Risk Management Report as of March 31, 2016

This translation of the Risk Management Report is for convenience purposes only.
The only binding version of the Risk Management Report is the Hebrew version

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General mapping of quantitative and qualitative information included in the Risks Management Report

This Risk Management Report includes disclosure requirements made by the Basel Committee in conjunction with Pillar 3 and other disclosure requirements, based on other sources, in conformity with directives and instructions of the Supervisor of Banks.

Below is a general mapping table which specifically identifies information not required in conjunction with Pillar 3, but which is based on other sources - primarily disclosure requirements of the Financial Stability Board ("FSB"). The table also provides a mapping of tables (schedules) included in this report.

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(1) All other information in this chapter is in conformity with disclosure requirements in conjunction with Basel Pillar 3.

Risk Management Report

This report includes additional information to the condensed consolidated financial statements of Bank Mizrahi Tefahot Ltd. and its subsidiaries as of March 31, 2016. The condensed financial statements and additional information to the condensed financial statements, including the Report of the Board of Directors and Management, this Risks Report and other supervisory disclosures have been approved for publication by the Bank's Board of Directors at its meeting held on May 18, 2016.

The Risk Management Report and other supervisory disclosures are compiled in conformity with directives of the Supervisor of Banks, which include disclosure requirements of Basel Pillar 3 and other disclosure requirements of the Financial Stability Board (FSB).

All of these reports are also available on the Bank's website.
www.mizrahi-tefahot.co.il >> about the bank >> investor relations >> financial statements.

The disclosure in this report is designed to allow users to evaluate significant information included with regard to implementation of the framework for capital measurement and adequacy and to implementation of provisions of "Basel III: A global regulatory framework for more resilient banks and banking systems".

Moshe Vidman
Chairman of the
Board of Directors

Eldad Fresher
President & CEO

Doron Klauzner
Vice-president,
Chief Risk Officer (CRO)

Approval date:
Ramat Gan, May 18, 2016

Forward-Looking Information

Some of the information in the Risk Management Report, which does not relate to historical facts, constitutes "forward-looking information", as defined in the Securities Law, 1968 (hereinafter: "the Law").

Actual Bank results may materially differ from those provided in the forward-looking information due to multiple factors including, inter alia, changes in local and global capital markets, macro-economic changes, geo-political changes, changes in legislation and regulation and other changes outside the Bank's control, which may result in non-materialization of estimates and/or in changes to business plans.

Forward-looking information is characterized by the use of certain words or phrases, such as: "we believe", "expected", "forecasted", "estimating", "intending", "planning", "readying", "could change" and similar expressions, in addition to nouns, such as: "plan", "goals", "desire", "need", "could", "will be". These forward-looking information and expressions involve risks and lack of certainty, because they are based on current assessments by the Bank of future events which includes, inter alia: Forecasts of economic developments in Israel and worldwide, especially the state of the economy, including the effect of macroeconomic and geopolitical conditions; changes and developments in the inter-currency markets and the capital markets, and other factors affecting the exposure to financial risks, changes in the financial strength of borrowers, the public's preferences, legislation, supervisory regulations, the behavior of competitors, aspects related to the Bank's image, technological developments and human resources issues.

The information presented here relies, inter alia, on publications of the Central Bureau of Statistics and the Ministry of Finance, on data from the Bank of Israel data, the Ministry of Housing and others who issue data and assessments with regard to the capital market in Israel and overseas as well as forecasts and future assessments on various topics, so that there is a possibility that events or developments predicted to be reasonable would not material, in whole or in part.

Scope

The Basel Committee is an international body established in 1974 by the central banks of different countries. The Committee's decisions and recommendations, although they have no binding legal validity, prescribe the supervisory regulations acceptable to the supervisory bodies of the banking systems in a majority of countries throughout the world. On June 26, 2004, the Basel Committee published new recommendations intended to assure proper regulation for arranging the rules of capital adequacy of banks in different countries (hereinafter: "Basel II"). A final, updated version of these regulations was published in June 2006. Basel II recommendations supersede the previous regulation dated 1988, known as Basel I, which included capital requirements due to credit risk, and was expanded in 1996 to include capital requirements for market risk as well.

Application of Basel II directives improved measuring and management of different risks factors facing the financial institution, and ensured better alignment of capital requirements to the risk level to which the financial institution is exposed.

Following the global financial crisis, the Basel Committee issued a new directive, known as Basel III. This directive is designed to handle the failings discovered in risks management and control processes during the crisis.

Key recommendations of the Basel Committee

Whereas the Basel I regulation was mainly aimed at capital allocation for credit risk and market risk (with respect to the negotiable portfolio) to which the financial institution is involved, Basel II expanded these regulations to afford better stability to financial institutions, by also addressing other risks, including operating risk and implementing a culture concerning risks management and control, including reporting and disclosure with regard there to. Therefore, Basel II regulations include, in addition to a material change in how capital is calculated (Pillar 1 of the regulations), also two other pillars, as specified below.

Basel II, Pillar 1 includes minimum capital allocation with respect to market risk, counter-party risk, credit risk and operating risk. The guidelines stipulate how capital is allocated for credit risk by enabling calculation of the minimum capital using a standard model relying on external debt rating by rating agencies recognized by the regulatory authority (in Israel: Bank of Israel - Supervisor of Banks). The model uses a large number of exposure groups while adapting risk coefficients to the various groups, and recognizes financial collateral which may be offset against the exposure. The directive allows banks to calculate the minimum capital requirement using internal models. These models are based on Bank assessments of its borrowers' quality, used to calculate the probability of borrowers entering a state of credit default, and the expected loss to the bank in case of credit default. Use of internal models requires approval by the regulatory authority, which is only granted after extensive validation of the model. According to the Supervisor of Banks' instructions, capital allocation with respect to credit risk is calculated using the standard method.

In the area of market risk, capital allocation in Israel is determined based on a standard model which estimates the bank's exposure with respect to basis, interest, equity and option risk in the bank's negotiable portfolio.
In the area of operational risk, the guidelines propose several alternative approaches for calculating the required capital: The basic indicator approach, according to which the bank will allocate capital for operating risk as a fixed percentage of average annual gross revenue over the past three years. The standard approach, in which the capital requirements are calculated by multiplying gross revenues from each line of business by a specific factor specific to that line of business. The advanced measurement approach, whereby the bank will allocate capital based on an internal model to be developed within the organization.

According to the Supervisor of Banks' directives, capital allocation with respect to operating risk is calculated using the standard method.

