fourth quarter, 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. As seen from the above Table, the market price of several of the securities presented in the said Table has risen subsequent to the balance sheet date. As of March 9, 2012, none of the securities carry unrealized losses of more than 40%.

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, 2011.

JP Morgan Chase (JPM). JPM reported a net income of US\$3.7 billion for the fourth quarter 2011, compared with a net income of US\$4.3 billion in the third quarter 2011 and a net income of US\$4.8 billion in the corresponding quarter last year. Allowance for credit losses was \$2.19 billion, compared to US\$2.35 billion in the previous quarter and compared to US\$3.2 billion in the corresponding quarter last year. Earnings per share amounted to US\$0.9 in the fourth quarter 2011 compared with US\$1.01 per share in the previous quarter. Total assets amounted to US\$2.26 trillion, a decrease compared to US\$2.29 trillion in the previous quarter. Non-performing loans at the fourth quarter 2011 were 5.06% of gross loans, a decrease compared to 5.18% in the previous quarter.

JPM remains a well-capitalized institution, having a Total Capital ratio of 15.40% as of December 31, 2011, compared to 15.32% in the previous quarter.

Subsequent to balance sheet date the security's price of JPM increased by approx. 10% compared to the market price as of December 31, 2011.

Wells Fargo & Co. (WFC). WFC reported a net income of US\$4.1 billion for the fourth quarter 2011, similar to the pervious quarter 2011 and compared to net income of US\$3.4 billion in the corresponding quarter last year. Allowance for credit losses amounted to US\$2.07 billion, an increase compared to \$1.84 billion in the previous quarter and a decrease compared to US\$2.98 billion in the corresponding quarter last year. The earnings per share amounted to US\$0.73 in the fourth quarter 2011 compared with US\$0.72 per share in the previous quarter. Total assets amounted to US\$1.3 trillion, similar to the previous quarter-end. Non-performing loans at the fourth quarter 2011 were 6.41% of gross loans, an increase compared to 6.28% in the previous quarter.

WFC is a well-capitalized institution, with a Total Capital ratio of 14.76% as of December 31, 2011, compared to 14.86% at the

end of the previous quarter.

Subsequent to balance Sheet date the securities price of WFC increased by approx. 6% compared to the market price as of December 31, 2011.

Bank of America (BOA). BOA reported a net income of US\$1.9 billion for the fourth quarter 2011, compared with a net income of US\$6.2 billion in the third quarter 2011 and a net loss of US\$1.2 billion in the corresponding quarter last year. The fourth quarter's results were effected by among other things, lower average loans and yields leading to net finance income that was lower compared to the corresponding quarter last year and has not changed compared to the previous quarter.

Allowance for credit losses was reduced to US\$2.9 billion compared to US\$3.4 billion in the previous quarter. The earnings per share amounted to US\$0.2 compared to US\$0.56 in the previous quarter. Total assets amounted to US\$2.13 trillion, a decrease compared to US\$2.22 trillion at the end of the previous quarter and compared to \$2.26 trillion in the corresponding quarter last year.

Non-performing loans at the fourth quarter 2011 were 7.54% of gross loans, an increase compared to 7.29% in the previous quarter.

BOA is a well-capitalized institution, with a Total Capital ratio of 16.75% as of December 31, 2011, compared with 15.86% in the previous quarter.

Subsequent to balance sheet date the security's price increased by approx. 4% compared to the market price as of December 31, 2011.

Sun Trust Banks (STI). STI reported a net income of US\$155 million for the fourth quarter 2011, compared with a net income of US\$215 million in the third quarter 2011 and compared to a net income of US\$184 million in the corresponding quarter last year. Allowance for credit losses was reduced to US\$328 million, compared to US\$348 million in the previous quarter. The earnings per share amounted to US\$0.28 in the fourth quarter 2011 compared with US\$0.39 per share in the previous quarter. Total assets amounted to US\$176.9 billion, an increase compared to US\$172.5 billion in the previous quarter.

Non-performing loans at the fourth quarter 2011 were 3.95% of gross loans, a decrease compared to 4.23% in the previous quarter.

STI is a well-capitalized institution, with a Total Capital ratio of 13.73% as of December 31, 2011, compared to 13.91% in the previous quarter.

A study of the volatility in the prices of STI securities during the period subsequent to the balance sheet date (and up to March 9, 2012) has not revealed a significant change in comparison to market prices as of December 31, 2011.

PART "B": ADDITIONAL DETAILS - THIRD PILLAR OF BASEL II

1. TABLE 4 D - COUNTERPARTY TYPE DISTRIBUTION OF EXPOSURES⁽⁴⁾⁽⁵⁾

	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 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
December 31 2010						
Sovereigns	14,212	19,288	-	-	-	33,500
Public sector entities	797	2,898	-	281	39	4,015
Banks	13,039	1,849	-	44	870	15,802
Corporates	*72,113	1,731	-	38,592	923	113,359
Secured by commercial real estate	*1,988	-	-	14	-	2,002
Single retailer exposures	16,543	-	-	17,913	9	34,465
Small business loans	10,026	-	-	3,484	3	13,513
Mortgage	17,775	-	-	2,107	69	19,951
Securitization	-	206	-	-	-	206
Other assets	-	-	7,330 ⁽⁶⁾	-	-	7,330
Total	146,493	25,972	7,330	62,435	1,913	244,143

* Reclassified - sorted from "corporates" to "secured by commercial real estate".

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).

(4) The gross credit balances as of December 31, 2011, are presented net of accounting write-offs and before allowance for credit losses. Such balances at December 31, 2010, are presented after deduction of provisions for doubtful debts.

(5) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1 to the financial statement.

(6) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 5 to the financial statement.

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 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⁾⁽⁷⁾	1,877	1,227	850	765	4,719
Total	144,471	74,411	57,639	9,765	286,286
December 31 2010					
Credit	80,856	42,543	25,914	3,019	152,332
Bonds	8,051	11,192	30,839	-	50,082
Others ⁽³⁾	⁽⁶⁾ 2,313	⁽⁶⁾ 164	208	4,645	7,330
Guarantees and other liabilities on account of clients ⁽⁴⁾	42,987	13,330	4,238	1,880	62,435
Transactions in derivative financial instruments ⁽⁵⁾	14,892	2,767	2,576	-	20,235
Total	149,099	69,996	63,775	9,544	292,414

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 in respect of which they were made.
- (2) Includes past due receivables totaling NIS 1,461 million as of December 31, 2011 and NIS 1,653 million as of December 31, 2010.
- (3) Primarily: cash, shares, fixed assets.
- (4) Off balance sheet credit risk is pre conversion to credit risk (pre multiplying by CCF coefficient).
- (5) Presented as calculated for the purpose of limitation on borrower indebtedness.
- (6) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the financial statement.
- (7) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.

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%	Deduction from capital	Total
in NIS millions									
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
December 31 2010									
Sovereigns	32,673	304	-	-	-	523	-	-	33,500
Public sector entities	-	2,753	-	1,257	-	5	-	-	4,015
Banks	-	13,337	-	1,792	-	672	1	-	15,802
Corporates	-	758	-	749	-	*110,066	1,786	-	113,359
Secured by commercial real estate	-	-	-	-	-	*2,002	-	-	2,002
Single retailer exposures	-	-	-	-	33,591	371	503	-	34,465
Small business loans	-	-	-	-	13,214	68	231	-	13,513
Mortgage	-	-	16,595	-	2,764	470	122	-	19,951
Securitization	-	-	-	35	-	19	-	152	206
Other assets	⁽³⁾ 1,951	⁽³⁾ -	-	-	-	⁽³⁾ 4,869	510	-	7,330
Total	34,624	17,152	16,595	3,833	49,569	119,065	3,153	152	244,143

For footnotes see next page.

3. TABLE 5 - EXPOSURE AMOUNTS ACCORDING TO RISK WEIGHTS (CONTINUED)

	0%	20%	35%	50%	75%	100%	150%	Deduction from capital	Total
in NIS millions									
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
December 31 2010									
Sovereigns	32,978	304	-	-	-	523	-	-	33,805
Public sector entities	-	2,754	-	1,088	-	5	-	-	3,847
Banks	-	7,940	-	7,031	-	671	1	-	15,643
Corporates	-	623	-	749	-	105,199	1,780	-	108,351
Secured by commercial real estate	-	-	-	-	-	2,002	-	-	2,002
Single retailer exposures	-	-	-	-	25,789	370	494	-	26,653
Small business loans	-	-	-	-	10,549	67	214	-	10,830
Mortgage	-	-	16,566	-	2,763	470	122	-	19,921
Securitization	-	-	-	35	-	19	-	-	54
Other assets	⁽³⁾ 1,951	⁽³⁾ -	-	-	-	⁽³⁾ 4,869	510	-	7,330
Total	34,929	11,621	16,566	8,903	39,101	114,195	3,121	-	228,436

* Reclassified - sorted from "corporates" to "secured by commercial real estate".

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) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 to the condensed financial statements.

4. TABLE 7 - REDUCTION OF CREDIT RISK

	Gross credit risk exposure before allowance for credit losses ⁽¹⁾⁽²⁾	Gross credit risk exposure after allowance 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 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 residential 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
December 31 2010						
Sovereigns debts		33,500	-	-	305	33,805
Public sector entities debts		4,015	-	(168)	-	3,847
Banks debts		15,802	(6,775)	-	6,616	15,643
Corporates debts		*113,359	(4,242)	(766)	-	108,351
Secured by residential real estate		*2,002	-	-	-	2,002
Single retailer exposures		34,465	(1,851)	(5,961)	-	26,653
Small business loans		13,513	(2,657)	(26)	-	10,830
Mortgage		19,951	(30)	-	-	19,921
Securitization		206	-	-	-	206
Other assets		⁽⁶⁾ 7,330	-	-	-	7,330
Total		244,143	(15,555)	(6,921)	6,921	228,588

* Reclassified - sorted from "corporates" to "secured by commercial real estate".

Footnotes:

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

5. TABLE 8 - DISCLOSURE REGARDING OVER THE COUNTER DERIVATIVES

	December 31	
	2011	2010
	in NIS millions	
Gross positive fair value of contracts ⁽¹⁾ :		
Interest rate contracts:		
Shekel/CPI	2	1
Other	1,972	1,100
Foreign currency contracts	1,093	970
Contracts on shares	177	82
Commodities and other contracts	27	47
Total Gross positive fair value of contracts	3,271	2,200
Potential off balance sheet exposure ⁽²⁾	1,550	1,709
Netting benefits	(3,052)	(1,996)
Current credit exposure after netting ⁽²⁾	1,769	1,913
Held collateral	(30)	(150)
Net derivatives credit exposure	1,739	1,763

Footnotes:

(1) Including embedded derivatives in the amount of NIS 31 million (December 31, 2010 NIS 72 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

	December 31	
	2011	2010
	in NIS millions	
Mortgage-backed securities (MBS):		
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS)	30	194
Bond backed securities (TRUPS CDO)	-	12
Total mortgage and asset-backed securities	30	206

	December 31			
	2011		2010	
	Total exposure	Capital requirements	Total exposure	Capital requirements
	9%		9%	
	in NIS millions			
Risk weights:				
50%	30	1	35	1
100%	-	-	19	2
Deductions from capital	-	-	152	152
Total	30	1	206	155

7. TABLE 13 - SHARES POSITION IN THE BANK'S PORTFOLIO

Following are details regarding investments in shares

December 31				
	2011		2010	
	Book value	Fair Value	Book value	Fair Value
In NIS millions				
Investments in shares of affiliated companies⁽¹⁾⁽²⁾:				
Non marketable shares	53	53	152	152
Shares in the available-for-sale portfolio:				
Marketable shares	28	33	39	55
Non marketable shares	625	625	626	626
Total shares in the available for sale portfolio	653	658	665	681
Total investment in shares	706	711	817	833

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 to the financial statements and "First International Bank of Israel Ltd." under "Main investee companies" below.

Capital requirement regarding share position⁽¹⁾

December 31		
	2011	2010
In NIS millions		
In respect of investments in venture capital funds, in private equity funds and in fund of hedge funds ⁽²⁾	71	69
In respect of investments in other shares ⁽³⁾	12	17
With respect to owner's loans ⁽³⁾	1	10
Total capital requirement regarding share position	84	96
Investments deducted from capital ⁽⁴⁾	1,576	⁽⁵⁾ 1,538

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 in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4 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	178-181
Table 2a	Capital structure - qualitative disclosure	Note 14 to the financial statements	440-450
Table 2b,c,e	Capital structure - quantitative disclosure	Capital resources - The Bank's capital adequacy Note 14(1),14(4) to the financial statements	440,442
Table 3a	Capital adequacy - qualitative disclosure	Capital resources - The Bank's capital adequacy	37-41
Table 3b,d,e,f,g	Capital adequacy - quantitative disclosure	Capital resources - The Bank's capital adequacy Note 14(3) to the financial statements	441
Section 824	General qualitative disclosure	Risk management policy and objectives, The structure and organization of the risk management function - factors involved in risk management	127-131
Table 4a	Credit risk - qualitative disclosure	Credit risk management	131-151
Table 4b	Credit risk - segmentation of credit risk according to the main credit exposure types	Credit risk management - Quantitative disclosure regarding credit risk	140
Table 4c	Credit risk - main geographic distribution of exposures	Management review - Schedule "F"	338-341
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"	308
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"	309
Table 4f	Credit risk - problematic debts	Management review - Schedule "E"	336-337
Table 4g	Credit risk - problematic debts classified according to main geographical areas	Management review - Schedule "F"	338-341

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 4h	Credit risk - movement in the balance of allowance for credit losses	Note 4d to the financial statements	412-414
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"	310-311
Table 7	Credit risk mitigation	Credit risk management - Reduction of credit risk Annex to the Report of the Board of Directors – Part "B"	312
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"	143-145
Table 9	Securitization exposure	Credit risk management – Securitization Annex to the Report of the Board of Directors – Part "B"	145
Table 10	Market risk	Management of market and liquidity risks	151-166
Table 12	Operational risks	Operational risks	167-170
Table 13	Share positions in the bank's portfolio	Share positions in the bank's portfolio Annex to the Report of the Board of Directors – Part "B"	167
Table 14	Interest rate risk in the banking book	Management of market and liquidity risks	314
			151-166

* 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, 2011	On December 31, 2010
	In NIS million	
Balances of assets deriving from transactions in derivative instruments where the counterparties are foreign financial institutions		
With an AA+ rating	208	179
With an AA rating	126	201
With an AA- rating	502	539
With an A+ rating	443	158
With an A rating	158	175
With a BBB rating	29	24
Not rated	36	20
Total against foreign financial institutions	1,502	1,296
Total against Israeli financial institutions	1,054	384
Total balances of assets deriving from transactions in derivative instruments	2,556	1,680

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⁽¹⁾:

	On December 31, 2011	On December 31, 2010
	In NIS million	
Off Balances of assets deriving from transactions in derivative instruments where the counterparties are foreign financial institutions		
With an AA+ rating	16	1,098
With an AA rating	41	971
With an AA- rating	145	2,877
With an A+ rating	11	558
With an A rating	20	639
With an BBB rating	-	59
Not rated	1	52
Total against foreign financial institutions	234	6,254
Total against Israeli financial institutions	17	2,861
Total Off balances of assets deriving from transactions in derivative instruments	251	9,115

Note:

- (1) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8 to the financial statements.

1. ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

(3) Following are details of the columns "Brokers" and "Other" in Note 20 B to the financial statements according to the overall credit to the public risk per economic sectors:

	On December 31, 2011	On December 31, 2010
	in NIS million	
Agriculture	2	12
Industry:		
Machines, electrical and electronic equipment	139	178
Mining, chemical industry and oil products	292	290
Other	36	257
Total industry	467	725
Construction and real estate:		
Construction and real estate acquisition	-	-
Real estate holdings	287	161
Other	47	29
Total Construction and real estate	334	190
Electricity and water	29	20
Commerce	44	147
Hotels, hotel services and food	4	1
Transportation and storage	30	121
Communications and computer services	3	65
Financial services:		
Financial institution (excluding banks)	193	479
Private customers active on the capital market	115	1,558
Financial holding institutions	47	249
Insurance and provident fund services	203	194
Total financial services	558	2,480
Other business services	19	102
Public and community services	143	7
Private individuals - housing loans	13	-
Private individuals - other	86	157
Total	1,732	4,027

(1) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.

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:

Sector	Balance sheet credit as of December 31	
	2011	2010
	in NIS millions	
Industry	1,005	*1,284
Construction and real estate	962	*1,780
Electricity and water	134	-
Commerce	99	100
Communications and computer services	108	435
Financial services	352	*354
Other business services	203	125
Total	2,863	4,078

* Reclassified

Exposure to leveraged finance (as defined above) as of December 31, 2011 amounted to NIS 2,863 million, compared to NIS 4,078 million at the end of 2010, a decrease of 30%. The decrease in the exposure, in 2011, deriving from the repayment and sale of credit. The balance of exposure presented in the table above, is net of accounting write-offs in accordance with the directive regarding impaired debts. The data for December 2010 has been reclassified to include transactions determined by the Bank to be defined as leverage finance.

3. CREDIT LEVELS IN EXCESS OF NIS 800 MILLION - ADDITIONAL DETAILS

Note 4 F 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	
	2011	2010
	in NIS thousands	
Field of activity:		
Financial services	1,146,172	42,842
Electricity and water ⁽²⁾	1,031,775	897,744
Real estate ⁽²⁾	1,097,532	982,447
Machinery, electric and electronic equipment ⁽²⁾	917,987	968,163
Communications and computer services	888,841	685,878
Transportation and storage ⁽²⁾	871,759	1,192,041
Real estate ⁽²⁾	500,023	951,963
Financial services ⁽²⁾	303,099	1,830,645
Civil engineering work ⁽²⁾	147,500	1,021,000

Footnotes:

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

(2) One of- 7 borrowers in the two upper levels in 2010.

(3) The data as of December 31, 2011, is before allowance for credit losses and as of December 31, 2010 is after provision for doubtful debts.

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 private banking segment. The data for the Corporate Division include the corporate banking segment and the commercial banking segment.

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

- The report to Management does not address the allocation of profits from the severance pay fund as is the case in segment reporting according to the public reporting instructions;
- The financial activity segment includes both the activity of the 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.

4. THE MAIN DIFFERENCES BETWEEN THE MANAGERIAL REPORTING FORMAT AND THE PUBLIC REPORTING FORMAT (CONTINUED)

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, 2011							
Reported net income (loss)	224	185	352	148	7	(64)	852
Net income (loss) for Management reports	212	176	350	141	6	(34)	852
Difference	12	9	3	7	1	(30)	-
Following is the composition of the differences:							
Income (loss) from financing activities before credit loss expenses**	3	8	(1)	9	-	(18)	-
Profit from severance pay funds	15	5	5	2	1	(27)	-
Total income that was transferred	18	13	4	11	1	(45)	-
Provision for taxes (tax savings) on operating income	6	4	1	4	-	(15)	-
Difference	12	9	3	7	1	(30)	-

For the year ended December 31, 2010							
Reported net income (loss)	*198	*179	*276	*116	56	*(121)	704
Net income (loss) for Management reports	*181	*170	*276	*111	55	*(89)	704
Difference	17	9	-	5	1	(32)	-
Following is the composition of the differences:							
Income (loss) from financing activities before credit loss expenses**	1	4	(7)	4	-	(2)	-
Profit from severance pay funds	25	10	7	4	1	(47)	-
Total Income that was transferred	26	14	-	8	1	(49)	-
Provision for taxes (tax savings) on operating income	9	5	-	3	-	(17)	-
Difference	17	9	-	5	1	(32)	-

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

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the 1990s, the number of people in the world who are under 15 years of age has increased from 1.1 billion to 1.5 billion, and the number of people aged 65 and over has increased from 0.2 billion to 0.5 billion (United Nations, 2002).

There are a number of reasons why the world population is ageing. First, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Second, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Third, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Fourth, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Fifth, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Sixth, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Seventh, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

Eighth, the number of people who survive to old age has increased. In 1950, the life expectancy at birth was 47 years for men and 51 years for women. By 2000, the life expectancy at birth had increased to 71 years for men and 76 years for women (United Nations, 2002).

SCHEDULE "A" - CONSOLIDATED BALANCE SHEET - MULTI-PERIOD DATA

As at December 31					
	2011	2010	2009	2008	2007
In NIS millions					
Assets					
Cash and deposits with banks	30,329	18,187	24,583	21,554	19,850
Securities	42,898	37,176	36,338	31,535	37,278
Securities borrowed or purchased under resale agreements	145	45	336	25	346
Credit granted to the public ⁽¹⁾	118,358	⁽²⁾ 124,902	⁽²⁾ 120,820	⁽²⁾ 122,511	⁽²⁾ 107,512
Allowance for credit loss ⁽¹⁾	(1,975)	⁽²⁾ (6,236)	⁽²⁾ (6,394)	⁽²⁾ (6,055)	⁽²⁾ (5,781)
Credit granted to the public, net	116,383	118,666	114,426	116,456	101,731
Credit granted to the Governments	1,640	1,556	1,820	1,491	374
Investments in affiliated companies	1,611	⁽³⁾ 1,674	⁽³⁾ 1,785	⁽³⁾ 1,817	⁽³⁾ 1,925
Buildings and equipment	3,080	⁽²⁾ 3,125	3,178	3,039	2,780
Intangible assets and goodwill	152	⁽²⁾ 169	⁽²⁾ 218	⁽²⁾ 272	⁽²⁾ 240
Assets in respect of derivative instruments	3,114	⁽²⁾ 2,039	⁽²⁾ 1,836	⁽²⁾ 3,407	⁽²⁾ 1,517
Other assets	3,131	⁽²⁾ (3)2,926	⁽²⁾ (3)3,035	⁽²⁾ (3)2,193	⁽²⁾ (3)2,148
Noncurrent assets held for sale	8	⁽²⁾ 13	-	-	-
Total Assets	202,491	185,576	187,555	181,789	168,189
Liabilities and Equity					
Deposits from the public	153,368	138,011	141,825	139,232	130,518
Deposits from banks	4,249	3,387	3,724	4,555	5,072
Deposits from the Government	925	461	284	206	125
Securities borrowed or purchased under resale agreements	6,700	7,227	7,651	7,194	5,895
Subordinated capital notes	12,239	12,294	11,529	9,373	7,437
Liabilities in respect of derivative instruments	4,432	⁽²⁾ 3,215	⁽²⁾ 2,489	⁽²⁾ 4,222	⁽²⁾ 1,559
Other liabilities	⁽²⁾ 9,463	⁽²⁾ 9,829	⁽²⁾ 10,158	⁽²⁾ 8,376	⁽²⁾ (3)8,607
Total liabilities	191,376	174,424	177,660	173,158	159,213
Equity capital attributed to the Bank's shareholders	10,745	⁽³⁾ 10,824	⁽³⁾ 9,597	⁽³⁾ 8,405	⁽³⁾ 8,829
Non-controlling rights in consolidated companies	370	328	298	226	147
Total equity	11,115	11,152	9,895	8,631	8,976
Total Liabilities and Equity	202,491	185,576	187,555	181,789	168,189

:Footnotes

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) Reclassified - see note 1B (4).

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

SCHEDULE "B" - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

	As at December 31				
	2011	2010	2009	2008	2007
	in NIS millions				
Financing Income					
Income from financing activities before credit loss expenses ⁽¹⁾	4,785	4,830	4,757	4,127	4,225
Credit loss expenses ⁽¹⁾	778	821	998	780	447
Income from financing activities after credit loss expenses	4,007	4,009	3,759	3,347	3,778
Operating and other Income					
Operating commissions	2,489	2,547	2,633	2,504	2,481
Net income on investment in shares	92	31	197	51	58
Other income	109	⁽³⁾ 82	⁽³⁾ 258	18	112
Total operating and other income	2,690	2,660	3,088	2,573	2,651
Operating and other Expenses					
Salaries and related expenses	3,459	⁽³⁾ 3,218	⁽³⁾ 3,130	⁽³⁾ 3,132	⁽³⁾ 3,107
Maintenance and depreciation of buildings and equipment	1,159	1,148	1,032	951	857
Amortization and impairment of intangible assets and goodwill ⁽²⁾	17	*49	*51	*49	*32
Other expenses	1,203	*1,244	*1,228	*1,242	*1,226
Total operating and other expenses	5,838	5,659	5,441	5,374	5,222
Operating income before taxes	859	1,010	1,406	546	1,207
Provision for taxes on operating income	87	⁽³⁾ 458	⁽³⁾ 554	⁽³⁾ 160	⁽³⁾ 539
Operating income after taxes	772	552	852	386	668
Bank's share in operating income (loss) net of tax effect of affiliated companies	103	186	158	(70)	45
Net income from ordinary operations:					
Before attribution to non-controlling rights holders	875	738	1,010	316	713
Attributed to the non-controlling rights holders	(84)	(70)	(72)	(78)	(56)
Net income from ordinary operations, attributed to bank's shareholders	791	668	938	238	657
Net income (loss) from extraordinary operations, net of taxes, before attribution to non-controlling rights holders	61	36	(20)	(10)	558
Net income:					
Before attribution to non-controlling rights holders	936	774	990	306	1,271
Attributed to the non-controlling rights holders	(84)	(70)	(72)	(78)	(56)
Net income attributed to bank's shareholders	852	704	918	228	1,215
Earnings per share of NIS 0.1 (in NIS):					
Net income from ordinary operations, attributed to bank's shareholders	0.75	⁽³⁾ 0.67	⁽³⁾ 0.94	⁽³⁾ 0.24	⁽³⁾ 0.66
Net income (loss) from extraordinary operations, net of taxes, attributed to bank's shareholders	0.06	0.04	(0.02)	(0.01)	0.56
Total	0.81	⁽³⁾0.71	⁽³⁾0.92	⁽³⁾0.23	⁽³⁾1.22
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	1,053,869	997,578	993,979	993,979	993,979

* Reclassified, see Note 1 B (4).

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED⁽¹⁾

	2011				2010			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Unlinked Israeli Currency:								
Assets ^{(4)(5)*}	98,072	4,889	4.99		86,189	3,737	4.34	
Effect of derivatives: ⁽³⁾								
Embedded and ALM derivatives	77,212	3,266			56,032	1,066		
Total assets	175,284	8,155		4.65	142,221	4,803		3.38
Liabilities ⁽⁵⁾	(88,610)	(1,834)	(2.07)		(78,306)	(953)	(1.22)	
Effect of derivatives: ⁽³⁾								
Embedded and ALM derivatives	(79,338)	(3,305)			(55,996)	(1,006)		
Total liabilities	(167,948)	(5,139)		(3.06)	(134,302)	(1,959)		(1.46)
Interest margin			2.92	1.59			3.12	1.92
Israeli Currency Linked to the CPI :								
Assets ^{(4)(5)*}	27,041	1,557	5.76		28,341	1,635	5.77	
Effect of derivatives: ⁽³⁾								
Embedded and ALM derivatives	1,908	62			342	(3)		
Total assets	28,949	1,619		5.59	28,683	1,632		5.69
Liabilities ⁽⁵⁾	(21,103)	(1,270)	(6.02)		(22,158)	(1,311)	(5.92)	
Effect of derivatives: ⁽³⁾								
Embedded and ALM derivatives	(4,746)	(570)			(5,159)	(369)		
Total liabilities	(25,849)	(1,840)		(7.12)	(27,317)	(1,680)		(6.15)
Interest margin			(0.26)	(1.53)			(0.15)	(0.46)

*The data for 2011 are presented before deduction of the average balance of the allowance for credit losses. The data for 2010 are presented after deduction of the average balance of the specific provision for doubtful debts.
For footnotes see page 330.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED⁽¹⁾ (CONTINUED)

	2011				2010			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Foreign Currency:⁽⁶⁾								
Assets ^{(4)(5) *}	57,747	6,263	10.85		61,485	(2,311)	(3.76)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	398	54			-	-		
Embedded and ALM derivatives	50,651	5,328			48,235	(1,925)		
Total assets	108,796	11,645		10.70	109,720	(4,236)		(3.86)
Liabilities ⁽⁵⁾	(63,461)	(5,272)	(8.31)		(68,346)	4,171	6.10	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(408)	(77)			-	-		
Embedded and ALM derivatives	(47,229)	(4,932)			(44,201)	1,388		
Total liabilities	(111,098)	(10,281)		(9.25)	(112,547)	5,559		4.94
Interest margin			2.54	1.45			2.34	1.08

*The data for 2011 are presented before deduction of the average balance of the allowance for credit losses. The data for 2010 are presented after deduction of the average balance of the specific provision for doubtful debts.

For footnotes see page 330.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED⁽¹⁾ (CONTINUED)

	2011				2010			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in NIS millions		%		in NIS millions		%	
Total:								
Monetary assets which generated financing income ^{(4)(5)*}	182,860	12,709	6.95		176,015	3,061	1.74	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	398	54			-	-		
Embedded and ALM derivatives	129,771	8,656			104,609	(862)		
Total assets	313,029	21,419		6.84	280,624	2,199		0.78
Monetary liabilities which generated financing expenses ⁽⁵⁾	(173,174)	(8,376)	(4.84)		(168,810)	1,907	1.13	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(408)	(77)			-	-		
Embedded and ALM derivatives	(131,313)	(8,807)			(105,356)	13		
Total liabilities	(304,895)	(17,260)		(5.66)	(274,166)	1,920		0.70
Interest margin			2.11	1.18			2.87	1.48
In respect of options		31				**66		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives) ⁽³⁾		1				(3)		
Commissions on financing operations and other financing income ⁽⁷⁾		679				**658		
Other financing expenses		(85)				(10)		
Income from financing activities before credit loss expenses ⁽⁹⁾		4,785				4,830		
Credit loss expenses ⁽⁹⁾		(778)				(821)		
Income from financing activities after credit loss expenses		4,007				4,009		

* The data for 2011 are presented before deduction of the average balance of the allowance for credit losses. The data for 2010 are presented after deduction of the average balance of the specific provision for doubtful debts.

** Reclassified.

For footnotes see next page.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED⁽¹⁾ (CONTINUED)

	2011	2010
	Average balance ⁽²⁾	Average balance ⁽²⁾
	in NIS millions	
Total:		
Monetary assets which generated financing income ^{(4)(5) *}	182,860	176,015
Assets related to derivative instruments ⁽⁸⁾	2,275	2,017
Other monetary assets ⁽⁵⁾⁽¹⁰⁾	2,586	**2,574
Provisions for credit losses ⁽⁹⁾⁽¹¹⁾	(1,903)	(665)
Total monetary assets	185,818	179,941
Total:		
Monetary liabilities which generated financing expenses ⁽⁵⁾	(173,174)	(168,810)
Liabilities related to derivative instruments ⁽⁸⁾	(3,380)	(3,021)
Other monetary liabilities ⁽⁵⁾⁽¹⁰⁾	(3,741)	** (3,475)
Total monetary liabilities	(180,295)	(175,306)
Surplus of monetary assets over monetary liabilities	5,523	4,635
Non-monetary assets ⁽¹⁰⁾	6,076	**6,243
Non-monetary liabilities	(803)	(718)
Total capital resources	10,796	10,160

* The data for 2011 are presented before deduction of the average balance of the allowance for credit losses. The data for 2010 are presented after deduction of the average balance of the specific provision for doubtful debts.

** Reclassified.

Footnotes:

- (1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).
- (2) Based on monthly opening balances, except for the 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 unrealized 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" : 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; 2010 – NIS 188 million in the unlinked segment, NIS 136 million in the CPI linked segment and NIS (110) 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) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.
- (10) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.
- (11) 2010 data: General and supplemental provision for doubtful debts.

SCHEDULE "C" - RATES OF FINANCIAL INCOME AND EXPENSES - CONSOLIDATED⁽¹⁾ (CONTINUED)

	2011				2010			
	Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)		Average balance ⁽²⁾	Financing income (expense)	Rate of income (expense)	
			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾			Excluding effect of derivatives	Including effect of derivatives ⁽³⁾
	in US\$ millions*		%		in US\$ millions*		%	
Foreign Currency – Nominal in US\$⁽⁶⁾*								
Assets ^{(4)(5)**}	16,081	535	3.33		16,318	478	2.93	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	116	-			-	-		
Embedded and ALM derivatives	14,536	329			13,175	199		
Total Assets	30,733	864		2.81	29,493	677		2.30
Liabilities ⁽⁵⁾	(17,806)	(195)	(1.10)		(18,223)	(155)	(0.85)	
Effect of derivatives: ⁽³⁾								
Hedging derivatives	(119)	(6)			-	-		
Embedded and ALM derivatives	(13,470)	(249)			(12,168)	(217)		
Total liabilities	(31,395)	(450)		(1.43)	(30,391)	(372)		(1.22)
Interest margin		414	2.23	1.38		305	2.08	1.08

* Nominal Israeli Shekel amounts translated to U.S. Dollars at the representative rate of exchange.

** The data for 2011 are presented before deduction of the average balance of the allowance for credit losses. The data for 2010 are presented after deduction of the average balance of the specific provision for doubtful debts.

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 unrealized gains/ (losses) on adjustments to fair value of trading bonds and gains/ (losses) in respect of available-for-sale securities: 2011 - in amount of US\$ (36) million; 2010 - in the amount of US\$ (28) 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, 2011				
	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*	76,519	11,774	5,058	5,062	2,432
Derivative financial instruments (except for options)	16,489	26,283	14,031	8,727	3,508
Options (in terms of base assets)	590	495	999	178	52
Total fair value	93,598	38,552	20,088	13,967	5,992
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	73,794	7,637	9,785	3,337	1,349
Derivative financial instruments (except for options)	18,005	29,174	16,199	7,995	4,496
Options (in terms of base assets)	801	467	827	19	7
Off-balance sheet financial instruments	1	1	7	1	-
Total fair value	92,601	37,279	26,818	11,352	5,852
Financial instruments, net					
Exposure to changes in interest rates in the segment	997	1,273	(6,730)	2,615	140
Cumulative exposure in the segment	997	2,270	(4,460)	(1,845)	(1,705)
CPI linked Israeli currency					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets*	499	1,082	4,420	7,941	6,362
Derivative financial instruments (except for options)	-	457	656	373	565
Options (in terms of base assets)	7	4	13	18	8
Total fair value	506	1,543	5,089	8,332	6,935
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	571	889	3,437	6,372	3,513
Derivative financial instruments (except for options)	78	116	675	1,771	1,105
Options (in terms of base assets)	3	14	87	139	26
Off-balance sheet financial instruments	1	1	8	1	-
Total fair value	653	1,020	4,207	8,283	4,644
Financial instruments, net					
Exposure to changes in interest rates in the segment	(147)	523	882	49	2,291
Cumulative exposure in the segment	(147)	376	1,258	1,307	3,598

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

** Weighted average by fair value of average effective duration.

*** Including shares listed under "No fixed maturity".

**** Including Israeli currency linked to foreign currency.

As at December 31, 2011								As at December 31, 2010		
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										
4,056	817	-	645	106,363	5.08%	0.81		90,554	4.81%	0.82
6,560	442	-	-	76,040		1.21		57,621		1.30
425	65	-	-	2,804		0.00		2,824		0.01
11,041	1,324	-	645	185,207		**0.96		150,999		**0.99
674	52	-	2	96,630	2.26%	0.29		83,103	1.81%	0.31
6,739	382	-	-	82,990		1.21		58,817		1.20
363	-	6	-	2,490		0.00		2,880		0.01
-	-	-	-	10		-		2		0.50
7,776	434	6	2	182,120		**0.70		144,802		**0.66
3,265	890	(6)	643	3,087				6,197		
1,560	2,450	2,444	3,087							
5,304	1,057	13	14	26,692	2.65%	3.55		28,781	2.45%	3.85
270	21	-	-	2,342		2.25		913		3.32
6	-	-	-	56		0.00		48		0.01
5,580	1,078	13	14	29,090		**3.44		29,742		**3.83
5,080	1,927	-	-	21,789	2.20%	3.98		23,236	1.69%	4.03
1,096	-	-	-	4,841		3.23		4,598		3.88
8	-	-	-	277		0.00		186		0.01
-	-	-	-	11		0.82		1		0.50
6,184	1,927	-	-	26,918		**3.81		28,021		**3.98
(604)	(849)	13	14	2,172				1,721		
2,994	2,145	2,158	2,172							

General notes:

- (1) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument, in a manner consistent with assumptions used in calculation of the fair value of said financial instrument. (For details regarding the assumptions used in calculating the fair value of financial instruments, see "Management of market and liquidity risks" under "Exposure to risks and risk management").
- (2) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.
- (3) The average effective duration of a group of financial instruments is an approximation of the change, in percentiles, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

SCHEDULE "D" - EXPOSURE TO CHANGES IN INTEREST RATES - CONSOLIDATED (CONTINUED)

	As at December 31, 2011				
	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****					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets*	23,868	13,699	8,955	5,557	2,715
Derivative financial instruments (except for options)	21,548	15,298	15,235	2,054	2,044
Options (in terms of base assets)	3,572	2,667	1,566	65	-
Off-balance sheet financial instruments	-	-	-	-	-
Total fair value	48,988	31,664	25,756	7,676	4,759
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	36,892	10,008	10,750	5,607	1,660
Derivative financial instruments (except for options)	17,876	11,851	12,761	2,727	2,345
Options (in terms of base assets)	3,352	2,693	1,662	99	17
Off-balance sheet financial instruments	-	-	2	-	-
Total fair value	58,120	24,552	25,175	8,433	4,022
Financial instruments, net					
Exposure to changes in interest rates in the segment	(9,132)	7,112	581	(757)	737
Cumulative exposure in the segment	(9,132)	(2,020)	(1,439)	(2,196)	(1,459)
Total exposure to changes in interest rates					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets*****	100,886	26,555	18,433	18,560	11,509
Derivative financial instruments (except for options)	38,037	42,038	29,922	11,154	6,117
Options (in terms of base assets)	4,169	3,166	2,578	261	60
Off-balance sheet financial instruments	-	-	-	-	-
Total fair value	143,092	71,759	50,933	29,975	17,686
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	111,257	18,534	23,972	15,316	6,522
Derivative financial instruments (except for options)	35,959	41,141	29,635	12,493	7,946
Options (in terms of base assets)	4,156	3,174	2,576	257	50
Off-balance sheet financial instruments	2	2	20	2	-
Total fair value	151,374	62,851	56,203	28,068	14,518
Financial instruments, net					
Exposure to changes in interest rates in the segment	(8,282)	8,908	(5,270)	1,907	3,168
Cumulative exposure in the segment	(8,282)	626	(4,644)	(2,737)	431

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

** Weighted average by fair value of average effective duration.

*** Including shares listed under "No fixed maturity".

**** Including Israeli currency linked to foreign currency.

As at December 31, 2011								As at December 31, 2010		
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										
2,431	1,082	-	801	59,108	3.50%	1.12		58,030	3.38%	1.60
1,709	382	-	-	58,270		0.67		47,698		0.66
220	-	-	-	8,090		0.00		12,237		0.01
-	-	-	-	-		-		1		0.50
4,360	1,464	-	801	125,468		**0.84		117,966		**1.05
3,242	11	-	-	68,170	1.57%	0.74		64,983	1.25%	0.69
2,174	405	-	-	50,139		0.82		44,000		0.86
350	3	(6)	-	8,170		0.00		11,976		0.01
-	-	-	-	2		0.70		-		-
5,766	419	(6)	-	126,481		**0.72		120,959		**0.69
(1,406)	1,045	6	801	(1,013)				(2,993)		
(2,865)	(1,820)	(1,814)	(1,013)							
11,791	2,956	13	2,123	192,826	4.26%	1.29		178,058	3.96%	1.57
8,539	845	-	-	136,652		1.00		106,232		1.03
651	65	-	-	10,950		0.00		15,109		0.01
-	-	-	-	-		-		1		0.50
20,981	3,866	13	2,123	340,428		**1.13		299,400		**1.30
8,996	1,990	-	2	186,589	2.00%	0.88		171,322	1.58%	0.96
10,009	787	-	-	137,970		1.14		107,415		1.18
721	3	-	-	10,937		0.00		15,042		0.01
-	-	-	-	26		0.41		45		0.03
19,726	2,780	-	2	335,522		**0.96		293,824		**0.99
1,255	1,086	13	2,121	4,906				5,576		
1,686	2,772	2,785	4,906							

General notes:

- (1) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument, in a manner consistent with assumptions used in calculation of the fair value of said financial instrument. (For details regarding the assumptions used in calculating the fair value of financial instruments, see "Management of market and liquidity risks" under "Exposure to risks and risk management").
- (2) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.
- (3) The average effective duration of a group of financial instruments is an approximation of the change, in percentiles, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

SCHEDULE "E" - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS

December 31, 2011								
Credit risk in respect of the public					credit losses ⁽⁴⁾			
Credit risk in respect of the public includes:								
Balance sheet credit risk ⁽¹⁾	Off-balance sheet credit risk ⁽²⁾	Total credit risk	Problematic credit risk ⁽³⁾	Impaired credit granted to the public	Periodic expenses of credit losses	Net accounting write-off recognized in the period	Balance of allowance for credit losses	
in NIS millions								
Lending Activity in Israel								
Agriculture	903	208	1,111	42	30	5	8	20
Industry	11,186	5,602	16,788	938	674	97	142	208
Construction and real estate ⁽⁷⁾	14,369	10,112	24,481	1,775	1,253	48	38	404
Electricity and water	1,064	1,094	2,158	7	-	1	1	1
Commerce	9,060	2,959	12,019	321	267	(11)	-	107
Hotels, hotel services and food	1,829	231	2,060	367	353	(11)	(9)	20
Transportation and storage	2,621	425	3,046	58	27	4	6	16
Communications and computer services	2,245	445	2,690	227	25	8	(4)	36
Financial services	8,903	1,601	10,504	299	276	42	78	35
Other business services	5,502	1,940	7,442	206	139	49	56	128
Public and community services	1,561	766	2,327	291	164	3	5	16
Private individuals - housing loans	19,659	419	20,078	469	-	(4)	7	230
Private individuals - other loans	17,043	17,985	35,028	338	197	150	184	423
Total lending Activity in Israel	95,945	43,787	139,732	5,338	3,405	381	512	1,644
Credit Risk Included in the Various Economic Sectors:								
Agricultural Settlement Movements ⁽⁵⁾	240	20	260	-	-	-	-	-
Local authorities ⁽⁶⁾	132	63	195	2	1	1	-	-
Lending Activity Outside of Israel								
Agriculture	199	91	290	17	17	4	-	5
Industry	4,550	3,713	8,263	25	3	5	12	54
Construction and real estate ⁽⁷⁾	7,718	1,431	9,149	1,850	1,661	248	208	187
Electricity and water	150	116	266	-	-	-	18	-
Commerce	4,697	2,524	7,221	466	31	36	31	81
Hotels, hotel services and food	918	7	925	229	229	9	7	13
Transportation and storage	610	469	1,079	52	52	8	-	19
Communications and computer services	33	27	60	3	2	-	1	-
Financial services	2,995	1,498	4,493	351	76	26	19	68
Other business services	1,960	791	2,751	279	132	69	36	59
Public and community services	27	16	43	-	-	-	-	-
Private individuals - housing loans	16	-	16	-	-	-	-	-
Private individuals - other loans	1,281	542	1,823	5	3	(12)	6	17
Total lending Activity Outside of Israel	25,154	11,225	36,379	3,277	2,206	393	338	503
TOTAL	121,099	55,012	176,111	8,615	5,611	774	850	2,147

* Balance sheet and off-balance sheet credit risk, commercial exposure and impaired credit granted to the public are stated prior to the effect of the allowance for credit losses and prior to the effect of deductible collateral in respect of debts of a single borrower and of a group of borrowers

:Footnotes

(1) Credit granted to the public of NIS 118,358 million, investments in bonds of the public of NIS 2,261 million and other assets pertaining to derivative instruments of the public of NIS 480 million, respectively.

(2) Credit risk relating to off-balance sheet financial instruments, as computed for the purpose of restrictions applying to debts of a single borrower.

(3) Balance sheet and off-balance sheet credit risk in respect of the public, which is impaired, substandard or under special mention, excluding balance sheet and off-balance sheet credit risk relating to private individuals.

(4) Including in respect of off-balance sheet credit instruments (stated in the balance sheet under "Other liabilities").

(6) Including corporations under their control.

(7) Of which: real estate activity in respect of lending activity in Israel 8,432 3,135 17,948 2,007 1,727 140 63 266

Of which: real estate activity in respect of lending activity outside of Israel 6,381 1,350 7,731 1,334 1,157 84 59 89

Of which: housing loans granted to certain acquisition groups that are in the

midst of construction processes 298 847 1,145 - - - - -

SCHEDULE "E" - CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS (CONTINUED)

December 31, 2010					
	Balance sheet credit risk (1)	off-balance sheet credit risk (2)	Total credit risk	Annual expense on provision for doubtful debts	Balance of problematic debt ⁽³⁾
in NIS millions					
Lending Activity in Israel					
Agriculture	813	233	1,046	14	45
Industry	12,265	6,643	18,908	103	1,065
Construction and real estate ⁽⁶⁾	14,506	10,840	25,346	91	1,701
Electricity and water	988	552	1,540	1	9
Commerce	8,715	2,535	11,250	71	395
Hotels, hotel services and food	1,943	252	2,195	(28)	446
Transportation and storage	2,868	669	3,537	7	62
Communications and computer services	2,529	395	2,924	9	287
Financial services	9,190	2,997	12,187	(3)	80
Other business services	6,401	2,273	8,674	72	267
Public and community services	1,452	584	2,036	6	280
Private individuals - housing loans	17,953	359	18,312	-	367
Private individuals - other loans	17,436	16,990	34,426	205	711
Total	97,059	45,322	142,381	548	5,715
Less a deposit abroad linked to the credit risk of the borrower	(53)	-	(53)	-	-
Total	97,006	45,323	142,328	548	5,715
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements⁽⁴⁾	254	22	276	-	105
Local authorities ⁽⁵⁾	148	59	207	-	4
2. Lending Activity Outside of Israel					
Agriculture	147	116	263	(1)	-
Industry	4,625	4,070	8,695	(2)	103
Construction and real estate	7,915	1,778	9,693	117	2,069
Electricity and water	390	265	655	-	-
Commerce	3,512	3,023	6,535	(4)	179
Hotels, hotel services and food	1,035	50	1,085	10	228
Transportation and storage	733	670	1,403	-	42
Communications and computer services	173	56	229	(8)	1
Financial services	3,638	2,784	6,422	18	474
Other business services	2,266	926	3,192	53	127
Public and community services	26	48	74	-	6
Private individuals - housing loans	18	-	18	-	-
Private individuals - other loans	1,009	668	1,677	10	13
Total	25,487	14,454	39,941	193	3,242
	122,493	59,776	182,269	741	8,957

* Reclassified

Footnotes:

(1) Credit to the public of NIS 119,334 million, investments in bonds, assets relating to derivative instruments of NIS 2,853 million, created with the public of NIS 306 million.

(2) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation. Due to lack of data, only partial information regarding unutilized credit lines is included in respect of a consolidated subsidiary.

(3) The balance of problematic debts net of credit covered by collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability limitation. Includes the components of off-balance sheet risk.

(4) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the agricultural settlement movements.

(5) Including corporations under their control.

(6) Of which: real estate activity in respect of lending activity in Israel 8,066 1,594 9,660 57 787

Of which: real estate activity in respect of lending activity outside of Israel 6,648 1,553 8,201 117 1,671

Of which: housing loans granted to certain acquisition groups that are in the midst of construction processes 256 544 800 - 1

Credit risk and the balance of problematic debts are presented after deducting specific provisions for doubtful debts.

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⁽⁷⁾

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	2,761	4,342
Total exposure to foreign countries	1,679	6,435	6,196
Includes - 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 allowance 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.
- (6) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 e (1).
- (7) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8 to the financial statements.

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, 2011 and December 31, 2010, the Bank had no such exposure.

C. Information regarding exposure to foreign countries having liquidity problems, for the year ending December 31, 2011:

A. Changes in the amount of balance sheet exposure to foreign countries having liquidity problems			
Outstanding balances			
In NIS millions			
	Greece	Ireland	Portugal
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	-

0									
0						Off-balance sheet exposure ⁽²⁾⁽³⁾⁽⁷⁾			Across the border balance sheet exposure ⁽²⁾
Balance sheet exposure to local resident customers of extensions of a banking corporation in a foreign country									
Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities	Total balance sheet exposure	Problematic commercial exposure	impaired debts	Total off- balance sheet exposure	Of which problematic commercial exposure	Due up to one year	Due over one year
0									
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	7,481	776	760	1,898	2	4,365	2,965
31,842	20,521	11,321	25,631	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).

SCHEDULE "F" - EXPOSURE TO FOREIGN COUNTRIES - CONSOLIDATED⁽¹⁾ (CONTINUED)

December 31, 2010				
Balance sheet exposure				
Across the border balance sheet exposure				
The Country		To governments ⁽³⁾	To banks	to Others
In NIS millions				
United States		1,437	1,848	2,019
United Kingdom		-	1,468	102
PIGS ⁽⁵⁾		-	208	47
Other		200	2,798	5,040
Total exposure to foreign countries		1,637	6,322	7,208
Includes - Total exposure to LDC countries		35	546	895

Notes:

- (1) Based on the final risk, net of the effect of guarantees and liquid collateral .
- (2) Credit risk of off-balance sheet financial instruments as computed for the purpose of borrower indebtedness limitations.
- (3) Governments, official institutions and central banks.
- (4) Outstanding problematic debts, net of debts secured by collateral that are deductible for the purpose of borrower and group of borrowers indebtedness limitation, excluding off-balance sheet risk components.
- (5) Portugal, Ireland, Greece and Spain.

Changes in the amount of balance sheet exposure to foreign countries having liquidity problems	Outstanding balances	
	In NIS millions	
	Greece	Ireland
Amount of exposure at the beginning of year	34	276
Net changes in the short-term exposure amount	(2)	(75)
Changes in remaining exposure:		
Amounts collected	(30)	(57)
Other changes (including provisions and write-offs)	-	(47)
Amount of exposure at period end	2	97

0									
0					Off-balance sheet exposure ⁽²⁾				
Balance sheet exposure to local resident customers of extensions of a banking corporation in a foreign country					Across the border balance sheet exposure				
Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities	Total balance sheet exposure	Outstanding problematic debts ⁽⁴⁾	Total off-balance sheet exposure	Of which problematic off-balance sheet credit risk			
							Due up to one year	Due over one year	
In NIS millions									
27,125	11,758	15,367	20,671	643	8,794	-	3,127	2,177	
1,457	199	1,258	2,828	131	5,042	-	955	615	
-	-	-	255	23		-	236	19	
1,344	1,284	60	8,098	1,330	2,118	()	4,682	3,356	
29,926	13,241	16,685	31,852	2,127	15,954	()	9,000	6,167	
965	965	-	1,476	2	276	-	1,053	423	

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 "G" - CONDENSED CONSOLIDATED BALANCE SHEET - MULTI QUARTER DATA

Quarter	2011				2010			
	4	3	2	1	4	3	2	1
In NIS millions								
Assets								
Cash and deposits with banks	30,329	29,316	23,703	20,781	18,187	16,636	21,944	23,731
Securities	42,898	37,774	33,102	34,257	37,176	39,605	38,012	36,566
Securities borrowed or purchased under resale agreements	145	157	82	204	45	130	324	338
Credit granted to the public ⁽¹⁾	118,358	120,480	119,132	118,586	⁽²⁾ 124,902	⁽²⁾ 125,466	⁽²⁾ 123,260	⁽²⁾ 120,717
Allowance for credit loss ⁽¹⁾	(1,975)	(1,964)	(1,843)	(1,916)	⁽²⁾ (6,236)	⁽²⁾ (6,337)	⁽²⁾ (6,325)	⁽²⁾ (6,401)
Credit granted to the public, net	116,383	118,516	117,289	116,670	118,666	119,129	116,935	114,316
Credit granted to the Government	1,640	1,641	1,608	1,570	1,556	1,547	1,529	1,507
Investments in affiliated companies	1,611	1,574	1,573	⁽³⁾ 1,555	⁽³⁾ 1,674	⁽³⁾ 1,652	⁽³⁾ 1,830	1,844
Buildings and equipment	3,080	3,057	3,086	3,128	⁽²⁾ 3,125	⁽²⁾ 3,088	3,138	3,167
Intangible assets and goodwill	152	154	165	167	⁽²⁾ 169	⁽²⁾ 193	⁽²⁾ 201	⁽²⁾ 210
Assets in respect of derivative instruments	3,114	3,560	1,908	2,111	⁽²⁾ 2,039	⁽²⁾ 2,237	⁽²⁾ 2,486	⁽²⁾ 1,894
Other assets	3,131	3,241	3,498	⁽³⁾ 3,285	⁽²⁾⁽³⁾ 2,926	⁽²⁾⁽³⁾ 2,567	⁽²⁾⁽³⁾ 3,018	⁽²⁾ 3,594
Noncurrent assets held for sale	8	5	6	50	⁽²⁾ 13	⁽²⁾ 13	-	-
Total Assets	202,491	198,995	186,020	183,778	185,576	186,797	189,417	187,167

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) Reclassified - see note 1B (4).

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

SCHEDULE "G" - CONDENSED CONSOLIDATED BALANCE SHEET - MULTI QUARTER DATA (CONTINUED)

Quarter	2011				2010			
	4	3	2	1	4	3	2	1
In NIS millions								
Liabilities and Equity								
Deposits from the public	153,368	149,197	139,296	136,088	138,011	137,810	140,720	139,887
Deposits from banks	4,249	4,362	4,151	4,533	3,387	4,960	5,093	3,797
Deposits from the Government	925	881	780	707	461	361	359	1,403
Securities borrowed or purchased under resale agreements	6,700	6,523	6,002	6,621	7,227	7,585	7,667	7,432
Subordinated capital notes	12,239	12,426	12,255	12,174	12,294	12,291	12,235	11,348
Liabilities in respect of derivative instruments	4,432	4,797	2,965	3,046	⁽²⁾ 3,215	⁽²⁾ 3,486	⁽²⁾ 3,510	⁽²⁾ 2,694
Other liabilities	9,463	9,969	9,900	⁽³⁾ 10,212	⁽²⁾⁽³⁾ 9,829	⁽²⁾⁽³⁾ 9,593	⁽²⁾⁽³⁾ 9,400	⁽²⁾ 9,978
Total liabilities	191,376	188,155	175,349	173,381	174,424	176,086	178,984	176,539
Equity capital attributed to the Bank's shareholders	10,745	10,491	10,352	⁽³⁾ 10,075	⁽³⁾ 10,824	⁽³⁾ 10,353	⁽³⁾ 10,095	10,301
Non-controlling rights in consolidated companies	370	349	319	322	328	358	338	327
Total equity	11,115	10,840	10,671	10,397	11,152	10,711	10,433	10,628
Total Liabilities and Equity	202,491	198,995	186,020	183,778	185,576	186,797	189,417	187,167

Footnotes:

- (1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.
- (2) Reclassified - see note 1B (4).
- (3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA

Quarter	2011			
	4	3	2	1
	In NIS millions			
Financing Income				
Income from financing activities before credit loss expenses ⁽¹⁾	1,140	1,067	1,289	1,289
Credit loss expenses ⁽¹⁾	252	226	188	112
Income from financing activities after credit loss expenses	888	841	1,101	1,177
Operating and other Income				
Operating commissions	614	621	619	635
Net income from investment in shares	14	26	36	16
Other income	30	71	6	2
Total operating and other income	658	718	661	653
Operating and other Expenses				
Salaries and related expenses	828	873	855	⁽³⁾ 903
Maintenance and depreciation of buildings and equipment	310	283	287	279
Amortization and impairment of intangible assets and goodwill ⁽²⁾	2	11	2	2
Other expenses	321	311	296	275
Total operating and other expenses	1,461	1,478	1,440	1,459
Operating income before taxes	85	81	322	371
Provision for taxes (tax savings) on operating income	(134)	(52)	121	⁽³⁾ 152
Operating income after taxes	219	133	201	219
Bank's share in operating income net of tax effect of affiliated companies	23	9	28	43
Net income from ordinary operations:				
Before attribution to non-controlling rights holders	242	142	229	262
Attributed to the non-controlling rights holders	(20)	(23)	(19)	(22)
Net income from ordinary operations, attributed to bank's shareholders	222	119	210	240
Net income from extraordinary operations, net of taxes, before attribution to non-controlling rights holders	-	2	21	38
Net income:				
Before attribution to non-controlling rights holders	242	144	250	300
Attributed to the non-controlling rights holders	(20)	(23)	(19)	(22)
Net income attributed to bank's shareholders	222	121	231	278
Earnings (losses) per share of NIS 0.1 (in NIS):				
Net income from ordinary operations, attributed to bank's shareholders	0.21	0.11	0.20	0.23
Net income from extraordinary operations, net of taxes, attributed to bank's shareholders	*_	*_	0.02	0.03
Total	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

* Lower than NIS 0.01.

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**SCHEDULE "H" - CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI QUARTER DATA
(CONTINUED)**

2010				
Quarter	4	3	2	1
In NIS millions				
Financing Income				
Income from financing activities before credit loss expenses ⁽¹⁾	1,293	1,331	1,091	1,115
Credit loss expenses ⁽¹⁾	274	169	261	117
Income from financing activities after credit loss expenses	1,019	1,162	830	998
Operating and other Income				
Operating commissions	646	635	632	634
Net income (loss) on investment in shares	31	(16)	21	(5)
Other income	⁽³⁾ 26	40	⁽³⁾ 6	⁽³⁾ 10
Total operating and other income	703	659	659	639
Operating and other Expenses				
Salaries and related expenses	⁽³⁾ 855	⁽³⁾ *741	⁽³⁾ *761	⁽³⁾ *861
Maintenance and depreciation of buildings and equipment	324	*286	*267	*271
Amortization and impairment of intangible assets and goodwill ⁽²⁾	*23	*8	*9	*9
Other expenses	*364	*286	*326	*268
Total operating and other expenses	1,566	1,321	1,363	1,409
Operating income before taxes	156	500	126	228
Provision for taxes on operating income	⁽³⁾ 104	⁽³⁾ 229	⁽³⁾ 5	⁽³⁾ 120
Operating income after taxes	52	271	121	108
Bank's share in operating income net of tax effect of affiliated companies	87	32	22	45
Net income from ordinary operations:				
Before attribution to non-controlling rights holders	139	303	143	153
Attributed to the non-controlling rights holders	(13)	(20)	(17)	(20)
Net income from ordinary operations, attributed to bank's shareholders	126	283	126	133
Net income from extraordinary operations, net of taxes, before attribution to non-controlling rights holders	5	1	30	-
Net income:				
Before attribution to non-controlling rights holders	144	304	173	153
Attributed to the non-controlling rights holders	(13)	(20)	(17)	(20)
Net income attributed to bank's shareholders	131	284	156	133
Earnings per share of NIS 0.1 (in NIS):				
Net income from ordinary operations, attributed to bank's shareholders	0.13	0.29	0.13	⁽³⁾ 0.13
Net income from extraordinary operations, net of taxes, attributed to bank's shareholders	**_	**_	0.03	**_
Total	0.13	0.29	0.16	⁽³⁾0.13
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	1,008,123	994,109	994,088	993,979

* Reclassified, see Note 1 B (4).

** Lower than NIS 0.01.

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

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, 2011 (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 28, 2012

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, 2011 (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 28, 2012

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, 2011, 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, 2011, 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, 2011 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 351, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as of December 31, 2011.

March 28, 2012
Dr. Yossi Bachar
Chairman of the
Board of Directors

Reuven Spiegel
President &
Chief Executive Officer

Joseph Beressi
Senior Executive Vice President
Chief Accountant

FINANCIAL STATEMENTS

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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, 2011, 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, 2011, based on criteria established in Internal Control - Integrated Framework issued by COSO.



Somekh Chaikin



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, 2011 and 2010 and for each of the years in the three-year period ended on December 31, 2011, and our report dated March 28, 2012, expressed an unqualified opinion on these financial statements as well as calling attention to Note 19C items 11.6 and 12 concerning motions for the approval of certain lawsuits as class action suits and regarding other claims against the Bank and consolidated subsidiaries, and item 14 regarding a decision of the Antitrust Commissioner.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 28, 2012

Ziv Haft
Certified Public Accountants (Isr.)



Somekh Chaikin



AUDITORS' REPORT TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD. - ANNUAL FINANCIAL STATEMENTS

We have audited the financial statements of Israel Discount Bank Limited (hereinafter: "the Bank") and the consolidated financial statements of the Bank and its consolidated subsidiaries: Balance sheets as at December 31, 2011 and December 31, 2010, 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, 2011. These financial statements are the responsibility of the Bank's Board of Directors and Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We did not audit the financial statements of certain affiliated companies, the investment in which amounted to NIS 32 million and NIS 68 million at December 31, 2011 and 2010, respectively, and the Bank's share in their results amounted to a profit of NIS 8 million, a profit of NIS 11 million and a loss of NIS 10 million, for the years ended December 31, 2011, 2010 and 2009, respectively. The financial statements of those companies were audited by other auditors, whose reports were furnished to us, and our opinion, insofar as it relates to amounts included in respect of those companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including those prescribed under the Israeli Auditors' Regulations (Auditor's Mode of Performance), 1973 and certain auditing standards applied in the audit of banking corporations as determined by directives and guidelines of the Supervisor of Banks. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's Board of Directors and Management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position - of the Bank and consolidated - as at December 31, 2011 and 2010, 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, 2011, 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 19C items 11.6 and 12 concerning motions for the approval of certain lawsuits as class action suits and item 14 regarding a decision of the Antitrust Commissioner.



Somekh Chaikin



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, 2011, 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 29, 2012, included an unqualified opinion on the effectiveness of internal control over financial reporting of the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)
March 28, 2012

Ziv Haft
Certified Public Accountants (Isr.)

Balance sheet as at December 31

		Consolidated		The Bank	
	Notes	2011	2010	2011	2010
in NIS millions					
Assets					
Cash and deposits with banks	2,15	30,329	18,187	42,059	29,617
Securities	3,15	42,898	37,176	18,960	15,345
Securities borrowed or purchased under resale agreements		145	45	145	45
Credit granted to the public ⁽¹⁾	4	118,358	⁽²⁾ 124,902	64,098	⁽²⁾ 72,825
Allowance for credit loss ⁽¹⁾	4	(1,975)	⁽²⁾ (6,236)	(1,044)	⁽²⁾ (4,655)
Credit granted to the public, net		116,383	118,666	63,054	68,170
Credit granted to Governments	5	1,640	1,556	1,616	1,551
Investment in investee companies (consolidated – affiliated companies)	6	1,611	⁽³⁾ 1,674	10,352	⁽³⁾ 10,154
Buildings and equipment	7	3,080	⁽²⁾ 3,125	2,249	2,315
Intangible assets and goodwill	7a	152	⁽²⁾ 169	-	-
Assets in respect of derivative instruments	20	3,114	⁽²⁾ 2,039	3,042	⁽²⁾ 1,957
Other assets	8	3,131	⁽³⁾⁽²⁾ 2,926	1,555	⁽³⁾⁽²⁾ 1,605
Noncurrent assets held for sale		8	⁽²⁾ 13	3	-
Total Assets		202,491	185,576	143,035	130,759
Liabilities and Equity					
Deposits from the public	9	153,368	138,011	115,165	104,109
Deposits from banks	10	4,249	3,387	4,139	3,365
Deposits from the Government		925	461	197	177
Securities borrowed or purchased under resale agreements		6,700	7,227	-	-
Subordinated capital notes	11	12,239	12,294	3,803	4,013
Liabilities in respect of derivative instruments	20	4,432	⁽²⁾ 3,215	4,174	⁽²⁾ 2,972
Other liabilities ⁽⁴⁾	12	9,463	⁽³⁾⁽²⁾ 9,829	4,812	⁽³⁾⁽²⁾ 5,299
Total liabilities		191,376	174,424	132,290	119,935
Equity capital attributed to the Bank's shareholders	13	10,745	⁽³⁾ 10,824	10,745	⁽³⁾ 10,824
Non-controlling rights in consolidated companies		370	328	-	-
Total equity		11,115	11,152	10,745	10,824
Total Liabilities and Equity		202,491	185,576	143,035	130,759

:Footnotes

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) Reclassified - see note 1B (4).

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

(4) Of which NIS 172 million and NIS 149 million in the consolidated, and NIS 127 million and NIS 125 million in the bank, as of December 31, 2011, and December 31, 2010, allowance for credit loss in respect of off-balance sheet credit instruments.

The notes to the financial statements are an integral part thereof.

March 28, 2012

Joseph Beressi
Senior Executive Vice President,
Chief Accountant

Reuven Spiegel
President &
Chief Executive Officer

Dr. Yossi Bachar
Chairman of the
Board of Directors

Statement of income for the year ended December 31

Consolidated				
	Notes	2011	2010	2009
In NIS millions				
Financing Income				
Income from financing activities before credit loss expenses ⁽¹⁾	23	4,785	4,830	4,757
Credit loss expenses ⁽¹⁾	4d	778	821	998
Income from financing activities after credit loss expenses		4,007	4,009	3,759
Operating and other Income				
Operating commissions	24	2,489	2,547	2,633
Net income on investment in shares	25	92	31	197
Other income	26	109	⁽³⁾ 82	⁽³⁾ 258
Total operating and other income		2,690	2,660	3,088
Operating and other Expenses				
Salaries and related expenses	27	3,459	⁽³⁾ 3,218	⁽³⁾ 3,130
Maintenance and depreciation of buildings and equipment		1,159	1,148	1,032
Amortization and impairment of intangible assets and goodwill ⁽²⁾	7a	17	*49	*51
Other expenses	28	1,203	*1,244	*1,228
Total operating and other expenses		5,838	5,659	5,441
Operating income before taxes		859	1,010	1,406
Provision for taxes on operating income	29	87	⁽³⁾ 458	⁽³⁾ 554
Operating income after taxes		772	552	852
Banking corporation's share in operating income (loss) net of tax effect of affiliated companies	6b	103	186	158
Net income from ordinary operations:				
Before attribution to non-controlling rights holders		875	738	1,010
Attributed to the non-controlling rights holders		(84)	(70)	(72)
Net income from ordinary operations, attributed to bank's shareholders		791	668	938
Net income (loss) from extraordinary operations, net of taxes, before attribution to non-controlling rights holders	30	61	36	(20)
Net income:				
Before attribution to non-controlling rights holders		936	774	990
Attributed to the non-controlling rights holders		(84)	(70)	(72)
Net income attributed to bank's shareholders		852	704	918
Earnings per share of NIS 0.1 (in NIS)	13,35			
Net income from ordinary operations, attributed to bank's shareholders		0.75	⁽³⁾ 0.67	⁽³⁾ 0.94
Net income (loss) from extraordinary operations, net of taxes, attributed to bank's shareholders		0.06	0.04	(0.02)
Total		0.81	⁽³⁾0.71	⁽³⁾0.92
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)		1,053,869	997,578	993,979

* Reclassified, see Note 1 B (4).

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) With regard to amortization of goodwill, see Note 1 D 2.

(3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

The notes to the financial statements are an integral part thereof.

Statement of income for the year ended December 31 (continued)

The Bank				
	Notes	2011	2010	2009
in NIS millions				
Financing Income				
Income from financing activities before credit loss expenses ⁽¹⁾	23	2,537	3,056	2,746
Credit loss expenses ⁽¹⁾	4d	587	524	654
Income from financing activities after credit loss expenses		1,950	2,532	2,092
Operating and other Income				
Operating commissions	24	1,114	1,150	1,182
Net income (loss) on investment in shares	25	-	(10)	143
Other income	26	162	128	285
Total operating and other income		1,276	1,268	1,610
Operating and other Expenses				
Salaries and related expenses	27	2,172	⁽²⁾ 2,054	⁽²⁾ 2,010
Maintenance and depreciation of buildings and equipment		824	823	727
Other expenses	28	436	517	469
Total operating and other expenses		3,432	3,394	3,206
Operating income (loss) before taxes		(206)	406	496
Provision for taxes (tax savings) on operating income	29	(136)	⁽²⁾ 174	⁽²⁾ 200
Operating income (loss) after taxes		(70)	232	296
Bank's share in operating income net of tax effect of investee companies	6b	861	⁽²⁾ 436	⁽²⁾ 642
Net operating income		791	668	938
Net income (loss) from extraordinary items, net of taxes	30	61	36	(20)
Net income attributed to bank's shareholders		852	704	918

Footnotes:

(1) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(2) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

The notes to the financial statements are an integral part thereof.

Statement of changes in shareholders' equity

Balance at December 31, 2008

Effect of the initial implementation of the guideline regarding employee rights

Balance at December 31, 2008, as reported after restatement**Changes in 2009 :**

Net Income for the year

Benefit in respect of equity based compensation transactions

Option expiration⁽³⁾

Net adjustments for the presentation of available-for- sale securities at fair value

Net adjustments for the presentation of available-for-sale securities reclassified to the income statement

Related tax effect

Financial statements translation adjustments

Balance at December 31, 2009

Changes in 2010 :

Net Income for the year

Issue of Shares

Benefit in respect of equity based compensation transactions

Option expiration⁽³⁾Exercise of options⁽⁴⁾

Net adjustments for the presentation of available-for- sale securities at fair value

Net adjustments for the presentation of available-for-sale securities reclassified to the income statement

Related tax effect

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 allowance 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

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, 2011

* An amount lower than NIS 1 million.

Footnotes:

(1) Translation adjustments of foreign operations, primarily from a consolidated subsidiary Israel Discount Bank of New York in amount of NIS 231 million, which was treated until December 31, 1994, in the financial statements of the Bank as a unit having a functional currency that differs from the reporting currency. Accordingly this item included the financing sources of this investment and the related tax effect until that date. Following the adoption of IAS21, the said balance was classified to retained earnings.

(2) Including an amount of NIS 2,704 million that is not available for distribution, see Note 13 F 2.

(3) In respect of 8,433,498 expired option warrants in 2011 (6,472,220 in 2010, 784,511 in 2009).

(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 with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

The notes to the financial statements are an integral part thereof.

Capital reserves				Other cumulative comprehensive income (loss)								
				Adjustment for presentation of available securities at fair value				Net gains (losses) on cash flow hedging		Equity attributed to the Bank's shareholders		Non-controlling rights holders in consolidated subsidiaries
Share capital	Share premium	Benefit in respect of equity-based compensation transactions	Other reserves	Total share capital and reserves	Translation adjustments ⁽¹⁾	Retained earnings ⁽²⁾						
in NIS millions												
658	2,939	50	212	3,859	(197)	(255)	-	5,390	8,797	226	9,023	
-	-	-	-	-	-	-	-	⁽⁵⁾ (392)	⁽⁵⁾ (392)	-	⁽⁵⁾ (392)	
658	2,939	50	212	3,859	(197)	(255)	-	4,998	8,405	226	8,631	
-	-	-	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	-	-	-	⁽⁵⁾ 918	⁽⁵⁾ 918	73	⁽⁵⁾ 991	
-	-	2	-	2	-	-	-	-	2	-	2	
-	3	(3)	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	1,014	-	-	-	1,014	-	1,014	
-	-	-	-	-	(556)	-	-	-	(556)	-	(556)	
-	-	-	-	-	(205)	-	-	-	(205)	-	(205)	
-	-	-	-	-	-	19	-	-	19	(1)	18	
658	2,942	49	212	3,861	56	(236)	-	5,916	9,597	298	9,895	
-	-	-	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	-	-	-	⁽⁵⁾ 704	⁽⁵⁾ 704	70	⁽⁵⁾ 774	
7	443	-	-	450	-	-	-	-	450	-	450	
-	-	*_	-	*_	-	-	-	-	*_	-	*_	
-	13	(13)	-	-	-	-	-	-	-	-	-	
*_	12	(12)	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	457	-	-	-	457	9	466	
-	-	-	-	-	(351)	-	-	-	(351)	(6)	(357)	
-	-	-	-	-	(33)	-	-	-	(33)	(1)	(34)	
-	-	-	-	-	-	-	-	-	-	(42)	(42)	
665	3,410	24	212	4,311	129	(236)	-	6,620	10,824	328	11,152	
-	-	-	-	-	-	-	-	(830)	(830)	(5)	(835)	
-	-	-	-	-	-	231	-	(231)	-	-	-	
665	3,410	24	212	4,311	129	(5)	-	5,559	9,994	323	10,317	
-	-	-	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	-	-	-	852	852	84	936	
-	-	-	-	-	-	-	-	13	13	20	33	
-	18	(18)	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	10	-	-	23	33	-	33	
-	-	-	-	-	-	-	-	-	-	(55)	(55)	
-	-	-	-	-	(86)	-	-	-	(86)	-	(86)	
-	-	-	-	-	(134)	-	-	-	(134)	(3)	(137)	
-	-	-	-	-	80	-	-	-	80	1	81	
-	-	-	-	-	-	1	-	-	1	-	1	
-	-	-	-	-	-	-	(15)	-	(15)	-	(15)	
-	-	-	-	-	-	-	7	-	7	-	7	
665	3,428	6	212	4,311	(1)	(4)	(8)	6,447	10,745	370	11,115	

Statement of cash flows for the year ended December 31

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
in NIS millions						
Cash Flows from Operating Activities						
Net income attributed to the Bank's share holders	936	⁽¹⁾ *774	⁽¹⁾ *990	852	⁽¹⁾ *704	⁽¹⁾ *918
Adjustments necessary to present cash flows from current operations:						
Bank's share in undistributed income of affiliated companies	(131)	(133)	(131)	(799)	⁽¹⁾ (349)	⁽¹⁾ (640)
Depreciation of buildings and equipment	592	567	484	445	426	355
Amortization of goodwill and intangible assets	17	*49	33	-	-	-
Provision for impairment of securities held for investment	32	83	120	3	29	10
Credit loss expenses	1,178	1,114	1,049	812	709	703
Gain on sale of available-for-sale and held-to-maturity securities	(258)	*(324)	*(543)	(90)	(187)	(363)
Realized and unrealized gain (loss) from adjustment to fair value of trading securities	(18)	(9)	(18)	(22)	(10)	(33)
Gain on sale of activity in affiliated company	-	(6)	-	-	-	-
Loss (gain) on realization of investment in affiliated company	(26)	(28)	17	-	-	-
Benefit with respect to the allotment of options	-	-	2	-	-	2
Provision for impairment in value of buildings	(11)	4	6	(11)	4	6
Loss (gain) on sale of buildings and equipment	(26)	(2)	2	-	(2)	-
Net deferred taxes	(131)	⁽¹⁾ (86)	⁽¹⁾ 237	(33)	⁽¹⁾ (66)	⁽¹⁾ 77
Severance pay – decrease in excess of deposits over the provision	140	⁽¹⁾ 58	⁽¹⁾ 24	26	⁽¹⁾ (1)	-
Inflation adjustment component of investing and financing activities	(893)	*2,155	*608	48	462	164
Changes in Balance Sheet Items:						
Other assets, net	(508)	*(27)	515	(506)	(185)	628
Other liabilities, net	699	⁽¹⁾ 258	⁽¹⁾ (146)	691	⁽¹⁾ 1,130	⁽¹⁾ (1,036)
Net Cash Flows from Operating Activities	1,592	4,447	3,249	1,416	2,664	791

* Reclassified

Footnote:

(1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

The notes to the condensed financial statements are an integral part thereof.

Statement of cash flows for the year ended December 31 (continued)

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(645)	(2,319)	(986)	(359)	-	-
Proceeds from redemption of held-to-maturity bonds	1,506	1,661	952	-	-	-
Proceeds from held-to-maturity bonds in a consolidated company	166	-	-	-	-	-
Acquisition of available-for-sale securities	(21,168)	(24,116)	(23,528)	(7,049)	(10,958)	(6,048)
Proceeds from sale of available-for-sale securities	11,093	14,058	13,678	4,736	8,230	6,302
Proceeds from redemption of available-for-sale securities	5,706	7,956	5,837	254	281	229
Proceeds of the sale of activity in an affiliated company	-	6	-	-	-	-
Net deposits with banks	(274)	(1,014)	1,354	(1,792)	(1,225)	(432)
Trading securities, net	(1,158)	(28)	(104)	(809)	10	(187)
Net credit granted to the public	(456)	(4,643)	1,468	2,898	(626)	1,524
Net credit granted to the Government	(84)	264	(329)	(65)	267	(357)
Net on securities borrowed or purchased under resale agreements	(100)	291	(311)	(100)	291	(311)
Reduction of (additional) investment in affiliated companies	(5)	1	(9)	(89)	(22)	(264)
Proceeds of the sale of investments in affiliated companies and dividend	165	277	181	321	233	78
Acquisition of buildings and equipment	(520)	(509)	(626)	(362)	(349)	(385)
Proceeds from sale of buildings and equipment	49	7	8	-	7	7
Net Cash Flows from Asset Transactions	(5,725)	(8,108)	(2,415)	(2,416)	(3,861)	156
Cash Flows From Liability and Capital Transactions:						
Net deposits from the public	15,556	(4,001)	2,189	11,255	(1,999)	3,177
Net deposits from banks	862	(337)	(831)	774	(599)	1,041
Net deposits from the Government	464	177	78	20	18	31
Net securities borrowed or purchased under resale agreements	(527)	(424)	457	-	-	-
Issuance of subordinated capital notes	344	1,237	2,419	79	687	350
Redemption of subordinated capital notes	(677)	(809)	(762)	(478)	(502)	(575)
Issue of share capital	-	450	-	-	450	-
Sale of shares in a subsidiary to non-controlling right holders	34	-	-	-	-	-
Dividend to non-controlling rights holders	(55)	(42)	-	-	-	-
Net cash flows from liability and capital transactions	16,001	(3,749)	3,550	11,650	(1,945)	4,024
Increase (decrease) in cash	11,868	(7,410)	4,384	10,650	(3,142)	4,971
Cash balance at beginning of year	16,042	23,452	19,068	14,080	17,222	12,251
Cash balance at end of year	27,910	16,042	23,452	24,730	14,080	17,222

The notes to the condensed 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:

	2011	2010	2009
	in NIS millions		
The Bank:			
Purchase of fixed assets	10	20	-
Lending of securities	(380)	703	(498)
Consolidated			
Purchase of fixed assets	25	28	13
Lending of securities	(178)	703	(498)

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 bank'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 28, 2012.

B. 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 or instruments in respect of which the fair value alternative had been chosen);
- 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;

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 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.

(3) Use of assessments 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 assessments, 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 assessments.

(4) Reclassification

Following the initial implementation of certain accounting standards and directives of the Supervisor of Banks (see Section 5 below), 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:

- Intangible assets and goodwill in the amounts of NIS 169 million, which in the balance sheets for December 31, 2010, were included under "Other assets", are presented as a separate item in the balance sheet as of December 31, 2011.
- Assets in respect of derivative instruments in the amounts of NIS 2,039 million, which in the balance sheets for December 31, 2010, were included under "Other assets", are presented as a separate item in the balance sheet as of December 31, 2011.
- Liabilities in respect of derivative instruments in the amounts of NIS 3,215 million, which in the balance sheets for December 31, 2010, were included under "Other liabilities", are presented as a separate item in the balance sheet as of December 31, 2011.
- Credit granted to the public data, net, as of December 31, 2010, has been reclassified in order to match the presentation format implemented as from January 1, 2011.
- Amortization and impairment expenses of intangible assets and goodwill in the amounts of NIS 49 million, and NIS 51 million, have been reclassified from "Other expenses" and are shown as a separate item for the years ended December 31, 2010 and December 31, 2009, respectively.
- Non-controlling rights in consolidated subsidiaries in the amounts of NIS 328 million as of December 31, 2010, are presented in the balance sheet and in the statement of changes in equity as part of equity.

The following classifications were made in addition:

- Note 4 presents a reclassification of the pro-forma data as of December 31, 2010. The reclassifications stem from the classification between various items in the Note, made in the period of integration of the Directive.
- The results of the exercise of options in the amount of NIS 65 million and NIS 42 million for the years ended December 31, 2010, and December 31, 2009, accordingly, have been reclassified from "Net income in respect of ALM derivative instruments" to the "Other financing income" item.
- Life assurance and property insurance commissions in the amounts of NIS 18 million and NIS 19 million, for the years ended December 31, 2010 and 2009, respectively, have been reclassified from the item "Other commissions" to the item "Commission on the distribution of financial products".
- Net gains on investments in shares in the amounts of NIS 27 million and NIS 19 million, for the years ended December 31, 2010 and 2009, respectively, have been reclassified from the item "Dividends from available-for-sale or trading shares" to the item "Gains on sale of shares available-for-sale".
- Payroll and related expenses in the amount of NIS 13 million for the year ended December 31, 2010, have been reclassified from the item "Adjustment of reserves for salary-related expenses due to changes in salaries during the year" to the item "Severance pay, pension, further education fund, jubilee awards, vacation pay, provident funds and retiree benefits".

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Other expenses in the amount of NIS 13 million for the year ended December 31, 2009, have been reclassified from the item "Other" to the item "Commissions".

(5) Initial implementation of accounting standards, updates of accounting standards and Directives of the Supervisor of Banks

During 2011, the Bank began to implement accounting principles and directives as detailed below:

1. Directives of the Supervisor of Banks on the subject of "measurement and disclosure of impaired debts, credit risk and allowance for credit losses" and amendment of the Directive in the matter of "treatment of problematic debts". It should be noted that the comparative data for prior periods have not been restated; therefore prior period data (data as of December 31, 2010 and for the years 2009 and 2010) is not comparable with the current period data. (For further details regarding the effect of the initial adoption of the Directive, see D 4 below);
2. International financial reporting standards (IFRS) relating to issues outside the core banking business, detailed below, and interpretations of the international financial reporting interpretation committee (IFRIC) applying to the implementation of these standards:
 - (1) IFRS 2, regarding "Share based payment";
 - (2) IFRS 3, (2008), regarding "Business combinations";
 - (3) IFRS 5, regarding "Non-current assets held for sale and discontinued operations";
 - (4) IAS 8, regarding "Accounting policies, changes in accounting estimates and errors";
 - (5) IAS 10, regarding "Events subsequent to the reporting period";
 - (6) IAS 16, regarding "Property, plant and equipment";
 - (7) IAS 17, regarding "Leases";
 - (8) IAS 20, regarding "Accounting treatment of government grants and disclosure regarding government assistance";
 - (9) IAS 21, regarding "The effects of changes in foreign exchange rates";
 - (10) IAS 27, (2008), regarding "Consolidated and separate financial statements";
 - (11) IAS 28, regarding "Investment in associates";
 - (12) IAS 29, regarding "Financial reporting in hyperinflationary economies";
 - (13) IAS 31, regarding "Interest in joint transactions";
 - (14) IAS 33, regarding "Earnings per share";
 - (15) IAS 34, regarding "Interim financial reporting";
 - (16) IAS 36, regarding "Impairment of assets";
 - (17) IAS 38, regarding "Intangible assets";
 - (18) IAS 40, regarding "Investment property".
3. U.S. Financial Accounting Standard No.157 (ASC 820-10), "Measurement of fair value" (hereinafter: "FAS 157"), and update of Accounting standard ASU 2010-06, "Improvement of disclosure regarding the measurement of fair value" (the Bank has selected not to implement at this stage the U.S. Financial Accounting Standard No.159 (ASC 825-10) "Fair value alternative for financial assets and financial liabilities" (hereinafter: "FAS 159")) (see subsection D 7 below).
4. The Supervisor of Banks' directive, "Strengthening Internal Control over Financial Reporting Regarding Employee Rights". The initial implementation of the directive, as from April 1, 2011, was made by means of a restatement (see D 15.3 below).
5. An update of accounting standard ASU 2011-02 in the matter of "A creditor's determination of whether a restructuring is a troubled debt restructuring" (see D 4.3 below).

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. 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 Opinion 29 of the Institute of Certified Public Accountants in Israel, excluding interested parties.

"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 or 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.

"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.

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. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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. Exchange rate differences stemming from the translation into the functional currency are recognized in profit and loss, excluding differences stemming from the translation into the functional currency of non-financial capital financial instruments classified as available-for-sale, financial liabilities hedging investments in foreign activities, or the hedging of cash flows recognized in other comprehensive profits. 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.

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).

Classification of the Bank's foreign extensions. According to guidelines of the Supervisor of Banks, prior to the adoption of IAS21, an overseas banking extension of a banking corporation has been classified as a foreign operation the functional currency of which is identical to the functional currency of the banking corporation. 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

extension. In determining the functional currency, 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 Bankorp will be classified as from January 1, 2012, as foreign operations the functional currency of which is different from the shekel. The change in classification will be treated prospectively as a change in the functional currency of such extension, so that currency translation differences will be recognized as from January 1, 2012, in other comprehensive profit and presented as part of "adjustments from translation of foreign operations".

Effect of the initial implementation. In accordance with guidelines of the Supervisor of Banks regarding the manner of initial implementation, the standard is applied from now onwards starting with the financial statements for periods beginning January 1, 2011. In view of this, the negative capital reserve created by translation differences in the amount of NIS 231 million, accumulated until 1994 in respect of the overseas banking extensions, which in the past had been classified as autonomous units, was recognized on the transition date as part of the retained earnings balance.

1.3 The following are the representative rates of exchange and the CPI and their annual rates of change:

	Annual rate of change					
	2011	2010	2009	2011	2010	2009
CPI (in points):						
Balance sheet month (December index)	116.0	113.5	110.6	2.2	2.6	3.9
Known at balance sheet month (November index)	116.0	113.1	110.6	2.6	2.3	3.8
Representative exchange rate (in NIS) at the balance sheet date of the:						
U.S. Dollar	3.821	3.549	3.775	7.7	(6.0)	(0.7)
Euro	4.938	4.738	5.442	4.2	(12.9)	2.7

2. PRINCIPLES OF CONSOLIDATION AND THE IMPLEMENTATION OF THE EQUITY METHOD

Basis of consolidation. Due to the initial implementation of IFRS 3 (2008), business combinations, IAS 27 (2008), consolidated and separate financial statements, IAS 28, investments in associates and IAS 31, interests in joint ventures, the Bank has changed the accounting policy applied in the treatment of business combinations and transactions with non-controlling rights in consolidated subsidiaries.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, acquisition of companies under joint control 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.

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 in consolidated subsidiaries 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.

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.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On such date, the Bank measures at fair value any investment remaining in the former affiliated company and recognizes in the item "Income from extraordinary items, net of tax" 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.

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 "Income from extraordinary items, net of tax". 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.

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.

The treatment in the Bank's stand alone financial statements. IAS27, excluding the treatment of investment in investee companies in the stand alone financial statements of the Bank, has been implemented for the first time. Accordingly, in preparing the standalone financial statements, the Bank has continued to recognize investee companies by the equity method of accounting. This, is in accordance with directives and guidelines of the Supervisor of Banks.

Effect of the initial implementation - IFRS 3 (2008) "Business combinations". According to guidelines of the Supervisor of Banks, a banking corporation may implement the standard retroactively or from now onwards, starting with the financial statements for periods beginning on January 1, 2011, the Bank had elected to implement the Standard from now onwards, starting with the financial statements for the period beginning on January 1, 2011. In view of this, the initial implementation of the standard had no effect. It should be noted that in accordance with the Standard, 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 the transition date (amortization of goodwill in 2010 amounted to NIS 25 million).

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 included 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 recognize pro-rata to the period of the transactions.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 3.2 Operating commissions in respect of services granted are recognized when the right to receive the commission materializes.
- 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.
- 3.7 Sale and leaseback transactions are presented in the financial statements in accordance with International Accounting Standard (IAS) 17.

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, as adopted by the public reporting directives.

The implementation of the directives applies on any balance and off balance liability, excluding debts measured according to fair value or according to the lower of cost or fair value, and excluding bonds and lease transactions, for which, there are specific rules regarding recognition and measurement of impairment.

The Bank has determined procedures for the classification of credit and for the measurement of provisions for credit losses in order to maintain a proper level of provision to cover anticipated credit losses as regards the credit portfolio as a whole.

The provision required to cover anticipated credit losses is to be computed based on one of the following: "provision on a group basis" or "provision on a specific basis". Furthermore, the Bank examines the overall appropriateness of the allowance for credit losses.

(1) Debts, the allowance for credit losses in respect of which is examined on a group basis

The allowance for credit losses in respect of small and homogeneous debts is assessed on a group basis. The population of these debts includes all housing loans, the allowance for credit losses in respect of whom is computed on the basis of the period in arrears, as well as other debts whose contractual debt balance is lower than NIS 1 million (in a consolidated subsidiary - lower than NIS 50 thousand and in another consolidated subsidiary, lower than NIS 500 thousand). Furthermore, provision on a group basis is also computed with regards to debts the allowance for credit losses in respect of which was examined on a specific basis (see below) and which have not been classified as "impaired".

(2) Debts, the allowance for credit losses in respect of which is examined on a specific basis

These include debts the contractual outstanding balance thereof exceeds NIS 1 million (in a consolidated subsidiary - exceeding NIS 50 thousand; in a consolidated credit card company, in respect of credit card debts of over NIS 500 thousand and credit granted to trading houses of any amount), excluding housing loans the allowance for credit losses in respect of which is computed on the basis of the period in arrears, and including restructured troubled debts.

(A) Impaired debts

- Classification

Debts classified as "impaired" include the following classes of problematic debts:

- All restructured troubled debts. (for details regarding the updating of the U.S. accounting standard in the matter of "Determination by the lender as to whether the restructuring of a debt comprises a restructuring of a troubled debt", see subsection 5 hereunder).
- Debts examined on a specific basis: debts the period in arrears in their respect exceeds ninety days (excluding "well secured" debts that are "in the process of collection" - as defined in the Directive), debts where no credit entries in an amount that is not below their average outstanding debt balance, have been recorded in their related current account

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

within a certain period of 240 days, debts constantly exceeding their approved credit facility during a period exceeding ninety days, as well as debts under legal proceedings (including stay of proceedings, receivership and bankruptcy).

- Any other debt, examined on a specific basis, and where the Bank believes that it may not be possible to collect all amounts due in accordance with its contractual terms.

- **Reversal of "impaired" classification**

The classification of a problematic debt as "impaired" may be reversed in the following cases:

- "Arrears components" no longer exist and the Bank believes that the balance of the debt will be repaid in full.
- The debt is "well secured" and is "in the process of collection".

(B) Non-impaired debts

Debts, the allowance for credit losses in their respect is examined on a specific basis (see above) and which are not classified as "impaired", the provision in their respect is to be computed on a group basis, differentiating between performing debts and debts classified as problematic (substandard or under special mention).