Basel II recommendations specify multiple principles for operating risks management, relating to aspects such as: degree of supervision by bank management and Board of Directors, existence of suitable organizational structure and culture, including a system of internal reporting and an efficient and effective flow of information, the manner of risk assessment and measurement and the existence of appropriate support systems. The department handling operating risk is required to act in order to map and identify operating risk, collect actual failure data and take action to reduce potential damage arising from an operating failure at the bank. Basel II principles further stipulate the responsibility of the Internal Auditor as an additional line of defense in handling operating risk.

Basel II Pillar 2 involves the Supervisory Review and Evaluation Process (SREP) and the Internal Capital Adequacy Assessment Process (ICAAP) aimed at ensuring that the bank's total capital is in line with its risk profile, specified capital targets (capital required by the Bank) and its business targets according to the strategic plan, beyond the minimum capital requirements which the Bank should hold according to Pillar 1. This includes, *inter alia*, a review of the minimum capital allocation (i.e. Pillar 1 calculations) for the Bank and the overall capital required with respect to other risk not included in the minimum capital allocation of Pillar 1, such as interest risk in the bank portfolio, credit concentration risk and other risk types. The calculation of overall capital required for the Bank is made under a diverse range of stress scenarios, which challenge the overall capital available to the Bank under normal circumstances, in order to ensure that the Bank has sufficient capital even in stress or emergency conditions. Therefore, stress tests are an important tool in estimating the total capital required of banks, and these feature prominently in Pillar 2 of the directive.

Furthermore, the directives for this pillar review the bank’s risks management processes, risks control processes, level of the bank’s corporate governance with regard to risks management, reporting and process management closely linked to risk management and the corporation’s capital and profit. The Bank emphasizes, in this pillar, quantitative and qualitative assessment processes, designed to review the risk profile to which the Bank is exposed in the course of its business operations.

Review of the Pillar 2 requirements is part of an annual report submitted to the Bank of Israel, in conformity with a schedule specified by the Bank of Israel. This report is submitted to the Bank of Israel after approval by the Bank’s management and Board of Directors. On December 31, 2015, the Bank sent its seventh ICAAR document to the Bank of Israel. For more information, see chapter Capital Adequacy below.

Basel II Pillar 3 involves reporting and disclosure to the regulating authority and to the public. This requires the bank to provide detailed, extensive disclosure of its risk level and its risks management processes. The Bank applies these requirements and other disclosure requirements as noted in this Risk Management Report.

As from January 1, 2014, the Bank applies provisions for capital measurement and adequacy, based on Basel III provisions, as published by the Supervisor of Banks and as incorporated in Proper Banking Conduct Directives 201-221. Basel III provisions stipulate significant changes in calculation of supervisory capital requirements, primarily for the following:

- Supervisory capital components.
- Deductions from capital and supervisory adjustments.
- Capital allocation with respect to CVA loss (Credit Value Adjustments) - loss due to revaluation at market value with respect to counter-party credit risk.

Application of the Basel Committee recommendations by the Israeli banking system

In Israel, Basel Committee recommendations have been implemented in Proper Banking Conduct Directives as follows:

Proper Banking Conduct Directive 201 - Introduction, scope and requirement calculation;

Proper Banking Conduct Directive 202 - Supervisory capital;

Proper Banking Conduct Directive 203 - Calculation of capital required with respect to credit risk using the standard approach;

Proper Banking Conduct Directive 204 - Calculation of capital required with respect to credit risk using the internal rating approach;

Proper Banking Conduct Directive 205 - Handling of securitization transactions;

Proper Banking Conduct Directive 206 - Calculation of capital required with respect to operating risk;

Proper Banking Conduct Directive 208 - Calculation of capital required with respect to market risk;

Proper Banking Conduct Directive 211 - Directives for assessment process of appropriateness of capital adequacy at banking corporations (Pillar 2);

Implementation of the framework

Provisions of Proper Banking Conduct Directives 201-211 "Measurement and Capital Adequacy" apply to the Bank Group and in particular to the Bank - Bank Mizrahi-Tefahot Ltd. - the parent company of the Group. Group companies to which the framework applies, in accordance with the supervisory consolidation basis, are the companies consolidated with the Bank's consolidated financial statements. There are no differences in the consolidation basis between accounting practices and the framework.

Below are major Bank Group companies, how they are weighted and their lines of business:

	Operating sector
1) Fully-consolidated subsidiary	
Bank Yahav for Government Employees Ltd.	Commercial bank
Tefahot Insurance Agency (1989) Ltd.	Insurance agency
Mizrahi International Holding Company Ltd. (B.V. Holland)	International holding company
Etgar Investment Portfolio Management Company of the Mizrahi Tefahot Group Ltd.	Portfolio management
Mizrahi Tefahot Issue Company Ltd.	Issuance company
Mizrahi Tefahot Trust Company Ltd.	Trust company
2) Associates (weighted by risk)	
Psagot Jerusalem Ltd. (“Psagot”)	Land for construction
Rosario Capital Ltd. ("Rosario")	Underwriting company
Mustang Mezzanine Fund Limited Partnership	Extending credit
Planus Technology Fund	Extending credit
3) Major subsidiary of a subsidiary (United Mizrahi Overseas International Holding Ltd. (BV Holland))	
United Mizrahi Bank (Switzerland) Ltd.	Commercial bank

To the best of the knowledge of Bank management, and relying on legal counsel, there are no prohibitions or significant restrictions on transfer of funds or supervisory capital between Bank Group companies.

Summary risk profile for the Bank

Key data

Below is key data relevant for the Bank risk profile:

	31.3.2016	31.12.2015	September 30, 2015	June 30, 2015	31.3.2015
Key financial ratios (in percent)					
Ratio of Tier I capital to risk elements	9.65	9.50	9.30	9.30	9.10
Total ratio of capital to risk elements	13.20	13.29	12.76	12.86	12.66
Leverage ratio(1)	5.23	5.32	5.32	5.24	-
(Quarterly) liquidity coverage ratio(2)	97	91	84	84	-
Expenses with respect to credit losses to loans to the public, net for the period(3)	0.01	0.19	0.15	0.11	0.09

(1) Leverage Ratio - ratio of Tier I capital, according to Basel rules, to total exposure. This ratio is calculated in conformity with Proper Banking Conduct Directive 218

(2) Liquidity Coverage Ratio - ratio of total High-Quality Liquid Assets to net cash outflow. This ratio is calculated in conformity with Proper Banking Conduct Directive 221, in terms of simple averages of daily observations in the reported period.

(3) Calculated on annualized basis.

Below is capital for calculation of capital ratio after supervisory adjustments and deductions:

	March 31, 2016	March 31, 2015	December 31, 2015
Tier 1 capital(1)	12,490	11,476	12,299
Tier II capital	4,598	4,485	4,916
Total capital	17,088	15,961	17,215

Total credit risk to the public(1):

	March 31, 2016	March 31, 2015	December 31, 2015
Total credit risk to the public	220,826	211,020	217,469

(1) For more information about total credit risk to the public, see the chapter "Risk overview" in the Report by the Board of Directors and Management.

Risk assets and capital requirements with respect to credit risk, market risk, CVA risk[4] and operating risk are as follows (NIS in millions):

	March 31, 2016		March 31, 2015		December 31, 2015	
	Weighted risk asset balances	Capital requirement[1]	Weighted risk asset balances	Capital requirement[2]	Weighted risk asset balances	Capital requirement[3]
Credit risk	120,049	15,486	116,994	14,624	120,136	15,377
Market risk	957	123	871	109	950	122
CVA risk with respect to derivatives[4]	703	91	797	100	657	84
Operating risk	7,744	999	7,435	929	7,743	991
Total risk assets	129,453	16,699	126,097	15,762	129,486	16,574

(1) The capital requirement was calculated at 12.9% of risk asset balances.
(2) The capital requirement was calculated at 12.5% of risk asset balances.
(3) The capital requirement was calculated at 12.8% of risk asset balances.
(4) Credit Value Adjustments - mark to market with respect to credit risk of counter-party, in conformity with Basel III provisions.

The change in risk assets in the first quarter of 2016 was primarily due to growth of the Bank's credit portfolio with respect to housing loans, due to continued increase in origination of housing loans. Furthermore, increased Bank business in the household segment and among micro, small and medium business clients resulted in increase in risk assets due to retail exposures.

Major developments in the Bank's risk profile

In recent years, the Bank has created a risks management and control framework, in conformity with Bank of Israel directives, market condition and its business targets. A major component of this framework is specification of the risk appetite by the Bank’s Board of Directors, which reflects the maximum exposures which the Board of Directors is willing to assume under normal conditions and under stress conditions, with constant monitoring of the Bank's risk profile in view of the specified risk appetite.

The Bank's risk appetite includes many benchmarks specified for various risks to which the Bank is exposed in the course of its business operations. The benchmark definition is, *inter alia*, relative to Bank capital. The risks list is determined by a dynamic process conducted by the Bank to map and identify risk, which is approved by the Board of Directors. Risk appetite is specified for various portfolios and activities arising from the Bank's business operations, using a range of qualitative and quantitative risk benchmarks, results of stress tests, restrictions on operations etc. Bank management has zero appetite for deviation from Board restrictions, so that management has imposed its own restrictions for some risk benchmarks. Management restrictions were set lower than the Board restrictions. These restrictions serve to alert before reaching within range of the risk appetite specified by the Board of Directors.

The Bank primarily uses two key processes to continuously monitor its risk profile: The first process, which results in the quarterly Risk Document, presents an overview of all risk benchmarks specified, in order to review the risk profile in view of the specified risk appetite. The second process, which results in the ICAAR (Internal Capital Adequacy Assessment Report) document, submitted annually; this report provides a summary of the Bank's annual ICAAP process, conducted as part of Basel Pillar 2, which includes the results of capital planning by the Bank, which challenges the Bank's business plan, using stress tests of various high severity levels, in order to ensure that the Bank has sufficient total capital to achieve the capital targets specified and its business plan. Risks management and control units at the Bank also report on the risk profile and, in particular, report any deviation from the risk appetite and monitor any deviations until they have been eliminated. The risk appetite for the various risks, how the risk profile is monitored and the required reporting chain for monitoring the risk profile and risk appetite, are incorporated in the Bank's policy documents which are approved, at least once a year, through a structured process which encompasses management, the Board's Risks Management Committee and the Board plenum.

A view of the Bank's risk profile, as reflected by the risks documents and results of the capital planning, indicates that the Bank has a relatively low risk profile and the potential loss due to unexpected events is low relatively to Bank equity and profit. The Bank's risk profile for the first quarter of 2016 is similar to the risk profile for 2015; during this period there were no deviations from the risk appetite specified by the Board of Directors for market, interest, liquidity, operating and credit risk; as of the end of this quarter, all benchmarks were a reasonable distance away from the risk appetite specified by the Board of Directors. During this year, the Bank continues to advance, in conformity with structured work plans, its handling of liquidity risk, given the new regulatory requirements specified by the Bank of Israel. The Bank also continues to upgrade the framework for handling "emerging" risks, such as compliance and regulatory risk, AML risk and cross-border risk - while allocating all of the required resources for addressing these risks. Note that the Bank has zero appetite for non-compliance with regulatory directives of the Bank of Israel.

The Bank's most recent capital planning, submitted to the Bank of Israel at the end of 2015, shows that the Bank has sufficient capital to achieve its total capital targets, including the core capital target specified for the most extreme stress test ("threat test", which is conducted under strict assumptions with regard to potential impact on the Bank). In particular, the Bank strongly emphasized, within such capital planning, the stress testing conducted with respect to the Bank's mortgage portfolio by diverse methods, which analyze the portfolio under extreme macro-economic conditions specified by the Bank of Israel, assuming non-recovery by clients and assuming no management action to minimize the impact. Analysis of stress tests conducted by the Bank shows that, in spite of the strict and conservative assumptions made in these scenarios, the potential loss for the mortgage portfolio is low in relation to the Bank's core capital.
Once a year, in conformity with Bank of Israel directives, the Bank submits the outcome of its Uniform Scenario, based on extreme macro-economic conditions, in the outline specified by the Bank of Israel for the banking system. The outcome of the Bank's most recent scenario (filed in February 2016) shows that the damage of this scenario to the Bank is low in relation to Bank capital and profit.
In accordance with the framework specified by the Bank for monitoring its risk profile, as described above, the Bank conducts another process as part of the ICAAP process. This is a qualitative process in which the different risks managers and controllers express their opinion as to the risk level, quality of its management and control as well as on the anticipated direction of development of various risks in the following year. The outcome of this process is discussed by Bank management, by the Board's Risks Management Committee and by the Board plenum. The outcome of the most recent process, conducted in the final quarter of 2015, indicates that the quality of risks management at the Bank is good and that an appropriate framework exists for addressing all risks in 2016, given the business targets, current risk profile and regulatory requirements.