(3) Recognition of interest income

(A) Interest accrual

The principles applied by the Bank in the matter of interest accrual in respect of "impaired" debts, include:

- Discontinuation of interest income accrual in respect of "impaired" debts, starting with the date of their classification as "impaired";
- The outstanding balance of accrued interest on an "impaired" debt until the beginning of the period in which it has been classified as "impaired" not collected by the date of its being classified as such is written off accounting wise;
- Notwithstanding the above, the Bank will continue to accrue interest in respect of restructured troubled debts, where the debt is being repaid according to the terms of the arrangement during a continuous period of at least six months, and expectations for the repayment of the loan are supported by a well based credit evaluation;
- In a consolidated credit card company - the discontinuation of accrual of interest as from arrears of ninety days and over, in respect of all types of credit.

(B) Collection of interest

Interest income in respect of impaired debts will be recognized under the following conditions:

- Upon the collection of an impaired debt (when collection of the recorded amount of the debt is assured), the current interest in respect of the recorded amount of the debt (based on the contractual interest rate), will be recognized. The balance of the interest not recognized as above, will be credited to the statement of income after collection in full of the recorded amount of the debt, everything on the basis of actual collection.
- Where classification of a debt as "impaired" has been reversed, interest income will be recognized as follows:
 - (1) Current interest income in respect of the recorded amount of the debt will be recognized in profit and loss on a current basis.
 - (2) Interest income written off in the past and not credited to profit and loss, shall be recognized as periodic income during the remaining period for the repayment of the debt, by the "effective interest" method.

(4) Accounting write-offs

In accordance with guidelines included in the Directive, the Bank distinguishes between two types of accounting write offs, as follows:

- **Writing-off of debts that had been examined on a specific basis and classified as impaired**

Debts examined on a specific basis and classified as impaired and which are considered uncollectible or having a very low value, leaving them as an asset would be unjustified, or would require long-term efforts, are to be written off accounting wise. Principles for the writing off of impaired debts have been determined in this respect, according to the following characteristics:

- Impaired debt the collection of which is "collateral dependent" - the part of the debt exceeding the assessment of the fair value of the collateral, net of selling expenses is to be written off accounting wise.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- A restructured troubled debt - the amount of the "conditional waiver" included in the debt arrangement is to be written off.
- Other impaired debts - the balance of the debt exceeding the amount expected to be received from the debtor shall be written off accounting wise, unless the Bank has evidence of additional collections expected from the borrower and on condition that certainty exists as to the loss to be sustained by the Bank. In general, an accounting write off in respect of uncertainty as to the amount of loss to be sustained by the Bank, shall not be deferred for over two years since the date on which the debt had been classified as impaired.
- **Writing off of debts, the allowance for credit losses in respect of which is examined on a group basis**
The writing off of such debts is made on the basis of the following principles and debt characteristics:
 - Debts which are not collateralized by house mortgage - the amount exceeding financial collateral shall be written off after 150 days since the beginning of the default.
 - Debt collateralized by a house mortgage - the amount of the debt exceeding the fair value of the housing property shall be written off after 180 days since the beginning of the default, excluding cases where the debt is treated in accordance with the period in arrears method.
 - Debts of individuals or corporations in bankruptcy or receivership - the part of the debt in excess of the value of the collateral received by the Bank is to be written off after sixty days since the date of the receivership order or of the liquidation order, as the case may be, on condition that collection of the collateral amount is expected.
 - Debts fraudulently created - the part of the debt in excess of the value of the collateral obtained by the Bank is to be written off accounting wise at the end of ninety days since the beginning of the default, on condition that foreclosure of the collateral had begun and is assured, no later than the end of ninety days since the beginning of the arrears period.

It should be clarified that an accounting write-off does not involve a legal waiver of the debt, but only reduces the reported outstanding balance of the debt for accounting purposes, while creating a new cost basis for the debt in the Bank's books.

(5) Allowance for credit losses

The allowance for credit losses reflects the Bank's assessment regarding credit losses inherent in its asset portfolio. In accordance with guidelines determined by the Directive, the principles for measurement of the provisions and of credit losses are divided into two groups, as follows:

- **Debts, the allowance for credit losses in respect of which are assessed on a specific basis**

Provisions for credit losses in respect of these debts computed on the basis of appropriate documentation, by one of the following methods:

- In respect of collateral dependent impaired debts - the allowance for credit losses comprises the difference between the recorded amount of the impaired debt and the fair value of the collateral (net of reliance factor), net, after realization expenses.
- In respect of other impaired debts - the balance of allowance for credit losses comprises the difference between the recorded amount of the impaired debt and the expected payments by the borrower, discounted on the basis of the original effective interest rate of the impaired debt, over and above amounts written off accounting wise, as stated above.

- **Debts, the allowance for credit losses in respect of which are assessed on a group basis**

The allowance for credit losses on a group basis is computed according to the following principles:

- Debts to which the provisional directive of the Bank of Israel, published on February 18, 2010, and in effect until December 31, 2012 applies:

The provisional directive applies to all credit instruments at the Bank, excluding debts examined on a specific basis and classified as impaired and housing loans, the provisions for loan losses in respect of which are computed by the "period in arrears method".

According to the provisional directive, the group provision is computed in respect of such debts by multiplying the recorded amount of credit to which the directive applies (segmentized according to economic sectors), by the "credit loss provisions coefficient", for each of the said economic sectors, While differentiating between non-problematic customers and problematic

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

customers (with substandard debts and debts under special mention), including debts that are reviewed on a specific basis and found not to be impaired.

In accordance with the provisional directive, the Bank has fixed a "credit loss provisions coefficient" for each of the economic sectors and for each of the sub-groups, as stated above, based on the "provisions and write-offs range" (computed on the basis of balances and provisions in each economic sector, as actually reported by the Bank in the years 2008-2010 and on accounting write-offs made as from January 1, 2011). In addition to calculating the range of historical loss rates in the various economic sectors, as stated, for the purpose of determining the suitable rate of provision, the Bank studies the different sector aspects including trends in the various economic sectors.

The Bank believes that the "coefficients for credit loss provision" determined for the purpose of evaluating the allowance for credit losses on a group basis, as stated, comprise the best available assessment (within the "provision range"), with respect to the rate of unidentified losses inherent in the credit portfolio, for each of the groups mentioned above.

Housing loans, the provision in respect of which is computed by the period in arrears method -

The provisions for credit losses in respect of these loans are computed on the basis of the rates determined in Proper Banking Management Directive No. 314, derived from the period in arrears of each of the loans.

- Off-balance sheet credit instruments (not classified as impaired) -

The provisions for credit losses in respect of such credit risk are computed by multiplying the recorded amount of the off-balance sheet credit risk in each economic sector, by the "credit loss provision coefficient", in accordance with the methodology described above in relation to the balance sheet credit risk, after conversion of the off-balance sheet credit risk into "credit equivalent", Based on credit conversion factors (CCF), determined on the basis of past experience and in the absence of past data - according to the rules determined in Proper Banking Management Directive No. 203 and certain adjustments based on past experience, where available.

- Other debt instruments - the provisions for credit losses in respect of other debt instruments are computed by multiplying the recorded amount of the debt instrument, by the "provision coefficient", based on the credit rating of the debt instrument.

In accordance with the provisional directive, the total group provision shall not fall below the outstanding amount of the general, supplemental and special provisions, as computed according to Proper Banking Management Directive No. 315, gross before tax ("grossed-up" amount).

In accordance with guidelines specified in the provisional directive, as from January 1, 2011, the Bank does not maintain general and supplemental provisions, however it continues to compute the supplemental provision and checks that in any event the amount of the group provision at the end of each reporting period is not below the general and supplemental provisions that would have been computed as of that date, before the tax effect.

(6) Troubled debt restructurings

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 settlement of the debt.

In order to determine whether the debt arrangement made by the Bank is to be considered a troubled debt restructuring, the Bank performs a qualitative examination of all the terms of the arrangement and the circumstances in which it had been made, with the aim of determining whether: (1) the borrower has financial difficulties, and (2) within the framework of the arrangement the Bank has granted a waiver to the borrower.

In order to determine whether the borrower has financial difficulties, the Bank examines whether signs of financial difficulties exist at date of the arrangement, or the existence of a reasonable possibility that the borrower will encounter financial difficulties in the absence of an arrangement. Among other things, the Bank examines the existence of one or more of the following circumstances: at date of the arrangement the borrower is in default, including where whatever other debt of the borrower is in default; in respect of debts that as of

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

date of the arrangement are not in arrears, the Bank estimates as to whether according to the present repayment ability of the borrower, it is probable that in the foreseeable future the borrower will encounter a default situation and will not be able to honor the original contractual terms of the debt; the debtor had been declared bankrupt, is in receivership, or significant doubts exist as to the borrower continuing as a going concern; and also that with no changes in the terms of the debt, the borrower will not be able to raise funds from other resources at the market interest rate accepted in the case of borrowers who are not in default.

If one or more of the following situations exist: as a result of the restructuring of the debt, the Bank is not expected to collect all the amount of the debt (including accrued interest in accordance with the contractual terms); the updated fair value of the collateral, in the case of debts collateral dependent, does not cover the contractual outstanding balance of the debt and indicates the inability to collect all amounts of the debt; the borrower is unable to raise funds at the market interest rate accepted in the case of debts having characteristics and terms similar to those of the debt that is subject to the arrangement.

Furthermore, the Bank does not classify a debt as a restructured troubled debt if, within the framework of the arrangement, the borrower had been granted a deferment in the repayment of the debt that is considered not material in view of the frequency of the installments, the contractual repayment period and the anticipated average maturity of the original debt. In this respect, where several arrangements had been made involving changes in terms of the debt, the Bank takes into account the cumulative effect of previous arrangements when determining whether the deferment in repayments is not material.

Restructured debts, including those, which prior to the restructuring, had been examined on a group basis, are classified as impaired debts and are assessed on a specific basis for the purpose of the allowance for credit losses or of an accounting write-off. In view of the fact that a debt that had undergone troubled debt restructuring, will not be repaid in accordance with its original contractual terms, it will continue to be classified as an impaired debt even after the borrower reverts to regular repayments under the new terms.

(7) Comprehensive appropriateness examination

According to the Directive an examination is required of the overall appropriateness of the allowance for credit losses. (the Bank persists in completing the preparations in full required in this matter).

Effect of the initial implementation. The Directive has been initially implementation for periods beginning January 1, 2011 and thereafter. The Directive was not applied retroactively in the financial statements for prior periods.

At date of the initial application, the Bank shall, among other things:

- Wrote off accounting wise any debt which at that date is eligible for accounting write-off;
- Classified under special mention, substandard or impaired any debt that matches the conditions for such classification. In this respect, it is clarified that despite the definition stating that a restructured troubled debt is an impaired debt, the Bank did not classify as impaired a debt that had been restructured prior to January 1, 2007, so long as the debt is not impaired under the terms of the restructuring agreement;
- Reversed all accumulated interest income that has not been collected in respect of any debt which at this date matches the related terms;
- Adjusted the balance of the allowance for credit losses in respect of credit granted to the public and in respect of off-balance sheet credit instruments as of January 1, 2011, to the requirements of the Directive. The said adjustments were recognized directly in the retained earnings item of the equity, net after tax effect;
- Adjusted the current taxes balance and of deferred tax assets and liabilities as of January 1, 2011.

4.2 The policy that had been implemented until December 31, 2010

- 1) The provision for doubtful debts included a specific provision, a general provision and a supplemental provision. The provision for doubtful debts of the Bank and the consolidated subsidiaries in Israel was made according to the directives of the Supervisor of Banks. The provisions for doubtful debts in the consolidated banking subsidiaries abroad, were determined according to generally accepted principles in those countries.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 2) The specific provision for doubtful debts has been recorded on the basis of the Bank's estimate of expected losses in credit portfolios, including off-balance sheet debt items, by examining and monitoring the financial condition of the debtors and their business activities, an assessment of collateral held, and an evaluation of the risks related to their financial condition, performed on a quarterly basis.
- 3) Interest income in respect of debt (or a part thereof) classified as non-performing, was not recognized as from the beginning of the quarter in which such debt have been declared as non-performing. Upon collection of the interest, such income was stated as "Other financing income".
- 4) The specific provisions regarding housing loans granted by banking subsidiaries in Israel, have been calculated according to the directives of the Supervisor of Banks, on an increasing scale in accordance with the extent of the arrears.
- 5) The supplemental provision for doubtful debts 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.
- 6) The directives of the Supervisor of Banks stipulate that the balance of the general provision for doubtful debts, at adjusted values, accumulated under the previous directives, at a rate of 1% of total indebtedness as of December 31, 1991, should be maintained. The adjustment of the general provision was discontinued on January 1, 2005, according to directives of the Supervisor of Banks. The balance of the general provision on December 31, 2010, amounted to NIS 424 million.
- 7) The supplemental provision and the general provision 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 provision for doubtful debts based on past experience and management's estimate of business and economic conditions, the concentration of the credit portfolio, quality of the borrowers and trend of arrears in repayments.
- 9) Bad debts 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 Additional instructions initially implemented

In December 2010, the Supervisor of Banks issued a circular in the matter of the treatment of problematic debts, which changed the definition of housing loans the provision in respect of which is assessed according to the period in arrears method. The amendment was applied from now onwards, starting with the financial statements for periods beginning on January 1, 2011.

In addition, in April 2011, the FASB published an update of accounting standard ASU 2011-02 in the matter of "A creditor's determination of whether a restructuring is a troubled debt restructuring. The rules determined by the ASU regarding identification of the arrangements defined as restructured troubled debt, have been adopted by the Supervisor of Banks and have become effective for periods beginning on July 1, 2011 and thereafter, and apply for the purpose of determining whether the restructuring comprises a troubled debt restructurings with respect to any debt arrangement made as from January 1, 2011. The changes in the manner of measurement of the allowance for credit losses were applied from now onwards, so that the updating of the provision required to be computed on a specific basis was recorded in the third quarter of 2011. The initial application of the ASU rules had no material effect.

4.4. Pro-forma data as of December 31, 2010

Note 1 A. to the financial statements as of December 31, 2010, presented pro-forma data regarding the effect (pro-forma) of the initial implementation of the Directive regarding "Measurement and disclosure of impaired debts, credit risk and allowance for credit losses" on certain balance sheet items on January 1, 2011, on principal balance sheet items in the financial statements as of December 31, 2010, had the Directive been initially implemented on that date.

In preparing the pro-forma data for its presentation in the interim financial statements as of March 31, 2011, certain changes had been included in the computation of the data (hereunder: "the amended pro-forma data").

The amended pro-forma data are presented in Note 4 below, as comparative figures as of December 31, 2010.

The following changes were included in computation of the pro-forma:

- (1) In accordance with the clarification by the Supervisor of Banks issued in April 2011, debts of private individuals classified as "credit risk under special mention", are, for the purpose of computing the group provision, classified as "problematic debts", even if their period in

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

arrears is less than ninety days. In the computation of the pro-forma data included in the financial statements as of December 31, 2010 (hereinafter: "initial pro-forma computations") the said debts had been classified as performing debts.

The gross effect of this change added NIS 32 million to the allowance for credit losses (pro-forma) as of December 31, 2010.

- (2) Completion of the conversion rate of performance guarantees and Sales Act guarantees into credit, based on an "internal model" formed by the Bank, instead of a conversion factor according to proper Banking management Directive No. 203.

The gross effect of this change deducted NIS 51 million from the allowance for credit losses (pro-forma) as of December 31, 2010.

- (3) In view of the continued review of the provisions for loan losses examined on a specific basis, the Bank's Management decided to include as of December 31, 2010, additional write-offs (pro-forma) in the amount of NIS 20 million.
- (4) In view of the review of credit risk related to housing loans, and in accordance with the guideline of the Supervisor of Banks dated May 1, 2011, the provisions for credit losses (pro-forma) as of December 31, 2010, have been increased by an amount of NIS 18 million.
- (5) The effect of the initial implementation in an affiliated company was restated and included an additional effect on equity in the amount of NIS 11 million.

Following are details of the effect of the change on the pro-forma data:

	Pro-forma data as of December 31, 2010		
	In NIS million		
	As previously reported	The restatement	As printed in this report
Cumulative effect, net of tax, of the initial implementation of the new Directive as of December 31, 2010	817	13	830

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 securities are presented at their fair value at the reporting date. Gains or losses due to adjustments to fair value are recorded in the statement of income.
- (c) "Available for sale securities" - securities not classified under the two previous categories. Securities available for sale are stated at their fair value on the balance sheet date, except for shares the fair value of which is not readily available, which are stated at cost less a provision for impairment in value not of a temporary nature which is recorded in the statement of income. Unrealized gains or losses resulting from the adjustment to fair value, net of the related tax effect, are recorded as a separate line item in Shareholders' Equity, and forwarded to statement of income upon sale or redemption of the securities.

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, 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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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;
- 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;

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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. The fair value of derivatives as abovementioned is stated, net, in the items "Other assets" or "Other liabilities".

Changes in the fair value of a derivative instrument shall be reflected in the statement of income, or shall be included in 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, a liability or a firm commitment, shall be recognized in the statement of income on a current basis, as well as the change in value of the hedged item, which may be related to the hedged risk.

The accounting treatment of changes in the fair value of derivatives that hedge exposure to changes in the cash flow generated by an asset, a liability or an anticipated transaction, depends on the effectiveness of the hedging relations.

- 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.
 - The non-effective part of the change in the fair value of a derivative designated as above is recognized immediately in the statement of income.
- Gain or loss on a derivative instrument not designated as a hedging instrument is recognized in the income statement as incurred.

In accordance with the decision to cancel the purpose of derivatives as hedging instruments in effect as from January 1, 2010, there were no hedging derivatives in 2010.

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.

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;
- Level 2 inputs: quoted prices on active markets for similar assets or similar liabilities; quoted prices on inactive markets for identical assets or liabilities; prices derived from evaluation models, where all significant inputs are observable in the market or are supported by observable market inputs;
- Level 3 inputs: unobservable inputs for assets or liabilities derived from evaluation models, one or more of their significant inputs are unobservable.

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

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Implementation of the provisions of FAS 157 requires termination of the use of a blockage factor in computing fair value and replaces the guidelines of EITF 02-3 (ASC 815-10) "Issues of accounting treatment of derivative contracts held for trading and energy trading contracts and risk management activities", which prohibit the recognition of day one gains and require to determine the fair value of derivative instruments that are not traded on an active market on the basis of the transaction cost.

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 useful 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 provisions for loan losses in respect of the debts.

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.

Disclosure requirements. FAS 157 extend the disclosure requirements regarding the measurement of fair value. In addition, ASU 2010-06 "Improving disclosure regarding the measurement of fair value", requires additional disclosure such as disclosure of significant changes from measuring fair value according to Level 2 to measurement according to Level 1 and vice versa, as well as giving explanations for such changes. Furthermore, disclosure is required for gross amounts of the changes in measurement of fair value according to Level 3, stemming from purchase, sale, issuance and repayment transactions. The new disclosure is required on a quarterly basis. The said disclosure requirements are reflected in these financial statements. Notwithstanding, Implementation of the said disclosure requirements is not mandatory for financial statements in respect of periods presented prior to the initial Implementation of the Standard. In view of this, the financial statements do not include comparative data for the new disclosure.

Effect of the initial implementation. FAS 157 (ASC 820-10) is effective as from January 1, 2011 onwards, and has been initially adopted in a limited format of retroactive implementation. In view of this, the standard is being implemented from now onwards, excluding financial instruments that had been measured prior to its initial implementation in the following manner:

- Positions of financial instruments traded on active markets, measured at fair value using the volume of holdings factor;

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- Financial instruments, including hybrid financial instruments, measured at fair value at date of initial recognition according to part A1 to the public reporting directives, while using the price of the transaction in accordance with the guidelines in footnote 3 of EITF 02-3 (ASC 815-10).

Implementation of the standard had no material effect.

As stated, the Bank has elected not to implement FAS 159 at this stage.

8. Offsetting assets and liabilities

8.1 The Bank offsets assets and liabilities 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.

8.4 The bank offsets between derivative instruments made with the same counterparty which are subject to a master netting arrangement.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Furthermore, according to guidelines of the Supervisor of Banks, certain securities sold to the Bank of Israel under repurchase terms, 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". 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.

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".

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.

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 "profit from extraordinary items, after tax" 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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 2 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.

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;

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- (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 operating income (loss) net of tax effect 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 operating income (loss) net of tax effect of affiliated companies".

- 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.

Effect of the initial implementation. The Standard has been implemented from now onwards, beginning on January 1, 2011. The initial implementation of the Standard had no effect.

15. EMPLOYEE BENEFITS

15.1 Liabilities in respect of employee rights are covered by appropriate provisions. For further details see Note 16 hereunder.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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". 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 guidelines included in the circular were applied as from April 1, 2011. The effect of the initial implementation was reflected by way of a retroactive implementation. The balance of retained earnings as of December 31, 2008, (the earliest period presented in these financial statements) has been restated by an amount of NIS 392 million (net of tax), in respect of severance pay, jubilee awards and post retirement benefits (see hereunder). The comparative figures have been restated.

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.

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 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).

The computation based on limitations set by Management has been initially prepared as of June 30, 2011.

The Supervisor of Bank requires the Bank to base the provision for long-service bonuses ("Jubilee Bonuses") and post retirement benefits, on an actuarial computation and to present it at discounted value. The actuarial computation is based on several parameters mentioned above. In light of the fact that the rate of retirement used in the past in the actuarial calculation of the aforesaid liability did not take into account rates of retirement with respect to employees' early retirement, implementing the Supervisor's directives with regard to employee rights required also to restate the provision with respect to these liabilities.

It should be noted that within the framework of the actuarial computation made as of June 30, 2011, within the framework of the initial implementation of the Directive, retirement of employees had been assumed in the framework of the approved retirement plan in 2011 (see

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Note 16 below). Also assumed were the scope of retirement and characteristics of retirees (seniority, gender and salary level), in accordance with assessments of the Bank's Management. The updated computation as of December 31, 2011, was based on the actual retirement scope and on the characteristics on the actual retiree population.

Effect of the initial implementation. Following is the effect of the retroactive implementation on each of the prior reporting periods presented in this report:

A. Income statement items

	For the year ended December 30, 2010			For the year ended December 30, 2009		
	As previously reported	The effect of restatement	As reported after restatement	As previously reported	The effect of restatement	As reported after restatement
In NIS millions						
Statement of Income						
Other income	83	(1)	82	261	(3)	258
Salaries and related expenses	3,190	28	3,218	3,175	(45)	3,130
Operating income before taxes	1,039	(29)	1,010	1,364	42	1,406
Provision for taxes on operating income	467	(9)	458	507	47	554
Operating income after taxes	572	(20)	552	857	(5)	852
Bank's share in operating income of affiliated companies, net of tax effect	186	-	186	158	-	158
Net income attributed to bank's shareholders	724	(20)	704	923	(5)	918
Earnings per shares of NIS 0.1 par value (in NIS)	0.73	(0.02)	0.71	0.093	(0.01)	0.92
An amount less than NIS 1 million.						

B. Balance sheet items

	31.12.2010			31.12.2009		
	As previously reported	The effect of restatement	As reported after restatement	As previously reported	The effect of restatement	As reported after restatement
In NIS millions						
Investments in affiliated companies	1,684	(10)	1,674	1,795	(10)	1,785
Other assets ⁽¹⁾	3,154	(228)	2,926	3,287	(252)	3,035
Other liabilities ⁽²⁾	9,650	179	9,829	10,023	135	10,158
Equity capital attributed to the shareholders of the bank	11,241	(417)	10,824	9,994	(397)	9,597
Total Shareholders' equity	11,569	(417)	11,152	10,292	(397)	9,895
Total Capital Ratio	13.7	(0.50)	13.2	12.10	(0.4)	11.70
Core Capital Ratio	7.90	(0.30)	7.60	7.00	(0.3)	6.70
Of which: Excess deposits for severance pay and pension, over provision	397	(394)	3	410	(410)	-
Of which: Excess provision for severance pay and pension, over deposits	52	207	259	42	157	199
Provisions for vacation pay, seniority bonus and retirement benefits	1,134	(28)	1,106	1,074	(22)	1,052

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Balance sheet items

	For the year ended December 30, 2010			For the year ended December 30, 2009		
	As previously reported	The effect of restatement	As reported after restatement	As previously reported	The effect of restatement	As reported after restatement
In NIS millions						
Statement of Income						
Salaries and related expenses	2,034	20	2,054	2,055	(45)	2,010
Operating income before taxes	426	(20)	406	451	45	496
Provision for taxes on operating income	180	(6)	174	155	45	200
Operating income after taxes	246	(14)	232	296	-	296
Bank's share in operating income of affiliated companies, net of tax effect	442	(6)	436	647	(5)	642
Net income attributed to bank's shareholders	724	(20)	704	923	(5)	918

	31.12.2010			31.12.2009		
	As previously reported	The effect of restatement	As reported after restatement	As previously reported	The effect of restatement	As reported after restatement
In NIS millions						
Investments in affiliated companies	10,212	(58)	10,154	10,051	(51)	10,000
Other assets ⁽¹⁾	1,841	(236)	1,605	1,839	(251)	1,588
Other liabilities ⁽²⁾	5,176	123	5,299	4,707	94	4,801
Equity capital attributed to the shareholders of the bank	11,241	(417)	10,824	9,994	(397)	9,597
(1) Of which: Excess deposits for severance pay and pension, over provision	384	(384)	-	392	(392)	-
(2) Of which: Excess provision for severance pay and pension, over deposits	-	151	151	-	116	116
Provisions for vacation pay, seniority bonus and retirement benefits	940	(28)	912	913	(22)	891

16. SHARE BASED COMPENSATION

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.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 an action together with a petition to have it approved as a class action suit, such period is not to include a period in which the Court has decided to stay the proceedings. Note 19 states separately the outstanding claims, in respect of which a reasonable assessment of the exposure to risk is not possible.

The Bank has described material legal proceedings being conducted against the Bank and Group companies. In this respect, the Bank has determined that as a general rule, a legal proceeding shall be disclosed where the amount claimed exceeds 0.5% of the equity capital of the Bank and it is not possible to assess the prospects of the risk exposure materializing and exceeds 1% of the equity capital where there are reasonably possible prospects of the risk exposure materializing or where the prospects of the risk exposure materializing are remote.

It should further be noted, that in cases where the Bank is one of the defendants in the action, and the claimants have not allocated the amount claimed to each of the defendants, the amount estimated as relevant to the Bank is computed to the best of ability, considering the fact that taking the full amount into account might be misleading and is not correct under the circumstances, and that the estimate made does not necessarily represent the allocation which at the end of the day would be decided by the Court.

The financial statements include appropriate provisions in accordance with generally accepted accounting principles and the estimates of the Managements of the Bank and of its subsidiaries, based on opinions of their legal Counsels.

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. Deferred taxes have been calculated according to the "liability" method, at tax rates expected to be applicable during the period in which the deferred taxes are realized, based on laws in force at the balance sheet date. The realization of deferred taxes receivable is contingent upon the future existence of taxable income. Management believes that such deferred tax assets will be realizable in the future.

18.2 A provision for deferred taxes is included in the financial statements for that part of the adjustment of depreciable non-monetary assets (excluding buildings - see Note 29 I) which will not be deductible for tax purposes.

18.3 Retained earnings of certain investee companies may be subject to additional taxes if and when distributed as cash dividends. With respect to consolidated subsidiaries - when a dividend distribution is not expected in the foreseeable future - no provision for taxes has been recorded.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

18.4 Profits from the future sale of investments in shares of investee companies may attract additional taxes. The provision for deferred taxes does not include taxes relating to the sale of investments in investee companies as long as the supposition of the ongoing holding of the investment exists.

18.5 The provision for taxes on income of the Bank and its consolidated subsidiaries which are financial institutions, for the purposes of Value Added Tax, includes profit tax levied on income as stipulated in the Value Added Tax Law. Value Added Tax levied on payroll of financial institutions is included in the statement of income under the item "Salaries and related expenses".

18.6 A deferred tax asset in respect of brought forwards tax losses and in respect of a brought forward right to a tax setoff is recognized in the books in cases where the said tax utilization in the foreseeable future is not uncertain. A deferred tax asset in respect of temporary differences is recognized where it is probable that a tax savings will arise upon their reversal. The creation of net deferred taxes shall not exceed the current tax in the period, unless in special cases where the tax realization in the foreseeable future is not uncertain.

18.7 Current and deferred taxes are recognized in the statement of income, unless the tax applies to a transaction or event that is recognized directly in equity. In such cases the tax expense is recognized in equity.

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 flows is presented classified into cash flows produced by current activities, by activities in assets and by activities in liabilities and capital. Cash flows produced by activities in assets and liabilities and capital are presented on a net basis, except for movements in securities for investment and non-monetary assets. The cash and cash equivalent item includes cash, bank deposits, marketable deposit certificates and deposits with central banks for an initial period of up to three months.

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.

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:

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- (a) Determination of the manner of presentation of the statement of income - the instruction modifies the format of the statement of income to that acceptable in the U.S. and the world at large. The new format changes the manner of presentation of the components of financing income in the body of the statement of income and in the notes relating thereto; eliminates the differentiation between commission from financing transactions and operating commissions; changes the classification of linkage increments on principal amounts as part of "interest", as well as changes the classification and names of other items in the statement of income. Furthermore, the instruction eliminates the item "income from extraordinary operations" and adopts the approach accepted in the U.S., according to which, specials items are defined as "irregular" and "infrequent" items, and determines that the classification of an event as a special item shall be possible only with the prior approval by the Supervisor of Banks. The instruction determines also changes regarding the format of additional notes to the financial statements.

Implementation of the instructions in this respect shall begin with the report for the first quarter of 2012, by way of retroactive implementation. The initial implementation of the instruction is not expected to have a material effect, save for changes in classification and presentation.

- (b) 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.

The rules determined by the instruction reflect a significant change compared with the rules existing today in the public reporting instructions. The preparations towards the implementation of the new rules included in the instruction are complex and the Supervisor of Banks intends to follow the preparation process of the banking corporations, in particular to everything related to the identification of qualified costs.

The circular determines that the instructions in this respect shall be implemented as from January 1, 2013, and thereafter. The instructions regarding the change in the definition of "interest" in respect of impaired debts shall be implemented in respect of debts classified as impaired as from January 1, 2012, and thereafter, only.

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").

In accordance with the provisions of the Standard, corporations to which the Securities Law, 1968 applies and which are obligated to report in accordance with the rules enacted under this Law, will prepare their financial statements in accordance with the international financial reporting standards, starting with the financial statements for the period beginning January 1, 2008 and thereafter. The above is not applicable to corporations, whose financial statements are prepared according to the directives and guidelines of the Supervisor of Banks, in accordance with the Securities Regulations.

In June 2009, the Supervisor of Banks issued a circular in the matter of "Reporting by banking corporations and credit card companies in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner according to which the IFRS will be adopted by banking corporations and credit card companies in Israel.

The circular clarifies that following the modification of the rules to international standards, the Supervisor of Banks will maintain his authority to issue binding clarifications as to the manner of implementation of the requirements specified by international standards, as well as prescribe further directives in cases where these are required in view of the requirements of regulatory authorities of developed countries, or regarding issues for which no reference exists in the international standards. In addition, the Supervisor of Banks will maintain his authority to issue

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

disclosure and reporting requirements, instructions regarding internal control over financial reporting and instructions relating to the work of the independent auditors.

According to the circular, the targeted date for the reporting by banks and credit card companies in accordance with the IFRS rules, are:

- As regards issues which are not part of the core banking business - as from January 1, 2011. However, the IFRS standards regarding matters detailed below have not yet become effective (see below):
 - IAS 7, regarding "Cash flow statements";
 - IAS 12, regarding "Income taxes";
 - IAS19, regarding "Employee benefits";
 - IAS 23, regarding "Borrowing costs";
 - IAS 24, regarding "Related party disclosures";
- 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.

A circular letter regarding "The adoption of certain international financial reporting standards (IFRS)" was issued on November 30, 2011. Among other things, it was determined in the circular that the said international financial reporting standards, except for IAS-19, shall be implemented by banking corporations as from January 1, 2012. Upon the initial implementation of the said standards, banks are required to act in accordance with the transitional instructions determined in the standards.

The initial implementation of the standards is not expected to have a material effect. However, the implementation of IAS-7 and IAS-24 is expected to have a presentation effect.

3. **Accounting Standard No. 23.** In December 2006, the Israel Accounting Standards Board published Accounting Standard No. 23 - "The accounting treatment of transactions between an entity and the controlling shareholder therein". The Standard replaces the Securities (Presentation in the financial statements of transactions between an entity and the controlling shareholder therein) Regulations 1996, which were adopted in the public reporting instructions of the Supervisor of Banks. The Standard states that assets and liabilities being the subject of a transaction between the entity and its controlling shareholders shall be measured at date of the transaction according to their fair value, and the difference between the fair value amount and the consideration determined for the transaction shall be recorded as part of shareholders' equity. Where the difference is a negative amount, it forms a dividend in substance, and therefore reduces the balance of retained earnings. A credit difference forms in substance an investment by the owners and is to be presented as a separate item in shareholders' equity to be designated as "Capital reserve on a transaction between the entity and its controlling shareholders".

The Standard discusses three issues relating to transactions between an entity and its controlling shareholders, as follows: (1) the transfer of an asset from the controlling shareholder to the entity or vice versa, transfer of an asset from the entity to the controlling shareholder; (2) assumption of debt of the entity to a third party, in part or in full, by the controlling shareholder, indemnification of the entity by the controlling shareholder in respect of an expense, a waiver of a debt, in part or in full, due by the entity to the controlling shareholder; and (3) loans granted by the entity to the controlling shareholder or granted by the controlling shareholder to the entity.

Furthermore, the Standard determines the disclosure that should be included in the financial statements with respect to transactions between the entity and its controlling shareholders during the period.

As above mentioned, the circular was issued on November 30, 2011, in the matter of "the adoption of certain international financial reporting standards (IFRS)". The circular states, among other things, that starting with January 1, 2012, the accounting treatment of transactions between a banking corporation and its controlling shareholders or a company under its control, shall be in accordance with accounting principles accepted by banks in the U.S.. In cases where the said principles do not relate to a particular treatment, the rules determined in Israeli Standard 23 shall apply.

This, consistently with the principles of adoption of the international financial reporting standards regarding issues that are not part of the core banking business.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

4. **Effective control for repurchase agreements.** In April 2011, the FASB published an update to accounting standard ASU 2011-03 regarding "Reconsideration of effective control for repurchase agreements", which constitutes an update of the rules determined in FAS 166 (ASC 860).

The update requires changing the manner of evaluation of the existence of effective control in the hands of a transferor in repurchase agreements. The evaluation of effective control is to be focused on the contractual rights and on the contractual liabilities of the transferor, and therefore, the following are to be disregarded: (1) criterion which requires that the transferor would be entitled to acquire the transferred securities even in case of default by the transferee, and (2) guidelines regarding the demand for collateral in respect of the above criterion. Additional criteria for testing the existence of effective control have not been changed by the ASU. Such criteria indicate that effective control over the transferred assets remains with the transferor (and therefore the transfer of assets is to be treated as a secured debt) if all the following terms apply:

- The assets that will be repurchased or redeemed are identical or identical in substance to the transferred assets;
- The agreement is for the repurchase or redemption of the assets before their due date, at a fixed price or at a determinable price; and -
- The agreement was made simultaneously with the transfer.

The update will apply for periods beginning after December 15, 2011 (namely, as from January 1, 2012) and will be implemented from now onwards in respect of new transactions and existing transactions changed at the beginning of the first quarterly or yearly period following its becoming effective.

The initial implementation of the standard is not expected to have a material effect.

5. **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 set out 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.

The new standards are:

- International financial reporting standard IFRS 10, "Consolidated financial statements". This standard replaces the guidelines of IAS 27, "Consolidated and separate financial statements", and the guidelines of SIC 12, "Consolidation - special purpose entities with regards to consolidation of financial statements".
- International financial reporting standard IFRS 11, "Joint arrangements". The standard replaces the guidelines of IAS 31, "Interests in joint ventures" and amends a part of the guidelines of IAS 28, "Investments in associates".
- International financial reporting standard IFRS 12, "Disclosure of interests in other entities".

The said standards will apply to annual periods beginning January 1, 2013, or thereafter. IFRS 10 and IFRS 11 shall be applied retroactively. Earlier implementation of any of the said standards is permissible subject to the early implementation of the three standards. Notwithstanding, it is possible to include the additional disclosure requirements under IFRS 12 in an early implementation without having to implement earlier the other standards.

The initial implementation of the standard is not expected to have a material effect.

6. **Update of accounting standard ASU 2011-04, "Measurement of fair value".**

This accounting update, updates the guidelines regarding the manner of measurement of fair value determined in U.S. financial accounting standard FAS 157 (ASU 820-10). The updates included in the ASU include clarifications of the intent of the FASB regarding the manner of

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

implementation of the rules pertaining to the measurement of fair value and regarding the disclosure requirements existing at the present time, as well as updates determining principles or specific requirements regarding the measurement of fair value and regarding disclosure requirements as to fair value measurement.

In a circular dated August 11, 2011, the Supervisor of Bank clarified that banking corporations are required to adopt the clarifications included in the said updated standards, as from January 1, 2012, onwards, by way of "from now onwards". Early implementation of the clarifications is not permitted.

The initial implementation of the standard is not expected to have an effect, except for a change in presentation.

7. **Draft guideline regarding the "treatment of put options granted to non-controlling rights shareholders"**

On December 26, 2011, the supervisor of Banks issued a draft guideline, as above, according to which, as from January 1, 2012, banking corporations will be required to treat put options written to non-controlling rights shareholders in accordance with the international financial reporting standards dealing with the matter.

Accordingly, put options written to non-controlling rights shareholders, which are settled in cash or by means of another financial instrument, shall be 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 shall be recognized in the statement of income by the effective interest method. Furthermore, the share of the Group in profits of the investee company shall include the share in profits of the non-controlling rights shareholders, to whom the Group had written the put options.

The Bank is studying the anticipated implications of the initial implementation of the guideline.

2. CASH AND DEPOSITS WITH BANKS⁽¹⁾

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
Cash and deposits with central banks	26,156	13,787	23,022	12,018
Deposits with commercial banks	4,020	4,185	3,138	3,126
Deposits with specialized banking institutions	153	215	15,899	14,473
Total cash and deposits with banks	30,329	18,187	42,059	29,617
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	27,910	16,042	24,730	14,080

Footnote:

(1) See Note 15 D, F, I, L for pledges.

3. SECURITIES⁽¹⁾

A. Composition of this item - consolidated

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	2,184	2,184	101	1	2,284
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	20	20	-	-	20
Total held-to-maturity bonds and bills	5,895	5,895	221	1	6,115

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)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	16,991	16,844	217	70	16,991
Of foreign governments	1,004	1,000	5	1	1,004
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	32	32	-	-	32
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

	December 31, 2011				
		Amortized cost	Unrealized gains	Unrealized	
	Book value	(for shares - cost)	from adjustment to fair value	losses from adjustment to fair value	Fair value ⁽²⁾
(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

General footnotes: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes:

- (1) See Note 15 for pledges.
- (2) Fair value data 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 under repurchase terms by a foreign consolidated subsidiary amounting to NIS 6,700 million (US \$1,754 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 625 million.
- (6) Recorded in the statement of income.

3. SECURITIES⁽¹⁾ (CONTINUED)

A. Composition of this item – consolidated (continued)

December 31, 2010					
	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	2,271	2,271	39	-	2,310
Of foreign governments	2,951	2,951	22	60	2,913
Of foreign financial institutions	55	55	2	-	57
Mortgage-backed-securities and Assets - backed-securities	1,435	1,435	29	1	1,463
Of others abroad	40	40	2	-	42
Total held-to-maturity bonds and bills	6,752	6,752	94	61	6,785

December 31, 2010					
	Book value	Amortized cost (for shares - cost)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	13,822	13,677	169	24	13,822
Of foreign governments	1,373	1,381	4	12	1,373
Of Israeli financial institutions	766	758	10	2	766
Of foreign financial institutions	2,123	2,342	15	234	2,123
Mortgage-backed-securities and Assets - backed-securities	8,976	8,819	174	17	8,976
Of others in Israel	340	315	27	2	340
Of others abroad	150	148	2	-	150
Total bonds and bills	27,550	27,440	401	291	⁽³⁾ 27,550
Shares:					
Fund of Hedge Funds	7	⁽⁷⁾ 7	-	-	7
Others	674	658	16	-	674
Total shares	681	665	16	-	⁽⁵⁾ 681
Total available-for-sale securities	28,231	28,105	⁽⁴⁾ 417	⁽⁴⁾ 291	28,231

For footnotes see next page.

3. SECURITIES⁽¹⁾ (CONTINUED)

A. Composition of this item – consolidated (continued)

December 31, 2010					
	Book value	Amortized cost (for shares - cost)	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value ⁽²⁾
(3) Trading Securities:					
Bonds and bills:					
Of the Israeli Government	2,037	2,038	3	4	2,037
Of foreign governments	11	11	-	-	11
Of Israeli financial institutions	5	5	-	-	5
Of foreign financial institutions	44	47	-	3	44
Mortgage-backed-securities and Assets - backed-securities	43	43	-	-	43
Of others in Israel	9	9	-	-	9
Of others abroad	32	34	1	3	32
Total bonds and bills	2,181	2,187	4	10	2,181
Shares	12	12	5	5	12
Total trading securities	2,193	2,199	(6)9	(6)15	2,193
Total securities	37,176	37,056	520	367	37,209

General footnotes: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes::

- (1) See Note 15 for pledges.
- (2) Fair value data 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 under repurchase terms by a foreign consolidated subsidiary amounting to NIS 7,227 million (US \$2,036 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 626 million.
- (6) Recorded in the statement of income.
- (7) The balance of the investment at December 31, 2010 is net of impairment considered not to be temporary in nature in the amount of NIS 61 million, and net of redemption of the part of the fund's units. In the first quarter of 2011, the fund redeemed all its units.

B. Composition of this item

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

3. SECURITIES⁽¹⁾ (CONTINUED)

A. Composition of this item – consolidated (continued)

December 31, 2011					
			Cumulative other comprehensive income		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value ⁽²⁾
(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

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⁾
(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

General footnote: See Note 23 E for details of results of bond investment activity. For results of investments in shares, see Note 25.

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data 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.

3. SECURITIES⁽¹⁾ (CONTINUED)

B. Composition of this item – the Bank

December 31, 2010					
	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	2,265	2,265	39	-	2,304
Total held-to-maturity bonds and bills	2,265	2,265	39	-	2,304

December 31, 2010					
	Book value	Amortized cost (for shares - cost)	Cumulative other comprehensive income		Fair value ⁽²⁾
			Profits	Losses	
(2) Available for sale securities:					
Bonds and bills:					
Of the Israeli Government	10,222	10,099	147	24	10,222
Of foreign governments	136	139	-	3	136
Of Israeli financial institutions	5	5	-	-	5
Of foreign financial institutions	622	630	8	16	622
Mortgage-backed-securities and Assets - backed-securities	2	2	-	-	2
Of others in Israel	94	86	9	1	94
Total bonds and bills	11,081	10,961	164	44	11,081
Shares:					
Fund of Hedge Funds	7	⁽⁶⁾ 7	-	-	7
Others	9	6	3	-	9
Total shares	16	13	3	-	⁽⁴⁾ 16
Total available-for-sale securities	11,097	10,974	⁽³⁾167	⁽³⁾44	11,097

.For footnotes see next page

3. SECURITIES⁽¹⁾ (CONTINUED)

B. Composition of this item – the Bank (continued)

December 31, 2010					
	Book value	Amortized cost (for shares - cost)	Unrealized gains from adjustment to fair value	Unrealized losses from adjustment to fair value	Fair value ⁽²⁾
(3) Trading Securities:					
Bonds and bills:					
Of the Israeli Government	1,973	1,974	3	4	1,973
Of foreign financial institutions	3	5	-	2	3
Total bonds and bills	1,976	1,979	3	6	1,976
Shares	7	4	5	2	7
Total trading securities	1,983	1,983	(5)8	(5)8	1,983
Total securities	15,345	15,222	214	52	15,384

General footnote: See Note 23 E for details of results of bond investment activity. For results of investments in shares, see Note 25.

Footnotes:

- (1) See Note 15 for pledges.
- (2) Fair value data 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 8 million.
- (5) Recorded in the statement of income.
- (6) The balance of the investment at December 31, 2010 is net of impairment considered not to be temporary in nature in the amount of NIS 61 million, and net of redemption of the part of the fund's units. In the first quarter of 2011, the fund redeemed all its units.

C. Transfer of bonds from the available-for-sale portfolio to the held-to-maturity portfolio. Due to the significant change in the treatment of available-for-sale bonds when computing the ratio of capital to risk assets (in Basel II terms), the Supervisor of Banks informed that he would allow banking corporations the one off transfer on March 31, 2010, of bonds from the available-for-sale portfolio to the held-to-maturity portfolio, subject to the terms determined by him. In accordance with that stated above, the Bank and IDB New York transferred on March 31, 2010, bonds from the available-for-sale portfolio to the held to maturity portfolio, as follows:

- The Bank transferred government bonds of a par value of NIS 1 billion, the stated value and fair value of which at transfer date amounted to NIS 1.1 billion;
- IDB New York transferred mortgage backed securities and securities of federal agencies and trading mortgage backed securities, the fair value and the stated value of which amounted on date of transfer to US\$568 million and US\$566 million, respectively (approx. NIS 2.1 billion).