Corporate governance for risks management at the Bank Group

The risks management and control framework at the Bank has been specified by the Bank's Board of Directors and is implemented by the President & CEO, management, Chief Risks Officer and various risks managers - as part of the Bank's business strategy. Due to the evolution in understanding in recent years of the importance of corporate governance for risks management, regulators across the world have made increased effort to deploy methodologies for risks management and control, both qualitative and quantitative. Qualitative and quantitative risks management includes appropriate corporate governance for risks management, an appropriate reporting chain and specification of risk appetite, designed to create an appropriate risks management culture. Bank operations in these aspects are based, *inter alia*, on Supervisor of Banks directives and in particular, on Proper Banking Conduct Directive 310 which became effective in early 2014. This directive specifies the principles for risks management and control in the Israeli banking system and stipulates the standards required of the banks for creating their risks management framework to be in line with regulatory requirements, the Bank's risk profile and its business targets.

Corporate governance of risks management

The Bank's risks management and control setup consists of all management and control layers at the Bank, from the Board of Directors, management and lines of business to control functions and Internal Audit. The Risks Control Division (headed by the Bank's CRO) is the overall entity tasked with risk management and control at the Bank. In conformity with Proper Banking Conduct Directive 310, the Bank has defined 3 lines of defense (LOD) in addition to the Board of Directors' lines of defense, which is responsible for specifying an appropriate culture and framework for handling risks and management, which is responsible for implementing the framework principles specified by the Board of Directors.

Lines of Defense

Line	Function	Reporting to	Role
First line	Lines of business	Line of business manager reports to the President & CEO	Unit management is fully responsible for risks management and for implementing an appropriate control environment for its operations
Second line	Risks Control Division	President & CEO	the Division, headed by the CRO, acts in concert with other divisions, including the Accounting and Financial Reporting Division, to assist management in promoting an integrated, cross-corporate vision of risks, plan and develop the risks management framework, challenge and ensure completeness and effectiveness of the risks management framework and internal controls and review of this framework in view of the strategic plan, annual work plan and the Bank's business targets.
Third line	Internal Audit	Bank's Board of Directors	Review the effectiveness and efficiency (mostly in retrospect) of risks management processes and pointing out weaknesses in internal controls which may impact the effectiveness of control.

These lines of defense are intended to ensure that the Bank has deployed an appropriate framework for risks management and control.

Different interfaces have been specified between the lines of defense, including forums and reporting incorporated into routine and emergency operations, in order to maintain appropriate corporate governance for risks management while achieving the Bank's business targets.

The functions involved in risks management and control at the Bank are as follows:

Bank’s Board of Directors

The main roles of the Board of Directors are to set Bank strategy and to approve Bank policy, which would guide the Bank in its daily operations; to supervise and ensure that management implements the policies in conformity with principles specified by the Board of Directors; ensure that clear areas of responsibility and reporting paths are in place at the Bank, instill an organizational culture at the Bank which demands implementation of high standards of professional behavior and integrity and ensure that the Bank is operating in compliance with the Law and regulation.

The Board of Directors plenum is responsible for discussion of matters related to risks management at the Bank, including the following:

- Monitor capital adequacy and the outcome of overall capital planning at the Bank, in conjunction with Basel II Pillars 1 and 2.
- Approve policy for handling different risks types and specify the maximum exposure allowed for different operating segments and under different market conditions of normal and emergency operations (risk appetite), approve the organizational preparations for management and control of the Bank's overall risk profile and create an appropriate internal control framework.
- Approve, map and identify risk and appoint different risks managers.
- Approve new (or revised) products / operations.

Audit Committee

The Audit Committee discusses audit reports of the Internal Auditor, the Independent Auditor as well as those of the Supervisor of Banks or any other competent authority. The Audit Committee points out faults in business management at the Bank, including those arising from organizational shortcomings, in consultation with the Internal Auditor or with the Independent Auditor and guides management on ways to amend them.

Risks Management Committee

The Risks Management Committee discusses matters related to risks management and control, capital planning and internal control at the Bank. The Committee makes recommendations to the Board of Directors on matters arising from current risks monitoring processes at the Bank for risk management and control.

President & CEO

The Bank President & CEO is responsible for implementation of the Bank's strategy and business plans. In this regard, the President & CEO is responsible for management of all risks at the Bank, provides leadership to management and Risk Owners for integrated, comprehensive management of all risks and capital, for implementation of an effective internal control system and supervises the proper function of all components of risks and capital management policy and strategy. The President & CEO is also responsible for reporting to the Board of Directors about the risks management, capital and internal controls policies and for reporting to the Board of Directors on the Bank's risk profile, including any deviations and alerts.

Bank management

In conformity with directives from the Board of Directors, management is responsible for ensuring that Bank operations are aligned with its business strategy and risk appetite - as specified by the Board of Directors. In actual fact, management is responsible for implementation of the principles of risks management and control framework, as specified by the Bank's Board of Directors, for reporting to the Board of Directors about implementation of the principles specified by the latter and in particular, about the risks profile and its development - and for instilling an organizational culture of risks managers in all Bank employees.

All members of Bank management are responsible for on-going risks management. Thus, they are responsible for implementation of the Bank's risks management policy, for reporting to the President & CEO and to the Board of Directors about risks management and for development of procedures and controls for risks management. Management is also responsible for regular reporting to the CRO, through dedicated committees or forums designated for risks management and control.

For a list of the different risks managers, see the chapter "Risk overview" in the Report by the Board of Directors and Management.

Management committees for risks management

The Bank operates risks management committees at all management levels. These committees act as professional management forums, designed to foster discussion of issues related to risks management and control and to promote the necessary moves for on-going upgrade of the Bank's risks management framework. Therefore, these committees are a highly important tool for overall risks management at the Bank. The main committees are: Supreme Credit Committee, Asset and Liability Management Committee and Management Committee for Operating Risks and Control. The committees operate in normal times and during emergency, in conformity with detailed procedures.

Risks Control Division

The Bank's Chief Risks Officer (CRO) is a member of management and Manager of the Risks Control Division. The CRO is responsible for the risks management function. This function is independent of operations of the risks-taking units and has direct access to information. The CRO has direct access to the Bank's Board of Directors.

The CRO is responsible for ensuring that a process is in place for identification, measurement, control, mitigation and regular reporting of risks inherent across all business operations at the Bank and for ensuring that the Bank risks profile and business results of Bank units are in line with the Bank's risk appetite.