The capital reserve in respect of adjustments of stating available-for-sale securities at fair value, relating to the securities transferred as above, amounted to NIS 26 million at December 31, 2011, and will remain part of equity as other comprehensive profit and will be amortized over the life of the bonds.

D. Sale of securities out of the "held to maturity" portfolio. 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).

E. Further details regarding mortgage and asset backed securities, on a consolidated basis

The Bank's securities portfolio as of December 31, 2011, includes investments in asset backed securities, primarily investment in mortgage backed securities (MBS) which are held for the most part by IDB New York.

3. SECURITIES⁽¹⁾ (CONTINUED)

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 GNMA's, 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.

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.

3. SECURITIES (CONTINUED)

F. Additional details (consolidated) regarding mortgage and asset backed securities and structured financial instruments

December 31, 2011				
⁽¹⁾ Other cumulative income				
	Amortized cost	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value	Fair value
In NIS millions				
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 by FHLMC and FNMA	51	-	-	51
Total securities for sale MBS securities	54	-	-	54
Total mortgage-backed securities (MBS)	12,791	199	28	12,962

3. SECURITIES (CONTINUED)

G. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE BACKED SECURITIES (CONTINUED)

December 31, 2010				
⁽¹⁾ Other cumulative income				
	Amortized cost	Unrecognized gains from adjustment to fair value	Unrecognized losses from adjustment to fair value	Fair value
In NIS millions				
1. Mortgage-backed securities (MBS):				
Available-for-sale trading securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	100	5	-	105
Securities issued by FHLMC and FNMA	2,623	93	3	2,713
Total mortgage-backed pass-through securities	2,723	98	3	2,818
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	6,092	76	14	6,154
Other mortgage-backed securities	2	-	-	2
Total mortgage-backed other MBS securities	6,094	76	14	6,156
Total available-for-sale MBS securities	8,817	174	17	8,974
Held-to-maturity securities				
A. Mortgage pass-through securities:				
Securities guaranteed by GNMA	110	2	-	112
Securities issued by FHLMC and FNMA	128	3	-	131
Total mortgage-backed pass-through securities	238	5	-	243
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	*979	16	1	*994
Other mortgage-backed securities	218	8	-	226
Total mortgage-backed other MBS securities	1,197	24	1	1,220
Total held-to-maturity MBS securities	1,435	29	1	1,463
Securities for sale				
A. Mortgage pass-through securities:				
Securities issued by FHLMC and FNMA	4	-	-	4
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued by FHLMC and FNMA	39	-	-	39
Total securities for sale MBS securities	43	-	-	43
Total mortgage-backed securities (MBS)	10,295	203	18	10,480
2. Asset-backed available-for-sale securities (ABS) and structured financial products:				
Credit financing the purchase of motor vehicles	2	-	-	2
Securitized Loan Portfolio (CDO)	12	-	-	12
Total asset-backed available-for-sale securities (ABS) and structured financial products	14	-	-	14
Total mortgage and asset-backed securities and structured financial products	10,309	203	18	10,494

* Reclassified

Footnote:

(1) Total other cumulative income - for available for sale securities.

3. SECURITIES (CONTINUED)

G. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE BACKED SECURITIES (CONTINUED)

Additional details regarding mortgage backed securities in unrealized loss position:

	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 trading 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

*Lost amount lower than NIS 1 million.

3. SECURITIES (CONTINUED)

G. ADDITIONAL DETAILS (CONSOLIDATED) REGARDING MORTGAGE BACKED SECURITIES (CONTINUED)

Additional details regarding mortgage backed securities in unrealized loss position (continued):

December 31, 2010				
	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	251	3	-	-
Total mortgage-backed pass through securities	251	3	-	-
B. Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	1,672	14	32	*-
Total other mortgage-backed securities	1,672	14	32	*-
Total available-for-sale MBS securities	1,923	17	32	*-
Held-to-maturity securities				
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	180	1	-	-
Other MBS securities	18	-	-	-
Total other mortgage-backed securities	198	1	-	-
Total held-to-maturity MBS securities	198	1	-	-
Securities for sale				
Other mortgage-backed securities (including CMO, REMIC and STRIPPED MBS):				
Securities issued or guaranteed by FHLMC, FNMA and GNMA	18	*-	-	-
Total bonds for sale MBS securities	18	*-	-	-
Total mortgage-backed securities (MBS)	2,139	18	32	-

*Lost amount lower than NIS 1 million.

- H. The available-for-sale securities portfolio includes corporate bonds, including bonds of banks, in a total amount of NIS 3,139 million (December 31, 2010: NIS 3,381 million). The balance of the said bonds included as of December 31, 2011, unrealized losses in the amount of NIS 344 million (December 31, 2010: NIS 238 million).
- I. Most of the unrealized losses as at December 31, 2011 relate to securities rated as "investment grade" and they are attributed to certain factors, including changes in market interest rate subsequent to date of acquisition, an increase in margins occurring in the credit market concerning similar types of securities, the impact of inactive markets and changes in the rating of securities. For debt securities, there are no securities past due or securities for which the Bank and/or its relevant consolidated companies estimates that it is not probable that they will be able to collect all the amounts owed to them pursuant to the investment contracts.
- In 2011, an other than temporary in nature write down was recorded on several securities, in the amount of US\$2 million (NIS 8 million) [2010: US\$13 million (NIS 46 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, 2011 except for certain securities, in respect of which a provision for impairment in value has been included.
- J. The securities portfolio of the Discount Group as at December 31, 2011, 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\$171 million, (NIS 653 million), compared to US\$420 million on December 31, 2010 (NIS 1,490 million).
- K. **Pledge on securities.** The balances of securities as of December 31, 2011, and December 31, 2010, include securities amounting to NIS 7,784 million and NIS 7,201 million, respectively, that had been pledged to lenders.

3. SECURITIES (CONTINUED)

- L. Fair value presentation.** The balances of securities as of December 31, 2011, and December 31, 2010, include securities amounting to NIS 36,378 million and NIS 29,798 million, respectively, that are presented at fair value.

M. Data regarding impaired bonds - consolidated

	December 31	
	2011	2010
	In NIS millions	
Recorded amount of impaired bonds not accruing interest income	69	27

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS

General. As from January 1, 2011, the Bank implements the new directive of the Supervisor of Banks regarding "Measurement and disclosure of impaired debts, credit risk and allowance for credit losses". In these condensed interim financial statements, disclosure is included according to the new format, modified to the reporting requirements in accordance with the said directive. In view of the fact that the new directive has been implemented from now onwards without restating the comparative figures, and for the comparability of the disclosure, the current period data will be presented hereunder compared with the corresponding data as of December 31, 2010 (pro-forma data), had the directive been initially implemented at that date.

A. The credit to the public

1. Consolidated

	December 31, 2011		
	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions		
Credit granted to the public examined on a specific basis ⁽¹⁾	63,035	1,185	61,850
Credit granted to the public examined on a group basis ⁽²⁾	55,323	790	54,533
Total credit granted to the public	118,358	1,975	116,383
Of which: Customers' liabilities for acceptances	195	2	193

	December 31, 2010 (pro-forma*)				
	Credit granted to the public before provision for doubtful debts	Accounting write-offs	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions				
Credit granted to the public examined on a specific basis ⁽¹⁾	**66,934	**3,891	63,043	**1,222	61,821
Credit granted to the public examined on a group basis ⁽²⁾	**57,968	**1,625	56,343	**846	55,497
Total credit granted to the public	124,902	5,516	119,386	2,068	117,318
Of which: Customers' liabilities for acceptances	287	-	287	2	285

* Restated, see note 1d 4.4 above.

** Reclassified, see note 1 b (4)

Footnotes:

- (1) Including credit examined specifically and found to be not impaired. The allowance for credit losses in respect of this credit was calculated on a group basis. For additional details regarding credit examined on a specific basis see note 4 b hereunder.
- (2) Credit, the allowance for credit losses in its respect is estimated on a group basis by the period in arrears method in accordance with the annex to Proper Banking Management Directive No. 314 and other credit not examined specifically for which the allowance for credit losses was calculated on a group basis. See note 4 c hereunder.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

A. The credit to the public (continued)

2. The Bank

	December 31, 2011		
	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions		
Credit granted to the public examined on a specific basis ⁽¹⁾	51,667	814	50,853
Credit granted to the public examined on a group basis ⁽²⁾	12,431	230	12,201
Total credit granted to the public	64,098	1,044	63,054
Of which: Customers' liabilities for acceptances	125	1	124

	December 31, 2010 (pro-forma*)				
	Credit granted to the public before provision for doubtful debts	Accounting write-offs	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions				
Credit granted to the public examined on a specific basis ⁽¹⁾	56,454	3,342	53,112	838	52,274
Credit granted to the public examined on a group basis ⁽²⁾	16,371	1,202	15,169	286	14,883
Total credit granted to the public	72,825	4,544	68,281	1,124	67,157
Of which: Customers' liabilities for acceptances	209	-	209	2	207

* Restated, see Note 1d 4.4 above.

Footnotes:

- (1) Including credit examined specifically and found to be not impaired. The allowance for credit losses in respect of this credit was calculated on a group basis. For additional details regarding credit examined on a specific basis see note 4 b hereunder.
- (2) Credit, the allowance for credit losses in its respect is estimated on a group basis by the period in arrears method in accordance with the annex to Proper Banking Management Directive No. 314 and other credit not examined specifically for which the allowance for credit losses was calculated on a group basis. See note 4 c hereunder.

Additional details:

Sale by the Bank in 2011 of credit portfolios

During 2011, the Bank sold credit portfolios in a total amount of approx. NIS 1,895 million.

In respect of a sale of a certain credit portfolio, 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 as above, amounts to NIS 430 million.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)**B. Credit to the public examined on a specific basis****1. Credit to the public examined on a specific basis includes:****A. Consolidated**

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions					
Impaired credit granted to the public ⁽¹⁾	5,570	435	5,135	5,801	**465	5,336
Unimpaired credit granted to the public, in arrears for 90 days or more ⁽²⁾	-	-	-	-	-	-
Unimpaired credit granted to the public, 30 days to 89 days in arrears ⁽²⁾	118	18	100	75	13	62
Other non impaired credit granted to the public ⁽²⁾	57,347	732	56,615	57,167	744	56,423
Total unimpaired credit granted to the public ⁽²⁾	57,465	750	56,715	57,242	757	56,485
Total credit granted to the public examined on a specific basis	63,035	1,185	61,850	63,043	1,222	61,821

B. The Bank

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions					
Impaired credit granted to the public ⁽¹⁾	4,723	277	4,446	4,784	280	4,504
Unimpaired credit granted to the public, in arrears for 90 days or more ⁽²⁾	-	-	-	-	-	-
Unimpaired credit granted to the public, 30 days to 89 days in arrears ⁽²⁾	59	12	47	20	3	17
Other non impaired credit granted to the public ⁽²⁾	46,885	525	46,360	48,308	555	47,753
Total unimpaired credit granted to the public ⁽²⁾	46,944	537	46,407	48,328	558	47,770
Total credit granted to the public examined on a specific basis	51,667	814	50,853	53,112	838	52,274

* Restated, see Note 1d 4.4 above.

** Reclassified, see Note 1 b (4)

Footnotes:

(1) Non performing impaired credit, excluding certain credit under restructuring as mentioned in section 4 above.

(2) Credit examined on a specific basis and found to be not impaired. The allowance for credit losses in respect of this credit, has been calculated on a group basis.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

B. Credit to the public examined on a specific basis (continued)

Additional information regarding impaired credit to the public examined on a specific basis:

	Consolidated		The Bank	
	December 31, 2011	December 31, 2010 (pro-forma*)	December 31, 2011	December 31, 2010 (pro-forma*)
	Recorded amount in NIS millions			
2. Impaired credit granted to the public in respect of which an allowance for credit losses on a specific basis exists	2,136	2,358	1,515	1,689
Impaired credit granted to the public in respect of which no allowance for credit losses on a specific basis exists	3,434	3,443	3,208	3,095
Total impaired credit granted to the public	5,570	5,801	4,723	4,784
3. Impaired credit granted to the public measured according to the present value of future cash flows	3,049	**3,388	2,517	2,638
Impaired credit granted to the public measured according to the value of the collateral	2,521	**2,413	2,206	2,146
Total impaired credit granted to the public	5,570	5,801	4,723	4,784

*Restated, see Note 1d 4.4 above.

**Reclassified, see Note 1 b (4)

4. Troubled debt restructuring involving a modification of credit terms:

A. Consolidated

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions					
Non performing debts	547	119	428	728	110	618
Performing debts, in arrears for 90 days or more	1	-	1	-	-	-
Performing debts, 30 days to 89 days in arrears	10	-	10	26	3	23
Performing debts	2,487	45	2,442	2,465	**40	2,425
Total (included in impaired credit granted to the public)	3,045	164	2,881	3,219	153	3,066

B. The Bank

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount	Allowance for credit losses	Net carrying amount
	in NIS millions					
Non performing debts	366	91	275	680	94	586
Performing debts, in arrears for 90 days or more	-	-	-	-	-	-
Performing debts, 30 days to 89 days in arrears	5	-	5	20	3	17
Performing debts	2,262	18	2,244	2,271	23	2,248
Total (included in impaired credit granted to the public)	2,633	109	2,524	2,971	120	2,851

*Restated, see note 1d 4.4 above.

**Reclassified, see note 1 b (4)

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

B. Credit to the public examined on a specific basis (continued)

5. Additional information regarding impaired credit to the public examined on a specific basis

	Consolidated	The Bank
	December 31, 2011	
	in NIS millions	
The average recorded amount of impaired credit granted to the public in the reported period.	5,515	4,658
Total interest income recognized in the reported period in respect of such credit during the period of time in which it had been classified as impaired*.	160	145
Total interest income that would have been recognized in the reported period had such credit accrued interest according to its original terms.	356	248
*Of which: interest income recorded according to the cash basis accounting method.	65	58

C. Credit to the public on a specific basis include:

1. Housing loans in respect of which a minimum allowance for credit losses was made according to the extent of arrears in accordance with the annex to Proper Banking Management Directive No.314:

Consolidated

Period in arrears										
Not in arrears and up to 60 days in arrears	In arrears less than 90 days		In arrears over 90 days					Balances in respect of refinanced loans in arrears (3)	Total	
	2 months to 3 months	Over 3 months to 6 months	Over 6 months to 15 months	Over 15 months to 33 months	Over 33 months	Total over 3 months				
December 31, 2011										
in NIS millions										
Amount in arrears	-	-	5	8	13	175		201	6	207
Of which: balance of allowance for interest ⁽¹⁾	-	-	1	1	2	88		92	-	92
Recorded amount	19,185	236	134	78	57	157		426	21	19,868
Balance of allowance for credit losses ⁽²⁾	32	-	1	11	31	144		187	11	230
Net carrying amount	19,153	236	133	67	26	13	239	10	19,638	
December 31, 2010** (pro-forma*)										
Amount in arrears	-	6	8	11	18	143		180	4	190
Of which: balance of allowance for interest ⁽¹⁾	-	-	2	4	5	69		80	-	80
Recorded amount**	17,531	270	127	115	63	210		515	18	18,334
Balance of allowance for credit losses** ⁽²⁾	23	-	3	17	35	154		209	9	241
Net carrying amount	17,508	270	124	98	28	56		306	9	18,093

* Restated, see note 1d 4.4 above.

** Reclassified, see note 1 b (4)

Footnotes:

(1) In respect of interest on amount in arrears.

(2) Not including balance of allowance for interest.

(3) Loans in which an agreement for the repayment of the arrears of the debtor was signed, were a change in the clearing schedule of the balance of the loan, not yet due for redemption, was made.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

C. Credit to the public on a specific basis include (continued):

2. Other credit not examined on a specific basis for which the credit loss allowance was calculated on a group basis

A. Consolidated

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount**	Allowance for credit losses**	Net carrying amount
	in NIS millions					
Impaired credit granted to the public	41	9	32	47	7	40
Unimpaired credit granted to the public, in arrears for 90 days or more	110	28	82	352	86	266
Unimpaired credit granted to the public, 30 days to 89 days in arrears	98	24	74	147	29	118
Other non impaired credit granted to the public	35,206	499	34,707	37,463	483	36,980
Total	35,455	560	34,895	38,009	605	37,404

B. The Bank

	December 31, 2011			December 31, 2010 (pro-forma*)		
	Recorded amount	Allowance for credit losses	Net carrying amount	Recorded amount**	Allowance for credit losses**	Net carrying amount
	in NIS millions					
Impaired credit granted to the public	-	-	-	-	-	-
Unimpaired credit granted to the public, in arrears for 90 days or more	99	25	74	310	75	235
Unimpaired credit granted to the public, 30 days to 89 days in arrears	68	14	54	113	21	92
Other non impaired credit granted to the public	12,264	191	12,073	14,746	190	14,556
Total	12,431	230	12,201	15,169	286	14,883

*Restated, see note 1d 4.4 above.

**Reclassified, see note 1 b (4)

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

D. Allowance for credit losses in respect of debts and off balance sheet credit instruments

1. Consolidated

	Allowance for credit losses			Total
	On a specific basis	On a group basis* According to the period in arrears	Other	
Balance of allowance for credit losses as at December 31, 2010 included in the financial statement ⁽¹⁾	(2)5,485	(3)167	(4)732	(1)6,384
Effect of the initial implementation of the new directives as at December 31, 2010***:				
Allowance for credit losses as of December 31, 2010, in respect of debts, the provision in respect of which is computed on a group basis.	(1,008)	39	969	-
Net accounting write-offs recognized as at January 1, 2011	(4,205)	-	(1,338)	(5,543)
Other changes in the allowance for credit losses as at December 31, 2010	218	**35	**1,129	1,382
Balance of allowance for credit losses as at December 31, 2010 in accordance with the new directives (pro-forma)	490	**241	**1,492	2,223
Twelve months ended December 31, 2011				
Credit loss expenses	696	(4)	86	778
Accounting write-offs	(940)	(7)	(303)	(1,250)
Recoveries of amounts previously written-off	217	-	183	400
Net accounting write-offs	(723)	(7)	(120)	(850)
Balance of allowance for credit losses, as at December 31, 2011	463	230	1,458	2,151

* Including provision on a group basis in respect of debts examined specifically and found to be not impaired.

** Restated, see Note 1d (4) above.

*** As a result of the initial implementation of the new directives regarding measurement of impaired debts and allowance for credit losses.

Footnotes:

(1) This amount was stated before 1.1.2011 under "provision for doubtful debts".

(2) This amount was stated before 1.1.2011 under "other specific provision".

(3) This amount was stated before 1.1.2011 under "specific provision according to the period in arrears".

(4) This amount was stated before 1.1.2011 under "supplemental provision". In accordance with the new directives regarding measurement of impaired debts and allowance for credit losses, as of January 1, 2011 banking corporations are not required to retain general, supplemental and special provision for doubtful debts.

	Allowance for credit losses			Total
	On a specific basis	On a group basis*		
		According to the period in arrears	Other	
in NIS millions				
Composition of the balance of the provision as of December 31, 2011				
In respect of credit granted to the public	435	230	1,310	1,975
In respect of debt that are not credit granted to the public	-	-	4	4
In respect of off-balance sheet credit instruments (included under other liabilities)	28	-	144	172
Total	463	230	1,458	2,151
Composition of the balance of the provision as of December 31, 2010 (pro-forma):				
In respect of credit granted to the public	476	241	1,351	2,068
In respect of debt that are not credit granted to the public	-	-	-	-
In respect of off-balance sheet credit instruments	14	-	141	155
Total	490	241	1,492	2,223

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

D. Allowance for credit losses in respect of debts and off balance sheet credit instruments (continued)

2. The Bank

	Allowance for credit losses			
	On a specific basis	On a group basis*		Total
		According to the period in arrears	Other	
Balance of allowance for credit losses as at December 31, 2010 included in the financial statement ⁽¹⁾	(2)4,396	(3)-	(4)384	(1)4,780
Effect of the initial implementation of the new directives as at December 31, 2010**:				
Allowance for credit losses as of December 31, 2010, in respect of debts, the provision in respect of which is computed on a group basis.	(840)	-	840	-
Net accounting write-offs recognized as at January 1, 2011	(3,367)	-	(1,202)	(4,569)
Other changes in the allowance for credit losses as at December 31, 2010	102	-	924	1,026
Balance of allowance for credit losses as at December 31, 2010 in accordance with the new directives (pro-forma)	291	-	946	1,237
Twelve months ended December 31, 2011				
Credit loss expenses	547	-	40	587
Accounting write-offs	(665)	-	(212)	(877)
Recoveries of amounts previously written-off	130	-	95	225
Net accounting write-offs	(535)	-	(117)	(652)
Balance of allowance for credit losses, as at December 31, 2011	303	-	869	1,172

* Including provision on a group basis in respect of debts examined specifically and found to be not impaired.

** As a result of the initial implementation of the new directives regarding measurement of impaired debts and allowance for credit losses.

Footnotes:

(1) This amount was stated before 1.1.2011 under "provision for doubtful debts".

(2) This amount was stated before 1.1.2011 under "other specific provision".

(3) This amount was stated before 1.1.2011 under "specific provision according to the period in arrears".

(4) This amount was stated before 1.1.2011 under "supplemental provision". In accordance with the new directives regarding measurement of impaired debts and allowance for credit losses, as of January 1, 2011 banking corporations are not required to retain general, supplemental and special provision for doubtful debts.

	Allowance for credit losses			
		On a group basis*		
	On a specific basis	According to the period in arrears	Other	Total
	in NIS millions			
Composition of the balance of the provision as of December 31, 2011				
In respect of credit granted to the public	277	-	767	1,044
In respect of debt that are not credit granted to the public	-	-	1	1
In respect of off-balance sheet credit instruments (included under other liabilities)	26	-	101	127
Total	303	-	869	1,172
Composition of the balance of the provision as of December 31, 2010 (pro-forma):				
In respect of credit granted to the public	280	-	844	1,124
In respect of debt that are not credit granted to the public	-	-	-	-
In respect of off-balance sheet credit instruments	11	-	102	113
Total	291	-	946	1,237

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

D. Allowance for credit losses in respect of debts and off balance sheet credit instruments (continued)

Following are details as of December 31, 2011, as published in accordance with the former directives:

	2010				2009			
	Specific provision ⁽¹⁾		Supplemental provision ⁽²⁾	Total	Specific provision ⁽¹⁾		Supplemental provision ⁽²⁾	Total
	According to period of arrears	Other			According to period of arrears	Other		
	In NIS millions				In NIS millions			
Consolidated								
Balance of provision at beginning of year	169	5,820	652	6,641	167	5,451	685	6,303
Provision for current year	44	1,035	117	1,196	50	1,214	66	1,330
Reduction of provision	(45)	(269)	(37)	(351)	(47)	(173)	(99)	(319)
Recoveries of amounts previously written-off	-	(24)	-	(24)	-	(13)	-	(13)
Provision charged to statement of Income	(1)	742	80	821	3	1,028	(33)	998
*Net write-offs	(1)	(1,062)	-	(1,063)	(1)	(657)	-	(658)
Exchange rate differentials	-	(15)	-	(15)	-	(2)	-	(2)
Balance of provision at end of year	167	5,485	732	6,384	169	5,820	652	6,641
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	84	64	148	-	184	63	247
The Bank								
Balance of provision at beginning of year	-	4,433	369	4,802	-	4,212	362	4,574
Provision for current year	-	694	46	740	-	725	42	767
Reduction of provision	-	(181)	(31)	(212)	-	(78)	(35)	(113)
Recoveries of amounts previously written-off	-	(4)	-	(4)	-	-	-	-
Provision charged to statement of Income	-	509	15	524	-	647	7	654
*Net write-offs	-	(535)	-	(535)	-	(426)	-	(426)
Exchange rate differentials	-	(11)	-	(11)	-	-	-	-
Balance of provision at end of year	-	4,396	384	4,780	-	4,433	369	4,802
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	81	44	125	-	173	44	217

* Net of debts collected during the year.

Footnotes:

(1) For loans for which a provision was made according to period of arrears - does not include a provision for interest on such debt in arrears. For other loans - does not include provision for interest on doubtful debts after such debts were determined as doubtful.

(2) Includes balance of a general provision for doubtful debts: Consolidated: NIS 424 million; 2009 - NIS 348 million. The bank: - NIS 197 million; 2009 - NIS 197 million.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

E. Additional details regarding housing loans and the manner of calculating the allowance for credit losses

Consolidated

December 31, 2011							
	Housing loans	Housing loans impaired or in arrears over 90 days ⁽¹⁾		Balance of allowance for credit losses			
					Other		
	Recorded amount ⁽⁵⁾⁽³⁾	Amount in arrears ⁽²⁾	Recorded amount	According to the period in arrears ⁽⁴⁾	On a group basis	On a specific basis	Total
in NIS millions							
Housing loans the allowance for credit losses must be calculated in their respect according to the period in arrears ⁽⁶⁾	19,868	207	447	230	-	-	230
Other housing loans ⁽⁷⁾	207	-	-	-	2	-	2
Total	20,075	207	447	230	2	-	232

Footnotes:

- (1) Impaired housing loans and housing loans in arrears for over 3 months.
- (2) Including interest on the amount in arrears.
- (3) Of which: housing loans bearing a variable interest rate in an amount of NIS 12,307 million.
- (4) Including balance of provision over the required according to the period in arrears in an amount of NIS 78 million.
- (5) Of which: housing loans for multi-purpose securing homes in the amount of NIS 1,171 million.
- (6) Of which: housing loans for specific acquisition groups in building procedure in an amount of NIS 299 million.
- (7) Including balance of credit at the bank in the amount of NIS 182 million.

Consolidated

December 31, 2010 (pro-forma*)							
	Housing loans	Housing loans impaired or in arrears over 90 days ⁽¹⁾		Balance of allowance for credit losses			
					Other		
	Recorded amount ⁽⁵⁾⁽³⁾	Amount in arrears ⁽²⁾	Recorded amount	According to the period in arrears ⁽⁴⁾	On a group basis	On a specific basis	Total
in NIS millions							
Housing loans the allowance for credit losses must be calculated in their respect according to the period in arrears ^{(6)**}	18,334	190	533	241	-	-	241
Other housing loans ⁽⁷⁾	100	-	-	-	-	-	-
Total	18,434	190	533	241	-	-	241

* Restated, see note 1d 4.4 above.

** Reclassified, see note 1 b (4)

Footnotes:

- (1) Impaired housing loans and housing loans in arrears for over 3 months.
- (2) Including interest on the amount in arrears.
- (3) Of which: housing loans bearing a variable interest rate in an amount of NIS 10,633 million.
- (4) Including balance of provision over the required according to the period in arrears in an amount of NIS 77 million.
- (5) Of which: housing loans for multi-purpose securing homes in the amount of NIS 1,101 million.
- (6) Of which: housing loans for specific acquisition groups in building procedure in an amount of NIS 256 million.
- (7) Including balance of credit at the bank in the amount of NIS 69 million.

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

F. Composition of credit to the public⁽¹⁾ and off-balance-sheet credit risk⁽³⁾, by size of credit to individual borrowers

1. Consolidated

			December 31						
			2011			2010			
			Number of borrowers ⁽²⁾	Credit ⁽¹⁾	Credit risk ⁽³⁾⁽⁵⁾	Number of borrowers ⁽²⁾	Credit ⁽¹⁾	Credit risk ⁽³⁾	
in NIS millions									
Credit limit (in NIS thousand):									
		Up to	10	808,642	1,730	1,333	895,783	1,780	1,692
Over	10	Up to	20	338,635	2,151	2,896	330,477	2,170	2,762
Over	20	Up to	40	250,017	3,460	3,751	244,782	3,445	3,627
Over	40	Up to	80	147,780	4,581	3,422	148,691	4,878	3,317
Over	80	Up to	150	59,239	4,520	2,010	61,372	4,618	1,935
Over	150	Up to	300	31,012	5,413	1,359	32,913	5,635	1,161
Over	300	Up to	600	22,390	8,676	1,416	22,858	8,494	1,071
Over	600	Up to	1,200	13,594	9,867	1,297	13,505	8,879	1,515
Over	1,200	Up to	2,000	3,319	4,185	880	3,502	4,133	913
Over	2,000	Up to	4,000 ⁽⁴⁾	2,350	5,278	1,262	2,356	5,027	1,281
Over	4,000	Up to	8,000 ⁽⁴⁾	1,181	5,083	1,629	1,192	4,976	1,628
Over	8,000	Up to	20,000 ⁽⁴⁾	947	9,148	2,610	1,015	8,769	3,516
Over	20,000	Up to	40,000 ⁽⁴⁾	515	10,181	3,780	531	9,847	3,987
Over	40,000	Up to	200,000 ⁽⁴⁾	594	29,095	13,899	648	30,361	15,620
Over	200,000	Up to	400,000 ⁽⁴⁾	46	8,186	4,157	47	8,963	4,036
Over	400,000	Up to	800,000 ⁽⁴⁾	16	5,926	2,145	19	7,020	3,154
Over	800,000	Up to	1,200,000 ⁽⁴⁾	6	3,619	2,335	6	3,487	2,527
Over	1,200,000	Up to	1,600,000 ⁽⁴⁾	-	-	-	-	-	-
Over	1,600,000	Up to	2,000,000 ⁽⁴⁾	-	-	-	1	11	1,820
Total			1,680,283	121,099	50,181	1,759,698	122,493	55,562	

Footnotes:

- (1) The credit and off-balance credit risk presented before the impact of the allowance for credit loss and collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability. Such balances at December 31, 2010, are presented after deduction of provisions for doubtful debts.
- (2) Number of borrowers based on total credit and credit risk.
- (3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower. (not including credit facilities under banks guarantees as of December 31, 2011- NIS 4,831 million, as of December 31, 2010- NIS 4,214 million).
- (4) Consolidated - by combining specific balances.
- (5) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.
- (6) The credit limit in the top level: NIS 1,146 million (2010: NIS 1,820 million)

4. CREDIT TO THE PUBLIC AND ALLOWANCE FOR CREDIT LOSS (CONTINUED)

F. Composition of credit to the public⁽¹⁾ and off-balance-sheet credit risk⁽³⁾, by size of credit to individual borrowers (continued)

2. The Bank

December 31									
2011					2010				
			Number of borrowers ⁽²⁾	Credit ⁽¹⁾	Credit risk ⁽³⁾⁽⁴⁾	Number of borrowers ⁽²⁾	Credit ⁽¹⁾	Credit risk ⁽³⁾	
in NIS millions									
Credit limit (in NIS thousand):									
		Up to	10	175,514	318	466	180,217	360	504
Over	10	Up to	20	113,807	650	1,012	114,733	697	1,036
Over	20	Up to	40	122,484	1,565	1,861	123,161	1,653	1,882
Over	40	Up to	80	92,937	2,896	2,216	91,780	2,974	2,217
Over	80	Up to	150	43,654	3,024	1,704	44,749	3,079	1,680
Over	150	Up to	300	15,392	2,190	919	16,903	2,402	958
Over	300	Up to	600	5,191	1,425	795	5,594	1,543	786
Over	600	Up to	1,200	2,899	1,573	907	3,100	1,671	922
Over	1,200	Up to	2,000	1,202	1,242	645	1,317	1,436	583
Over	2,000	Up to	4,000	1,173	2,409	968	1,216	2,449	1,006
Over	4,000	Up to	8,000	815	3,163	1,421	831	3,145	1,480
Over	8,000	Up to	20,000	569	5,352	1,882	630	5,343	2,564
Over	20,000	Up to	40,000	302	6,104	2,523	306	5,802	2,775
Over	40,000	Up to	200,000	302	17,088	6,579	334	18,932	7,672
Over	200,000	Up to	400,000	44	8,130	3,936	41	7,605	3,937
Over	400,000	Up to	800,000	11	3,915	1,849	19	7,002	3,360
Over	800,000	Up to	1,200,000	6	3,619	2,249	5	2,851	2,264
Over	1200000	Up to	1,600,000	-	-	-	-	-	-
Over	1,600,000	Up to	2,000,000	-	-	-	1	11	1,820
Total				576,302	64,663	31,932	584,937	68,955	37,446

Footnotes:

- (1) The credit and off-balance credit risk presented before the impact of the allowance for credit loss and collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability. Such balances at December 31, 2010, are presented after deduction of provisions for doubtful debts.
- (2) Number of borrowers based on total credit and credit risk.
- (3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.
- (4) For details regarding changes in the measurement of indebtedness in respect of OTC derivatives transactions, the result of which is a material decline in reported balances of indebtedness regarding off-balance sheet credit risk of the said derivatives, see Note 20 subsection 8.
- (5) The credit limit in the top level: NIS 1,146 million (2010: NIS 1,820 million)

5. CREDIT GRANTED TO GOVERNMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
Deposit of the Accountant General - tender for teaching employees	1,591	1,551	1,591	1,551
Other credit ⁽¹⁾	49	5	25	-
Total credit granted to Governments	1,640	1,556	1,616	1,551

Footnote:

(1) Including credit to foreign governments: Consolidated - NIS 23 million (2010: NIS 4 million), the Bank - no balance.

6. INVESTMENT IN investee COMPANIES

A. Consolidated

	December 31, 2011			December 31, 2010		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
In NIS millions						
Investments						
Shares stated on equity basis (including goodwill) ⁽¹⁾	1,606	-	1,606	⁽³⁾ 1,553	-	1,553
Other investments:						
Capital notes	-	-	-	49	-	49
Shareholders' loans	5	-	5	72	-	72
Total other investments	5	-	5	121	-	121
Total investments	1,611	-	1,611	1,674	-	1,674
Includes:						
Earnings accumulated since January 1, 1992	1,033	-	1,033	⁽³⁾ 962	-	962
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	(31)	-	(31)	3	-	3
Adjustment for translation of foreign currency financial statements	-	-	-	(2)	-	(2)
Details Regarding Goodwill:						
Original amount	3	293	296	4	293	297
Stated value ⁽²⁾	-	142	142	-	149	149
Book and Market Values of Marketable Investments:						
Book value	1,558	-	1,558	⁽³⁾ 1,522	-	1,522
Market value	900	-	900	1,425	-	1,425

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 with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

B. The Bank

	December 31, 2011			December 31, 2010		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	in NIS millions					
Investments:						
Shares stated on equity basis (including goodwill) ⁽¹⁾	1,594	7,105	8,699	⁽²⁾ 1,558	⁽²⁾ 7,044	8,602
Other investments:						
Subordinated debt notes and Capital notes	-	1,651	1,651	-	1,550	1,550
Shareholders' loans	2	-	2	2	-	2
Total other investments	2	1,651	1,653	2	1,550	1,552
Total investments	1,596	8,756	10,352	1,560	8,594	10,154
Includes:						
Retained earnings since January 1, 1992	1,075	3,763	4,838	⁽²⁾ 1,001	⁽²⁾ 3,562	4,563
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	(31)	(75)	(106)	1	22	23
Adjustment for translation of foreign currency financial statements	-	(4)	(4)	-	31	31
The State's bonus to the employees (privatization)	-	32	32	-	32	32
Net adjustments on the hedging of cash flows	-	(9)	(9)	-	-	-
Details Regarding Goodwill:						
Original amount	3	292	295	4	292	296
Stated value	-	142	142	-	148	148
Book and Market Values of Marketable Investments:						
Book value	1,558	-	1,558	⁽²⁾ 1,522	-	1,522
Market value	900	-	900	1,425	-	1,425

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 with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

The Bank's share of income or loss of investee companies

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	In NIS millions					
The Bank's share of operating income of investee companies (consolidated - affiliated companies)	128	136	149	918	437 ^{*(2)}	666 ^{*(2)}
Provision for impairment in value of investee companies	-	(3)	(1)	(3)	(17)	(8)
	128	133	148	915	420	658
Provision for taxes:						
Current taxes	-	-	-	26	37	26
Deferred taxes ⁽¹⁾	25	(53)	(10)	28	(53)	(10)
Total provision for taxes (tax saving)	25	(53)	(10)	54	(16)	16
Bank's share in operating income net of tax effect of investee companies						
(consolidated - affiliated companies)	103	186	158	861	436	642

Footnotes:

(1) Including the increase (decrease) in the provision for taxes in respect of the Bank's share in the results of the First International Bank: 2011 - NIS 25 million, 2010 – NIS (53) million and 2009 - NIS 10 million.

(2) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

6. INVESTMENT IN INVESTEE COMPANIES (CONTINUED)

C. Information on principal investee companies

						Value of investment in shares on equity			
Name of Company	Details of company	Share in capital conferring rights to profits		Share in voting rights		Equity basis ⁽¹⁾		Market value	
		2011	2010	2011	2010	2011	2010	2011	2010
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	24	21	-	-
Israel Discount Bank of New York ⁽³⁾	Commercial bank, U.S.A	100.00	100.00	100.00	100.00	2,994	2,714	-	-
Mercantile Discount Bank Ltd.	Commercial bank	100.00	100.00	100.00	100.00	1,764	⁽¹²⁾ 1,807	-	-
Discount Mortgage Bank Ltd. ⁽¹⁴⁾	Mortgage bank	100.00	100.00	100.00	100.00	863	1,127	-	-
Israel Credit Cards Ltd. ⁽⁴⁾	Credit card service	71.83	71.83	79.00	79.00	870	804	-	-
Discount Leasing Ltd.	Equipment leasing	100.00	100.00	100.00	100.00	109	108	-	-
Discount Israel Capital Markets and Investments Ltd.	Underwriting and investments	100.00	100.00	100.00	100.00	(37)	(34)	-	-
Discount Manpikim Ltd.	Securities issue	100.00	100.00	100.00	100.00	59	59	-	-
IDB (Swiss) Bank Ltd.	Commercial bank, Switzerland	100.00	100.00	100.00	100.00	211	197	-	-
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	270	238	-	-
Inc, (Delaware) Realty IDBNY ⁽⁵⁾	Holding company, USA	100.00	100.00	100.00	100.00	1,837	1,669	-	-
LLC Realty IDB ⁽⁶⁾	Investment company, USA	100.00	100.00	100.00	100.00	6,729	6,194	-	-
Company held by Discount Israel Capital Markets and Investments Ltd.:									
Freenet A.K. Communications Ltd. ⁽¹⁶⁾	Holding company	100.00	100.00	100.00	100.00	74	(6)	-	-
Companies held by Israel Credit Cards Ltd.:									
Diners (Club) Israel Ltd. ⁽¹⁵⁾	Credit card service	51.00	51.00	51.00	51.00	44	42	-	-
Cal Mimun Ltd.	Credit facilitate	100.00	100.00	100.00	100.00	63	107	-	-
2.Affiliated Companies:									
First International Bank of Israel Ltd. ⁽⁷⁾	Commercial bank	26.45	26.45	26.45	26.45	1,558	⁽¹²⁾ 1,522	900	1,425

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.

(6) Included in the financial statements of IDBNY Realty (Delaware), Inc.

Of which: excess of cost balance		Other investments		Contribution to net operating income attributed to bank's shareholders		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	
2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
In NIS millions													
-	-	-	-	1	(2)	-	-	-	-	3	3	-	-
-	-	288	267	326	(22)	-	-	-	-	⁽¹³⁾ (96)	(256)	-	-
-	-	82	-	136	⁽¹²⁾ 107	-	-	-	-	38	61	-	-
-	⁽⁹⁾ 7	509	500	39	29	-	-	290	-	-	-	-	-
⁽⁹⁾ 142	⁽⁹⁾ 142	17	25	114	76	-	-	140	108	-	7	42	103
-	-	-	-	1	1	-	-	-	-	-	-	-	-
-	-	190	190	10	(11)	-	-	-	-	-	1	-	-
-	-	-	-	3	2	-	-	3	-	-	-	-	-
⁽¹¹⁾ 10	⁽¹¹⁾ 20	-	-	5	(13)	(3)	(14)	-	-	-	-	-	-
-	-	-	-	48	18	-	-	-	-	(4)	11	-	-
-	-	-	-	162	(72)	-	-	-	-	(2)	(2)	-	-
-	-	-	-	544	(288)	-	-	-	-	(71)	(48)	-	-
-	-	531	531	69	20	-	-	-	-	(4)	(5)	-	-
-	-	-	-	14	12	-	-	-	-	-	-	-	-
-	-	28	30	35	42	-	-	-	-	-	-	-	-
-	-	-	-	⁽¹⁰⁾ 101	⁽¹⁰⁾ 180	-	-	-	212	(21)	2	-	-

(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: 2011 – NIS 25 million, 2010 – NIS (53) million.

(11) Including in the Intangible assets and goodwill, see Note 7 A.

(12) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

(13) For details regarding the reclassification of an amount of NIS 231 million, following the initial implementation of IAS 21, see Note 1 D 1.2 above.

(14) For details regarding the decision to merge Discount Mortgage Bank Ltd. with and into the Bank, see subsection "F" below.

(15) For details regarding the holding of a controlling interest in Dinars and as regards the put option written to the other interest holders, see Note 33 A below.

(16) For details regarding the agreement for the merger of Freenet A.K. Communications Ltd. with and into Israel Discount Capital Markets & Investments Ltd., see Subsection G below.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

D. Summary information regarding affiliated companies

1. Summary information regarding the financial condition

	Rate of ownership As a percentage	Total assets	Total liabilities	Capital attributed to company owners	Capital attributed to non-controlling rights holders
		In NIS millions			
31.12.2011	26.45	101,127	94,838	5,888	401
31.12.2010	26.45	100,687	94,528	5,750	409

2. Summary information regarding results of operation

	Rate of ownership As a percentage	Net income	Net income attributed to company shareholders	Net income attributed to non-controlling rights holders
		In NIS millions		
2011	26.45	524	485	39
2010	26.45	510	482	28
2009	26.45	604	561	43

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;
- 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

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

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, as well as 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. The determining date may be postponed under certain conditions determined in the agreement. Among other things, if the completion of the unification of capital of FIBI is not achieved within one year from date of signing the agreement, the determining date shall be postponed to December 31, 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.

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

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

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 has already included in its financial statements as of December 31, 2009, a provision for taxes in the amount of NIS 120 million, in respect of its holdings in FIBI, 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, 2011, is NIS 1,558 million. The market value of the Bank's holdings in FIBI totaled on December 29, 2011 (the last trading date prior to the balance sheet date) NIS 900 million. The market value of this investment at March 22, 2012 was NIS 1,097 million.

(3) An opinion in the matter of the provision for impairment in value

The Bank received an opinion rendered by Prof. Yoram Eden, CPA (Isr.), who gave his consent to the inclusion thereof in the financial statements, in which he examined the question whether the Bank should be required, in accordance with accepted accounting principles, to include a provision for the impairment in value of its investment in FIBI.

Restrictions in performing the valuation. The First International bank 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.

Performing a valuation based on the reports of FIBI's. For the purpose of performing the valuation, Prof. Eden relied on public information only, and in particular, on audited annual financial statements and reviewed interim financial statements published by FIBI the last of which as of September 30, 2011. 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.

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.

6. INVESTMENTS IN INVESTEE COMPANIES (CONTINUED)

Conclusion. In view of that stated in the Opinion, Prof. Eden reached the conclusion that the recoverable value amount of the investment of Discount Bank in the First International Bank is in the range of 94.7% and 105.7% of the stated value of the investment in the books of Discount Bank. Whereas the equity value falls deep in the range of the recoverable value amount, Prof. Eden is of the opinion that the investment in the First International Bank has not been materially impaired. Accordingly, in the opinion of Prof. Eden, the Bank is not required to include a provision for impairment in respect of its investment in shares of the First International Bank.

The Bank reviewed the opinion and relied on 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 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 THE BANK AND DISCOUNT MORTGAGE BANK LTD. ("DMB")

The Boards of Directors of the Bank and of its subsidiary DMB approved on November 23, 2011, the merger of DMB with and into the Bank.

Based on Management's assessment, the financial statements include a provision in respect of the anticipated merger expenses. The merger is conditional upon conditions precedent, which as of date of publication of this report are still unfulfilled.

G. MERGER BETWEEN FREENET A.K. COMMUNICATIONS LTD. ("FRENET") 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.

The merger is conditional upon conditions precedent, which as of date of publication of this report are still unfulfilled.

7. BUILDINGS AND EQUIPMENT

A. Composition

Consolidated					
	Buildings and land*	Equipment, furniture and vehicles	Hardware	Software	Total
in NIS millions					
Cost:					
Balance as at December 31, 2009	2,367	781	1,130	2,220	6,498
Additions	48	59	84	346	537
Assets designated for sale	(26)	-	-	-	(26)
Disposals	(22)	(19)	(181)	(63)	(285)
Balance as at December 31, 2010	2,367	821	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	2,386	847	1,077	2,824	7,134
Depreciation and impairment loss:					
Balance as at December 31, 2009	943	496	893	988	3,320
Depreciation for the year	75	50	104	329	558
Impairment loss	4	-	-	-	4
Assets designated for sale	(13)	-	-	-	(13)
Disposals	(13)	(16)	(181)	(60)	(270)
Balance as at December 31, 2010	996	530	816	1,257	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	1,031	566	855	1,602	4,054
Carrying amount:					
Balance as at December 31, 2009	1,424	285	237	1,232	3,178
Balance as at December 31, 2010	1,371	291	217	1,246	3,125
Balance as at December 31, 2011	1,355	281	222	1,222	3,080
Average weighted depreciation rate for year 2010	5.2%	9.9%	21.3%	16.7%	12.6%
Average weighted depreciation rate for year 2011	4.4%	9.9%	21.7%	17.0%	12.2%

Includes instalations and leashold improvements.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

A. Composition (continued)

	Buildings and land*	The Bank			Total
		Equipment, furniture and vehicles	Hardware	Software	
					in NIS millions
Cost:					
Balance as at December 31, 2009	1,660	426	861	1,686	4,633
Additions	11	28	67	263	369
Disposals	(21)	(16)	(176)	(54)	(267)
Balance as at December 31, 2010	1,650	438	752	1,895	4,735
Additions	35	22	63	252	372
Assets designated for sale	(11)	-	-	-	(11)
Disposals	(5)	(12)	(45)	(19)	(81)
Balance as at December 31, 2011	1,669	448	770	2,128	5,015
Depreciation and impairment loss:					
Balance as at December 31, 2009	683	231	678	659	2,251
Depreciation for the year	52	30	75	262	419
An impairment loss	4	-	-	-	4
Disposals	(12)	(15)	(176)	(51)	(254)
Balance as at December 31, 2010	727	246	577	870	2,420
Depreciation for the year	50	30	74	290	444
An impairment loss	1	-	-	5	6
Reversal of impairment loss	(17)	-	-	-	(17)
Assets designated for sale	(7)	-	-	-	(7)
Disposals	(4)	(12)	(45)	(19)	(80)
Balance as at December 31, 2011	750	264	606	1,146	2,766
Carrying amount:					
Balance as at December 31, 2009	977	195	183	1,027	2,382
Balance as at December 31, 2010	923	192	175	1,025	2,315
Balance as at December 31, 2011	919	184	164	982	2,249
Average weighted depreciation rate for year 2010	5.0%	8.9%	20.0%	16.3%	12.5%
Average weighted depreciation rate for year 2011	4.0%	9.0%	20.0%	16.7%	12.1%
Includes installations and leasehold improvements.					

B. The Bank and a consolidated subsidiary own leasehold rights for periods ending in the years 2012-2056.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
C. Depreciated balance of buildings and land includes:				
Installations and leasehold improvements depreciated balance	151	⁽¹⁾ 138	62	63
Balance of provision for impairment loss	32	⁽¹⁾ 48	30	⁽¹⁾ 46
D. Financial leasing rights:				
Balance of non-capitalized leasehold	26	29	22	25
Balance of capitalized leasehold	89	⁽¹⁾ 87	57	⁽¹⁾ 55
E. Depreciated balance of not yet registered buildings	239	259	63	82
F. Depreciated balance of buildings not in use by the bank, the majority of which are rented to other parties	18	⁽¹⁾ 17	6	⁽¹⁾ 10
G. Depreciated balance of buildings and equipment designated for sale	8	⁽¹⁾ 14	4	-
Impairment loss recognized in the current year	-	-	-	-
Reversal of impairment loss during the year	-	-	-	-
H. The cost of in-house development of computer software:				
The cost of software put into operation	1,991	⁽¹⁾ 1,616	1,835	1,520
Accumulated depreciation	(1,114)	⁽¹⁾ (865)	(1,024)	(794)
Depreciable amount	877	751	811	726
Accumulated costs in respect of software under development	82	⁽¹⁾ 209	58	160
Total cost of in-house development of computer software	959	960	869	886
I. Gross value of fully depreciated fixed assets still in use	1,671	1,268	883	551
J. Recognized cost for fixed assets items in mounting stage:				
Cost of real estate	8	155	4	8
Cost of equipment	7	18	7	18
⁽¹⁾ Reclassified				
	for the year ended December 31			
	2011	2010	2009	
	in NIS millions			
K. Detail of operating leasehold*				
Recognized operating lease expenses**				
Consolidated	131	128	121	
The Bank	78	75	72	

* 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, 2009, 2010 and 2011	293	78	371
Amortization and losses on impairment			
Balance as at December 31, 2009	119	34	153
Amortization for the year	25	10	35
Loss from impairment	-	14	14
Balance as at December 31, 2010	144	58	202
Amortization for the year	7	7	14
Loss from impairment	-	3	3
Balance as at December 31, 2011	151	68	219
Stated value			
Balance as at December 31, 2009	174	44	218
Balance as at December 31, 2010	149	20	169
Balance as at December 31, 2011	142	10	152

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	
	2011	2010	2011	2010
	In NIS millions			
Net deferred tax assets (see Note 29 J)	1,417	⁽¹⁾ 646	852	⁽¹⁾ 324
Excess advance tax payments over current provisions	130	57	81	-
Excess deposits for severance pay and pensions, over provision (see Note 16 E, I)	-	⁽¹⁾ 3	-	⁽¹⁾ -
Issue costs and discount expenses of subordinated capital notes	33	32	39	39
Income receivable	226	183	84	94
Surrender value of life assurance policies owned by a consolidated subsidiary	627	581	-	-
Assets in respect of the "Maof" market operations	211	386	211	386
Gold deposit	106	581	106	581
Assets received in respect of credit settlement	4	9	-	-
Other debtors and debit balances	377	448	182	181
Total other assets	3,131	⁽²⁾2,926	1,555	⁽²⁾1,605

Footnotes:

- (1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.
(2) Reclassified - see note 1 B (4).

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	In NIS millions			
Demand deposits	35,562	33,766	17,684	18,000
Time and other deposits	113,326	99,293	93,143	81,629
Savings plan deposits	4,480	4,952	4,338	4,480
Total deposits from the public	153,368	138,011	115,165	104,109

10. DEPOSITS FROM THE BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	In NIS millions			
Commercial banks:				
Demand deposits	1,401	957	251	266
Time deposits	2,028	1,175	3,649	2,400
Acceptances	197	282	126	209
Central banks:				
Schedule deposits	568	707	-	-
Specialized banking institutions:				
Deposits on demand	1	14	61	67
Schedule deposits	54	252	52	423
Total deposits from banks	4,249	3,387	4,139	3,365

11. SUBORDINATED CAPITAL NOTES

			Consolidated		The Bank	
	Average maturity ⁽¹⁾	Internal rate of return ⁽¹⁾	December 31		December 31	
	years	%	2011	2010	2011	2010
	in NIS millions					
Subordinated capital notes not convertible into shares ⁽³⁾ :						
In linked Israeli currency	4.99	6.35	2,907	2,971	213	278
In Israeli currency, linked to CPI	6.78	5.36	7,584	7,626	1,842	2,038
Subordinated capital notes convertible into shares:						
In Israeli currency, linked to CPI ⁽²⁾	10.00	5.26	1,748	1,697	1,748	1,697
Total subordinated capital notes			12,239	12,294	3,803	4,013

Footnotes:

⁽¹⁾ Internal rate of return is the rate which discounts the projected payment flow of amounts presented in the balance sheet. Average 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 average period to maturity relates to the consolidated statements as of December 31, 2011.

⁽²⁾ Subordinated capital notes regarded as "hybrid tier I capital" (see Note 14 7 below).

⁽³⁾ Of which: NIS 9,945 million, listed for trade on the Tel Aviv Stock Exchange (2010: NIS 9,897 million).

12. OTHER LIABILITIES

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
in NIS millions				
Net provision for deferred taxes (see Note 29 J)	16	14	15	14
Payments excess current tax provisions over advance	19	125	1	102
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16 E, I)	396	⁽¹⁾ 259	177	⁽¹⁾ 151
Provisions for vacation pay, seniority bonus and retirement benefits	1,144	⁽¹⁾ 1,106	910	⁽¹⁾ 912
Deferred income	150	*159	74	68
Payables for credit card activity	5,406	5,456	2,548	2,595
Provision for doubtful debts in respect of guarantees	172	149	127	125
Accrued expenses	715	780	363	274
Commitment in respect of "Maof" market operations	211	386	211	386
Amounts received from realization of other creditors and credit balances	1,234	*1,395	386	672
Total other liabilities	9,463	⁽²⁾ 9,829	4,812	⁽²⁾ 5,299

* Reclassified between "Income in advance" and "Other creditors and credit balances".

Footnotes:

(1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

(2) Reclassified - see note 1 B (4).

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, 2011 and 2010	
	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 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 3.53, and at the time of liquidation to a distribution in an amount of NIS 58.92. 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).

In December 2006 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.

D. SHARE ISSUANCE IN 2010

In December 2010 the bank completed a share offer to the public as well as a rights issue, as follows:

- On December 6, 2010, the Bank completed a share offer to the public issuing 34,000,000 ordinary "A" shares, according to a shelf offer report dated December 6, 2010, for total gross consideration of NIS 263.8 million.
- On December 16, the Bank completed a rights offer issuing 38,881,192 ordinary "A" shares, for which exercise notices had been received, according to a shelf offer report dated November 28, 2010 (as updated on November 29, 2010), for total gross consideration of NIS 198.3 million. The Bank's controlling shareholders have exercised in full the rights offered to them.

The net proceeds of the above mentioned offers amounted to NIS 450 million.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

E. EQUITY BASED COMPENSATION 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 G), 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 shall vest on January 1, 2012 and his last lot shall vest 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")

In each of the following cases, the vesting date of each annual lot of phantom rights shall be deferred or an annual lot shall expire:

- (1) In the event that the Bank's most recent quarterly financial statements issued prior to the vesting date of the relevant annual lot, will present a net loss from ordinary operations on a cumulative basis over the four quarters preceding the said vesting date, then the vesting date of the said annual lot will be deferred and will apply immediately after the date of issue of the Bank's quarterly financial statements showing a net profit from ordinary operations on a cumulative basis over the most recent four quarters preceding the said financial statements (and the exercise period will also be deferred, respectively). In determining the net profit or loss from ordinary operations for the purpose of this item, expenses stemming from an early retirement plan in respect of a part the Bank's employees, the budget for which will be approved by the Board of Directors, if at all performed, shall be eliminated;
- (2) In the event that the Bank's most recent financial statements issued prior to the vesting date of the relevant annual lot, will show a material deviation from the required total capital adequacy ratio, then the vesting date of the said annual lot will be deferred and will apply immediately after the date of issue of the Bank's quarterly financial statements showing a total capital adequacy ratio that does not materially deviate from the required total capital adequacy ratio. In this respect, a deviation at a rate exceeding 20% of the required total capital adequacy ratio will be considered a material deviation;
- (3) In the event that the Bank will be obliged to convert into the Bank's ordinary shares the outstanding balance of principal and interest of subordinate capital notes (of whatever Series) issued by the Bank (this in accordance with the terms of issue of the said subordinate capital notes), then the right to receive the annual lot of phantom rights, the vesting thereof takes effect during the four quarters following the conversion event, as above, shall expire.

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.

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

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

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 (all amounts stated above include payroll tax).

(2) An option plan for the Bank's officers (excluding the former Chairman of the Board and the former President & CEO)

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 in terms of the plan). 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 above exercise prices are linked to the CPI and are subject to adjustments stemming from the distribution of cash dividends and/or bonus shares as well as a rights issue by the Bank.

The exercise price of each of the said option warrants as of December 31, 2011, were NIS 7.25 in respect of three officers (out of the seven officers mentioned above, two officers who are still in office and one officer who retired in 2011, though on December 31, 2011 was still entitled to exercise the options that had been granted to him), NIS 10.05 in respect of the officer who joined the Bank on March 1, 2006.

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 will end on December 31, 2012, all subject to the provisions specified in the plan as regards the termination of employment of the offerees with the Bank.

In accordance with section 102 of the Income tax ordinance, all the option warrants under the plan were allotted in the name of a Trustee for and on behalf of the offerees, in accordance with the terms of the capital gains alternative by means of the Trustee.

Procedure for the exercise of the options - At each exercise date, the amount of the benefit to the offeree will be computed and the Bank would issue to the Trustee for the offeree a number of ordinary shares, the total market value of which, based on the closing market price of the Bank's shares on the trading date preceding the exercise date, equals the amount of the monetary benefit.

The Bank will convert into share capital, that part of its earnings, within the meaning of section 302(b) of the Companies Law, 1999, ("the Companies law"), from premium on shares or from any other source included in its shareholders' equity, as stated in Section 304(a) of the Companies Law, equal to the par value amount of the exercised shares to be allotted as stated.

Each option warrant not exercised in accordance with the terms of the plan until the end of the period determined for its exercise, shall become null and void and would not entitle to any rights whatever.

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

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

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 (two thirds over a period of 2.8 years and the additional one third over a period of 4.8 years). In the years 2006, 2007 and 2009, a total of 3,530,301 option warrants expired following the retirement in those years of three officers. In 2010, 2,876,540 option warrants were exercised by officers. 1,307,518 option warrants expired on January 4, 2011 (the date of expiry of the first lot of the option warrants allotted in accordance with the plan).

During 2011, an additional 653,760 option warrants expired following the retirement of two officers. The balance of the unexpired option warrants on December 31, 2011, in respect of four officers amounted to 1,438,272 option warrants. The said balance includes 326,880 option warrants in respect of an officer who retired from office on August 11, 2011 (termination of employer/employee relations on December 31, 2011), and who, according to the terms of the plan, may exercise the balance of the option warrants allotted to him until June 28, 2012, and 392,256 option warrants in respect of an officer who retired from office on September 30, 2011 (termination of employer/employee relations on April 27, 2012), and who, according to the terms of the plan, may exercise the balance of the option warrants allotted to him until October 24, 2012. The outstanding balance includes also 392,256 option warrants in respect of an officer who retired from the Bank in the course of the year and was appointed President & CEO of one of the Bank's subsidiaries in Israel, and which under these circumstances, in accordance with the terms of the plan, will be considered for the purpose of the plan as if he continued in office at the Bank and as if his engagement by the Bank had not been terminated. The balance of the option warrants may be exercised until December 31, 2012. All payroll expenses had been recognized until the end of 2010 as payroll expenses against a capital reserve (2010: an amount of NIS 1.8 million in respect of six officers; 2009: an amount of NIS 1 million in respect of seven officers). At date of expiry or exercise of the option warrants, which have been vested, the Bank allocates to the balance of premium the related part of the capital reserve.

(3) Option plan for the former Chairman of the Board and former President & CEO

The Bank's special shareholders meeting held on August 26, 2007, approved the terms of office of the Bank's former Chairman of the Board as well as the issue of option warrants to the former Chairman of the Board within the framework of the stock option plan for the former Chairman of the Board and for the former President & CEO.

Within the framework of the option plan, 8,090,275 option warrants were allotted to a trustee on behalf of the former President & CEO, and an equal number of options to a trustee on behalf of the former Chairman of the Board of Directors; each option exercisable into one ordinary share. The exercise price of the options was NIS 8.455. The price was determined according to the closing rate of the Bank's shares on the stock exchange on the day prior to the date of approval by the general meeting, linked to the CPI, subject to adjustments.

In view of the termination of office of the former Chairman of the Board on January 1, 2010, option warrants, included in the portion for 2010, have expired (1,618,055 option warrants). The balance of the option warrants, entitlement to which had come into effect, expired on June 30, 2010. 3,236,110 option warrants of the former President & CEO expired on January 4, 2011, and the balance of 3,236,110 of his option warrants expired on June 30, 2011, as a result of the termination of office on December 31, 2010.

The economic value of the option warrants, for purposes of recording in the Bank's financial statements, was calculated according to the Monte Carlo method, i.e. accepted statistical quantitative method for purposes of pricing financial instruments, including options for employees. The economic value of all the option warrants allocated to the trustee on behalf of the former Chairman of the Board of Directors and the President & the former CEO according to the option plan, is calculated as of the date of approval by the general meeting, according to the closing rate of the Bank's shares on the stock exchange on the preceding day, was NIS 31.3 million.

All payroll expenses had been recognized until the end of 2010 as payroll expenses against a capital reserve. (2010 : a reduction in expense of NIS 2.2 million; 2009 : recognition of expense of NIS 1.3 million).

Actually, the former Chairman and President & CEO did not exercise option warrants granted to them under the said plan.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

(4) 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 legal counsel (hereinafter - "offeree B"), this in continuation to previous resolutions in their respect, including a resolution of January 2007, which, among other things, determined that the option plan to be offered to them shall be as similar as possible to the option plan granted to the Bank's officers, approved in March 2006 and ratified in July 2006 (see 2 above), *mutatis mutandis*.

"Phantom option" plan. Offeree A and Offeree B will be 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 cash benefit shall be added the grossed up tax difference between the marginal tax applying to the offeree member of Management and the capital gains tax that would have been paid by him had he received the option warrants according to an option plan subject to Section 102 of the Income Tax Ordinance (the capital gains option). The grossed up tax amounts and the amount of cash benefit shall be known together as the "phantom award".

The exercise price of each of the phantom options shall be determined according to the closing market price of 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"), subject to adjustments as detailed in the plan.

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, as follows:

- The first portion included 784,511 phantom options to Offeree A and 653,759 phantom options to Offeree B was granted to the offerees on February 24, 2010. The phantom options included in the first portion are exercisable within two years from the above date.
- The second portion included 196,128 phantom options to Offeree A and 163,440 phantom options to Offeree B was granted to offeree B on February 24, 2011 (the office of offeree "B" was terminated before the said date). The phantom options included in the second portion are exercisable within three years from the above date.

As of the date of the decision the exercise price was NIS 10.066 and NIS 9.923 respectively (adjusted in respect of a dividend distributed on October 6, 2008).

The offerees shall be entitled to the phantom options only if they will serve as officers of the Bank on the determining date. The plan includes provisions for the shortening of the exercise period and the pro-rata granting of the phantom options in cases of termination of employment as well as provisions regarding the modification of the plan under certain circumstances.

The exercise of the phantom options does not have any effect on the Bank's share capital.

The fair value of the options granted to the two offerees, based on the Black & Scholes model, amounts to NIS 2.8 million. The fair value, as stated, has been computed on the basis of the assumption that all the phantom options would be exercised on the last day of the exercise period determined in their respect and it does not take into account the fact that these are not marketable options and that the date determining the right to a part of the phantom options has not yet arrived. The total fair value of the phantom award, also taking into consideration the grossing up of the said tax differences, amounts to NIS 3.7 million.

It is emphasized that the above computation serves only as an indication of the cost of the phantom award, and that the actual cost may be different because it is affected by changes in the price of the Bank's shares during the period of the plan, as well as changes that might occur, if at all, in future tax rates.

The expense in respect of the first portion of the phantom options has been recognized in the income statement of the financial report for December 31, 2010 while the expense in respect of the second portion will be distributed over the period to its date of entitlement. At each reporting date, until the exercise of the phantom options, a calculation of the fair value of the plan shall be made, in accordance with the market terms at that date, and the resultant difference will be recognized in the income statement.

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

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 financial statements as of December 31, 2011, included a reduction in expense with respect to the said plan in the amount of NIS 0.7 million (2010 : expense of NIS 0.7 million) (the above amounts include payroll tax).

(5) SHARE BASED PAYMENT OF THE SHARE OPTION TYPE – QUANTITATIVE DETAILS

A. Share based payment for the Bank's Officers

	2011		2010		2009	
	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS	Number of Options	Weighted average exercise price ⁽¹⁾ in NIS
Changes in option						
Outstanding at beginning of the year	3,399,550	8.60	6,276,090	7.83	7,452,857	7.42
Exercised during the year ⁽²⁾	-	-	2,876,540	7.03	-	-
Expired during the year	1,961,278	9.35	-	-	1,176,767	6.85
Outstanding at end of the year ⁽³⁾	1,438,272	7.88	3,399,550	8.60	6,276,090	7.83

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		December 31, 2009	
	Range 1	Range 2	Range 1	Range 2	Range 1	Range 2
Exercise price range (in NIS)	7.25	10.05	7.07	9.66-9.8	7.01	9.55-9.68
Number of options	1,111,392	326,880	1,438,272	1,961,278	4,314,812	1,961,278
Weighted average exercise price (in NIS)	7.25	10.05	7.07	9.73	7.01	9.62
Weighted average contractual life (years)	0.97	0.50	2.00	0.67	1.67	1.67
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		2009	
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	6,472,220	9.07	16,180,550	8.97	16,180,550	8.64
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	16,180,550	8.97
Of which exercisable:	-	-	6,472,220	9.07	6,472,220	8.97

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.

(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	
	2011	2010
	in NIS thousands	
Total liabilities arising from share-based payment transactions	3,944	8,129
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	(4,185)	8,129

F. 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, the following restrictions:

- (a) No dividends shall be distributed from earnings retained by the Bank up to September 30, 2004. If losses were incurred after that date, no dividends shall be distributed until after such losses have been recovered. Furthermore, no dividends are to be distributed from gains on sale of the Bank's significant assets during the period of five years from date of the permit. After that date, dividends may be distributed from such gains subject to the prior written approval of the Supervisor (The Bank's retained earnings as of September 30, 2004, which, as stated, may not be distributed, amount to NIS 2,704 million).
- (b) Notwithstanding the aforementioned, dividends may be distributed from gains on sale of the Bank's significant assets during the period of five years from date of the permit, if all the following conditions exist:
 1. The sale results from legal requirements applying to the Bank;
 2. The distribution of dividends from such gains shall not cause a reduction in the minimum capital ratio that existed at the Bank prior to the sale of the said assets;

13. SHAREHOLDERS' EQUITY, PREFERRED SHARES, SHARE BASED PAYMENT TRANSACTIONS AND DIVIDENDS (CONTINUED)

3. The Bank's Board of Directors shall approve such distribution after having examined the Bank's needs and its business plans;
4. Prior approval of the Supervisor in writing has been given for such distribution after the Supervisor had examined the Bank's capital adequacy and the basis for the Board's decision.

(3) Distribution of a dividend in respect of preferred shares

On September 2, 2010, the General Meeting of Shareholders resolved to approve as final dividend for 2009, the interim dividend of 6%, paid on December 30, 2009, 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.

On October 26, 2011, the General Meeting of Shareholders resolved to approve as final dividend for 2010, the interim dividend of 6%, paid on December 30, 2010, 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.

On December 5, 2011, the Bank's Board of Directors resolved to pay on December 28, 2011, 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 2012, 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, 2011, 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	
	2011	2010
	in NIS millions	
Tier 1 capital post deductions	11,898	⁽¹⁾ 11,689
Tier 2 capital post deductions	7,173	⁽¹⁾ 7,090
Total capital	19,071	18,779

2. Weighted credit risk assets balance

	31 December	
	2011	2010
	in NIS millions	
Credit risk	120,256	⁽¹⁾ 125,628
Market Risk	1,875	2,907
Operational risk	13,418	13,233
Total weighted credit risk assets balance	135,549	141,768

For notes to the table see after item 4.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)**3. Ratio of capital to risk assets**

Ratio of capital to risk assets		
	31 December	
	2011	2010
	in %	
A. The bank		
Ratio of original tier 1 capital to risk assets	8.1	⁽¹⁾ 7.7
Ratio of tier 1 capital to risk assets	8.8	⁽¹⁾ 8.2
Ratio of total capital to risk assets	14.1	⁽¹⁾ 13.2
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	9.7	⁽⁵⁾⁽¹⁾ 10.5
Ratio of total capital to risk assets	13.2	⁽⁵⁾⁽¹⁾ 13.1
Ratio of total minimum capital required by the Supervisor of Banks	9.0	9.0
2. Discount Mortgage Bank LTD. and its subsidiaries		
Ratio of tier 1 capital to risk assets	9.1	12.5
Ratio of total capital to risk assets	13.9	18.3
Ratio of total minimum capital required by the Supervisor of Banks	9.0	9.0
3. Discount Bakcorp Inc. ⁽²⁾		
Ratio of tier 1 capital to risk assets	14.3	12.5
Ratio of total capital to risk assets	16.5	14.7
Ratio of total minimum capital required by the Supervisor of Banks	⁽³⁾ 8.0	⁽³⁾ 8.0
4. Israel Credit Cards LTD.		
Ratio of tier 1 capital to risk assets	16.2	15.5
Ratio of total capital to risk assets	16.7	16.2
Ratio of total minimum capital required by the Supervisor of Banks	⁽⁴⁾ 9.0	⁽⁴⁾ 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	
	2011	2010
	in NIS millions	
A. Tier 1 capital		
Equity	10,745	⁽¹⁾ 10,824
Minority interests in the equity of consolidated subsidiaries	370	328
Complex capital instruments	1,723	1,680
Less goodwill	(142)	(149)
Less other intangible assets	(10)	(20)
Less net gains on fair value adjustments of available for sale securities	-	(129)
Less investments in non-realistic companies with significant influence	(788)	⁽¹⁾ (769)
Less other deductions from tier 1 capital	-	(76)
Total tier 1 capital	11,898	11,689
B. Tier 1 capital		
1. Upper tier II capital		
45% of net gains amount, pre related tax influence, on fair value adjustments of available for sale securities	-	90
General provision for doubtful debts	254	254
Complex capital instruments	1,362	1,322
Other upper tier II capital components	2	2
2. Lower tier II capital		
Subordinated capital notes	6,343	⁽¹⁾ 6,267
3. Amounts deducted from tier 2 capital		
Investments in non-realistic companies with significant influence	(788)	⁽¹⁾ (769)
Other deductions from tier 2 capital	-	(76)
Total tier 2 capital	7,173	7,090

Footnotes:

- (1) Restated in accordance with guidelines of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.
- (2) The data in this item was computed in accordance with the rules mandatory in the U.S.A.
- (3) 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%.
- (4) 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.
- (5) Restated-Discount Mercantile has adjusted the ratio of capital to risk components by means of restating the prior periods, in order to reflect a revision of the credit facilities conversion coefficient with respect to the provision of sale guarantees for apartment purchasers that have not been utilized. The revision has increased the credit risk assets as at December 31, 2010, by NIS 152 million (the aforesaid revision had a negligible effect on the bank).

5. Policy regarding capital for the interim period

The Basel Committee published in December 2009 draft recommendations in the matter of "Strengthening the resilience of the banking sector", and informed that it is its intention to publish a material part of the proposed changes as final recommendations as early as at the beginning of 2011, with effect as from December 31, 2012.

In his letter of June 30, 2010, the Supervisor of Banks informed that he is following developments in this respect and intends to examine the new recommendations in their final form with a view of modifying the existing directives applying in Israel, as the case may be.

In the interim period until the modification of the directives, the said letter requires banking corporations to take the following actions:

- To adopt until December 31, 2010, a target for the core capital ratio; this ratio is to relate to the core capital, less all deductions required by tier I, in accordance with Proper Banking Management Directive No. 202, "Measurement and capital adequacy - components of capital". The target has to be determined at a rate not lower than 7.5%;
- To submit to the Supervisor of Banks by the end of August 2010, a work plan designed to attain the said target;

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

- A banking corporation encountering difficulties, as stated above, should apply to the Supervisor of Banks in order to arrive at an agreed layout for reaching the target.
- To avoid the distribution of dividend, without prior approval from the Supervisor of Banks, if a bank has not attained the said target or if the distribution of the dividend will create such a situation.

The Supervisor of Banks informed on January 24, 2011, that the Bank may determine a core capital target of not less than 7.5% in effect until December 31, 2011 instead of December 31, 2010, on condition that certain terms determined by the Supervisor of Banks are fulfilled, including approval of a capital adequacy outline for maintaining a core capital target of not less than 7.5% until December 31, 2011, even if significantly different developments than those assumed at the base of the work plan occur. Furthermore, the Board of Directors shall receive a monthly report regarding compliance with the capital outline that had been determined, and that such report will also be submitted to the Supervisor of Banks. The Bank is required to form the said plan and submit it to the Supervisor of Banks.

The meeting of the Board of Directors held on March 2, 2011, approved a detailed outline for attaining a core capital target at the rate of between 7.5% and 8%, and in any case, a target that shall not fall below 7.5%, as well as a total capital adequacy ratio of not less than 13%, and this until December 31, 2011. The layout is based on strict management of the Bank's capital and includes a series of measures to assure the said capital targets even under conservative scenarios.

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.

The core capital ratio as of December 31, 2011, computed in accordance with the above, reached a ratio of 8.1% (December 31, 2010: 7.6%). 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.

Draft guideline in the matter of the minimum core capital ratios. On March 14, 2012, the Supervisor of Banks delivered to all banking corporations a draft guideline stating his intention to determine a higher minimum core capital ratio than that required at the present time. According to this draft, 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.

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.

The Bank is studying the anticipated demands of the Supervisor of Banks, as contained in the draft guideline, and intends to make the necessary preparations in order to comply with the requirements to be determined.

The Bank's core capital ratio as of December 31, 2011, stands at 8.1%.

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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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 intention 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.

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). The said notes were issued in consideration for NIS 135 million, namely, i.e. at a discount of 14.6% of their adjusted value.

On September 22, 2008, the Supervisor of Banks approved the said capital notes as hybrid capital instruments recognized as part of the Bank's Tier I capital, as defined in Proper Banking Management Directive No. 311 - "The minimum capital ratio", subject to the following conditions:

- a. The capital notes are to be issued under terms identical to those of the capital notes issued as part of the existing Series;
- b. The rate of the Hybrid Tier I Capital is not to exceed 15% of the Bank's total Tier I capital;
- c. The capital notes are not and will not be pledged in favor of the Bank or in favor of its subsidiary companies.

The Bank complies with the said conditions.

Additional issues of tier I hybrid capital Series "A". The remainder of the not yet issued subordinated capital notes Series "A" amounted, at December 31, 2011, to NIS 853 million. It should be noted that the balance of the shares remaining in the Bank's authorized share capital, which may be used in the event of a compulsory conversion of capital notes Series "A" (83 million shares; see Note 13 C above) may enable additional issues in the amount of approx. NIS 202 million, and each additional issue in excess of the said amount will require the increase of the Bank's authorized share capital.

Terms of the subordinated capital notes - Series "A". The subordinate capital notes were issued for a period of 99 years and the principal will be repayable on January 1, 2106. The principal and interest on the notes are linked to the CPI and will bear annual interest as stated. The interest on the subordinate capital notes is payable quarterly.

The Bank is entitled, at its own discretion, to redeem the subordinate capital notes prematurely, after a minimum of 15 years from the issuance date, subject to the conditions stated in the notes and to approval from the Supervisor of Banks.

The subordinated capital notes will bear linked interest at the rate of 5.10%. In the event that the capital notes are not prematurely redeemed after fifteen years, they will bear interest at a variable rate, to be determined in advance for each period of five years, with the addition of step-up interest at a rate of 1% over the original spread determined for the first fifteen years (namely 2.495%).

The subordinate capital notes include special provisions, as detailed below, mainly compulsory conversion of the principal amount and/or interest into 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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.
- (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;

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

- (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;
 - (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. In accordance with resolutions of the Board of Directors dated February 9, February 23 and March 25, 2009, The Bank entered into an agreement with Migdal Insurance Company Ltd. (participation in profits), Migdal Insurance Company Ltd. (nostro) and Migdal Makefet Pension Funds and Provident Funds Management Ltd., each of them separately according to its share, for the private placement of NIS 350 million par value of 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

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

is payable quarterly. The Bank shall be entitled to announce, at its own discretion, the early redemption of the principal sum of the subordinated capital notes and of the linkage increments and interest accrued as of date of the actual early redemption, subject to the terms specified in the note, and subject to the prior approval of the Supervisor of Banks.

The subordinated capital notes will, in the period from date of issue and until December 31, 2021 (hereunder: "the first interest period"), carry linked interest at the rate of 8.7%. In the event that an early redemption will not occur on December 31, 2021, then the subordinated capital notes will carry interest at a variable rate to be fixed in advance for each period of five years, with the addition of a "step up" interest of 1% over the original margin fixed for the first interest period (namely, 7.13%).

The subordinate capital notes include special provisions, as detailed below, mainly compulsory conversion of the principal amount and/or interest into 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 the issue of additional hybrid capital instruments, see Section 6(b) 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), for a total consideration of NIS 1,258 million, designated as upper tier II capital.

Terms of the subordinated capital notes to serve as upper tier II capital. The subordinated capital notes will be issued for a period of 49 years; the principal sum of the subordinated capital notes will be repayable in one amount on a date to be determined in the first shelf offer report for the relevant series. The principal and interest of the subordinated capital notes are linked to the CPI. Interest on the said subordinated capital notes will be paid four times a year.

The Bank shall be entitled, at its discretion, to prematurely redeem the subordinated capital notes, starting with the end of the period to be announced in the shelf offer report and which in no case shall be shorter than ten years (hereinafter: "the initial period"), subject to the terms specified in the notes and subject to the approval of the Supervisor of Banks.

Until the end of the initial period, the capital notes will bear linked interest to be determined in the tender. In the event that the capital notes are not prematurely redeemed at the end of the initial period, then in the period beginning with the end of the initial period, they will bear interest at a

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

variable rate, to be determined in advance for each period of five years, with the addition of step-up interest at a rate to be determined in the first shelf offer report, as stated.

The rights of the holders of the subordinated capital notes shall be deferred as regards claims by all other creditors of Discount Manpikim and of the Bank of any class, with the exception of holders of capital notes which constitute and/or will constitute from time to time the hybrid tier I capital issued by the Bank.

Terms for the recognition of the subordinated capital notes as upper tier II capital. Below are details of the terms specified by the Supervisor of Banks for the recognition of the subordinated capital notes as upper tier II capital:

1. Capital adequacy at date of issuance - at date of issue of the hybrid capital instrument, the ratio of capital to 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. Redeemability - Only capital notes that have been fully paid up in cash may be considered upper tier II capital.
8. Collateral - the liability in accordance with the capital notes may not be secured by collateral.
9. Pledge on capital notes - the capital notes may not be financed and may not be pledged as security for a loan granted by the Bank or a subsidiary thereof.
10. Suspension of interest payments - Interest payments shall not be made if on their due date "suspending circumstances" prevail, as the term is defined below, and the payment thereof shall be deferred for unlimited periods. The suspending circumstances are:
 - (a) The 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.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

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.
 - (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".

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

17. Allotment to related parties - The Bank shall not allot (to the extent that the matter depends on the Bank upon the initial issue) the hybrid capital notes to provident funds and/or mutual funds controlled and/or managed by the Bank.
18. Transparency - The terms of issue will be clear and disclosed. In this respect, full disclosure shall also be given in the 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 its principal characteristics.

For details regarding the issue of additional hybrid capital instruments, see Section 6(b) 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, 2011 amounted to US\$1,488 million (NIS 5,684 million) [December 31, 2010: US\$1,588 million (NIS 5,635 million)].

In addition, IDB New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US\$220 million (NIS 841 million) as of December 31, 2011 as a collateral for deposits received from it [as at December 31, 2010: US\$298 million (NIS 1,059 million)].

- B.** IDB New York has sold securities, under buyback terms, in the amount of US\$2,067 million (NIS 7,899 million) as of December 31, 2011 [as at December 31, 2010: US\$2,340 million (NIS 8,303 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 3 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, 2011, amounted to NIS 29 million (December 31, 2010: NIS 37 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, 2011, was NIS 53 million (2010: NIS 99 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, 2011, totaled NIS 779 million (December 31, 2010: NIS 625 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, 2011, to NIS 77 million (December 31, 2010: NIS 78 million).

15. PLEDGES (CONTINUED)

Balance of collateral provided to the Ma'of Clearing House:

	Balance as of December 31, 2011	Highest balance during the year 2011	Average balance* in 2011	Balance as of December 31, 2010
In NIS millions				
Cash	10	16	13	11
Securities	846	852	801	692

* The reporting is made on the basis of the month-end balances.

- G.** As collateral for the obligations of Yatzil Finance and its subsidiaries towards the banks, the said companies registered an assignment by way of a pledge and a fixed and floating pledges on all their rights according to agreements with business houses for the discount of IsraCard, VISA, American Express and Diners Club Israel vouchers, and all the rights to receive monies and payments from IsraCard, ICC, American Express and Diners, under power of assignment of rights and under the business house agreement. As of balance sheet date there was no obligation towards the banks.
- H.** Israel Discount Bank (Switzerland) has pledged assets in the amount of CHF 0.5 million (December 31, 2010: CHF 0.5 million), as collateral for credit facilities in the amount of US\$0.5 million.
- I.** As detailed in Note 19 C 4 hereunder, in accordance with the requirements of the Articles of the Tel-Aviv Stock Exchange Clearinghouse Ltd. (hereinafter: "the Clearinghouse" or "Stock Exchange Clearinghouse") Articles and the bylaws of the Clearinghouse, the Bank pledged as security for its obligations towards the Clearinghouse all the Bank's rights in the security deposit managed by the Clearinghouse (in which the Bank deposits securities) and all its rights in an account opened with another bank. The value of the collateral amounted on December 31, 2011, to NIS 159 million (as at December 31, 2010: NIS 144 million).

MDB has created a similar pledge in favor of the Stock Exchange Clearing House. The value of the collateral as of December 31, 2011, amounted to NIS 8 million (December 31, 2010: NIS 9 million).

Balance of collateral provided to the Stock Exchange Clearing House:

	Balance as of December 31, 2011	Highest balance during the year 2011	Average balance* in 2011	Balance as of December 31, 2010
In NIS millions				
Cash	14	14	14	13
Securities	153	198	129	140

* 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, 2011, at NIS 3.38 billion (December 31, 2010: NIS 4.61 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 454 million (December 31, 2010: NIS 480 million).

15. PLEDGES (CONTINUED)

Details of the pledge agreement:

	Balance as of December 31, 2011	Highest balance during the year 2011	Average balance* in 2011	Balance as of December 31, 2010
In NIS millions				
Pledged securities (market value)	3,830	3,884	3,808	5,093

* 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 the credit tender.

The bank and MDB did not participate in 2011 in the said credit tenders.

Details of the deposits:

	Balance as of December 31, 2011	Highest balance during the year 2011	Average balance* in 2011	Balance as of December 31, 2010
In NIS millions				
Deposits with the Bank of Israel	23,401	26,842	19,680	11,441

* The report is based on outstanding monthly balances.

- L.** The Bank enters into Credit Support Annex (CSA) type agreements with foreign banks intended to minimize mutual credit risks arising on derivative trading between banks. According to these agreements, the value of the inventory of derivative transactions made by the parties is measured periodically, and in the event that the net exposure of one of the parties exceeds a predetermined limit, that party is obligated to transfer deposits to the other party by way of a pledge, until the date of the next measurement. As of December 31, 2011, the Bank allocated in favor of foreign banks deposits in a total amount of NIS 407 million (December 31, 2010: NIS 339 million).
- M.** The Bank deposits bonds with foreign brokers (in the United States) as collateral for option transactions performed by its customers by means of these brokers. The value of such collateral at December 31, 2011 amounted to NIS 36 million (December 31, 2010: NIS 83 million). The highest balance of the collateral in 2011 was 132 million, while the average balance was NIS 112 million.

15. PLEDGES (CONTINUED)**N. The sources of the securities that had been received and which the Bank is entitled to sell or pledge, at their fair value, before setoffs effect:**

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	In NIS millions			
Securities received as part of security burrowing transactions against cash	142	42	142	42
Total	142	42	142	42
The sources of securities that had been received as collateral and securities of the Bank, at their fair value, before setoffs effect:				
Securities granted as part of security burrowing transactions against cash	142	42	142	42
Total	142	42	142	42

O. Details of securities pledged to the lenders:

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	In NIS millions			
Available for sale securities	3,449	4,886	2,140	3,460
Held-to-maturity bonds	4,335	2,315	2,247	2,037
Total	7,784	7,201	4,387	5,497

These securities have been deposited as collateral with the lenders, who are not permitted to sell or pledge them.

16. EMPLOYEE BENEFITS

- A. (1) The Bank's liability 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.

The Bank and its subsidiaries are not permitted to withdraw these deposits except for the purpose of making severance payments.

In certain consolidated banking subsidiaries, several officers are entitled to "adjustment" bonus* equal to six to twelve months' salaries, and in respect of which adequate provisions have been included.

- B. The Bank's employees and those of its consolidated subsidiaries in Israel are entitled to long-service bonuses equal to a certain number of monthly salaries, and to a certain number of additional vacation days, upon completing 20, 30 and 40 years of employment in the Bank. In accordance with instructions of the Supervisor of Banks the provision in respect of this liability is computed on an actuarial basis and stated at its present value. The capitalization rate, set by the Supervisor of Banks, on an actuarial computation is 4%, and considering the future payroll increases, the amount of the liabilities for employee rights, in respect of the Bank's employees, is capitalized at a payroll increase rate of 2.5%, similar to 2010. The financial

16. EMPLOYEE BENEFITS (CONTINUED)

statements include provisions for long-service bonuses totaling: Consolidated - NIS 408 million (2010: NIS 399 million); the Bank - NIS 310 million (2010: NIS 314 million).

An agreement with the representatives of the employees was signed in November 2007, regarding the "Jubilee vacation" days, according to which, among other things, the entitlement of new employees to "Jubilee vacation" was abolished.

- C.** The Bank's employees 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 125 million (2010: NIS 157 million); and for the Bank - NIS 89 million (2010: NIS 125 million).
- D.** The Bank's employees 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 611 million (2010: NIS 550 million); the Bank - NIS 511 million (2010: NIS 473 million).

E. Provision and deposits due to employees' severance pay and allowance payments are as follows:

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
Deposits	2,587	2,575	2,295	2,292
Provision	2,880	⁽¹⁾ 2,783	2,472	⁽¹⁾ 2,443
Excess of provision over deposits	(293)	(208)	(177)	(151)
The excess (shortage) of provision over the deposits is included in the item:				
Other assets (Note 8)	-	⁽¹⁾ 3	-	⁽¹⁾ -
Other liabilities (Note 12)	(293)	⁽¹⁾ (211)	(177)	⁽¹⁾ (151)
Total, Net	(293)	(208)	(177)	(151)

Footnote:

(1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

- 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, at a budget of NIS 400 million (which, under certain circumstances may have been increased by an additional amount of NIS 100 million). A detailed retirement plan was submitted for approval of the Board of Directors on August 24, 2011. The program was put into operation at the end of October 2011, and terminated in March 2012.
- The total budget of the plan was NIS 850 million, gross, including severance pay in accordance with the law. In actuality, approx. 340 employees retired within the framework of the plan, with a total cost (including severance pay in accordance with the law) that amounted to approx. NIS 600 million.

16. EMPLOYEE BENEFITS (CONTINUED)

- 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 (in US\$ millions)

	December 31	
	2011	2010
Amount of provision	49	32
Amount of deposits	21	18
Excess of provision over deposits	28	14
Excess of provision over deposits included in the item:		
Other liabilities (Note 12)	28	14
	%	%
The annual discount rate	5.22	5.22
The anticipated annual rate of return on the funds assets	8.25	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 March 26, 2006, the Bank's Board of Directors resolved to approve an award plan to members of the Bank's management, including the Internal Auditor. 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 (within the framework of an additional budget, the volume of which will also be derived from the annual rate of return on equity), in a differential manner according to his judgment, and in accordance with the extent of achievement of the specific targets set by him for each management member. The said distribution 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%.

The Bank's Board of Directors was entitled to eliminate exceptional profits or losses, that do not stem from current operations, for the purpose of computing the rate of annual return on equity. The Bank's Board of Directors was entitled to change or cancel the award plan, in whole or in part, provided that the change or cancellation would take effect in the calendar year following the year in which the decision for cancellation or change was taken.

The award plan to members of the Bank's management, including the Internal Auditor, was ratified by the Audit Committee and by the Board of Directors at the meetings held on July 15 and 16, 2006. Since then, the Board of Directors decided from time to time to apply the said plan to newly appointed management members.

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.

16. EMPLOYEE BENEFITS (CONTINUED)

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").

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).

Notwithstanding 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.

16. EMPLOYEE BENEFITS (CONTINUED)

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.

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 that member.
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

16. EMPLOYEE BENEFITS (CONTINUED)

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.

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 will be paid no later than April 27, 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.

For details regarding a stock option plan for the Bank's officers, see Note 13 E (2) and (3). For details regarding a phantom option plan for the Bank's officers, see Note 13 E (1) and (4).