Internal Audit Division

Internal Audit is the third line of defense within corporate governance for risks management, for testing the risks management framework and for the effectiveness of internal control at the Bank. Typically in retrospect, using diverse tools, including: Risks-focused work plan, debriefs and ad-hoc testing. The outcome of audit work and recommendations are sent to the relevant functions and implementation of its recommendations is monitored.

Other forums for risks management and control operating at the Bank

As part of corporate governance for risks management and in line with Bank policy on stress testing, the Bank has created other forums for risks and capital management and control:

- Internal control forum – for integration of diverse Bank entities responsible for implementing an internal controls framework at the Bank.
- Capital planning and management forum – for monitoring development of Bank capital in view of Bank targets.
- Liquidity Forum (221) - for arrangement of the Bank framework for handling Regulation 221, concerning the standard minimum liquidity ratio.
- Forums for addressing stress testing – for creating an appropriate framework for implementation of stress testing as a key tool for risks management and control at the Bank.
- Risks Monitoring Forum (RMF) – diverse forums, led by the Chief Risks Officer together with business unit managers, to discuss various issues arising from risks management and internal controls of each business unit.
- Bank subsidiaries forum – for ensuring that the risks management framework at subsidiaries is aligned with risks management requirements for the Group.

The Code of Ethics

Full transparency is a prerequisite of corporate governance, and in particular as relates to efficient risks management. A policies of proper disclosure of events, support processes and appropriate organizational structure create regular work interfaces which support the Board of Directors and allow it to discharge its duties. In order to perform the foregoing with due professional approach, the organization promotes an "internal controls culture". This means that the Bank’s Board of Directors and management promote, throughout the organization, a high level of ethics and integrity, to be disseminated by the following means:

- Effective communication channels to ensure messages with regard to ethics, integrity and the importance of internal controls are conveyed from the Board of Directors and executive management to all Bank staff.
- Personal example set by senior management.
- A written code of ethics, with documentation of all employees having read it and confirmed it.
- Supervisory mechanisms to ensure staff compliance with requirements and rules of conduct.
- Mechanisms to promote reporting of suspected improper actions.
- Enforcement mechanisms against those in breach of the code of conduct.

The Bank's Code of Ethics was written following over one year of meetings and discussions, attended by many Bank managers and staff. No doubt, acquiring a ready-made code of ethics from external ethics experts would have shortened this process - but this would have missed the main objective of this code: to accurately and authentically reflect the Bank Spirit and its organizational culture, as reflected by its management and staff.

On November 24, 2008 the Bank’s Board of Directors approved the values of the Code of Ethics which is binding on the organization as a whole and on each employee and manger individually.

Bank remuneration policy

For more information about the Bank's remuneration policy, see chapter "Remuneration" in the 2015 Risk Management Report on the Bank website.

Corporate governance of risks management at subsidiaries

As part of overall risks management at the Bank, risks management is coordinated with Bank subsidiaries. Supervision and control over subsidiaries is regular and reports are received from subsidiaries listing their exposure to various risks factors. As from this quarter, reports by Bank subsidiaries are incorporated into the Bank's quarterly risk document.

Risk culture

Current business activities at the Group involving diverse products and financial instruments, both on- and off-balance sheet, expose the Group to diverse risks, including market risk, interest risk, liquidity risk, credit risk, operating risks, information security and cyber risk, compliance and regulatory risk, AML risk and cross-border risks.

In recent years, the Bank's Board of Directors and management have put in place a framework for risks and capital management and control at the Bank. This framework is designed to create an appropriate culture at the Bank for appropriate risks management, in support of achievement of the Group's business targets. This framework consists of multiple layers operating in tandem at Bank units, designed to ensure that the Bank can manage, measure and mitigate its risks during normal operation and in case of an internal or external stress event or emergency.

The key layers and principles put in place are as follows:

- Mapping and identification of risks to which the Bank is exposed - this process is the basis for risks management at the Bank because, absent the capacity to identify risks inherent in Bank operations, the Bank would be less capable of managing and mitigating such risks. Therefore, the Bank's Board of Directors and management have put in place an orderly process for risks mapping and identification at the Bank. This process is conducted at least once a year and the list of risks is approved by the Board of Directors. For each risk, a determination is made as to whether it is material for Bank operations, based on a materiality threshold specified as percentage of the Bank's core capital; in addition, a risk owner (Risk Owner) is appointed for each risk mapped as material. As part of this process, the Board of Directors determines the risks scale. This scale specifies severity levels - low, medium or high, as percentage of the Bank's core capital, in order to enable all Bank units to identify the severity of each mapped risk and to enable communication across all Bank units, which is based on a uniform definition of severity level.
- Lines of defense required for risks management and control – The Bank has specified five lines of defense. Board of Directors –Responsible for specifying principles required for addressing each risk, in particular setting the risk appetite, which reflects the level of risk the Bank is willing to bear, given macro-economic conditions prevailing in the market, the Bank's business operations, strategic plan and regulatory requirements. The risk appetite reflects the exposure limits allowed for Bank operations and is specified for normal and stress operations, with the Bank using various stress tests to estimate the potential damage by each identified and mapped risk. Management – Responsible for implementation of the principles specified by the Bank's Board of Directors and in particular, current review of various risks profiles in view of the risk appetite specified. Bank management has specified multiple management restrictions (management guidelines), designed to monitor how close the Bank's risk profile is to the risk appetite specified by the Board of Directors, even before deviating from it. Management is responsible for reporting to the Board of Directors about development of the risks profile and for ensuring that resources, IT systems, processes and moves are in place which allow the Bank to adhere to the principles specified by the Board of Directors for management and control of each risk. Below the management level are the three lines of defense, as specified in Proper Banking Conduct Directive 310 of the Bank of Israel. First line – risks-taking business units,

headed by the appointed risks managers. Units in the first line are responsible for implementing controls in order to ensure that they do not exceed the risk appetite and principles specified for management and control of each risk. Units in the second line do not take risks and are responsible for regular control, in real time in as much as possible, as an additional control circle to the one applied in the first line. The second line is led by the Bank's Chief Risks Officer, who is responsible for operation of the Bank's risks management function and who manages multiple risks associated with internal controls risk at the Bank: operating risk, compliance and regulatory risk, AML risk, information security and cyber risk, fraud and embezzlement risk, cross-border risk and model risk, resulting from inappropriate use by Bank units of models involved in risks management processes. The Chief Risks Officer is a member of management, has direct access to data and is responsible for credit analysis and control. The Chief Risks Officer acts together with other members of management, which are gatekeepers: Manager, Accounting and Financial Reporting Division and Manager, Legal Division - in order to ensure an appropriate control system, as close as possible to operations of the first line, in order to ensure compliance with the framework and principles specified by the Board of Directors and management. The third line of these operations is Internal Audit, which acts in conformity with an orderly work plan while maintaining its independence, in order to ensure (typically in retrospect) that the first and second lines are following the specified principles. In conjunction with this role, Internal Audit is responsible for conducting a process to review the effectiveness of internal control.