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS

Consolidated

December 31 2011							
Israeli currency			Foreign currency ⁽¹⁾			Non monetary items	Total
Non-linked	Linked to the CPI	In US\$	In Euro	In other currencies			
in NIS millions							
Assets							
Cash and deposits with banks	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	-	-	-	-	1,606	1,611
Buildings and equipment	-	-	-	-	-	3,080	3,080
Intangible assets and goodwill	-	-	-	-	-	152	152
Assets in respect of derivative instruments	1,672	7	113	73	1,083	166	3,114
Other assets	1,498	49	1,032	40	134	378	3,131
Noncurrent assets held for sale	-	-	-	-	-	8	8
Total assets	109,574	26,211	48,947	6,939	4,767	6,053	202,491
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 agreements	-	-	6,700	-	-	-	6,700
Subordinated capital notes	2,907	9,332	-	-	-	-	12,239
Other liabilities in respect of derivative instruments	1,778	809	345	107	1,227	166	4,432
Other liabilities	8,265	99	591	51	64	393	9,463
Total liabilities	99,833	21,539	54,877	9,038	5,530	559	191,376
Difference	9,741	4,672	(5,930)	(2,099)	(763)	5,494	11,115
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	2,839	2,972	(152)	221	(261)	5,496	11,115
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	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE TERMS (CONTINUED)

Consolidated (continued)

December 31, 2010							
Israeli currency			Foreign currency ⁽¹⁾			Non monetary items	Total
Non-linked	Linked to the CPI	In US\$	In Euro	In other currencies			
in NIS millions							
Assets							
Cash and deposits with banks	12,626	618	3,087	1,088	768	-	18,187
Securities	12,603	6,292	16,535	686	367	693	37,176
Securities borrowed or purchased under resale agreements	45	-	-	-	-	-	45
Credit granted to the public, net	65,359	19,160	25,651	5,523	2,973	-	118,666
Credit granted to the Government	2	1,550	1	-	3	-	1,556
Investments in affiliated companies	60	57	-	7	-	⁽⁴⁾ 1,550	⁽⁴⁾ 1,674
Buildings and equipment ⁽²⁾	-	-	-	-	-	3,125	3,125
Intangible assets and goodwill ⁽²⁾	-	-	-	-	-	169	169
Assets in respect of derivative instruments ⁽²⁾	1,467	13	279	46	161	73	2,039
Other assets ⁽²⁾	⁽⁴⁾ 722	53	988	44	620	499	⁽⁴⁾ 2,926
Noncurrent assets held for sale ⁽²⁾	-	-	-	-	-	13	13
Total assets	92,884	27,743	46,541	7,394	4,892	6,122	185,576
Liabilities							
Deposits from the public	71,592	11,609	42,268	8,743	3,799	-	138,011
Deposits from banks	1,463	485	1,262	114	63	-	3,387
Deposits from the Government	231	75	155	-	-	-	461
Securities loaned or sold under repurchase agreements	-	-	7,227	-	-	-	7,227
Subordinated capital notes	2,971	9,323	-	-	-	-	12,294
Liabilities in respect of derivative instruments ⁽²⁾	1,414	1,017	247	246	219	72	3,215
Other liabilities ⁽²⁾	⁽⁴⁾ 8,153	145	868	42	63	558	⁽⁴⁾ 9,829
Total liabilities	85,824	22,654	52,027	9,145	4,144	630	174,424
Difference	7,060	5,089	(5,486)	(1,751)	748	5,492	⁽⁴⁾ 11,152
Effect of non-hedging derivative instruments:							
Derivative instruments (except for options)	(1,257)	(2,679)	⁽³⁾ 2,848	⁽³⁾ 2,021	⁽³⁾ (933)	-	-
Options in the money, net (in terms of underlying asset)	(294)	-	527	(234)	1	-	-
Options out of the money, net (in terms of underlying asset)	53	12	52	(116)	(4)	3	-
Total	5,562	2,422	(2,059)	(80)	(188)	5,495	⁽⁴⁾11,152
Options in the money, net (discounted par value)	(360)	-	700	(340)	-	-	-
Options out of the money, net (discounted par value)	(623)	472	572	(417)	(7)	3	-

Footnotes:

(1) Includes those linked to foreign currency.

(2) Reclassified, see note 1B (4).

(3) Reclassified.

(4) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE (CONTINUED)

A. The Bank

December 31, 2011							
Israeli currency			Foreign currency ⁽¹⁾			Non-monetary Items	Total
Non-linked	Linked to the CPI	In US\$	In EURO	In other currencies			
NIS millions							
Assets							
Cash and deposits with banks	28,793	9,644	3,047	316	259	-	42,059
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	40,320	4,777	10,808	5,160	1,989	-	63,054
Credit granted to Governments	25	1,591	-	-	-	-	1,616
Investments in affiliated companies	852	513	288	-	-	8,699	10,352
Buildings and equipment	-	-	-	-	-	2,249	2,249
Debit balances of derivative financial instruments	1,676	4	1,075	58	71	158	3,042
Other assets	1,156	15	29	7	126	222	1,555
Noncurrent assets held for sale	-	-	-	-	-	3	3
Total assets	87,597	19,794	15,617	6,203	2,480	11,344	143,035
Liabilities							
Deposits from the public	71,905	11,955	20,406	7,985	2,914	-	115,165
Deposits from banks	1,493	176	2,084	186	200	-	4,139
Deposits from the Government	98	99	-	-	-	-	197
Subordinated capital notes	214	3,589	-	-	-	-	3,803
Credit balances of derivative financial instruments	1,779	676	1,162	308	91	158	4,174
Other liabilities	4,302	23	175	23	10	279	4,812
Total liabilities	79,791	16,518	23,827	8,502	3,215	437	132,290
Difference	7,806	3,276	(8,210)	(2,299)	(735)	10,907	10,745
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)	(475)	-	357	104	14	-	-
Options out of the money, net, (in terms of base asset)	333	-	(254)	(71)	(8)	-	-
Total	1,297	1,723	(2,696)	(60)	(426)	10,907	10,745
Options in the money, net, (discounted nominal value)	(568)	-	660	70	(162)	-	-
Options out of the money, net, (discounted nominal value)	1,221	-	(924)	(346)	49	-	-

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES ACCORDING TO LINKAGE (CONTINUED)

A. The Bank (continued)

			December 31, 2010					
	Israeli currency		Foreign currency ⁽¹⁾			Non-monetary Items	Total	
	Non-linked	Linked to the CPI	In US\$	In EURO	In other currencies			
NIS millions								
Assets								
Cash and deposits with banks	16,894	9,253	2,495	746	229	-	29,617	
Securities	10,835	3,407	417	630	33	23	15,345	
under resale agreements Securities borrowed or purchased	45	-	-	-	-	-	45	
Credit granted to the public, net	42,777	6,597	10,999	5,144	2,653	-	68,170	
Credit granted to Governments	-	1,551	-	-	-	-	1,551	
Investments in affiliated companies	856	432	267	-	-	⁽⁴⁾ 8,599	⁽⁴⁾ 10,154	
Buildings and equipment ⁽²⁾	-	-	-	-	-	2,315	2,315	
Debit balances of derivative financial instruments ⁽²⁾	1,473	7	217	41	157	62	1,957	
Other assets ⁽²⁾	⁽⁴⁾ 563	14	-	15	614	399	⁽⁴⁾ 1,605	
Total assets	73,443	21,261	14,395	6,576	3,686	11,398	130,759	
Liabilities								
Deposits from the public	61,269	12,440	19,696	7,797	2,907	-	104,109	
Deposits from banks	1,136	110	1,904	173	42	-	3,365	
Deposits from the Government	102	75	-	-	-	-	177	
Subordinated capital notes	278	3,735	-	-	-	-	4,013	
Credit balances of derivative financial instruments ⁽²⁾	1,414	871	219	234	172	62	2,972	
Other liabilities ⁽²⁾	⁽⁴⁾ 4,356	95	383	2	13	450	⁽⁴⁾ 5,299	
Total liabilities	68,555	17,326	22,202	8,206	3,134	512	119,935	
Difference	4,888	3,935	(7,807)	(1,630)	552	10,886	⁽⁴⁾ 10,824	
Effect of non hedging derivative instruments:								
Derivative instruments (except for options)	(1,292)	(2,318)	⁽³⁾ 2,647	⁽³⁾ 1,886	⁽³⁾ (923)	-	-	
Options in the money, net, (in terms of base asset)	(355)	-	607	(253)	1	-	-	
Options out of the money, net, (in terms of base asset)	99	12	10	(117)	(4)	-	-	
Total	3,340	1,629	(4,543)	(114)	(374)	10,886	10,824	
Options in the money, net, (discounted nominal value)	(518)	-	862	(344)	-	-	-	
Options out of the money, net, (discounted nominal value)	(503)	472	459	(421)	(7)	-	-	

Footnotes:

(1) Includes those linked to foreign currency.

(2) Reclassified, see note 1 B (4).

(3) Reclassified.

(4) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

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, 2011**

	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⁾	42,647	11,910	12,703	11,230	6,814
Liabilities	67,879	10,173	12,893	2,699	1,395
Difference	(25,232)	1,737	(190)	8,531	5,419
Derivative instruments (excluding options)	(3,304)	2,094	(3,293)	703	66
Options (in terms of underlying assets)	(258)	(43)	70	22	20
Israeli currency, CPI-linked:					
Assets	348	847	3,558	3,385	3,269
Liabilities	963	1,787	6,024	3,288	1,839
Difference	(615)	(940)	(2,466)	97	1,430
Derivative instruments (excluding options)	(74)	173	(125)	(602)	(773)
Options (in terms of underlying assets)	-	-	-	-	-
Foreign currency-local activity⁽⁹⁾:					
Assets ⁽⁷⁾	6,937	4,341	2,336	2,637	1,196
Liabilities	18,582	8,324	7,019	226	64
Difference	(11,645)	(3,983)	(4,683)	2,411	1,132
Derivative instruments (excluding options)	5,150	(419)	2,662	(434)	(256)
Options (in terms of underlying assets)	258	43	(72)	(22)	(20)
Foreign currency-foreign activity of extensions:					
Assets	4,137	3,507	9,772	5,699	3,688
Liabilities	18,326	1,966	4,251	3,608	1,449
Difference	(14,189)	1,541	5,521	2,091	2,239
Derivative instruments (excluding options)	23	(8)	-	-	-
Non-monetary items:					
Assets	9	4	7	1	-
Liabilities	7	-	-	1	-
Difference	2	4	7	-	-
Options (in terms of underlying assets)	-	-	2	-	-
Total:					
Assets	54,078	20,609	28,376	22,952	14,967
Liabilities	105,757	22,250	30,187	9,822	4,747
Difference	(51,679)	(1,641)	(1,811)	13,130	10,220
Derivative instruments (excluding options)	1,795	1,840	(756)	(333)	(963)
Options (in terms of underlying assets)	-	-	-	-	-
B. Balance Sheet Amount at December 31, 2010					
Total:					
Assets ⁽⁸⁾	39,411	23,022	28,948	19,308	14,974
Liabilities ⁽⁸⁾	95,135	21,407	25,937	8,297	5,591
Difference	(55,724)	1,615	3,011	11,011	9,383
Derivative instruments (excluding options)	771	3,138	221	(1,360)	(1,335)

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 presented net of the effect of accounting write-offs and provisions for credit losses.
- (2) Includes past-due receivables totaling NIS 1,461 million (2010: NIS 1,653 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)		The contractual rate of return, in percentages(5)
							No fixed maturity date(2)	Total	
	4,453	4,519	16,497	5,942	683	117,398	1,850	109,574	4.72
	902	795	1,968	614	192	99,510	102	99,833	2.45
	3,551	3,724	14,529	5,328	491	17,888	1,748	9,741	2.27
	(489)	(657)	(218)	128	-	(4,970)	-	(6,850)	-
	55	70	9	3	-	(52)	-	(52)	-
	3,650	1,940	8,301	5,254	1,144	31,696	14	26,211	3.36
	1,472	1,260	5,386	2,330	-	24,349	-	21,539	3.36
	2,178	680	2,915	2,924	1,144	7,347	14	4,672	-
	(511)	(45)	(881)	(21)	-	(2,859)	-	(1,700)	-
	-	-	-	-	-	-	-	-	-
	1,122	809	2,409	379	8	22,174	239	20,481	2.98
	42	29	41	23	-	34,350	2	36,412	0.96
	1,080	780	2,368	356	8	(12,176)	237	(15,931)	2.02
	(73)	(201)	(208)	21	-	6,242	-	8,533	-
	(55)	(70)	(9)	(3)	-	50	-	50	-
	2,946	2,369	4,719	5,418	1,491	43,746	1,919	40,172	2.58
	839	819	3,468	-	-	34,726	166	33,033	1.42
	2,107	1,550	1,251	5,418	1,491	9,020	1,753	7,139	1.16
	-	-	-	-	-	15	-	17	-
	-	-	-	-	-	21	6,032	6,053	-
	-	-	-	-	-	8	551	559	-
	-	-	-	-	-	13	5,481	5,494	-
	-	-	-	-	-	2	-	2	-
	12,171	9,637	31,926	16,993	3,326	215,035	10,054	202,491	3.93
	3,255	2,903	10,863	2,967	192	192,943	821	191,376	2.09
	8,916	6,734	21,063	14,026	3,134	22,092	9,233	11,115	1.84
	(1,073)	(903)	(1,307)	128	-	(1,572)	-	-	-
	-	-	-	-	-	-	-	-	-
	10,039	10,066	29,986	21,893	5,265	202,912	10,248	185,576	4.15
	3,638	3,042	11,279	3,081	181	177,588	781	174,424	1.81
	6,401	7,024	18,707	18,812	5,084	25,324	9,467	11,152	2.34
	(1,028)	(594)	(1,074)	(58)	-	(1,319)	-	-	-

(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 4,798 million (2010: NIS 5,374 million) and an amount of NIS 1,430 million with no due date (2010: NIS 1,854 million).

(7) Including current loan account credit facilities in the amount of NIS 757 million (2010: NIS 1,068 million) and an amount of NIS 106 million with no due date (2010: NIS 141 million).

(8) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

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, 2011**

	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⁾	35,706	8,163	8,680	9,723	5,045
Liabilities	54,749	8,850	8,556	1,988	1,071
Difference	(19,043)	(687)	124	7,735	3,974
Derivative instruments (excluding options)	(3,308)	2,139	(3,545)	703	66
Options (in terms of base assets)	(256)	(36)	107	10	7
Israeli currency, CPI-linked:					
Assets	335	754	2,387	2,517	2,350
Liabilities	594	1,464	3,982	2,274	1,377
Difference	(259)	(710)	(1,595)	243	973
Derivative instruments (excluding options)	(74)	195	(125)	(579)	(749)
Options (in terms of base assets)	-	-	-	-	-
Foreign currency-local activity⁽³⁾:					
Assets ⁽⁷⁾	6,498	3,939	2,337	2,519	1,110
Liabilities	17,497	8,601	6,589	206	48
Difference	(10,999)	(4,662)	(4,252)	2,313	1,062
Derivative instruments (excluding options)	5,152	(489)	2,906	(469)	(291)
Options (in terms of base assets)	256	36	(107)	(10)	(7)
Foreign currency-foreign activity of extensions:					
Assets	708	522	540	446	249
Liabilities	588	364	97	10	-
Difference	120	158	443	436	249
Derivative instruments (excluding options)	3	(8)	-	-	-
Non-monetary items:					
Assets	-	-	-	-	-
Liabilities	-	-	-	-	-
Difference	-	-	-	-	-
Total:					
Assets	43,247	13,378	13,944	15,205	8,754
Liabilities	73,428	19,279	19,224	4,478	2,496
Difference	(30,181)	(5,901)	(5,280)	10,727	6,258
Derivative instruments (excluding options)	1,773	1,837	(764)	(345)	(974)
Options (in terms of base assets)	-	-	-	-	-

B. Balance Sheet Amount at December 31, 2010

Total:					
Assets ⁽⁸⁾	29,726	14,597	17,770	12,224	11,101
Liabilities ⁽⁹⁾	65,814	17,006	17,640	4,526	2,164
Difference	(36,088)	(2,409)	130	7,698	8,937
Derivative instruments (excluding options)	776	3,073	175	(1,426)	(1,343)

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 presented net of the effect of accounting write-offs and provisions for credit losses.
- (2) Includes past-due receivables totaling NIS 1,295 million (2010: NIS 1,223 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	Balance sheet amount ⁽⁴⁾		The contractual rate of return, in percentages ⁽⁵⁾
						Total cash flows	No fixed maturity date ⁽²⁾ Total	
	3,293	3,511	14,555	5,496	803	94,975	1,271	4.46
	835	772	1,897	567	187	79,472	-	2.10
	2,458	2,739	12,658	4,929	616	15,503	1,271	2.36
	(489)	(657)	(220)	128	-	(5,183)	-	-
	6	6	11	3	-	(142)	-	-
	3,497	1,386	6,331	3,323	864	23,744	21	3.37
	1,272	1,168	4,729	2,204	-	19,064	-	3.65
	2,225	218	1,602	1,119	864	4,680	21	(0.28)
	(485)	(22)	(339)	-	-	(2,178)	-	-
	-	-	-	-	-	-	-	-
	1,098	915	2,211	281	-	20,908	192	3.09
	58	17	-	-	-	33,016	2	0.97
	1,040	898	2,211	281	-	(12,108)	190	2.12
	(108)	(231)	(641)	-	-	5,829	-	-
	(6)	(6)	(11)	(3)	-	142	-	-
	144	191	11	-	-	2,811	768	3.56
	-	2	12	-	-	1,073	6	2.09
	144	189	(1)	-	-	1,738	762	1.47
	-	-	-	-	-	(5)	-	-
	-	-	-	-	-	-	11,344	-
	-	-	-	-	-	-	437	-
	-	-	-	-	-	-	10,907	-
	8,032	6,003	23,108	9,100	1,667	142,438	13,596	4.06
	2,165	1,959	6,638	2,771	187	132,625	445	2.00
	5,867	4,044	16,470	6,329	1,480	9,813	13,151	2.06
	(1,082)	(910)	(1,200)	128	-	(1,537)	-	-
	-	-	-	-	-	-	-	-
	6,421	7,706	21,755	8,806	1,729	131,835	13,903	3.96
	1,863	2,090	7,564	2,963	175	121,805	523	1.59
	4,558	5,616	14,191	5,843	1,554	10,030	13,380	2.37
	(1,033)	(597)	(1,027)	(26)	-	(1,428)	-	-

(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 3,314 million (2010: NIS 3,680 million) and an amount of NIS 1,182 million with no due date (2010: NIS 1,549 million).

(7) Including current loan account credit facilities in the amount of NIS 561 million (2010: NIS 856 million) and an amount of NIS 59 million with no due date (2010: NIS 140 million).

(8) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

	Consolidated		The Bank		Consolidated		The Bank	
	Balance ⁽¹⁾	Provision ⁽²⁾	Balance ⁽¹⁾	Provision ⁽²⁾	Balance ⁽¹⁾	Provision ⁽²⁾	Balance ⁽¹⁾	Provision ⁽²⁾
	December 31,2011				December 31,2010			
	in NIS millions							
A. Off-Balance Sheet Financial Instruments⁽³⁾								
Contract balances or their stated amounts at year end Transactions involving credit risk:								
Letters of credit	1,827	1	1,031	-	1,468	22	716	22
Credit guarantees	2,754	29	1,725	19	3,590	19	2,199	16
Guarantees for home purchasers	4,929	23	3,687	15	5,037	69	3,416	53
Other guarantees and obligations	5,614	31	4,989	26	5,560	39	4,996	34
Unutilized credit line for credit cards	14,450	19	4,146	7	13,999	-	4,184	-
Unutilized revolving and other credit lines	8,104	21	7,070	17	8,596	-	7,645	-
Irrevocable commitments to extend credit approved but not yet granted ⁽⁴⁾	18,580	41	9,508	37	19,837	-	10,399	-
Commitment to issue guarantees	3,508	7	2,367	6	4,064	-	2,895	

Footnotes:

- (1) Contract balance or their stated amounts at period end before of allowance for credit loss.
- (2) Balance of allowance for credit loss at period end.
- (3) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.
- (4) 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 on loan payments

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
Balance of loans granted out of deposits repayable according to the repayment of the loans ⁽²⁾				
Israeli currency - non linked	1,807	1,319	1,768	1,282
Israeli currency - linked to the CPI	1,255	1,452	15	13
Foreign currency	563	705	563	705
Total	3,625	3,476	2,346	2,000

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 62 million (2010: NIS 80 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, 2011						2010	
	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	-	-	-	2	5	-	7	7
Expected future flows based on Management's estimates of early repayments	-	-	-	2	5	-	7	7
Discounted expected future flows based on Management's estimates of early repayments ⁽¹⁾	-	-	-	1	2	-	3	4
In Israeli currency, CPI-linked:								
Future contractual flows	9	17	16	32	10	-	84	98
Expected future flows based on Management's estimates of early repayments	9	15	12	19	5	-	60	73
Discounted expected future flows based on Management's estimates of early repayments ⁽²⁾	9	15	11	17	4	-	56	66
In foreign currency:								
Future contractual flows	1	2	1	-	-	-	4	7
Expected future flows based on Management's estimates of early repayments	1	2	1	-	-	-	4	7
Discounted expected future flows based on Management's estimates of early repayments ⁽³⁾	1	2	1	-	-	-	4	6

Information as to the granting of loans during the year by the mortgage banks:

	December 31	
	2011	2010
Loans out of deposits repayable according to the repayment of loans	1	3
Standing loans	1	3

Footnotes:

(1) Discounted at the rate of 5.29% (2010: 5.41%)

(2) Discounted at the rate of 1.72% (2010: 1.84%)

(3) Discounted at the rate of 1.13% (2010: 1.00%)

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)**C. Contingent liabilities and other special commitments**

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
	in NIS millions			
1. Long-term leasehold - rent payable in future years:				
First year	123	122	57	59
Second year	92	93	51	50
Third year	71	69	37	39
Fourth year	60	57	31	31
Fifth year	47	47	22	24
Sixth year and thereafter	192	196	76	69
Total	585	584	274	272
2. Commitment to acquire buildings and equipment	80	73	51	38

3. 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, 2011, amounts to approx. NIS 29 million, comprising 2.59% of the total risk fund at that date. The two banks were required to provide collateral in favor of the Ma'of Clearing House by way of securities (Government bonds) in an amount that would cover their possible liability in respect of their share in the risk fund, as stated, as well as an additional amount derived from the volume of operations in this field of each of the banks (see Note 15 F). Each of the banks is also committed to pay the Ma'of Clearing House any monetary charge that may result from its operations and from the operation of their customers involving the writing of options traded within the framework of the Clearing House.
4. According to the articles of the Stock Exchange and the byelaws of the Tel Aviv Stock Exchange Clearing House, the members are committed towards the Clearing House to cover any amount resulting from the obligations on behalf of themselves or their customers as well as for other Stock Exchange members who are not members of the Clearing House and their customers, in respect of transactions conducted by way of the Clearing House. Furthermore, each member is also responsible for his share of the Risk Fund, established for this purpose, based on the clearing ratio of turnovers of the members. As collateral for their obligations towards the Clearing House, the Bank and 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).
5. 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 redrafted 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 18,126 thousand, 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.
- 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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 20 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.

- c) MDB committed to indemnify Mercantile Capital Markets Ltd., with respect to claims that might be submitted against it in respect of professional liability in excess of amounts stated in the insurance policies purchased in its name. The letter of indemnity is in effect until March 31, 2012, and is limited to NIS 23 million.
6. 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.
7.
 - 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 Manpikim Ltd., a wholly owned and controlled subsidiary of the Bank, has granted indemnification to its Directors, with respect to a financial liability that might be imposed on any of them and with respect to reasonable legal expenses in connection with a prospectus for the public issue and the listing for trade of subordinated capital notes, published in March 2004, in a total amount of NIS 500 million, under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification payable to all Directors as a group will not exceed the gross proceeds of the said issue. Discount Manpikim Ltd. has granted its Directors identical indemnification in connection with a prospectus regarding the offer to the public and the listing for trade of subordinated capital notes issued in November 2004, in a total amount of NIS 600 million.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

- e) Discount Manpikim Ltd. granted in September 2006 indemnification to directors as well as the CEO of the company with respect to monetary liability that might be imposed on any of them and with respect to reasonable litigation expenses in connection with a shelf prospectus for the issue and listing for trade of subordinated capital notes, dated September 2006, and this under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification granted to all of the directors and to the CEO as a whole shall not exceed the gross proceeds of the said issue, and in any case no more than NIS 1.5 billion. In September 2007, Discount Manpikim Ltd. approved a similar indemnify to the CEO appointed subsequently to the issue of the shelf prospectus, regarding shelf offering reports to be published subsequently to the date of the resolution, in accordance with the said shelf prospectus.
- f) Discount Manpikim Ltd. granted in February 2008 indemnification to directors as well as the CEO of the company with respect to monetary liability that might be imposed on any of them and with respect to reasonable litigation expenses in connection with a shelf prospectus for the issue and listing for trade of subordinated capital notes, dated February 2008, and this under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification granted to all of the directors and to the CEO as a whole shall not exceed the gross proceeds of the said issue, and in any case no more than NIS 2 billion.
- g) Discount Manpikim Ltd. granted in February 2009 indemnification to directors as well as the CEO of the company with respect to monetary liability that might be imposed on any of them and with respect to reasonable litigation expenses in connection with the issue of subordinated capital notes in accordance with the amended a shelf prospectus dated December 24, 2008, and this under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification granted to all of the directors and to the CEO as a whole shall not exceed the gross proceeds of the said issue, and in any case no more than NIS 3 billion.
- h) The Bank's Board of Directors approved the granting of indemnification by Discount Issuers Ltd. to the Board members and President & CEO of Discount Manpikim Ltd., with respect to a shelf Prospectus dated June 18, 2010, and shelf offer reports to be 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) 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.
- j) 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 US\$1\$ million. In any event, the cumulative amount of the indemnification shall not exceed the total consideration for the transaction, with the addition of interest and linkage 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 12.7 hereunder).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

- k) 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.
- l) **Responsibility 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. The policy was 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.
- On June 30, 2010, the Annual General Meeting of shareholders approved the Bank's engagement in a policy with respect to the responsibility of officers of the Bank and of companies in which the Bank holds, directly or indirectly, an interest of 50% or more in the equity or voting therein. The policy was for a period of one year as from April 1, 2010 and until March 31, 2011. The details of the policy are as described above (except for the change according to which the insurance premium amounted to US\$812 thousand, and the Bank's share excluding the subsidiaries did not exceed US\$500 thousand).
- m) **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 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.

- n) On March 21, 2021, 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.
- o) **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 the commitment to indemnify and exemption were granted in accordance with principles and group limitations approved by the Bank's board in July 2009.
- p) **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 as 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 on July 2009.
8. 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

9.
 - a) In November 2008, the Bank signed a guarantee, unlimited in amount, in favor of the VISA Europe organization, securing all liabilities of ICC, applying due to the status of ICC as a member of the VISA Europe organization, this in relation to the transactions of VISA connected to the operations of ICC both in Israel and abroad. ICC has signed an indemnification letter in favor of the Bank with respect to the said guarantee.
 - b) The Bank issued a guarantee in the amount of US\$10 million, in favor of the MasterCard Worldwide organization, to secure the activity of ICC within the framework of the Organization.
 - c) As security for the liabilities of E.R.N. (Israel) Ltd., an affiliated company of ICC, towards a certain commercial bank, the Bank has issued a guarantee in the amount of NIS 4 million.
10. 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.
11. **Various actions against the Bank and its consolidated subsidiaries:**

Various actions are pending against the Bank and its consolidated subsidiaries. These include class action suits and requests to approve actions as class action suits. Among others, allegations are raised in these claims with regard to the unlawful debiting of interest and/or the debiting of interest not in accordance with agreements, subjecting one service to another service, failure to execute instructions, applications for the confirmation of attachment orders in respect of attachments served by third parties on the assets of debtors which they allege are held by the Bank, the unlawful debiting of accounts, mistakes in value dates, the invalidity of collateral security and the realization thereof, applications for injunctions ordering the Bank to refrain from paying out bank guarantees or documentary credit, as well as allegations pertaining to provident funds, securities, construction loans, applications for the removal of restrictions on an account pursuant to the Dishonored Checks Law, 1981. In the opinion of the 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 1,175 million.

- 11.1 In November 1999 a former customer of the Bank submitted to the Tel-Aviv District Court a claim against the Bank in the amount of NIS 456 million.

In the action, the plaintiff alleged wrongful doings made in his accounts until 1989. According to the plaintiff, who maintained a business account with the Bank, the Bank exploited his mental and physical condition, and made use of his account and the accounts of his family members as if they belonged to the Bank, while opening dozens of additional accounts without permission, concealing information, forging signatures, taking out loans in the name of the plaintiff, buying and selling securities fictitiously and embezzling funds.

On September 25, 2011, the Court dismissed the claim. The Court decided that the claim should be dismissed both due to the time limitation and as to the matter itself. The Court determined that the larger part of the Claimant's arguments had been refuted, while no proof had been shown regarding the other part of the arguments. The Court charged the Claimant with the refund of expenses to the Bank in the amount of NIS 400 thousand.

On December 15, 2011, the Claimant filed an appeal against the decision of the Court together with a request for exemption from Court fees in respect of the appeal proceedings. The motion for exemption from Court fees was dismissed, though the amount of the guarantee which the Claimant is required to deposit was reduced to NIS 30 thousand. According to the Court's decision, the Claimant has to deposit the amount of the guarantee until and no later than April 15, 2012.

- 11.2 On September 1, 2004, an application for exemption from the Court fee was submitted to the Tel Aviv District Court in connection with a suit in a sum of NIS 500 million brought by the liquidators of a company against forty defendants, one of which was the Bank. The Court partially accepted the request for exemption and determined the fee at NIS 320 thousand.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

The suit against the Bank turns on three causes only, which relate to alleged injury valued at US\$4 million in respect of a transaction undertaken between the company in liquidation and a third party involving the sale of an asset mortgaged to the Bank, which, according to the liquidators' assertions, was sold for less than its true value, the release of the shareholders of one of the companies in the group from their guarantees in relation to the debts of the company to the Bank totaling NIS 3 million; and the return of deferred payment orders to the company in liquidation without the items passing through the company's bank account, thus causing injury valued at NIS 9 million. It should be noted that the liquidators claim that the 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.

On November 29, 2009, the Bank resubmitted a motion for the amendment of the claim brief so that it will accurately define the amount of the claim against it. The motion is still pending.

In addition, the Bank motioned for the in limine dismissal of the claim on the grounds of limitation. The motion was dismissed and on November 16, 2008, the Bank filed a request to the District Court for permission to appeal the said decision, the hearing of which has been suspended until the conclusion of the moderation process between the parties. The moderation process has been ended in November 2010 without an agreement. Hearings were held on January 13 and February 20, 2011, of the said motion for approval of the appeal. The appeal has been dismissed with no Order for expenses, the Bank preserving its arguments, and the matter will be discussed in the course of the hearing of the principal case.

In January 2011, the Liquidators of the company applied to the Court for instructions regarding the conduct of further investigations and submission of an amended suit brief in the light of new information that had been received from a past controlling shareholder of the company. At this stage the case is due for a preliminary hearing on April 29, 2012, for the hearing of the preliminary arguments of the parties.

On February 28, 2012, the meeting of creditors of Credit Lines Group approved a compromise arrangement, according to which the Respondents will pay a total amount of NIS 26 million, and the claim will be dismissed. The Bank's share in this arrangement amounts to NIS 1.5 million.

A motion for approval of the arrangement was filed with the Court on March 19, 2012.

- 11.3 On June 19, 2006, an action was filed together with a motion for its approval as a class action against the State of Israel and 31 other defendants, including the Bank, MDB, Discount Gemel and the Provident funds of MDB.

The claimants allege that the defendants have unlawfully received payments in respect of foreclosures imposed by those who were granted execution through the magnetic media. The principal claim is that the defendants do not provide the service required by law, in that they do not provide full and detailed information in their reply to the Bailiff Office, and accordingly are not entitled to the payment determined in the regulations.

The amount of the claim against all defendants totals NIS 233 million. The claim does not specify the amount claimed from each of the defendants. The Bank estimates that the maximum exposure of the companies of the Discount Group involved in this case for the restitution claim would not exceed NIS 10 million.

On November 24, 2010, the Supreme Court dismissed the appeal filed by the Bank, MDB and additional defendants, against the ruling of the District Court not to admit the motion for dismissal in limine of the lawsuit. On April 28, 2011, the Bank submitted its response to the motion for approval of the action as a class action suit. The hearing of the case is fixed for April 1, 2012.

- 11.4 Hereunder are details regarding a class action suit, which has been appealed against as such:

A lawsuit was filed on September 12, 2006, against the Bank, Bank Leumi Le'Israel B.M. ("Bank Leumi") and Bank Hapoalim Ltd. ("Bank Hapoalim") (together: "the defendant banks"), as well as a motion for approval of the lawsuit as a class action suit. The Plaintiff assessed the amount claimed at NIS 7 billion in respect of all the defendant banks, reserving the right to amend this amount in accordance with developments during the course of the litigation.

The Plaintiff argued that most of the credit to the public is concentrated in the hands of the defendant banks, and that they coordinated among themselves the prices applying to five parameters in everything relating to credit.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

The Plaintiff alleges that the similarity in prices of the five parameters at the defendant banks indicates the existence of coordination between them that resulted in huge profits to these banks and caused enormous damage to the public and to the economy.

The Plaintiff's claim is that it has a cause of action both under the Restrictive Trade Practices Law, there being a prohibited binding arrangement, and under the Banking Law (Service to customer), as it is argued that the defendant banks exploited customers' distress, their ignorance and inexperience in order to provide them with banking services under unreasonable terms.

The relief requested by the Plaintiff is a retroactive reduction in the prices of the five parameters charged during the past ten years for all customers of the defendant banks. Alternatively, the Court is asked to rule a different relief in favor of all members of the class or in favor of the public.

On January 21, 2007, the District Court admitted the Plaintiff's motion to recognize the lawsuit as a class action suit on grounds derived from the Restrictive Trade Practices Law (hereinafter: "the decision of the District Court"). In its ruling, the Court noted, inter-alia, that the Restrictive Trade Practices Authority (hereinafter: "the Authority") is conducting a widespread criminal investigation "the largest ever conducted by the Authority regarding suspicion of felonies committed by the banking industry in contravention of the Restrictive Trade Practices Law, 1988", as noted in the letter of the legal counsel for the Authority dated May 20, 2007, which had been attached by the Plaintiff to the material presented to the Court.

In this respect, it should be noted that the Commissioner issued on April 26, 2009, a ruling as detailed in Section 14 below.

On April 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.

After consideration of the motions for appeal filed by the banks against the decision recognizing the lawsuit as a class action suit, as well as the brief and the position of the Attorney General to the Government, the Supreme Court instructed in its decision that the motions be heard by an expanded panel of the Court.

Hearing of the appeal was held on March 13, 2011. On April 14, 2011, the Supreme Court instructed the parties and the Attorney General to submit their comments on the ramifications of the determination of the Antitrust Commissioner on the case (see Section 14 below). In addition, the Court instructed the Claimant to state in the document to be submitted by it whether it has further evidence as to coordination of interest rates between the banks, and if so - to present in summary form details of such evidence, their substance and nature. The plaintiff filed his response on May 30, 2011 and the banks submitted their briefs by August 22, 2011. 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). On December 18, 2011, the banks filed their response to the response of the Government Attorney General. The claimants submitted their response on December 19, 2011.

- 11.5 On November 23, 2006, a lawsuit was filed to the Jerusalem District Court together with a motion for its approval as a class action suit against the Bank, Bank Hapoalim BM and Bank Leumi Le Israel BM ("the defendant banks"). The claimants assess the amount of the claim at between NIS 5.2 and NIS 5.6 billion for all the defendants, while they reserve the right to amend the claim brief.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

In the claim brief the claimants argue that the defendant banks charge the private household sector interest at an exorbitant rate, which is much higher than the interest rate charged to the commercial and business sectors, this without any economic and commercial justification. According to the claimants, they have a cause of action under the Restrictive Trade Practices Law, due to the defendant banks constituting, as alleged by them, a "a concentration group", which according to them misuses its monopolistic power, while reducing competition and causing harm to the public and because, as they claim, there exists prima facie a binding contract between the defendant banks, and also under the Banking Law (Service to customer) and under the Consumer Protection Law in respect of - according to their claim - misleading consumers with respect to the accepted price for credit service to the household sector and to the determination of interest rates while utilizing their distress and ignorance for engaging them in transactions at unreasonable terms and/or for the purpose of receiving consideration that exceeds the accepted consideration.

The Bank responded to the motion to approve the claim as a class action suit.

On May 15, 2008, the Court decided to stay the proceedings until a ruling is given in the appeal filed by the banks with respect to the action described in item 11.4 above. On December 14, 2011, the Court ruled that the case should be submitted for his consideration upon receipt of the notice by the parties regarding the decision in the claim described above in item 11.4, or on June 1, 2012, whichever is earlier.

- 11.6 On June 30, 2008, a motion for the approval of an action as a class action suit against the Bank, Bank Hapoalim and Bank Leumi, was submitted to the Tel Aviv District Court. The core issue of the suit rests on the Plaintiffs' claim that, since the end of the 1990's and possibly even earlier, the three defendant banks created a cartel coordinating the prices of commissions charged to their customers.

The Plaintiffs further claim that the banks have created an unlawful restrictive business practice regarding the rates of the various commissions charged to customers. As alleged by the Plaintiffs, as a result of the cartel, the price paid by the public is higher than the price that would have been paid had competition not been prevented by the cartel.

The causes for the action are as follows: Violation of Section 4 of the Antitrust Law the Plaintiffs request that the rules applying to a concerted group/monopoly, as these terms are defined in the said Law, should apply to the defendant banks; a material misrepresentation in accordance with the Consumer Protection Law; violation of Section 2 of the Fiduciary Law; violation of the provisions of the Unlawful Creation of Wealth Law.

The Plaintiff estimates the gap between commissions actually charged and the commissions that would have been charged had the banks not acted as they did, at 25%. Based on this assessment, the Plaintiffs claim 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).

The Bank filed its response on March 19, 2009.

Documents which, according to the Claimants, had been seized by the Antitrust Commissioner were attached, among other things, to this motion. In this respect, it should be noted that the Commissioner issued on April 26, 2009, a ruling as detailed in Section 14 below.

According to the decision of the District Court of October 7, 2009, the claim will be heard together with the claim described in Section 12.3 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 14 below). On June 5, 2011, the Claimants submitted a motion for renewal of the proceedings. On February 23, 2012, the Court dismissed the motion for renewal of the proceedings. In its decision the Court stated that a hearing of the motions for approval of the lawsuits as class action suits concurrently with the proceedings conducted at the Antitrust Tribunal, constitute dual hearings and a waste of public resources.

- 11.7 An action and a motion for the approval of the action as a class action suit 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".

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

The Claimants argue that the banks have furtively charged a "realization commission" at the rate of 0.5% of the amounts due to the option holders upon expiry of the options, this without providing proper and sufficient disclosure.

The Claimants further argue that the "realization commission" was charged by the Defendants despite the fact that they do not have to take any action justifying such a commission, and that no reasonable ratio exists between the rate of the commission and the so called action required from the Defendants and that the respondent banks did not receive approval of the Bank of Israel for charging such a commission. The combined damage to all members of the group is estimated by the Claimants at NIS 672 million. The Claimants do not disclose the amount of the damage attributed to each of the Defendants.

Hearing of the evidence in the case has been completed and dates have been fixed for submission of the summations.

- 11.8 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 Claimants argue that the violation interest constitutes an agreed compensation, and therefore the Court is entitled to reduce it under Section 15 of the Contract Law ("Relief"), 1970, as no reasonable relation exists between the agreed compensation and the amount of damage caused to the banks as a result of the violation. The reduction in the violation interest is called for also by the interpretation of the agreements according to the opinion of the parties. Charging the Claimants with violation interest comprises an unjust enforcement of the agreement. The banks' insistence on charging the Claimants with violation interest comprises lack of good faith and its collection by the banks constitutes illegal creation of wealth.

According to the Claimants, the principal rationale for the circumstances that justify the reduction in interest is the length of time between the date of the receivership and the date of sale of the shares.

The Bank's share in the alleged damage, based on its share in the credit consortium, is approx. 10% and that of MDB is 4%.

In accordance with the decision of the District Court, The Claimants filed a monetary claim of approx. NIS 830 million.

On March 29, 2010, the banks filed a defense brief. During 2010, procedures for the disclosure of documents were conducted. As from 2011, evidence proceedings are continuing in this case.

- 11.9 On November 2, 1997 a law suite was filed with the Tel-Aviv District Court and a motion to approve the filing of a class-action suit against Discount Mortgage Bank ("DMB") and against three additional mortgage banks regarding the charging of commissions for life assurance and property insurance of borrowers. It was argued, inter alia, that the Bank compelled the plaintiffs to purchase these insurance policies as a condition for signing the loan and mortgage agreements. The amount set in the class-action suit is NIS 500 million, with no specific allocation to the banks involved.

Whereas, with respect to another request to approve an action as a class action, in a matter practically identical, the Court had already handed down its decision, which was appealed against, the Judge presiding in this case has decided that it will be heard only after the Supreme Court will issue a judgment in principle on the matters in dispute that were raised in the appeal against the ruling already given with respect to the other motion.

On December 5, 2011, the Court that hears the other motion, gave the compromise agreement the validity of a Court verdict.

- 11.10 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.

The claimant and her deceased husband were borrowers of DMB and provided that bank with a life assurance policy as collateral for the repayment of the loan in case of death of one of the borrowers. Following the death of the husband the remaining borrower wished to act on the policy and accordingly DMB informed the assurance company of the balance of the loan with the addition of an early repayment charge.

According to the claimant, adding the early repayment charge was illegal, and the claim should be admitted on the following grounds: contractual grounds, the illegal creation of wealth, lack of proper disclosure and misleading the customer.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

In the motion for approval of a class action, 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.

Preliminary discussions have been held in this case on March 3, 2010, and on April 6, 2010, at the conclusion of which, the Court instructed the parties to sum up their arguments. The parties have submitted their summation briefs. A decision has not yet been given.

- 11.11 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. 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. It is being claimed 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. The Claimant further argues that in this way, DMB illegally collected amounts of NIS tens of millions in each year. The Claimant seeks to represent the customers who had been charged with an early repayment commission in the last seven years, to obtain an order for the restoration of the commission illegally charged, together with interest and linkage increments, and for the indemnification of the Claimant, as representative of the class, in a total amount of 25% of the amount claimed.

Discount Mortgage Bank has submitted its response brief. On December 19, 2011, the parties submitted an authorized motion for the approval of a compromise, which includes an agreed mechanism for the computation of an early repayment commission and for the refund of commission according to agreed criteria. Following the hearing of the summation of the arguments of the parties, the Court was motioned to approve the compromise mechanism as well as decide the scope of the refund. A hearing was held on December 21, 2011, within the framework of which it was decided that Discount Mortgage bank will submit a deposition supporting the data that had been provided at the hearing, and a further hearing was fixed for April 1, 2012.

- 11.12 On May 29, 2011, the Bank was served with a motion for the admission of a claim as a derivative claim. The claim for an amount of NIS 107 million was served against a third party, companies under his control and against the Bank.

The Claimant argues that the Bank has been an accessory to collusion to dispose of the assets of the company in whose name the Court is petitioned to approve the claim as a derivative claim. The bank filed its response brief on July 14, 2011.

It should be noted that on May 26, 2011, the Tel Aviv District Court admitted in full a motion filed by the Bank for the appointment of a Receiver for this company (an appeal has been filed against the said decision).

At the preliminary hearing held on February 6, 2012, the Claimant was instructed to inform the Court by May 1, 2012, as to whether he intends to motion for completion of argument within the framework of the motion for approval, and if necessary a hearing will be held on June 3, 2012.

12. Requests to approve certain actions against the Bank and its consolidated subsidiaries as class action suits and other actions for which it is not possible at this stage to evaluate their prospects of success:

A class action suit and requests to approve certain actions as class action suits, 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 have been included in respect therewith.

- 12.1 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. The action is for an amount of NIS 105 million.

The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, since the insured amounts included the land component, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

On September 10, 2000, DMB filed its response to the petition for approval of a class action suit, in which the Court is requested to dismiss the petition in limine and as regards its substance. It should be noted that Phoenix Insurance also responded to the petition requesting the Court dismiss the petition in limine and as regards its substance.

On October 29, 2000, the claimants submitted their reply to the above response, in which they repeat the request for approval of a class action suit.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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 11.9 above, and consequently the Court decided to defer the hearing of the said petition until after the verdict is given in those other pleas. The Supreme Court rejected on April 4, 2001, a plea for permission to appeal this decision.

In its decision of December 25, 2000, the District Court did not determine that proceedings against Phoenix Insurance should also be deferred. Phoenix Insurance petitioned the Supreme Court for permission to appeal in this respect. On January 28, 2002, the Supreme Court admitted the plea of Phoenix Insurance and ordered to stay proceedings against it at the District Court as well.

The case was transferred for hearing at the District Court of the Central Region.

The District Court of Central Region decided to suspend the hearing of the case until after a ruling is given at the Supreme Court, in accordance with the decision that had already been taken in this case by the District Court in 2000.

On July 12, 2011, the Tel Aviv District Court issued its decision regarding the other motion, according to which the parties submitted for approval of the Court a compromise agreement, and the Court instructed the parties to respond prior to the approval of the agreement. On December 5, 2011, the Court that hears the other motion, gave the compromise agreement the validity of a Court verdict.

- 12.2 A motion for exemption from Court fees regarding a lawsuit in the amount of NIS 96 million filed with the Tel Aviv District Court on February 6, 2008. The motion was filed by the controlling shareholder of a company, being a debtor of the Bank, in respect of which a receivership order and a liquidation order had been issued.

The Plaintiff claims that the Bank, in a negligent manner lacking good faith, had applied for a receivership order against the company and at a later date also applied for an order to liquidate the company despite the fact that the total value of the company's assets exceeded the amount of the debt to the Bank.

The Plaintiff attributes to the Bank the responsibility for the acts and/or omissions of the Receiver and/or of the Liquidator of the company, which as alleged by him, caused the company heavy damage.

As it seems, the claim against the Bank has no legal and/or factual grounds and the amounts claimed are most excessive.

The Claimant passed away in April 2010. At the end of March 2011, the Court accepted the motion for the replacement of the deceased by his heirs, directed the deletion of the plea for exemption from Court fees and determined that the fees are to be paid within forty-five days. On June 16, 2011, the heirs of the deceased filed a motion for exemption from Court fees. On November 25, 2011, the Court's Registrar dismissed the motion for exemption from Court fees. In accordance with the decision of the Registrar, unless the Appellants pay the fees within 30 days, the claim will be dismissed. On December 21, 2011, an appeal was filed against the decision of the Registrar. A hearing was held on January 16, 2012, in which the Court ruled that the appeal had been belatedly submitted. To the extent that the Appellants will persist on their appeal and to the extent that an extension for its submission is granted, a decision in the appeal will be given. The Appellants motioned for extension of the date for submission of the appeal. The matter has not yet been decided.

As long as exemption is not granted or the Court fee is not paid, the lawsuit is not considered as filed.

- 12.3 On May 12, 2009, an action was filed against the Bank, Bank Leumi, Bank Hapoalim, Mizrahi-Tefahot Bank and the First International Bank together with a motion to approve the action as a class action suit.

The action is based on the statement of the Antitrust Commissioner (see item 14 below) according to which binding arrangements regarding the communication of information with respect to commissions had existed between the defendant banks.

The Claimants argue that a binding arrangement had existed between the said banks with respect to commission rates charged by these banks and that the banks established a coordinated policy, which, as alleged by the claimants, was typified by prohibited cooperation and exchange of information.

The Claimants argue that the banks created between them a binding arrangement in contravention of Sections 2 and 4 of the Antitrust Law and that according to Section 50 of that Law an act of commission or omission in contravention of the provisions of the Law constitute a damaging injustice.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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 11.6 above. The Court ordered a stay in the hearing of the motion for approval until a decision is given in the appeal against the Commissioner's ruling, to be submitted by the banks to the Antitrust Tribunal. (see item 14 hereunder). As above mentioned, on June 5, 2011, the Claimants filed a plea for renewal of proceedings in the motion for approval of the class action suit. On February 23, 2012, the Court dismissed the motion for renewal of the proceedings. In its decision the Court stated that a hearing of the motions for approval of the lawsuits as class action suits concurrently with the proceedings conducted at the Antitrust Tribunal, constitutes dual hearings and a waste of public resources.

- 12.4 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. As argued by the investigators, 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 Liquidator has applied for clarification of the decision and on August 22, 2011, the Court gave its decision in which it reiterated that the lawsuit against the Bank may not be financed by the liquidation funds. The Liquidator filed an appeal on September 14, 2011, against the said decision of the District Court.

The clarifications by the parties have been submitted to the Supreme Court. A decision in the matter is still pending.

On October 27, 2011, the Special Manager applied for exemption from Court fees in respect of a monetary claim in the amount of NIS 75 million, submitted concurrently against the Bank and other parties. The Bank and the State submitted their objection to the motion for exemption from Court fees. On January 2, 2012, the District Court ruled that a decision regarding the motion for exemption from Court fees shall be given following the decision of the Supreme Court in the motion for permission to appeal.

A preliminary case hearing has been fixed for September 6, 2012.

- 12.5 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. They claim that the banking laws, the consumer protection law as well as the civil wrongs ordinance provide them with a cause for action. The personal damage claimed in respect of all the Claimants amounts to NIS 10, while the damage to the group as a whole is assessed by the Claimants at NIS 153 million.

A motion has been submitted for approval of a procedural agreement, according to which the banks will submit their response within thirty days of the preliminary case hearing. On March 5, 2012, the Court ruled that at this stage the banks are not required to submit a response to the motion for approval of the procedural agreement. A preliminary hearing of the case is scheduled for April 5, 2012.

- 12.6 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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.

The Bank and Discount Provident Ltd. have indemnification liabilities relating to the period prior to the sale of the relevant funds, which might materialize, if the said motion and action are approved and accepted (see item 7 J 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.

12.7 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 Ltd., Bank Leumi Le-Israel Ltd., Israel Credit Cards Ltd., Israel Discount Bank Ltd., the First International Bank of Israel Ltd., IsraCard Ltd. and Bank Hapoalim Ltd. (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. Certain requests for approval of class actions against FIBI:

The financial statements of FIBI in describing details of requests for approval of class actions that are pending against this bank and against its subsidiaries, and with respect to which management of FIBI, after consulting with legal advisors, is unable to estimate, at this stage, the prospects of these claims and therefore no provision has been made therein, make mention of the following procedure:

In 1997, claims were brought in the Tel Aviv District Court against two subsidiaries of FIBI - the First international Mortgage Bank Ltd. and Atzma'ut Mortgage and Development Bank Ltd. (hereinafter: "the mortgage banks in the First International Group"), which in the meantime have been merged into FIBI, and against other mortgage banks, in which it was claimed that the said banks unlawfully charged borrowers with a commission relating to life assurance and property insurance policies, and that the borrowers are entitled to the refund of such amounts. These claims total approx. NIS 1.5 billion (in nominal values). A petition to approve these actions as a class action suits was also filed. The said claims and petition did not include the Group.

In November 1997, the Court ruled as to the action filed in July 1997, according to which it dismissed the claim in the form of a class action according to the Banking Law (Service to customer), 1981, and the Restrictive Practices Law, 1988. Nevertheless, the Court ruled that it was possible to hear a claim for a declarative relief under Section 29 of the Civil Code Regulations, with respect to causes of action created prior to May 10, 1996 (date of publication of the amendments to these Laws regarding class actions).

In December 1997, the said banks applied to the Supreme Court for permission to appeal against the said judgment, as well as petitioned the court to stay execution of the proceedings until judgment is passed in this appeal. The request for permission to appeal and for the stay of execution has been admitted by the Supreme Court.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

In a hearing held by the Supreme Court in the above appeal on November 25, 2001, the parties accepted the suggestion of the Court to stay the hearing of the appeals until a judgment is given in another appeal case pending at the Supreme Court, in which a fundamental decision is to be given in the matter of the status, applicability and terms of Section 29 of the Civil code Regulations, a question standing at the heart of the said appeal.

On April 2, 2003, a judgment was given in that other appeal in the matter of the status and applicability of Section 29 for the purpose of submitting a class action. Therefore, on April 10, 2003, the Supreme Court decided that the parties submit their arguments in writing as to the continuation of the appeal proceedings. All the parties have already submitted their briefs as stated. The decision of the Supreme Court in the matter has not yet been given.

On September 1, 2005, a decision was given in the further hearing in the matter of the status and application of Regulation 29, which left the ruling as is. This ended, for the time being, the use of Regulation 29 as an instrument for serving class action suits.

Pursuant to the Class Action Suits Law, 2006, published on March 12, 2006, new arrangements have been established, essentially different from the laws in existence prior to the enactment of the above law, as regards to the filing of class action suits. According to the law, the Court is empowered to also apply the provisions of the new law to actions that had been pending prior to its enactment, under terms specified in the law. Until the date of publication of these financial statements, no such motions have been filed by any of the claimants as stated above. At the recommendation of the Supreme Court, all parties to the claim, which was submitted in July 1997, referred the case to mediation. The parties to this claim had reached a compromise agreement that was approved by the Court.

Gross income recorded by the First International Bank group from mortgage operations, management fees and services concerning life assurance of borrowers and insurance of the properties mortgaged to secure the mortgage loans, amounted in 2011 to NIS 14.3 million, compared with NIS 15.0 million in 2010.

If the remaining claim, as described above, is admitted, then the income of the First International Bank from such operations will be reduced.

14. On March 19, 2008, following an investigation conducted since 2004 by the Antitrust Authority, the Authority informed the Bank that in view of the investigation findings, the Antitrust Commissioner ("the Commissioner") is studying the possibility of applying the authority conferred on her by law and determine that binding arrangements had existed between Bank Hapoalim Ltd., Bank Leumi Ltd., Mizrahi-Tefahot Bank, the First International Bank Ltd. and the Bank (hereinafter: "the banks"), in the matter of communicating information regarding to commissions.

The Bank was given a chance to submit its position in writing to the Commissioner before she takes a decision whether to make use of the said authority. In September 2008, the Bank submitted to the Commissioner its position in writing within the framework of hearing, in which the Bank presented the factual and legal reasons supporting its argument that there is no place for the Commissioner to make use of her authority to determine that a binding arrangement had in fact existed.

In January 2009, the Authority suggested to the banks the possibility of forming an "agreed order" as an alternative to the publication of the decision being considered, that will include a cash payment of NIS 290 million, to be allocated between the banks, so that the Bank's share in this amount will be NIS 80 million. The Authority also suggested that the "agreed order" will include agreed limitations on the communication of information between banks, as well as the mapping and regulation of all collaborative activities between them.

In February, 2009, the Bank informed the Authority that it rejects the said suggestion for an "agreed upon order".

On April 26, 2009, the Antitrust Commissioner issued a decision under Section 43(a)(1) of the Antitrust Law, 1988, according to which binding arrangements had existed between the banks regarding the communication of information with respect to commissions ("the Commissioner's decision"). 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.

According to the Commissioner's decision, communication of information in the said statement constitutes a binding arrangement within the meaning of the Antitrust Law.

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. The Bank disputes the ruling, its findings and conclusions. On March 24, 2010, the Bank appealed against the Commissioner's decision. On February 22, 2011, the Commissioner submitted her response to the motions for appeal that had been submitted by the Bank and by the other banks to which the Commissioner's decision relates. In May 2011, the parties agreed to submit the case to mediation. In December 2011, the mediator informed the Tribunal of the failure of the mediation proceedings. Following this, the appeal proceedings continue before the Antitrust Tribunal.

The Tribunal ruled that preliminary motions should be submitted until February 20, 2012. The Bank has filed a motion for the deletion of arguments and annexes from the response of the Commissioner as well as a motion to direct the Commissioner to hand over investigation material not yet provided. The Tribunal ruled that the Respondent shall reply to the motions by April 5, 2012.

At this stage, it is not possible to assess the results of the said proceedings and their implications.

15. (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, 2011, DCMI has a commitment to additional investments in 12 such entities amounts totaling US\$55.2 million (as of December 31, 2010, US\$155.4 million).
 - (b) Several portfolio companies held by two funds, in which DCMI has an interest, were sold in February 2012. The consideration received by DCMI from the said funds in respect of the above mentioned sales, amounted to US\$13.8 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 2012, amounts to US\$9 million, gross before tax, based on the consideration received net of the part held in escrow.
 - (c) DCMI owns approx. 19.6% of the equity of Menif. The Board of Directors of Discount Israel Capital Markets and Investments Ltd. 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 53.7 million (linked to the CPI) in order to match the ratio of shareholding in Menif. As of December 31, 2011, guaranties have been provided in the amount of NIS 47.1 million (December 31, 2010 - NIS 51.3 million).
 - (d) In addition, as of December 31, 2011, the Bank is committed to invest US\$4 million in a venture capital fund. Furthermore, MDB has a commitment to invest in six venture capital funds amounts totaling US\$1.8 million, as of December 31, 2011.
 - (e) In March 2012, DCMI signed an agreement for investment in an additional fund, in which DCMI committed to invest an amount of up to US\$70 million, but no more than 20% of the amount of investment commitments of the fund. The fund has not yet begun operations.
16. **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).

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%.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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.

17. **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 engagement period is for five years, as from November 1, 2007 (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.

18. **Sale of investment in KFS.** On March 30, 2009, DCMI signed an agreement for the sale to Karden of all of its holdings in the shares of KFS - 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 though the option was exercised at the end of two whole years. The option is exercisable at any time within the said period of six years, unless this period is shortened following the listing for trade of the KFS shares or another event of their sale (as these are specified in the option agreement). If and when DCMI exercises the option, then it will be entitled to rights including a "tag along" right in the case of sale of a controlling interest by Karden and the right to participate in future allotments of shares. The shares of DCMI are also subject to the right of first refusal by Karden, and all subject and in accordance with the terms prescribed in the option agreement.

Being cautious, the Bank did not take into account, in computing the provision for impairment made, the economic value attributed to the option.

A loss of NIS 18 million was recognized in the financial statements as of March 31, 2009, in respect of the realization of the investment in KFS (most of which was in respect of exchange rate differentials recorded in relation to this investment up to realization date).

19. **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. The parties are negotiating to solve the dispute in accordance with the layout predetermined in advance in the agreement.

Concurrently, on August 10, 2010, the parties signed an agreement, according to which the purchasers' group paid MDB on August 17, 2010, the amount which is not in dispute (in the amount of NIS 54 million) and deposited with a trustee a bank guarantee in the amount of NIS 10 million, to serve as security in the event that the position of MDB will be accepted at the conclusion of the dispute. In view of the above, 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.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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.

20. **Sale of the basket certificate operations.** On November 2, 2010, the Bank and Tachlit, a wholly owned subsidiary of the Bank, signed a binding memorandum of understanding (hereinafter - "the Memorandum") with Dash Apex Holdings Ltd. (hereinafter - "Dash"), Synergetica Ltd. (controlled by Michael Davis) (hereinafter - "Synergetica") and Mr. Michael Davis. In accordance with the Memorandum, Tachlit will sell 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 as specified in the Memorandum.

The transaction was consummated on March 24, 2011, following fulfillment of conditions precedent, including, among other things, obtaining all regulatory approvals required for the transaction and completion of the due diligence review by DS. Net gain of NIS 29 million was recorded in the financial statements, in respect of the above transaction as income from extraordinary operations. 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.

21. a. Chairman of the Board during the period of November 1997 to January 2006 (hereinafter: "Past Chairman of the Board") ended his tenure of office on January 31, 2006, following the closing of the transaction for the sale of a controlling interest in the Bank. His remuneration and terms of employment were approved by the general meetings of shareholders held on January 15, 1998, October 5, 1999 and June 14, 2004, including his entitlement to regular severance pay and an adaptation award equal to full twelve months salary.
- b. In 2004, the 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 yet 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 yet been brought for approval by the general meetings of shareholders.
- e. Without derogating from the resolutions detailed in items b to d above, the Bank intended to bring for approval of the 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.
- g. In a letter dated March 26, 2006, the Bank's controlling shareholders informed the Accountant General at the Ministry of Finance and the CEO of M.I. Holdings Ltd. of their intention to bring for approval of the Bank's authorized organs, as the case may be, the proposals for various payments to the past Chairman of the Bank's Board of Directors, as detailed in items b to e above.

The controlling shareholders clarified that, for the sake of propriety they deemed it proper to bring to the attention of the Government the proposed payments by the Bank to the past Chairman, as detailed above, though, in their opinion, such payments are not considered payments to an interested party within its meaning in the agreement for the sale of the controlling interest in the Bank, and therefore do not require the consent of the Government.

- h. In a letter dated March 26, 2006, the Accountant General at the Ministry of Finance informed that the State opposes the intended payments as detailed in the above said letter of the controlling shareholders (see g above).
- i. On January 8, 2009, the former chairman of the Board of Directors submitted, through his representative, a demand for the payment of various amounts in respect of his term of office at the bank (hereunder: "the demand letter").

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

- j. In the demand letter, the representative of the former Chairman of the Board suggested that the issue be submitted to the decision of a third party, in order to avoid referring the case to the Court.
- k. The Bank's Board of Directors 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.
- l. On March 16, 2009, the representative of the former chairman informed that he agrees to the Bank's demand.
- m. On March 18, 2009, the Bank and the former Chairman applied to Prof. Yaakov Ne'eman to act as above. It was further agreed that the proceedings before him shall be conducted in accordance with the First Addendum to the Arbitration Law, 1968; each party will bear its own costs while the arbitrator fee and its allocation to the parties will be decided by the arbitrator. It should be noted that the former Chairman limited his claim to an amount of NIS 17 million (this amount was provided in the Bank's books as part of a specific and non-specific provisions).
- n. On that day, March 18, 2009, the first meeting in front of Prof. Ne'eman was held, in which, among other things, two witnesses on behalf of the former Chairman were heard. The Bank has not yet presented its arguments with respect to the demand of the former Chairman.
- o. On March 25, 2009, the representatives of the State of Israel and of M.I. Holdings Ltd. sent the Bank and the controlling shareholders a letter in which they argue, among other things, that the Bank's consent to the said proceedings without prior notice to the State and without enabling it to participate in the proceedings, is in contradiction to the law and prevents the State from stating its position in the matter. In continuation, the State requested to cancel the arbitration process and to revert the issue to the approval of the authorized organs in the Bank. Without derogating from the above, The Bank was requested to freeze the proceedings before the arbitrator and to verify that no decisions be taken before the discussion is resolved. The Bronfman-Schron Group also announced that will join the demand by the State to suspend all proceedings and refrain from taking any decisions until the matter is entirely clarified and discussed in full with the State.
- p. In the Bank's opinion, the consent of the shareholders, including the State, is not required for these proceedings. The process implemented is a proper one, appropriate to the circumstances and the Bank's benefit and is lawful. Notwithstanding, the Bank and the Past Chairman applied to Prof. Ne'eman for a stay of three weeks in the proceedings in order to clarify the matter with the controlling shareholders and the State. It was agreed that in the event that Prof. Ne'eman will not be able to continue acting as an expert arbitrator in the matter due to his expected appointment as a Government Minister, then the matter will be forwarded to another expert arbitrator, the identity of whom has been agreed upon by the parties.
- q. After discussions of this issue, representatives of the State announced, in a letter dated May 27, 2009, that they insist on their objection to making the payments to the former Chairman and to continuation of the arbitration proceedings. The State representatives added that this position is also endorsed by Bronfman-Schron Group. The State's position was, inter alia, that making the payments is subject to approval by the General Meeting of Shareholders.
- r. The representatives of the Bank's former Chairman have approached the Bank, requesting fulfillment of the Bank's commitments and resumption of negotiations in front of an external expert, as agreed. The Bank has not yet responded to this approach.
- s. 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)

- t. 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. As of date of publication of this Report, the hearing of the motion itself has not yet taken place.

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.

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.
3. It is possible for the Bank to enter an agreement that in itself does not constitute a derivative instrument but which contains an embedded derivative. In respect of each contract the Bank evaluates whether the economic characteristics of the embedded derivative are not clearly and closely connected to those of the hosting agreement, and examines whether an independent instrument with the same terms of the embedded instrument would have agreed with the definition of a derivative instrument. Where the above terms are fulfilled, the embedded derivative is separated from the hosting agreement, treated as a derivative in its own right and stated in the balance sheet together with the hosting agreement at its fair value, changes in its fair value being taken currently to the income statement. Where the Bank is unable to reliably identify and measure an embedded derivative for the purpose of its separation from the hosting agreement, the agreement as a whole is stated in the balance sheet at fair value.
4. The Bank maintains a written documentation of all hedging relations between hedging instruments and the items hedged, as well as the object and strategy of risk management by way of creating the various hedging transactions.

The documentation includes the specific identification of the asset, liability, the firm commitment or the anticipated transaction, which were determined as the hedged item, and the manner in which the hedging instrument is expected to hedge against risks involved in the hedged item. The Bank assesses the effectiveness of hedging relations both at the beginning of the transaction and on a continuing basis, in accordance with its risk management policy.
5. The Bank discontinues its hedging accounting from the following points onward when:
 - a. It has been determined that the derivative is no longer effective, setting off the changes in fair value or the cash flows of the hedged item;

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

- b. The derivative has expired, 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 hedging an effective fair value, the derivative will continue to be stated in the balance sheet at its fair value, however the hedged asset or liability will no longer be adjusted for changes in fair value.

When hedging accounting is discontinued due to the fact that the hedged item no longer qualifies as a firm commitment, the derivative will continue to be stated in the balance sheet at fair value and every asset or liability which previously were stated based on the recognition as a firm commitment shall be removed from the balance sheet and recognized as income or loss in the income statement for the reported period.

6. Fair value hedging

Certain derivatives are being designated by the Bank as hedging fair value. The changes in the fair value of derivatives hedging against exposure to changes in fair value of an asset or liability, are currently recognized in the income statement, as well as the changes in the fair value of the hedged item, that could be related to the risk being hedged.

7. Cash flow hedge

The Bank 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.

8. The financial statements as of December 31, 2011, include a change in measurement of indebtedness regarding OTC derivatives transactions, in accordance with the change stated in Proper Banking Management Directive No. 313, regarding restrictions on indebtedness of a borrower and a group of borrowers.

The amended Directive states that in computing the future potential exposure for the remaining period of the contract, the "add-on" coefficient to be used is the one used in computing exposure for Basel II purposes, multiplied by three. This replaces the computation of 10% of the stated amount of the future transaction, used until now for computing the exposure.

In consequence of the said change, the reported balances of indebtedness in respect of off-balance sheet credit risk regarding derivative instruments have substantially declined.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. Volume of activity on a consolidated basis

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	-	5,182	-	-	-
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	75,317	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	-	-	-	-	38
Forward contracts	-	-	449	-	93
Marketable option contracts					
Options written	-	*-	533	5,760	*-
Options purchased	-	*-	533	5,760	*-
Other option contracts					
Options written	-	560	346	151	1,374
Options purchased	-	560	586	152	1,290
Swaps	-	790	103	-	-
Total	-	1,910	2,550	11,823	2,795
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.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. Volume of activity on a consolidated basis (continued)

December 31, 2010					
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
in NIS millions					
1. Par value of derivative instruments					
A. Hedging derivatives ⁽¹⁾					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	-			
B. ALM derivatives ⁽¹⁾⁽²⁾					
Futures contracts	-	5,887	-	-	-
Forward contracts	1,082	7,284	12,468	-	-
Marketable option contracts					
Options written	-	-	310	-	-
Options purchased	-	-	293	-	-
Other option contracts					
Options written	-	-	15,098	355	-
Options purchased	-	-	15,046	3	-
Swaps	-	45,831	28,306	-	-
Total	1,082	59,002	71,521	358	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	23,485			
C. Other derivatives ⁽¹⁾					
Futures contracts	-	*110	-	*1,745	*11
Forward contracts	40	*-	695	*-	*3,968
Marketable option contracts					
Options written	-	**-	225	3,754	1
Options purchased	-	**-	225	3,754	1
Other option contracts					
Options written	-	521	373	147	13,946
Options purchased	-	408	638	174	12,899
Swaps	-	1,176	15	-	-
Total	40	2,215	2,171	9,574	30,826
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate					
	-	563			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts			5,164		

* Reclassified between Forward contracts And Futures contracts

** 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		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
in NIS millions					
2. Gross fair value of derivative instruments					
A. Hedging derivatives ⁽¹⁾					
Positive gross fair value	-	-	-	-	-
Negative gross fair value	-	37	-	-	-
B. ALM derivatives ⁽¹⁾⁽²⁾					
Positive gross fair value	2	1,931	1,055	-*	-
Negative gross fair value	79	2,262	1,942	1	-
C. Other derivatives ⁽¹⁾					
Positive gross fair value	-	41	38	177	27
Negative gross fair value	-	37	19	177	27

	December 31, 2010				
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts
	Shekel/CPI	Other			
	in NIS millions				
A. Hedging derivatives ⁽¹⁾					
Positive gross fair value	-	-	-	-	-
Negative gross fair value	-	-	-	-	-
B. ALM derivatives ⁽¹⁾⁽²⁾					
Positive gross fair value	-	1,047	911	1	-
Negative gross fair value	55	1,261	1,827	2	-
C. Other derivatives ⁽¹⁾					
Positive gross fair value	1	53	59	81	47
Negative gross fair value	1	45	24	80	46

* 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)**B. Derivative instrument credit risk based on the counterparty to the contract on a consolidated basis**

December 31, 2011						
	Stock markets	Banks	Dealers/brokers	Governments and central banks	Others	Total
In NIS millions						
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 deriving 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 31 million of positive gross fair value of embedded derivative instruments.
 (2) Of which, a balance of non-related derivative instruments of NIS 3,114 million reflected in the item "Other assets".
 (3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness. See subsection 8 above.

December 31, 2010						
	Stock markets	Banks	Dealers/brokers	Governments and central banks	Others	Total
In NIS millions						
Gross positive fair value of derivative instruments ⁽¹⁾	41	1,724	28	-	407	2,200
Net of set-off agreements	5	44	-	-	40	89
Balance of assets deriving from derivative instruments ⁽²⁾	36	1,680	28	-	367	2,111
Off-balance sheet credit risk in respect of derivative instruments ⁽³⁾	101	9,115	34	53	3,598	12,901
Total credit risk in respect of derivative instruments	137	10,795	62	53	3,965	15,012

Footnotes:

- (1) Of which, NIS 72 million of positive gross fair value of embedded derivative instruments.
 (2) Of which, a balance of non-related derivative instruments of NIS 2,039 million reflected in the item "Other assets".
 (3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness. See subsection 8 above.

20. DERIVATIVE INSTRUMENT ACTIVITY - VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

C. Due dates – par value – consolidated year and balances

December 31, 2011					
	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Total
In NIS millions					
Interest rate contracts					
Shekel/CPI	458	888	792	338	2,476
Other	14,015	17,808	26,511	19,579	77,913
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	2,397	193	205	-	2,795
Total	78,238	46,067	31,844	22,671	178,820

December 31, 2010					
	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Total
In NIS millions					
Interest rate contracts					
Shekel/CPI	40	225	572	285	1,122
Other	9,228	15,949	20,090	15,950	61,217
Foreign currency contracts	49,489	24,146	2,242	2,979	78,856
Contracts on shares	9,513	142	277	-	9,932
Commodities and other contracts	30,524	3	299	-	30,826
Total	98,794	40,465	23,480	19,214	181,953

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, 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.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

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 granted 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 provisions 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, 2011, 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, 2010: 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 72 million. Increasing the discount interest rate by 0.1 basis point would have reduced the fair value of the problematic debts by NIS 5 million (compared to NIS 74 million and NIS 4 million, respectively, as of December 31, 2010).

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 111 million (compared to NIS 199 million at December 31, 2010). 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, 2011 4.0 years, compared to 3.44 years, taking into consideration the forecast for early redemptions.

The general, supplemental and special provisions for doubtful debts were not deducted from the balance of outstanding credit for the purpose of calculating the cash flows when determining the fair value.

Deposits, 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.

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 7 million (compared to NIS 15 million at December 31, 2010). 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, 2011 3.88 years, compared to 3.81 years, taking into consideration the forecast for early redemption.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

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.

D. Composition - consolidated

December 31, 2011				
Stated balance				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets:				
Cash and deposits with banks	2,147	28,182	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	11,984	104,399	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	54,866	140,862	195,728	195,940
Financial liabilities:				
Deposits from the public	15,489	137,879	153,368	153,694
Deposits from banks	1,112	3,137	4,249	4,246
Deposits from the Government	547	378	925	931
Securities borrowed or purchased under resale agreements	-	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	28,836	160,333	189,169	191,021

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
- (2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

D. Composition – consolidated (continued)

December 31, 2010				
Stated balance				
	(1)	(2)	Total	Fair value
in NIS millions				
Financial assets:				
Cash and deposits with banks	2,494	15,693	18,187	18,337
Securities	*29,798	*7,378	37,176	37,209
Securities borrowed or purchased under resale agreements	-	45	45	45
Credit to the public, net	23,190	95,476	118,666	119,293
Credit to the Government	5	1,551	1,556	1,556
Assets in respect of derivative instruments	*2,039	-	2,039	*2,039
Other financial assets	*1,504	-	1,504	*1,504
Total financial assets	59,030	120,143	179,173	179,983
Financial liabilities:				
Deposits from the public	14,601	123,410	138,011	138,394
Deposits from banks	641	2,746	3,387	3,613
Deposits from the Government	125	336	461	472
Securities borrowed or purchased under resale agreements	-	7,227	7,227	7,868
Subordinated capital notes	8	12,286	12,294	13,569
Liabilities in respect of derivative instruments	*3,215	-	3,215	*3,215
Other financial liabilities	*7,403	-	7,403	*7,403
Total financial liabilities	25,993	146,005	171,998	174,534

* Reclassified - see note 1 B (4).

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
- (2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. Composition – The Bank

December 31, 2011				
Stated balance				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets:				
Cash and deposits with banks	-	42,059	42,059	41,962
Securities	16,354	2,606	18,960	19,041
Securities borrowed or purchased under buy-back agreements	-	145	145	145
Credit to the public, net	-	63,054	63,054	62,763
Credit to the Government	-	1,616	1,616	1,616
Assets in respect of derivative instruments	3,042	-	3,042	3,042
Other financial assets	387	-	387	387
Total financial assets	19,783	109,480	129,263	128,956
Financial liabilities:				
Deposits from the public	-	115,165	115,165	115,643
Deposits from banks	260	3,879	4,139	4,133
Deposits from the Government	-	197	197	193
Subordinated capital notes	-	3,803	3,803	4,028
Liabilities in respect of derivative instruments	4,174	-	4,174	4,174
Other financial liabilities	3,121	-	3,121	3,121
Total financial liabilities	7,555	123,044	130,599	131,292

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
(2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. Composition – The Bank (continued)

December 31, 2010				
Stated balance				
	(1)	(2)	Total	Fair value
in Nis millions				
Financial assets:				
Cash and deposits with banks	384	29,233	29,617	29,790
Securities	13,072	2,273	15,345	15,384
Securities borrowed or purchased under buy-back agreements	-	45	45	45
Credit to the public, net	3,345	64,825	68,170	68,156
Credit to the Government	-	1,551	1,551	1,551
Assets in respect of derivative instruments	*1,957	-	1,957	*1,957
Other financial assets	*765	-	765	*765
Total financial assets	19,523	97,927	117,450	117,648
Financial liabilities:				
Deposits from the public	718	103,391	104,109	105,050
Deposits from banks	182	3,183	3,365	3,361
Deposits from the Government	-	177	177	178
Subordinated capital notes	-	4,013	4,013	4,412
Liabilities in respect of derivative instruments	*2,972	-	2,972	*2,972
Other financial liabilities	*3,444	-	3,444	*3,444
Total financial liabilities	7,316	110,764	118,080	119,417

* Reclassified - see note 1 B (4).

Footnotes:

- (1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.
- (2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

F. Items measured at fair value on a recurring basis - consolidated

December 31, 2011					
Fair value measurements using -					
	Quoted prices in an active market (tier 1)	Other significant seen data (tier 2)	Significant non- seen data (tier 3)	Influence of deduction agreements	Book value
In NIS millions					
Assets					
Available for sale securities:					
Of the Israeli Government	16,624	367	-	-	16,991
Of foreign governments	145	859	-	-	1,004
Of Israeli financial institutions	758	4	-	-	762
Of foreign financial institutions	58	2,009	-	-	2,067
Mortgage-backed-securities and Assets -backed-securities	-	11,842	-	-	11,842
Of others in Israel	123	155	-	-	278
Of others abroad	-	32	-	-	32
Shares	22	11	-	-	33
Total available-for-sale securities	17,730	15,279	-	-	33,009
Trading Securities:					
Of the Israeli Government	3,037	181	-	-	3,218
Of foreign governments	-	6	-	-	6
Of Israeli financial institutions	4	-	-	-	4
Of foreign financial institutions	-	45	-	-	45
Mortgage-backed-securities and Assets -backed-securities	-	54	-	-	54
Of others in Israel	27	-	-	-	27
Of others abroad	-	10	-	-	10
Shares	3	2	-	-	5
Total trading securities	3,071	298	-	-	3,369
Credit granted to the public in respect of securities loaned	1,191	-	-	-	1,191
Assets in respect of derivative instruments					
Shekel/CPI Interest Rate Contracts	-	-	2	-	2
Other Interest Rate Contracts	-	1,972	-	-	1,972
Foreign Exchange Contracts	15	1,019	59	(111)	982
Equity Derivative Contracts	175	2	-	(10)	167
Commodity and other Contracts	2	25	-	(5)	22
Assets in respect of the "Maof" market operations	211	-	-	-	211
Total assets	22,395	18,595	61	(126)	40,925
Liabilities					
Deposits from the public in respect of securities borrowed	490	18	-	-	508
Liabilities in respect of derivative instruments					
Shekel/CPI Interest Rate Contracts	-	-	79	-	79
Other Interest Rate Contracts	5	2,331	-	-	2,336
Foreign Exchange Contracts	14	1,074	873	(111)	1,850
Equity Derivative Contracts	175	3	-	(10)	168
Commodity and other Contracts	2	25	-	(5)	22
Commitments in respect of the "Maof" market operations	211	-	-	-	211
Short sales of securities	23	-	-	-	23
Total liabilities	920	3,451	952	(126)	5,197

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

G. Changes in items measured at fair value on a recurring basis included in item 3 - consolidated

	Fair value as at December 31, 2010	Total realized and unrealized gains (losses)	Issuances	Acquisitions	Clearings	Fair value as at December 31, 2011	Unrealized gains (losses) in respect of held instruments as at December 31, 2011
in NIS millions							
Liabilities in respect of derivative instruments, net							
Interest Rate Contracts	(55)	(32)	(1)	(1)	(1)10	(77)	(1)(33)
Foreign Exchange Contracts	(962)	28	(1)(281)	(1)278	(1)123	(814)	53

Footnote:

(1) Included in the statement of income in the item "Income from finance activities before credit loss expenses"

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

A. Balances

December 31, 2011											
Interested parties ⁽¹⁾								Related parties held by the Bank ⁽¹⁾			
Controlling Shareholders ⁽²⁾		Others Shareholders ⁽³⁾		Directors and President ⁽⁴⁾		Others ⁽⁵⁾		Affiliated		Others ⁽⁶⁾	
(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)
in NIS millions											
Assets:											
Deposits with banks	-	-	-	-	-	-	-	36	39	-	-
Securities ⁽⁹⁾	-	-	-	-	-	-	-	-	-	11	11
Credit granted to the public ⁽¹¹⁾	*-	*-	19	53	-	-	-	36	408	596	198
Allowance for credit loss ⁽¹¹⁾	-	-	-	-	-	-	-	(6)	(2)	(3)	(2)
Credit granted to the public, net ⁽¹¹⁾	-	-	19	53	-	-	-	30	406	593	196
Investments in affiliated companies ⁽⁹⁾	-	-	-	-	-	-	-	1,611	1,611	-	-
Other assets	-	-	-	-	-	-	-	53	115	-	-
Liabilities:											
Deposits from the public	3	4	4	9	-	-	-	3,471	3,833	100	226
Deposits from banks	-	-	-	-	-	-	-	116	195	-	-
Subordinated capital notes	-	-	-	-	-	-	-	10	11	-	-
Other liabilities	-	-	-	-	4	4	-	58	69	-	-
Shares (included in shareholders' equity)	2,890	2,890	-	-	-	-	-	-	-	-	-
Credit risk in sheet financial off-balance-instruments ⁽¹⁰⁾	3	3	2	11	-	-	-	92	1,052	17	41

* In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 6 million for credit received by a third party.

For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

A. Balances (continued)

December 31, 2010												
Interested parties ⁽¹⁾								Related parties held by the Bank ⁽¹⁾				
Controlling Shareholders ⁽²⁾		Others Shareholders ⁽³⁾		Directors and President ⁽⁴⁾		Others ⁽⁵⁾		Affiliated		Others ⁽⁶⁾		
(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)	(7)	(8)	
Assets:												
Deposits with banks	-	-	-	-	-	-	-	15	95	-	-	
Securities ⁽⁹⁾	-	-	-	-	-	-	-	-	-	398	413	
Credit granted to the public ⁽¹¹⁾	*-	*-	17	64	-	-	31	41	244	300	258	670
Allowance for credit loss ⁽¹¹⁾	-	-	-	-	-	-	(6)	(6)	(12)	(12)	-	-
Credit granted to the public, net ⁽¹¹⁾	-	-	17	64	-	-	25	35	232	288	258	670
Investments in affiliated companies ⁽⁹⁾	-	-	-	-	-	-	-	-	1,684	1,684	-	-
Other assets	-	-	-	1	-	-	-	-	23	62	-	-
Liabilities:												
Deposits from the public	1	7	8	139	-	-	-	2	**550	**1,638	168	564
Deposits from banks	-	-	-	-	-	-	-	-	200	595	-	-
Subordinated capital notes	-	-	-	-	-	-	-	-	16	17	-	-
Other liabilities	-	-	-	-	-	-	-	-	31	31	-	-
Shares (included in shareholders' equity)	2,923	2,923	-	-	-	-	-	-	-	-	-	-
Credit risk in sheet financial off-balance- instruments ⁽¹⁰⁾	3	3	4	21	0	0	-	1	1,003	1,063	46	87

* In addition, a controlling shareholder gave a personal guarantee in the amount of NIS 10 million for credit received by a third party .

** Reclassified.

For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)**B. Summarized results of transactions with related and interested parties**

For the year ended December 31, 2011						
	Interested parties ⁽¹⁾				Related parties held by the Bank ⁽¹⁾	
	Controlling Shareholders ⁽²⁾	Others Shareholders ⁽³⁾	Directors and president ⁽⁴⁾	Others ⁽⁵⁾	Affiliated companies	Others ⁽⁶⁾
in NIS millions						
Income from financing activities before credit loss expenses* ⁽¹¹⁾	-	1	-	-	12	7
credit loss expenses	-	-	-	-	(1)	1
Non-financing income	-	-	-	-	14	1
Non-financing expenses**	-	-	(16)	-	(30)	-
Total	-	1	(16)	-	(5)	9

For the year ended December 31, 2010						
	Interested parties ⁽¹⁾				Related parties held by the Bank ⁽¹⁾	
	Controlling Shareholders ⁽²⁾	Others Shareholders ⁽³⁾	Directors and president ⁽⁴⁾	Others ⁽⁵⁾	Affiliated companies	Others ⁽⁶⁾
in NIS millions						
Income from financing activities before credit loss expenses* ⁽¹¹⁾	-	3	-	2	*** (40)	12
credit loss expenses	-	-	-	(6)	(12)	
Non-financing income	-	-	-	-	14	17
Non-financing expenses**	-	-	(20)	(3)	(23)	-
Total	-	3	(20)	(7)	(61)	29

* See Note D.

** See Note C.

*** Reclassified.

C. Benefits from the Bank and consolidated subsidiaries to interested parties*

	For the year ended December 31, 2011		For the year ended December 31, 2010	
	Directors and President & CEO ⁽⁴⁾		Directors and President & CEO ⁽⁴⁾	
	Total benefit	Number of benefit Recipients	Total benefit	Number of benefit Recipients
in NIS millions				
Interested parties employed by the Bank or on its behalf	8	2	12	2
Directors who are not employed by the Bank or on its behalf	6	*15	6	*18
Total	14	17	18	20

* Including one and five Directors who retired during 2011 and 2010 respectively.

For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

D. Results of financing transactions (before credit loss expenses) of the Bank and its consolidated subsidiaries with related and interested parties*

	Consolidated		Of which from Affiliated Companies			
	2011	2010	2009	2011	2010	2009
	in NIS millions					
A. On assets						
Credit granted to the public	23	15	116	9	3	105
Deposits with Banks	-	-	1	-	-	1
Total	23	15	117	9	3	106
B. On liabilities						
Deposits from the public	(74)	** (14)	** (17)	(68)	** (18)	** (19)
Deposits from the banks	-	(21)	(6)	-	(21)	(6)
Subordinated capital notes	-	(1)	(2)	-	(1)	(2)
Other liabilities	-	-	-	-	-	-
Total	(74)	(36)	(25)	(68)	(40)	(27)
C. On Derivative Financial Instrument						
Financing income (expenses) from other transactions	65	(4)	32	65	(4)	32
Total	65	(4)	32	65	(4)	32
D. Other						
Other financing income	6	2	9	6	1	6
Other financing expenses	-	-	(1)	-	-	-
Total	6	2	8	6	1	6
Total income (expenses) from financing activities before credit loss expenses⁽¹¹⁾	20	(23)	132	12	(40)	117

* 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.

** Reclassified.

Footnotes: (relating to Note 22 A,B & C):

- (1) Interested party - as defined by Securities Regulations.
Related party - as defined in Opinion 29 of the Institute of Certified Public Accountants in Israel, but is not an interested party.
- (2) Controlling shareholder – as defined in the Securities Law.
- (3) Whoever holds 5% or more of the issued share capital of the banking corporation or of the voting rights therein, whoever is entitled to appoint one or more of the directors of the corporation or its general manager.
- (4) Including spouses and their infant children.
- (5) A corporation in which a Interested party hold 25% or more of its issued share capital or of the voting rights therein, or is entitled to appoint 25% or more of the members of its board of directors
- (6) A corporation in which a banking corporation holds 10% or more of its issued share capital or of the voting rights therein, or is entitled to appoint 10% or more of the members of its board of directors or is entitled to appoint its president & CEO, an
- (7) The balance at balance sheet date.
- (8) The highest balance during the year on the basis of month-end balances.
- (9) Details of these items are included also in the following notes:
Securities - Note 3.
Investments in Investee Companies - Note 6
Guarantees - Note 19A.
- (10) Credit risks relating to off-balance sheet financial instruments, as computed for the purpose of the limitations on indebtedness of a borrower.
- (11) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

- E.** As from October 31, 1993, through January 31, 2006 the State of Israel held a majority of the Bank's shares (on December 31, 2005, it held 57.09% of the shares). On December 31, 2009, the state owned 25% of the shares. During the course of 2010, the State sold its holdings of the Bank and as from October 29, 2010, the State does not hold any shares in the Bank. The Supervisor of Banks has exempted the Bank from defining the State as "a related party" in the Bank, and accordingly balances and transactions with the State and companies under its control are not given.
- F.** On January 31, 2006, the transaction signed on February 1, 2005 entered into by M.I. Holdings Ltd. and the Government of Israel (hereinafter: "the Government") on the one hand, and a corporation controlled by the Bronfman Family and others and a corporation controlled by Mr. Rubin Schron (hereinafter together: "the Buyers") on the other hand, for the sale of a controlling interest in the Bank (hereinafter: "the Agreement for the sale of a controlling interest in the Bank"), was completed, whereby:
- The Buyers acquired 26% of the Bank's issued share capital;
 - The Buyers were granted an option for a period of three years from date of the transaction, to acquire further shares comprising up to an additional 25% of the Bank's issued share capital. The option expired at the end of 2008 without being exercised;
 - Arrangements have been made between the Government and the Buyers as to the coordination of their voting and of their exercise of control of the Bank. (these arrangements were terminated with the sale of the balance of the Bank's shares held by the State).

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.

G. 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(e)(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, recreation 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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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.

From February 2010 (during eight months), the Bank paid the Chairman of the Board advance payments of NIS 50 thousand per month for his monthly wages. These advance payments were offset against the monthly wages that were paid to the Chairman in respect of the said 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(e)(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 bore 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, recreation 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 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 entitled 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).

H. 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 at their discretion on an annual award to be granted to the Chairman in respect of 2010 in accordance with criteria to be formed, on condition that the annual award in respect of this year shall not exceed NIS 2.4 million (gross). The decision on the payment of an annual award in respect of 2010, if taken, shall be subject to installment payments as detailed hereunder. No decision regarding this matter has in fact been made.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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.

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 readjustment 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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 (provisions 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.

(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 will be paid no later than April 27, 2012 (the payment to the Chairman of the Board – subject to approval of the General Meeting of Shareholders), 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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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 is brought for approval of the Board of Directors on March 28, 2012, and will be brought for approval of the General Meeting of the Shareholders.

I. Remuneration plan for the Former President & CEO and the Former Chairman of the Board

On January 30, 2007, the Bank's audit committee approved a comprehensive remuneration plan for the President & CEO who retired from office on December 31, 2010 (hereinafter: "the former President & CEO") and to the Chairman of the Board of Directors who retired from office on January 1, 2010 (hereinafter: "the former Chairman").

The remuneration plan was formulated for a period of five years (as from February 2006) and 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.

Employment agreement with the Bank's former President & CEO. 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 & CEO (replacing the previous employment agreement with him), for a period of five years, as from February 1, 2006.

The agreement stipulated indemnification to which the former President & CEO has been entitled in the event that the Bank would have terminated his service prior to the end of the defined period of the agreement or in the event of material impairment of his authority, to an amount equivalent to payment of his full salary, including benefits and provisions, as detailed in the employment agreement, for the remainder of the period until the determining date. In addition, the President & CEO was entitled to a proportionate share of the annual bonus for the year in which the employment agreement was terminated.

The former President & CEO have 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 & CEO will also be entitled to a special assiduity bonus for his period of work in the Bank (taking into account his previous years of work), subject to completion of five continuous years of service in the position as from February 1, 2006 until the determining date. The bonus will be equivalent to 12 months' salary (without social benefits or other supplementary benefits therein).

The extent of the former President & CEO's 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 & CEO 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 & CEO was entitled to paid vacation, sick leave, recreation 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 employment agreement determined that the Bank will grant the President & CEO, annually from 2006 until 2010, a special bonus as detailed hereunder.

The agreement also included provisions regarding responsibilities levied on the former President & CEO, being among others: provisions regarding a cooling off period of three months and maintenance of confidentiality.

Employment agreement with the Bank's former Chairman of the Board of Directors. On July 18, 2007 the Board of Directors decided, after receiving the Bank's Audit Committee's, approval, to approve the personal employment agreement between the Bank and the former Chairman of the Bank's Board of Directors, which is similar in principle to the personal employment agreement of the former President & CEO, except for several matters, including, among other things, the following matter:

according to the engagement agreement, the former Chairman was entitled, under certain circumstances, to agreed compensation in an amount equal to his full salary including benefits and provisions, in respect of the remaining period until the determining date, or, under other circumstances, to an award in an amount equal to twelve months of salary, though, in any event, he was not entitled to double compensation, as stated.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

The agreement for the engagement of the former Chairman of the Board was approved by a Special General meeting of shareholders held on August 26, 2007.