- Policy documents for management of various risks – For each material risk, the Board of Directors issues a specific policy document, which sets out the required principles for addressing such risk, including the forums and functions responsible for management and control of such risk, how the risk is measured, business and regulatory requirements and ways to mitigate such risk. Bank management specified procedures, which ensure that the lines of defense properly implement the principles specified in the policy; in addition there are two master policy documents: one specifies master principles for risks management, capital management and internal controls in line with Bank of Israel Directives and, in particular, Directive 310 (the master directive for risks management); the other specifies a master policy specific for stress testing by the Bank, which lists the master principles for conducting stress testing at the Bank and how to use the results of such stress testing. Thus, the Bank reflects the significant importance attached to risks management in both normal and emergency operations.

- The Bank's risk appetite framework – Risk appetite is important for the Bank's capacity to manage risks in line with its business strategy; events which have occurred at other banks around the world have emphasized the importance of this framework as part of the Bank's risks management culture. The Bank has specified over 100 diverse benchmarks for risk appetite for various risks, lines of business and operating segments in the Bank's business. On-going monitoring, as conducted at the Bank, is designed to provide an outlook into the Bank's risk profile and to review the potential for deviation from the risk appetite specified by the Board of Directors. Because of the importance of risk appetite, the Bank’s Board of Directors has issued a special policy document which lists the Bank's risk appetite framework: In Part I, this document lists ways to monitor the risk appetite and required reports from Bank management to the Board of Directors. In Part II, this document lists all risk benchmarks specified, in order to provide a summary overview of exposure caps specified for the Bank.

- The Bank's quarterly risks document – This document is the main reporting tool by Bank management with regard to the risk profile. This document also presents a qualitative and quantitative view over development of all risks benchmarks specified; in discussions, emphasis is placed on benchmarks which are getting close to the risk appetite, the implications of such closeness on the risk profile and action required in order to reduce the risk level - because Bank management has zero risk appetite for deviation from exposure caps specified by the Board of Directors. Thanks to the detailed view of the evolution of risks management provided by the Bank's quarterly risks document, this is one of the main tools used by management for reporting the status of risk appetite to the Board of Directors, with the risk analyzed by various tools included in the specified risks management and control framework and as listed in the Bank's annual ICAAR document.
- The Bank's ICAAP process and ICAAR report – The ICAAP process is part of Basel II, Pillar 2 and is designed to describe the Bank's risks management and control framework and all of its components. The document core includes a description of the Bank's capital planning process, which is conducted for a three-year planning horizon, included in the annual ICAAR document, which challenges the Bank's capital targets and strategic plan by a range of stress tests, in order to ensure that even in case of a material stress event, the Bank has sufficient capital to survive it.
- Qualitative analysis of the Bank's risk profile – Once a year, as part of the ICAAP process, the Bank conducts a structured, orderly process of self-assessment which allows the Bank to perform qualitative analysis of its risks profile. In this process, which complements the overview of quantitative risk benchmarks at the Bank, as noted above, the group of risks managers and the group of risks controllers (each group independently of the other) rate the level of various risks (on a pre-specified risk scale), the quality of management of various risks and the direction of evolution of each risk, in their opinion, over the next work year. This process is designed to identify weaknesses in the management and control processes for the various risks and to ensure that there is awareness of such weaknesses, if any, and in particular - that an appropriate framework for addressing them has been specified. This process is conducted using structured questionnaires for each risk. The outcome of this process is discussed by Bank management, by the Risks Management Committee of the Board of Directors and is approved by the Board of Directors.
- Approval process for new product / activity – The launch of a new product or activity at the Bank (as well as revision of an existing one) in order to achieve business targets has the potential for deviating from the specified risk management and control framework and in particular, from the risk appetite. Therefore, the Bank’s Board of Directors and management have issued a dedicated policy document, which sets out how the Bank addresses a new product or activity (or a materially revised one). This policy is an annex to the Bank's master policy and includes a dedicated checklist, used by the Bank to assess the impact of launching the new product or activity on the entire list of risks mapped by the Bank, the technology and accounting aspects associated with such launch and the alignment with the Bank's current risk profile, in normal operations and during emergencies - by applying stress tests. The effect of the new product / activity on the Bank's current risk profile determines how it would be approved: those having material effect on the Bank's risk profile are approved by the Board of Directors.

- Stress tests – The Bank regards stress tests as highly important. These form a major tool for risk management and control at the Bank. Therefore, in recent years the Bank has developed a long list of methods and approaches for conducting stress testing, which are in line with Bank of Israel requirements and with evolving general practice around the world - in particular after the most recent financial crisis. The Bank has stipulated a dedicated master policy which describes the various methods applied by the Bank and how the results of various stress tests are used. Stress testing is used by the Bank to determine risk appetite and is a key components of the capital planning process within ICAAP. The Bank has a diverse group of stress tests, applied to identify the potential impact of various risks to the Bank's business and financial targets. The major stress tests used by the Bank in its normal operations - and as part of capital planning within ICAAP - are applied at the portfolio level, at sub-portfolio level where relevant for Bank operations and at transaction level. The stress testing methodology applied by the Bank includes: Stress level scenarios, performed with variation in risk factors relevant for the operations being tested (movement in exchange rates, interest rates etc.); stress tests based on past stress events in the local or global market (the 2008 crisis, the 1998 crisis, the high-tech crisis at the start of this century etc.) with reconstruction of past events and review of their impact on the Bank's current portfolio; macro-economic scenarios, performed by varying the macro-economic conditions based on Bank assumptions or on changes issued by th Bank of Israel to the entire banking system under the uniform scenario, with development of equations which translate the effect of macro-economic factors on the portfolio (such as: an equation which translates the effect of unemployment on default rates in retail credit segments); and scenarios performed according to an outline specified by the Bank, in line with the outline specified by the Bank of Israel in their reference scenarios. As part of capital planning, the Bank performs a powerful scenario in which the Bank also reviews damage from all of the major risks mapped by the Bank. This scenario, known as the "threat scenario", was specifically designed to test for very large potential damage to the Bank.
- Reporting chain – Risks communication is a key pillar of the Bank's capacity to manage its risks. Therefore, the Bank's Board of Directors and management have issued a dedicated procedure, the Reporting Chain procedure, which lists the required reporting under normal conditions, in a state of alert and under stress (emergency) conditions. In a state of alert, where a deviation from the specified risk appetite has occurred, or when another material event has occurred, this procedure specifies exactly the required reporting to ensure appropriate handling of this deviation - until it has been eliminated. Reporting according to this procedure takes place between all lines of defense specified at the Bank, as needed and in accordance with potential natural conditions.
- Risks mitigation – Risks identification and mapping by the Bank, the risk appetite framework and the forums appointed by the organization for risks management and control - all are designed to allow the Bank to mitigate its risks - in particular when a stress event or another material event for Bank operations have occurred. The Bank has established a range of forums convened during normal operations and design to create risks communication between the various lines of defense and to ensure information flows so as to allow the Bank to address the material risks for its operations or the potential for development of such events. These forums are designed to cover the range of risks mapped by the Bank. As part of the risks management culture at the Bank, other forums have been established to allow the Bank to address emerging risks: reputation risk, information security and cyber risk,