The employment agreement of the former President & CEO and the former Chairman of the Board of Directors stipulates that the Bank will grant each of them, annually as from 2006 until 2010, a special bonus that will not exceed twice their annual salary (hereinafter: "the maximum annual bonus"). The annual bonus will only be granted in respect of a year in which the Bank's financial statements record a net income.

The annual bonus was calculated according to five indices as detailed in the agreement, wherein the maximum annual bonus for each index constituted 25% of the maximum annual bonus. The annual bonus for each of the indices has been determined according to the operating results in the relevant period, in such a way that a minimum goal, target goal and maximum goal were fixed regarding each index. Fulfillment of the minimum goal entitled the officer to 20% of the maximum annual bonus for the relevant index, fulfillment of the target goal entitled the officer to 50% of the maximum annual bonus for the relevant index and fulfillment of the maximum goal entitled the officer to the maximum annual bonus for the relevant index.

Following are the indices for purposes of determining the annual bonus: increase in the Bank's market share; increase in the Bank's scope of activity; increase in the rate of coverage of expenses; decrease in margin in respect of the Bank's return on equity compared to average return on equity of other banks; attaining return on equity goals.

The former President & CEO did not attain in 2010 the determined indices; therefore he was not entitled to an award in respect of this year. In 2009 the former President & CEO and the former Chairman of the Board received, in accordance with the terms of the agreement, a bonus in the amount of NIS 3.85 million each.

J. "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").

Pursuant to the agreement, IDB New York is to sublease the area to the Company in consideration for a monthly rental fee of US\$45.19 per one square foot which is the fee paid by the former tenant of the area. The agreement states that the rental fees are to be paid on a monthly basis.

The resolutions passed on April 13, 2008 and on April 15, 2008, by the Audit Committee and by the Bank's Board of Directors, respectively, approved the amendments to the 2005 agreement, mainly relating to an increase of US\$3.25 per sq. foot in rental fees. The annual rental fees payable amounted to US\$324,000 reflecting US\$52.7 per sq. foot. In addition, as security for the tenant's obligations under the 2005 agreement, the controlling shareholder provided a personal unlimited guarantee in amount as well as a monetary deposit of US\$81,000.

The amendment of the 2005 agreement has been discussed and approved by the authorized organs of IDB New York, and was brought for approval of the Bank's authorized organs as a qualifying transaction.

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 has vacated the leased property and since May 2009 it is unoccupied, though the rental payments has been paid regularly.

The Lessee informed IDB New York that he has an alternative lessee interested in renting the property in accordance with the lease agreement. IDB New York may not object to the identity of the lessee unless on reasonable grounds.

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.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

- K.** On May 23, 2006, the Bank (which at a later date transferred its rights to Mercantile Discount Bank) entered into an agreement with a third party, who owns the commercial center in Upper Beitar, for the lease of an area of 250 sq. meters, intended for a new Bank branch. About a month following that date, the said third party sold the commercial center to a company in which Mr. Matthew Bronfman has a 35% equity interest. The monthly rental and management payments amount to US\$23 per sq. meter and the lease period is for five years with an option granted to the lessee to extend the lease period by two additional periods of five years each.
- L.** 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, 2011, amounted to NIS 7,342 million (as at December 31, 2010 - NIS 7,329 million).
- M.** The Bank and Mercantile Discount Bank have commitments towards the Tel-Aviv Stock Exchange and towards the "Ma'of" clearing house as mentioned in Note 19 C 3 and Note 19 C 4.
- N.** Investee companies of the Bank are included in the framework of the undertaking granted by the Bank to VISA Europe (as stated in Note 19 C 9).
- O.** As to indemnification for interested and related parties and for details as to arrangements for insurance, exemption and indemnification of Directors at the Bank or persons appointed 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 7, items L and M.
- P.** 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.

- Q.** On July 6, 2008, the Board of Directors, following approval of the Audit Committee, approved the payment of annual remuneration and remuneration for participation in meetings to outside Directors and to other present and future Directors 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 outside Director), 2000, as amended in the Companies Regulations (Amendment) (Rules for remuneration and expenses to an outside 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.
- R.** 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

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

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).

23. INCOME FROM FINANCING ACTIVITIES BEFORE CREDIT LOSS EXPENSES

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
A. On Assets⁽³⁾						
Credit granted to the Public ⁽⁴⁾	8,860	3,042	6,105	4,822	1,486	3,474
Credit granted to the Governments	42	36	19	40	37	18
Deposits with the Bank of Israel and cash	610	123	201	488	121	57
Deposits with Banks	522	(197)	521	1,129	499	1,150
Securities borrowed or purchased under buy-back agreements	6	4	2	6	4	2
Bonds ⁽¹⁾	2,652	34	1,160	646	338	550
Other assets	(6)	19	24	(7)	18	24
Total	12,686	3,061	8,032	7,124	2,503	5,275
B. On Liabilities⁽³⁾						
Deposits from the public	(6,413)	2,486	(2,537)	(4,295)	1,000	(2,256)
Deposits from the Government	(47)	(48)	(4)	(1)	(1)	(1)
Deposits from banks	(320)	122	(70)	(220)	100	(6)
Securities borrowed or purchased under resale agreements	(691)	185	(179)	-	-	(3)
Subordinated capital notes	(905)	(838)	(885)	(314)	(304)	(354)
Total	(8,376)	1,907	(3,675)	(4,830)	795	(2,620)
C. In Respect of Derivative Financial Instruments and Hedging Activities						
Net expenses in respect of ALM derivative instruments ⁽⁵⁾	(115)	*(787)	*(365)	(80)	*(707)	*(372)
Net income (expenses) in respect of other derivative instruments	(4)	1	53	(3)	(2)	7
Total	(119)	(786)	(312)	(83)	(709)	(365)
D. Other						
Commissions on financing activities	181	177	171	117	107	106
Other financing income ⁽²⁾	498	*481	*562	279	*364	*379
Other financing expenses	(85)	(10)	(21)	(70)	(4)	(29)
Total	594	648	712	326	467	456
Total income from financing activities before credit loss expenses	4,785	4,830	4,757	2,537	3,056	2,746
Of which: Net exchange differences	(33)	302	45	(286)	484	33

* Reclassified, see Note 1 B (4).

Footnotes:

(1) See Note 23 E.

(2) Including interest income on problematic debts in 2010: consolidated - NIS millions 104, bank - NIS millions 73 (2009: consolidated - NIS millions 95, bank - NIS millions 48)

(3) Including the effective component of hedging relations.

(4) As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

(5) Derivative instruments comprising a part of the asset and liability management system of the Bank, which were not designed for hedging relationships.

23. INCOME FROM FINANCING ACTIVITIES BEFORE CREDIT LOSS EXPENSES (CONTINUED)

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
E. Results of Activity in Investments in Bonds⁽¹⁾						
Accrual basis, financing income (expenses) from bonds:						
Held-to-maturity	547	27	71	116	89	-
Available for-sale	1,968	(66)	931	458	179	404
Trading	137	73	158	72	70	146
Total included in income on assets from financing activities	2,652	34	1,160	646	338	550
Net gains on sale of held-to-maturity bonds, including provision for decline in value	4	(42)	-	-	-	-
Gains on sale of available-for-sale bonds	153	272	393	94	182	251
Losses on sale of available-for-sale bonds	(11)	(1)	(5)	(4)	(1)	(5)
Provision for decline in value of available-for-sale bonds	(12)	(8)	(119)	(3)	(3)	(10)
Net realized and unrealized gains from adjustment of trading bonds to fair value ⁽²⁾	19	1	13	23	1	34
Total included in other financing income	153	222	282	110	179	270
Total from investments in bonds	2,805	256	1,442	756	517	820
F. Details of the Net Effect of Derivative Instruments Hedging Earnings From Financing Operations						
Financing expenses in respect of assets (item A)	(23)	-	(19)	22	-	(19)
Footnotes:						
(1) Financing income generated by mortgage backed securities (MBS) - in US \$ millions	85	105	113	-	-	-
Financing income (expenses) generated by mortgage backed securities (MBS) - in NIS millions	1,147	(345)	140	-	-	-
(2) Of which, a part of the gains and losses relating to trading bonds that are still on hand at balance sheet date - in NIS millions	(9)	(37)	79	(4)	(39)	76

24. OPERATING COMMISSIONS

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
Ledger fees	617	633	655	387	399	414
Credit cards	922	914	1,010	99	104	106
Operations in securities and in certain derivative instruments	301	338	339	210	231	249
Commissions on the distribution of financial products	102	*99	*74	77	72	50
Management, operational and trusteeship services for institutional bodies	32	35	49	-	-	16
Handling credit	258	254	221	147	142	125
Conversion differences	112	119	135	85	92	106
Foreign trade services	57	58	57	47	46	46
Net income from credit portfolio services	16	19	20	4	5	5
Other commissions	72	*78	*73	58	59	65
Total operating fees	2,489	2,547	2,633	1,114	1,150	1,182

* Reclassified, see Note 1 B (4).

25. NET GAINS (LOSSES) FROM INVESTMENT IN SHARES

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
Gains on sale of shares available-for-sale	112	*53	*190	-	6	136
Losses and provision for decline in value of available-for-sale shares	(20)	(33)	(36)	-	(26)	(19)
Net realized and unrealized gains (losses) from adjustment of trading securities to fair value ⁽¹⁾	(1)	8	5	(1)	9	(1)
Dividends from available-for-sale or trading shares	1	*3	*38	1	1	27
Total from investments in shares	92	31	197	-	(10)	143

* Reclassified, see Note 1 B (4).

Footnote:

(1) Of which part of the income (loss) related to trading shares that are still on hand at balance sheet date: consolidated: NIS (0.4) million, Bank: NIS (0.4) million, (2010-consolidated: NIS 7 million, Bank: NIS 7 million, 2009-consolidated: NIS (1) million, Bank: NIS (1) million).

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, that was recorded in the "Gains" from investments in shares, net" item.
- B. **Realization of non-financial assets.** During 2011, 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 99 million (2010 – NIS 27 million; 2009 – NIS 19 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 (2009 - NIS 19 million).
- D. During 2009, the Bank realized the balance of the "Bezeq" shares, which served as collateral that a certain borrower received from a consortium of banks. The share of the Bank and of Mercantile Discount Bank ("MDB").in the proceeds of the realization of these shares, net of fees and expenses

25. NET GAINS (LOSSES) FROM INVESTMENT IN SHARES (CONTINUED)

of the Receiver, amounted to NIS 439 million (the Bank: NIS 314 million). The Bank and MDB recorded in this respect, in these financial statements, gains before tax in the amount of NIS 121 million (the Bank: NIS 87 million).

For details regarding a lawsuit filed against the Bank, MDB and additional banks, See Note 19 C hereunder, Section 11.8.

- E. During 2009, dividends in respect of "Bezeq" shares in the amount of NIS 38 million (consolidated) and NIS 27 million (the Bank) were received;
- F. During 2009, the Bank realized the balance of the "HOT" shares, which had been received as part of a creditors' arrangement with a certain borrower, for a total consideration of NIS 55 million, and recorded gains in the amount of NIS 22 million.
- G. During 2009, the Bank sold shares in "Harel" for a total consideration of NIS 190 million. In respect of the said realization the Bank recorded gains before tax in the amount of NIS 25 million.

26. OTHER INCOME

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
In NIS millions						
Management fees from consolidated subsidiaries	-	-	-	4	4	4
Profit from severance pay funds	34	⁽¹⁾ 63	⁽¹⁾ 257	34	59	229
Other income	75	19	1	124	65	52
Total other income	109	82	258	162	128	285

Footnote:

- (1) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

Additional details:

An agreement has been signed in the reviewed period 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, most of it reflected in the item "Other operating income".

27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
in NIS millions						
Salaries	2,317	2,169	2,135	1,459	1,349	1,338
Expense resulting from share based payment transactions ^{(1)*}	(4)	7	2	(4)	7	2
Severance pay, pension, further education fund, seniority bonuses, vacation and medical insurance ⁽³⁾	505	**417	422	323	**279	259
National Insurance and payroll taxes	469	451	434	339	327	316
Other related expenses	124	116	102	55	59	62
Adjustment of reserves for salary-related expenses due to changes in salaries during the year ⁽³⁾	26	**51	29	-	**26	27
Voluntary retirement program expenses ⁽²⁾	22	7	6	-	7	6
Total salaries and related expenses	3,459	3,218	3,130	2,172	2,054	2,010
Includes: Overseas salaries and related expenses	456	408	445	16	17	18
Of which an expense resulting from transactions treated as share based payment transactions settled by capital instruments.	-	-	2	-	-	2

** Reclassified, see Note 1 B (4).

Footnotes:

- (1) See Note 13 E.
- (2) Including payroll tax.
- (3) Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

28. OTHER EXPENSES

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	In NIS millions					
Advertising	198	219	169	51	90	59
Communications	125	128	132	60	67	69
Computer services	142	130	149	90	97	101
Office expenses	36	32	31	19	16	15
Insurance	66	63	82	9	11	14
Professional services	166	172	154	71	71	55
Directors' fees	17	15	14	6	6	5
Instruction and training	32	26	15	10	12	10
Fees	61	52	*55	29	23	24
Other	360	*407	*427	91	124	117
Total other expenses	1,203	1,244	1,228	436	517	469

* Reclassified, see Note 1 B (4).

29. PROVISIONS FOR TAXES ON OPERATING INCOME

A. Composition

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
Taxes for current year	240	534	420	-	188	133
Taxes for previous years	(51)	13	26	(55)	-	5
Total current taxes	189	547	446	(55)	188	138
Addition (deduction):						
Deferred taxes for current year	(116)	*(84)	*150	(95)	*(14)	*95
Deferred taxes for previous years	14	(5)	(42)	14	-	(33)
Total deferred taxes	(102)	(89)	108	(81)	(14)	62
Total provision for taxes (tax saving) on operating profit	87	458	554	(136)	174	200
Includes taxes (tax saving) of foreign subsidiaries	15	77	99	(30)	(12)	4

*Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

29. PROVISIONS FOR TAXES ON OPERATING INCOME (CONTINUED)**B. Reconciliation between the theoretical tax which would apply had the operating income been taxed at the statutory tax rate applying to the Bank of Israel, to the provision of taxes on operating income as charged in the statement of income:**

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
Statutory tax rate on banks in Israel	34.48%	35.34%	36.21%	34.48%	35.34%	36.21%
	in NIS millions					
Income tax at the statutory tax rate	296	*357	*509	(71)	*144	*180
Income tax (tax savings) on:						
Income of foreign subsidiaries	(87)	62	14	-	-	-
General and supplemental provision for doubtful debts	-	6	2	-	6	3
Income exempt from tax or taxed at preferred rates	5	11	(3)	8	11	-
Adjustment differences on depreciation and capital gains	2	1	22	2	1	25
The effect of payroll tax saving in respect of current losses.	25	-	-	25	-	-
Other non-deductible expenses	35	34	45	24	9	16
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	(18)	(8)	(44)	(3)	(1)	(41)
Change in the balance of deferred taxes resulting from the change in tax rates	(106)	*4	*56	(81)	*4	*45
Taxes for prior years	(37)	8	(16)	(41)	-	(28)
Income of Israeli subsidiaries	(28)	(17)	(31)	1	-	-
Provision for taxes (tax saving) on income	87	458	554	(136)	174	200

*Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

- C. (1) Final tax assessments have been issued to the Bank for the tax years up to and including 2007. Final withholding tax assessments have been issued to the Bank for the years up to and including 2007. 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.
- (2) In December 2011, a tax assessment notice based on best judgment was issued to the Bank for the 2008 tax year. The assessment included a demand for tax payments, including interest and CPI linkage payments, amounting to NIS 30 million. The Bank believes that the said assessment has no material effect on the Bank's business results, as the tax liability effects timing differences.
- (3) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2005 to 2008.
- D. The consolidated balance as of December 31, 2011, of the carry forward tax losses, deductibles and timing differences amounted to NIS 298 million (December 31, 2010: NIS 196 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. Changes in the rate of "Payroll tax" and "Profit Tax"
- (1) A Value Added Tax Order (Tax rate applying to non-profit organizations and financial institutions) (Provisional directive), 2009, was published on July 1, 2009. Accordingly, in the period from July 1, 2009 and December 31, 2010, the rate of wage tax and profit tax applying to financial institutions will be 16.5% instead of 15.5% (hereinafter: "the Amendment"). According to the Amendment, the new rate of profit tax will apply to one half of the earnings for 2009. Therefore, the average rate of profit tax for 2009 has been 16%.

29. PROVISIONS FOR TAXES ON OPERATING INCOME (CONTINUED)

- (2) On December 31, 2009, a Value Added Tax Order (tax rate applying to non-profit organizations and financial institutions) (Provisional order) (Amendment), 2009, was officially published, according to which, in the period from January 1, 2011 to December 31, 2010, the rate of wage tax and profit tax applying to financial institutions will be 16% instead of 16.5%.
- (3) On February 24, 2011, a Value Added Tax Order (tax rate applying to non-profit organizations and financial institutions) (Provisional order) (Amendment), 2010, was officially published, according to which, in the period from January 1, 2011 to December 31, 2012, the rate of wage tax and profit tax applying to financial institutions will be 16% instead of 15.5%.

The effect of the said amendments on the Bank's profits is not significant.

- G. **Amendments to the Income Tax Ordinance.** On July 14, 2009, the Knesset passed the Economic Efficiency Act (Legislation amendments for the implementation of the economic program for the years 2009 and 2010), 2009, which stipulated, among other things, an additional gradual reduction in the corporate tax rates down to 18% as from the 2016 tax year and thereafter. The said change reduced the deferred tax balance alongside recording of a one-off tax expense of NIS 32 million in 2009.
- H. Following the said amendments to items F-G above, the statutory tax rate applying to banking corporations stood at 36.21% in 2009, 35.34% in 2010 and 34.48% in 2011. The statutory tax rates applying to banking corporations will be as follows: in the 2011 tax year - 34.48%, in the 2012 tax year - 33.62%, in the 2013 tax year - 32.47%, in the 2014 tax year - 31.60%, in the 2015 tax year - 30.74% and in the 2016 tax year and thereafter - 29.00%.

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, adopted by the Government according to a decision of October 30, 2011. 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%. Following the said amendment, the statutory tax rate applying to financial institutions in 2011 is 34.48%. The statutory tax rate applying to financial institutions in 2012 will be 35.34%, and in 2013 and thereafter - 35.06%.

Current taxes for the periods reported in these financial statements are 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 anticipated on the reversal dates. The effect of the change in the tax rate on the financial statements as of December 31, 2011, is 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 legislation amendments are expected to increase, as from 2012 and thereafter, the current tax payments (corporate tax, profit tax and payroll tax) of the Bank and its subsidiaries in Israel.

- I. Presented below is the adjusted amount of non-monetary assets, the depreciation of which will not be recognized as a deductible expense or as part of the cost when sold, and which is deemed a permanent difference in respect of which no deferred taxes are recorded:

	Consolidated		The Bank	
	December 31			
	2011	2010	2011	2010
	in NIS millions			
Balance at beginning of year	48	59	40	51
Non-deductible amount for the current year	(7)	(11)	(4)	(11)
Balance at end of year	41	48	36	40

29. PROVISIONS FOR TAXES ON OPERATING INCOME (CONTINUED)

J. YEAR AND 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	
	2011	2010	2011	2010	2011	2010	2011	2010
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	713	141	35.1	31.6	-	-	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	399	*311	35.1	29.3	-	-	-	-
On excess of provision of severance pay	112	*80	34.7	28.9	-	-	-	-
On income tax carry-forward deductions	91	40	25.0	31.9	-	-	-	-
On foreign operations	287	221	34.5	35.3	-	-	-	-
On securities	-	14	-	33.6	5	-	33.0	-
On adjustment of depreciable non-monetary assets	-	-	-	-	183	154	33.6	28.7
On other monetary assets	49	46	30.3	26.0	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	62	67	31.6	34.5
Total, net	1,651	853	34.0	31.2	250	221	33.2	29.8

*Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

29. PROVISIONS FOR TAXES ON OPERATING INCOME (CONTINUED)

J. YEAR AND 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	
	2011	2010	2011	2010	2011	2010	2011	2010
	in NIS millions		in percentage		in NIS millions		in percentage	
On specific provision for doubtful debts	534	99	35.1	31.4	-	-	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	339	*265	35.1	29.0	-	-	-	-
On excess of provision of severance pay	72	*64	35.1	29.0	-	-	-	-
On income tax carry-forward deductions	91	34	25.0	34.5	-	-	-	-
On foreign operations	-	8	-	35.3	-	-	-	-
On securities	-	20	-	34.5	2	-	35.1	-
On adjustment of depreciable non-monetary assets	-	-	-	-	158	135	33.9	28.8
On other monetary assets	23	22	35.1	29.0	-	-	-	-
Reserve for tax on income of Investee companies	-	-	-	-	62	67	31.6	34.5
Total, net	1,059	512	33.9	30.2	222	202	33.4	30.0

*Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

	Consolidated		The Bank	
	December 31			
	2011	2010	2011	2010
	in NIS millions			
Deferred taxes are included:				
In "Other assets" (Note 8)	1,417	*646	852	*324
In "Other liabilities" (Note 12)	(16)	(14)	(15)	(14)
Total, net	1,401	632	837	310

*Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

30. NET INCOME ON EXTRAORDINARY ITEMS, AFTER TAXES:

	Consolidated			The Bank		
	2011	2010	2009	2011	2010	2009
	in NIS millions					
Capital income on sale of buildings and equipment, see (C)	35	3	1	-	3	1
Capital loss on sale of buildings and equipment	-	-	(1)	-	-	(1)
Reversal of provision (provision) for impairment in value of buildings ⁽¹⁾	6	-	(1)	6	-	(1)
Income (loss) on sale of shares of previously consolidated subsidiary	(4)	48	(17)	-	-	-
Gain of sale of the basket certificate operation, see (a)	48	-	-	-	-	-
Gain on sale of further education funds activities, see (B)	-	6	-	-	-	-
Income before taxes	85	57	(18)	6	3	(1)
Provision for taxes on profit from extraordinary items:						
Current taxes	(25)	(1)	(2)	-	(1)	(1)
Deferred taxes	(2)	(20)	-	-	-	-
Total provision for taxes	(27)	(21)	(2)	-	(1)	(1)
Income (loss) after taxes	58	36	(20)	6	2	(2)
Bank's share in income (loss) on extraordinary items after taxes of investee (in consolidated-affiliated) companies	3	-	-	55	34	(18)
Income (loss) on extraordinary items, after taxes, attributed to bank's shareholders	61	36	(20)	61	36	(20)

Footnote:

(1) According to the estimated recoverable value amount of the buildings.

Additional details:

- (a) For details regarding the sale of the basket certificates operation, in respect of which a net gain of NIS 29 million was recognized in 2011, see Note 19 C 20 above.
- (b) **Sale of the mutual funds management operations of MDB.** On September 21, 2010, an agreement was signed for the sale of the mutual funds management operations of MDB in consideration for NIS 6.5 million. The transaction was consummated on October 17, 2010. The net gain derived from this transaction amounted to NIS 5 million.
- (c) **Sale of properties owned by MDB.** On October 31, 2010, and on November 7, 2010, MDB and a subsidiary of which signed agreements for the sale of properties owned by them for a total consideration of NIS 37.2 million. Possession of the properties was passed to the purchasers at the end of April 2011, subject to the fulfillment of conditions precedent specified in the agreements. In respect of this sale, MDB recorded in the financial statements a net gain of NIS 23 million, as income from extraordinary operations.

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

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

banking product. The said file also clarified that the data for the international operations segment is to be presented similarly to the segment data presentation of the operations of the Group in Israel.

The operations of the Group are divided into six principal segments, as detailed hereunder. The segments also include, as aforementioned, the relevant part relating to banking products (credit cards, capital market activity, mortgage loans and construction and real estate).

It should be noted that these segments of operation do not accord with the organizational structure, mainly due to the fact that certain operations are reflected in the various segments, such as credit card activities and the capital market activity, and not within the organizational framework in which they are being operated.

- **Retail Banking - Household Segment:** This segment includes customers of the Bank's and Mercantile Discount Bank's ("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 US\$1 million and over, as well as foreign resident customers with financial wealth held at the Bank of US\$0.5 million and above. The segment also includes customers of 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.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

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.

Operational income. The operational and other income, which the bank collects from customers, are reflected directly in the segment in which the activity of the customer is reflected. Some of the income derived from foreign currency operations with customers is credited to the trading desk.

2) Expenses

Identifiable direct expenses are specifically and directly reflected in the related segments.

Overhead expenses (mainly head office expenses), which cannot be related to a specific segment, are charged to the segments using an estimate based on various charging formulas, most of them based on volume of operation indices and some of them based on estimates and assessments of the 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 34.48% (2010: 35.3%).

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.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

According to the system described above, each customer "bears" its own relevant expenses, which are accumulated in the various segments according to the affiliation of customers to these segments.

The format described above does not allow the determination as to what expenses of one segment were charged to another segment (referred to in the reporting format as "inter-segment activity"). The Supervisor of Banks permitted the Bank to report on the basis of the mechanism it developed for the purpose of allocating income and expenses, and in consequence thereof not to report inter-segment transfers.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments

For the year ended December 31, 2011								
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management Non-Financial Companies	Other	Total Consolidated
in NIS millions								
Income from financing activities before credit loss expenses*								
- From external sources	(1,850)	699	2,465	1,338	529	3	1,601	4,785
- Intersegmental	3,415	119	(1,407)	(632)	(186)	-	(1,309)	-
Total Income from financing activities	1,565	818	1,058	706	343	3	292	4,785
- Operating and other income From external sources	1,502	427	339	189	255	79	(101)	2,690
Total income	3,067	1,245	1,397	895	598	82	191	7,475
Credit loss expenses*	146	113	281	165	37	-	36	778
Operating and other expenses	2,534	863	573	509	559	6	794	5,838
Operating Income (loss) before taxes	387	269	543	221	2	76	(639)	859
Provision for taxes (tax savings) on operating income	112	86	182	73	3	5	(374)	87
Operating Income (loss) before taxes	275	183	361	148	(1)	71	(265)	772
Bank's share in operating income of affiliated companies	3	-	-	-	-	-	100	103
Net income from ordinary operations								
Attributed to the non-controlling rights holders	(66)	(6)	(9)	(3)	-	-	-	(84)
Income from extraordinary operations, net of taxes	12	8	-	3	8	(4)	34	61
Net Income (loss) Attributed to the shareholders of the banking corporation	224	185	352	148	7	67	(131)	852
Return on equity (percentage)	9.3	18.3	9.8	8.4	1.7	76.4	(11.8)	8.2
Average Assets	36,975	13,481	43,251	19,439	6,466	718	71,564	191,894
Of which - Investment in Investee companies	10	(2)	-	-	-	28	1,509	1,545
Average Liabilities	63,869	13,850	25,511	8,044	36,101	721	33,002	181,098
Average Risk-assets	32,086	13,480	47,710	23,501	5,255	1,164	16,794	139,990
Average assets of provident and mutual funds	-	-	-	-	-	-	2,295	2,295
Average customers' securities	34,235	8,487	85,998	10,546	25,542	-	-	164,808
Average other assets under management	3,690	364	412	1,248	2,249	-	-	7,963
Margin from credits activity	860	648	827	581	117			
Margin from deposits activity	676	139	74	87	250			
other	29	31	157	38	(24)			
Income from financing activities before credit loss expenses*	1,565	818	1,058	706	343	3	292	4,785

*As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments (continued)

For the year ended December 31, 2010								
	Financial Management						Total	
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Non-Financial Companies	Other	Consolidated
in NIS millions								
Income (loss) from financing activities before credit loss expenses**								
- From external sources	1,759	1,777	760	764	(219)	(3)	(8)	4,830
- Intersegmental	(373)	(857)	265	(108)	554	(1)	520	-
Total Income (loss) from financing activities	1,386	920	1,025	656	335	(4)	512	4,830
- Operating and other income From external sources	1,570	*464	261	201	226	(7)	(55)	2,660
Total income (loss)	2,956	1,384	1,286	857	561	(11)	457	7,490
Credit loss expenses**	191	214	***222	182	***10	-	2	821
Operating and other expenses	*2,402	*907	*596	*526	*465	4	*759	5,659
Operating Income (loss) before taxes	363	263	468	149	86	(15)	(304)	1,010
Provision for taxes (tax savings) on operating income	*111	*93	*192	*36	39	(9)	*(4)	458
Operating Income (loss) before taxes	252	170	276	113	47	(6)	(300)	552
Bank's share in operating income of affiliated companies	3	-	-	-	-	4	179	186
Net income from ordinary operations Attributed to the non-controlling rights holders	(70)	-	-	-	-	-	-	(70)
Income from extraordinary operations, net of taxes	13	9	-	3	9	-	2	36
Net Income (loss) Attributed to the shareholders of the banking corporation	198	179	276	116	56	(2)	(119)	704
Return on equity (percentage)	*9.5	*16.9	7.3	*7.4	*17.2	(2.4)	*(10.4)	7.0
Average Assets	33,516	15,242	45,259	18,204	6,583	624	*66,756	186,184
Of which - Investment in Investee companies	9	(1)	-	-	-	23	*1,613	1,644
Average Liabilities	59,446	14,830	21,638	10,318	36,603	721	*32,468	176,024
Average Risk-assets	29,693	15,071	54,158	22,298	4,620	1,094	***15,349	142,283
Average assets of provident and mutual funds	27	10	230	16	187	-	2,292	2,762
Average customers' securities	33,360	9,186	*80,484	8,541	22,833	-	-	154,404
Average other assets under management	3,614	347	182	1,361	2,187	-	-	7,691
Margin from credits activity	858	741	872	533	116	-	-	-
Margin from deposits activity	483	110	71	77	227	-	-	-
other	45	69	82	46	(8)	-	-	-
Income (loss) from financing activities before credit loss expenses**	1,386	920	1,025	656	335	(4)	512	4,830

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

***Restated

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

C. Activity sectors in Discount Bank business segments (continued)

For the year ended December 31, 2009								
	Households	Small Businesses	Corporate Banking	Middle Market Banking	Private Banking	Financial Management Non-Financial Companies	Other	Total Consolidated
in NIS millions								
Income (loss) from financing activities before credit loss expenses**								
- From external sources	196	840	1,905	623	263	1	929	4,757
- Intersegmental	1,057	(22)	(808)	35	99	(3)	(358)	-
Total Income from financing activities	1,253	818	1,097	658	362	(2)	571	4,757
- Operating and other income From external sources	***1,626	***525	424	229	187	33	***64	3,088
Total income	2,879	1,343	1,521	887	549	31	635	7,845
Credit loss expenses**	249	191	293	219	15	-	31	998
Operating and other expenses	*2,226	*834	*696	*593	444	4	*644	5,441
Operating Income (loss) before taxes	404	318	532	75	90	27	(40)	1,406
Provision for taxes on operating income	*120	*110	*195	*38	*58	*6	*27	554
Operating Income (loss) before taxes	284	208	337	37	32	21	(67)	852
Bank's share in operating income of affiliated companies	1	-	-	-	-	(7)	164	158
Net income from ordinary operations Attributed to the non-controlling rights holders	(54)	(6)	(9)	(3)	-	-	-	(72)
Income from extraordinary operations, net of taxes	-	-	-	-	-	(18)	(2)	(20)
Net Income (loss) Attributed to the shareholders of the banking corporation	231	202	328	34	32	(4)	95	918
Return on equity (percentage)	*13.4	*26.3	*8.8	*2.5	*15.1	(9.0)	*8.3	10.2
Average Assets	31,023	14,581	48,352	19,349	6,478	749	*67,242	187,774
Of which - Investment in Investee companies	10	-	-	-	-	120	*1,560	1,690
Average Liabilities	64,200	14,206	24,652	10,479	37,730	745	*23,155	175,167
Average Risk-assets	26,524	11,785	57,162	21,328	3,277	749	*15,022	135,847
Average assets of provident and mutual funds	55	25	426	83	308	-	2,182	3,079
Average customers' securities	29,366	6,275	64,172	8,014	18,718	-	-	126,545
Average other assets under management	3,659	302	141	1,518	1,419	-	-	7,039
Margin from credits activity	763	669	938	555	115	-	-	-
Margin from deposits activity	444	83	79	62	259	-	-	-
other	46	66	80	41	(12)	-	-	-
Income from financing activities before credit loss expenses**	1,253	818	1,097	658	362	(2)	571	4,757

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

**As regards the absence of comparability between the data of the current period and that of prior periods, see Note 1 B (5) 1.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

D. Information on geographical areas

	Income ⁽¹⁾			Net Income			Assets	
	For the year end December 31						As at December 31	
	2011	2010	2009	2011	2010	2009	2011	2010
	in NIS millions							
Israel	6,485	*6,258	*6,601	941	*587	*813	162,315	*147,493
Europe	101	117	149	(194)	(33)	(14)	4,335	5,356
North America	728	951	957	84	127	109	31,992	29,622
South America	161	164	138	21	23	10	3,849	3,105
Total Overseas	990	1,232	1,244	(89)	117	105	40,176	38,083
Total Consolidated	7,475	7,490	7,845	852	704	918	202,491	185,814

(1) Income-earnings from financing operations before provision for doubtful debts and other operating income.

* Restated with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

32. EARNMARKED DEPOSITS, CREDIT AND DEPOSITS FROM EARNMARKED DEPOSITS

	Consolidated		The Bank	
	December 31		December 31	
	2011	2010	2011	2010
in NIS millions				
Credit and deposits from earmarked deposits				
Credit granted to the public	408	436	171	155
Total	408	436	171	155
Earmarked deposits				
Deposits from the public	2	2	2	1
Deposits from banks	190	215	-	-
Deposits from the Government	196	180	172	154
Total	388	397	174	155

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 Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together - "the Purchasers") shares comprising 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter - "Diners"). Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The transaction was consummated on December 18, 2006.

Within the framework of the agreement, ICC received preference "A" shares that entitle it to receive that part of the profits of Diners attributed to the operations that are not related to the activity of YOU Club, and this until such time that YOU Club reaches a level of operations determined in the agreement. At this stage, the "YOU Club" activity has not reached the level specified in the agreement.

The consideration for the shares has been financed by a loan granted to the Purchasers by ICC. The shares sold are to serve as collateral for the loan, which is to be repaid at different dates over a number of years, during which the Purchasers are entitled to decide on returning the shares to ICC instead of repayment of the loan, and ICC on its part is entitled to demand the return of the shares, all in accordance with the terms stated in the agreement for the sale of the shares and therefore the sale was not recognized in the financial statements.

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

33. CREDIT CARD ACTIVITY (CONTINUED)

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). Upon the agreement becoming effective, an amount of NIS 14 million was credited to the non-controlling rights holders in consolidated subsidiaries, in addition to NIS 20 million credited to the equity.

B. Arrangements between the credit card companies and between such companies and the banks

1) Arrangements between credit card companies. At the beginning of September 2001, ICC, The First International Bank ("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. The Tribunal proceedings in the case have been divided in two, firstly, determination of the proper methodology for determining the issuer commission, and only afterwards the Tribunal will be required to its implementation.

On August 31, 2006, the Antitrust Tribunal handed down a ruling regarding the methodology for the determination of the Cross Clearing Commission (hereinafter: "the methodology decision"), while adopting the principal points of the Commissioner's position on the matter. Within the framework of the methodology decision, it has been determined, among other things, that the proper methodology for the computation of the issuer commission is made-up of the cost of approving the transaction, the cost of securing payment and the cost of financing the credit.

On February 1, 2007, the Appellants filed an appeal with the Supreme Court against the ruling of the Tribunal. As regards this appeal, the Appellants have reached an agreement with the Commissioner, obtaining (on December 27, 2009), the status of a Court verdict, whereby the hearing of their arguments regarding the methodology for the determination of the issuer commission will be postponed until the hearing within the framework of an appeal against a ruling to be given in connection with the arrangement concerning cross-clearing.

Concurrently with the procedures in Tribunal, negotiations have been conducted between the Commissioner and the credit card companies - ICC, LeumiCard and Isracard - regarding the agreement for the formation of a cross clearing system for VISA cards and MasterCard. In view of the said negotiations, the appellants requested the Commissioner to issue a provisional permit, enabling them to complete the negotiations prior to the expiration of the provisional arrangement between them. On September 6, 2006, the Commissioner of the Antitrust Authority granted the request, extending the exemption granted to the existing arrangement between the parties until October 31, 2006.

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

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

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

33. CREDIT CARD ACTIVITY (CONTINUED)

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

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

The Agreement further provides that until May 30, 2007, a joint interface would be established and operated to enable the three credit card companies to effect the clearing of VISA and MasterCard credit card transactions. The joint interface went into operation in the beginning of June 2007. Following the signing of the Agreement, IsraCard joined the local agreement for cross clearing existing between ICC and LeumiCard with respect to the VISA brand. Since June 2007, ICC also started the clearing of MasterCard in accordance with the tri-party cross clearing agreement. The arrangement has been submitted for approval of the Antitrust Tribunal and is the subject of the proceedings being conducted before the Tribunal. Five objections to the tripartite agreement have been filed with the Tribunal.

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.

Appointment of an expert. According to the methodology ruling, the Tribunal decided that in order to examine whether the tripartite agreement brought for approval is compatible with public interest, an expert is to be appointed to examine the rate of issuer commission, issuer commission categories and the rate of its amortization. The Tribunal has decided that the expert shall perform the examination in accordance with the methodology determined in previous proceedings (see above), the expert being appointed and supervised by the Antitrust Authority. The expert rendered an opinion on January 4, 2009 (within the framework of an interim report). The parties including ICC have, at this stage, waived the interrogation of the expert and the submission of the claim sum-up briefs, and the Tribunal has been asked to instruct the expert to continue his work to the second stage, until submission of his final opinion.

In view of the fact that the expert has been appointed Chairman of the Board of Discount Bank and in accordance with the decisions of the Court dated August 13, and November 1, 2010, the Chief Economist of the Securities Authority ("Chief Economist") has been appointed Expert. An expert opinion was submitted to the Tribunal on May 23, 2011, in the matter of the computation of the issuer commission (named also as "cross clearing commission"), by Dr. Parizat, Chief Economist of the Antitrust Authority (hereinafter: "the complementary opinion").

Expert opinion on behalf of the Appellants. Three expert opinions were submitted in September 2011, on behalf of the appellants: Bank Leumi and LeumiCard, Bank Hapoalim and IsraCard, and Israel Credit Cards.

Extension of the provisional permit. On July 20, 2011, the Appellant motioned the Tribunal for an extension until December 31, 2011, of the validity period of the provisional permit granted to the tripartite arrangement. The Commissioner recommended the granting of a provisional permit until December 31, 2011, on condition that as from November 1, 2011, the issuer commission will be reduced to a rate not exceeding an average of 0.875% (instead of as from July 1, 2012, in accordance with the tripartite agreement). On August 7, 2011, the Tribunal instructed the extension of the provisional permit granted to the Appellants until December 31, 2011, on condition that as from November 1, 2011, the rate of the cross commission shall not exceed an average of 0.875%.

Following the motion of the Appellants and the recommendation of the Commissioner in this matter, the Tribunal decided on December 28, 2011, that the provisional permit shall be extended until February 29, 2012, or until a ruling is given in the matter (the earlier of the two), and this, provided that the rate of the issuer commission remains unchanged at 0.875%.

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,

33. CREDIT CARD ACTIVITY (CONTINUED)

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 Appellants forego the right to appeal the methodology decision;
- The Appellants inform that, for the purpose of the compromise agreement, and subject to the approval by the Tribunal of the amended arrangement with all its terms, they do not object to the interim report and to the manner by which the opinion complementing the interim report will be implemented, this subject to the following;
- 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%.
- In the event that the Tribunal will not concede to the status request and will not approve the amended arrangement including all its terms, as requested (unless the Appellants have otherwise agreed), the amended arrangement including all its terms will become automatically null and void, whereas the tripartite arrangement shall remain established – for approval of the Tribunal. In this case, the rights and arguments of the Appellants and of the Commissioner will be reserved.

The Antitrust Tribunal approved on March 7, 2012, the said compromise arrangement.

It is not possible at this stage to assess the results of this process. 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. 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 adversely affected as a result of the said reduction in the cross commission.

- 2) A joint issuance agreement between ICC and FIBI.** On November 20, 2007, a three year agreement for a joint issuance was signed, following which the agreement will be renewed for an additional period of three years, unless either of the parties gives a six month notice of his wish to terminate the engagement. The said agreement replaced a previous agreement of August 1, 2000.

In recent months the First International Bank and ICC conduct negotiations regarding the renewal of the issuance agreement and its terms. The principles for the agreement have not as yet been formed and approved by the authorized organs. Notwithstanding, on basis of understandings reached as of now, an increase in the rate of royalties payable to the First International Bank is apparent."

- 3) A joint issuance agreement with Mizrahi-Tefahot Bank.** On November 18, 2008, ICC and Diners signed an agreement with Mizrahi-Tefahot Bank for the joint issuance of VISA, MasterCard and Diners Club credit cards, including Mizrahi-Tefahot branded cards, and for determining operating arrangements and providing services by ICC and/or Diners for credit cards issued by them and distributed by Mizrahi-Tefahot Bank to its customers. This agreement replaces the agreement between the parties dated July 26, 1995, as amended.

The agreement is for a period of five years from date of signature. In the event that the option for the purchase of ICC shares described hereunder is exercised or redeemed, the period of the agreement will be extended to ten years from date of signature. The agreement period

33. CREDIT CARD ACTIVITY (CONTINUED)

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 redemption).

The agreement is subject to all regulatory requirements under any law, if such exist.

- 4) **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.

The granting of an option to Union Bank to purchase 3% of ICC's share capital. Within the framework of the agreement for a joint issue, 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, comprising 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

33. CREDIT CARD ACTIVITY (CONTINUED)

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.

The option will come into effect upon obtaining the regulatory approvals required by law, to the extent required. At this stage, the conditions precedent for the option to become effective have not yet been fulfilled.

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.

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 prima facie finding brought to light in the affair reported by the Bank as "developments in the field of international electronic trade clearing and additional matters". 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. 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.

35. EARNING PER SHARE

	Consolidated		
	2011	2010	2009
Basic earnings⁽¹⁾ Per share of NIS 0.1 (in NIS)			
Net income from ordinary operations, attributed to bank's shareholders	0.75	⁽²⁾ 0.67	⁽²⁾ 0.94
Net income (loss) from extraordinary operations, net of taxes, attributed to bank's shareholders	0.06	0.04	(0.02)
Total	0.81	⁽²⁾0.71	⁽²⁾0.92
Total number of shares of NIS 0.1 par value, used for the above computation (in thousands)	1,053,869	997,578	993,979

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 with respect to the retroactive implementation of the directives of the Supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

36. INFORMATION BASED ON NOMINAL DATA FOR TAX PURPOSES - THE BANK

	December 31	
	2011	2010
	in NIS millions	
Balance Sheet		
Total assets	142,664	⁽¹⁾ 130,363
Total liabilities	132,284	⁽¹⁾ 119,925
Equity capital attributed to the Bank's shareholders	10,380	10,438
	For the Year Ended on December 31	
	2011	2010
	in NIS millions	
Statement of Income		
Net income	873	⁽¹⁾ 740

Footnote:

(1) Restated with respect to the retroactive implementation of the directives of the supervisor of Banks regarding employee rights, see Note 1 B (5) 4.

MAIN OFFICE

Tel Aviv, 23 Yehuda Halevi Street
Tel: 972-3-5145555

OVERSEAS BRANCH

London, United Kingdom: 65 Curzon Street

SUBSIDIARY BANKS ABROAD

Israel Discount Bank of New York

website: <http://www.idbbank.com>

head Office: 511 Fifth Avenue, New York

New York Branch: 1350 Broadway

Staten Island, NY Branch:

201 Edward Curry Avenue, Suite 204

Brooklyn, NY Branch:

705 Avenue U, Brooklyn, New York

Beverly Hills, CA Branch:

9401 Wilshire Boulevard, Suite 600

Downtown Los Angeles, CA Branch:

888 South Figueroa Street, Suite 550

Aventura, FL Branch:

Harbour Centre, 18851 NE 29th Avenue,
Suite 600

Grand Cayman (B.W.I.) Branch:

P.O.Box 694GT, 11 Dr. Roy's Drive

Representative Offices:

Tel Aviv, Israel / Santiago, Chile /

São Paulo, Rio de Janeiro, Brazil /

Lima, Peru / Mexico City, Mexico /

Montevideo, Uruguay

Discount Bank Latin America, Uruguay

Montevideo Head Office: Rincon 390

Branches throughout Uruguay

IDB (Swiss) Bank Ltd.

Geneva, Switzerland Head Office:

100 Rue du Rhone

Zurich Branch: Talacker 41

Representative Office: Tel Aviv, Israel

SUBSIDIARIES IN ISRAEL

BANKING

Mercantile Discount Bank

Discount Mortgage Bank*

CAPITAL MARKETS

Israel Discount Capital Markets & Investments

Tachlit Discount - Portfolio Management

FINANCIAL

Israel Credit Cards

Diners Club Israel

Discount Leasing

Discount Manpikim

TRUST SERVICES

Discount Trust

Website: www.discountbank.co.il

* In the process of merger with and into the bank.