compliance and regulatory risk, AML risk and cross-border risk. Bank policy documents explicitly list the forums to operate during emergency, including a dedicated policy document on business continuity and another policy document which specifies the behavior by relevant Bank units upon occurrence of a financial stress event in the market. Thus, special emergency forums would be activated at the Bank by the risks managers in case of occurrence, or potential occurrence, of such events related to credit, market and interest risk in the bank portfolio and liquidity risk. Policy documents and procedures prepared by Bank units establish potential escape plans which the Bank could activate should such events occur. The escape plans specify the required reporting chain between Bank managers, the entities to be involved in such an event and the means to be applied or considered in case of such need. Another tool for risks mitigation is conducting structured training and debriefing of events. Policies set by the Board of Directors and management, as well as relevant procedures, stipulate structured training. Furthermore, the Bank is currently about to complete an effort to establish a uniform methodology for debriefing, learning lessons and how to learn from past events, at the Bank or at other financial institutions, in order to allow the organization to mitigate the risk of further occurrence of such events or of similar events.

- IT systems to support risks management and control – The Bank has several major systems which allow Bank units to get information, calculate exposure, perform stress tests and review their risk profile in line with the risk appetite, under normal and emergency conditions. The Bank regularly reviews the quality of information in Bank systems and the needs for risks management and control, in order to ensure that vital, high-quality information is available to Bank units. In particular, the Bank has expanded its action to provide backup for its main systems, as part of the Bank's business continuity plan - and conducts regular exercises in order to ensure business continuity in case of emergency.

For more information about the remuneration structure at the Bank and how it supports the risk culture, see chapter "Remuneration" in the 2015 Risk Management Report on the Bank website.

Regulatory capital

Regulatory capital structure

Supervisory capital is composed of two tiers: Tier I capital (including Tier I equity and Tier I additional capital) and Tier II capital.

Tier I equity includes equity attributable to equity holders of the Bank and the interest of external shareholders in equity of subsidiaries (excess capital at subsidiaries is not taken into account).

Tier I equity includes supervisory adjustments and deductions from capital - goodwill, investments in capital components of financial institutions, cumulative other comprehensive income with regard to cash flow hedges for items not presented at fair value on the balance sheet and adjustments with respect to liabilities for derivatives, due to change in the Bank's credit risk (DVA).

Additional Tier I capital consists of equity instruments which fulfill the specified requirements. As of March 31, 2016, the Bank has no equity instruments included in additional Tier I capital.

Tier II capital consists of a group provision for credit losses and equity instruments which fulfill the specified requirements.

The amount of the group provision is recognized as Tier II capital up to 1.25% of weighted risk assets for credit risk.

Tier II capital instruments include loss-absorption provisions, whereby they would be converted into shares or the principal would be reduced if the Bank's Tier I equity should drop below 5%, or in case of another event leading to dissolution of the Bank, as specified by the Supervisor of Banks. The Bank has instruments which include provisions for reduction of principal.

Tier II capital also includes innovative complex equity instruments and subordinated notes, which were previously issued and do not qualify as supervisory capital pursuant to Basel III directives - and are therefore gradually reduced in conformity with transitional provisions.

Restrictions on capital structure

- Tier II capital shall not exceed 100% of Tier I capital after required deductions from such capital.
- Capital instruments qualified for inclusion in Tier II capital shall not exceed 50% of Tier I capital after required deductions from such capital.

Below is a summary of supervisory capital components as of:

	March 31, 2016		December 31, 2015	
	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III
	NIS in millions			
Tier I equity before regulatory adjustments and deductions	12,592	151	12,397	216
Total regulatory adjustments to and deductions from Tier I equity	102	10	98	16
Tier I capital	12,490	161	12,299	232
Tier II capital	4,598	2,680	4,916	3,127
Total capital	17,088	2,841	17,215	3,359
Total risk weighted assets	129,453	-	129,486	-
Ratio of Tier I capital to risk elements	9.65%		9.50%	
Ratio of total capital to risk elements	13.20%		13.30%	
Minimum Tier I capital adequacy ratio required by Supervisor of Banks	9.42%		9.30%	
Minimum overall capital adequacy ratio required by Supervisor of Banks	12.92%		12.80%	

Below is the detailed composition of supervisory capital, in conformity with disclosure requirements of Basel Pillar 3.

In order to present the connection between the Bank's consolidated balance sheet and supervisory capital components, the following table includes references to another table, later in this chapter (hereinafter: "Stage 2"). This other table lists the balance sheet items which include the supervisory capital components.

According to the directives, each line of this table should be completed, even if the supervisory capital component or the supervisory adjustment are zero or negligible.

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
Tier I capital: Instruments and retained earnings						
1	Ordinary share capital issued by the banking corporation and ordinary share premium for shares included in Tier I capital	2,215	-	2,214	-	1+2
2	Retained earnings, including dividends proposed or declared after the balance sheet date	9,993	11	9,746	16	3
3	Accumulated other comprehensive income and retained earnings for which disclosure has been given	(51)	47	(38)	59	4
4	Tier I equity instruments issued by the banking corporation, eligible for inclusion in regulatory capital during transitional period	-	-	-	-	
5	Ordinary shares issued by consolidated subsidiaries of the banking corporation, which are held by a third party (non-controlling interests)	435	94	474	140	5
6	Tier I equity before regulatory adjustments and deductions	12,592	151	12,397	216	
Tier I capital: Regulatory adjustments and deductions						
7	Prudential valuation adjustments	-	-	-	-	
8	Goodwill, net of related deferred tax liability, if applicable	87	-	87	-	6
9	Other intangible assets, other than mortgage-servicing rights, net of related deferred tax liability	-	-	-	-	7+8

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
10	Deferred tax assets that rely on future profitability of the banking corporation, excluding those arising from temporary differences	-	-	-	-	9
11	Accumulated other comprehensive income with respect to cash flows hedging of items not listed at fair value on the balance sheet	6	4	6	8	10
12	Shortfall of provisions to expected losses	-	-	-	-	
13	Increase in shareholders' equity due to securitization transactions	-	-	-	-	
14	Unrealized gains / losses from changes to fair value of liabilities arising from change to own credit risk of the banking corporation. In addition, with regard to liabilities with respect to derivatives, all debt value adjustments (DVA) arising from own credit risk of the banking corporation is to be deducted	9	6	5	8	11
15	Excess deposits over provision, net of deferred tax liabilities to be settled should the asset become impaired or be disposed in conformity with Public Reporting Directives	-	-	-	-	12+13
16	Investment in own ordinary shares, held directly or indirectly (including commitment to purchase shares subject to contractual obligations)	-	-	-	-	
17	Reciprocal cross-holdings in ordinary shares of financial corporations	-	-	-	-	
18	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation does not hold more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	14
19	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation holds more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
20	Mortgage servicing rights whose amount exceeds 10% of Tier I equity	-	-	-	-	
21	Deferred tax assets arising from temporary differences, whose amount exceeds 10% of Tier I equity	-	-	-	-	
22	Amount of mortgage servicing rights, deferred tax assets arising from temporary differences and investments that exceed 10% of the ordinary share capital issued by financial corporations, which exceeds 15% of Tier I equity of the banking corporation	-	-	-	-	
23	Of which: With respect to investments that exceed 10% of the ordinary share capital issued by financial corporations	-	-	-	-	
24	Of which: With respect to mortgage servicing rights	-	-	-	-	
25	Of which: Deferred tax assets arising from temporary differences	-	-	-	-	
26	Regulatory adjustments and other deductions stipulated by the Supervisor of Banks	-	-	-	-	
26.A	Of which: With respect to investments in capital of financial corporations	-	-	-	-	
26.B	Of which: With respect to mortgage servicing rights	-	-	-	-	
26.C	Of which: Additional regulatory adjustments to Tier I equity, not included in sections 25.A and 25.B.	-	-	-	-	
	Regulatory adjustments to Tier 1 capital, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	-	-	-	-	
27	Deductions applicable to Tier I equity, due to insufficient additional Tier I and Tier II capital to cover deductions	-	-	-	-	
28	Total regulatory adjustments to and deductions from Tier I equity	102	10	98	16	
29	Tier I capital	12,490	161	12,299	232	

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
Additional Tier I capital: Instruments						
30	Additional Tier I equity instruments issued by the banking corporation and premium for such instruments	-	-	-	-	
31	Of which: Classified as equity in conformity with Public Reporting Regulations	-	-	-	-	15a+16a
32	Of which: Classified as liabilities in conformity with Public Reporting Regulations	-	-	-	-	
33	Additional Tier I equity instruments issued by the banking corporation, eligible for inclusion in regulatory capital during transitional period	-	-	-	-	15a+16a
34	Additional Tier I equity instruments issued by subsidiaries of the banking corporation, held by third party investors	-	-	-	-	17
35	Of which: Additional Tier I equity instruments issued by subsidiaries of the banking corporation, held by third party investors, subject to phase-out from additional Tier I capital	-	-	-	-	
36	Tier I capital, before deductions	-	-	-	-	
Additional Tier I capital: Deductions						
37	Investment in own additional Tier I equity instruments, held directly or indirectly (including commitment to purchase such instruments subject to contractual obligations)	-	-	-	-	
38	Reciprocal cross-holdings in additional Tier I equity instruments	-	-	-	-	
39	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation does not hold more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
40	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation does not hold more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	
41	Other deductions stipulated by the Supervisor of Banks	-	-	-	-	
41.A	Of which: With respect to investments in capital of financial corporations	-	-	-	-	
41.B	Of which: Other deductions from Tier I capital, not included in section 1.A	-	-	-	-	
	Other deductions from Tier 1 capital, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	-	-	-	-	
	Of which: Additional regulatory adjustments to Tier I capital, not included in section 38.A	-	-	-	-	
42	Deductions applicable to additional Tier I capital, due to insufficient Tier II capital to cover deductions	-	-	-	-	
43	Total deductions from additional Tier I capital	-	-	-	-	
44	Additional Tier I capital	-	-	-	-	
45	Tier I capital	12,490	161	12,299	232	

Tier II capital: Instruments and provisions

46	Instruments issued by the banking corporation (not included in Tier I capital) and premium on such instruments	596	-	417	-	18a
47	Tier II capital instruments issued by the banking corporation, eligible for inclusion in regulatory capital during transitional period	2,680	2,680	3,127	3,127	18b
48	Tier II capital instruments issued by subsidiaries of the banking corporation to third party investors	-	-	-	-	19

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
49	Of which: Tier II capital instruments issued by subsidiaries of the banking corporation, held by third party investors, subject to phase-out from Tier II capital	-	-	-	-	
50	Group provisions for credit losses by effect of related tax	1,322	-	1,372	-	20
51	Tier II capital, before deductions	4,598	2,680	4,916	3,127	
Tier II capital: Deductions						
52	Investment in own Tier II capital instruments, held directly or indirectly (including commitment to purchase such instruments subject to contractual obligations)	-	-	-	-	
53	Reciprocal cross-holdings in Tier II capital instruments of financial corporations	-	-	-	-	
54	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation does not hold more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	
55	Investments in the capital of financial corporations not consolidated in the public financial statements of the banking corporation, where the banking corporation holds more than 10% of the issued ordinary share capital of the financial corporation	-	-	-	-	
56	Other deductions stipulated by the Supervisor of Banks	-	-	-	-	
56.A	Of which: With respect to investments in capital of financial corporations	-	-	-	-	
56.B	Of which: Other deductions from Tier II capital, not included in section 51.A	-	-	-	-	
	Regulatory adjustments to Tier 2 capital, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	-	-	-	-	

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
57	Total deductions from Tier II capital	-	-	-	-	
58	Tier II capital	4,598	2,680	4,916	3,127	
59	Total equity	17,088	2,841	17,215	3,359	
	Total risk weighted assets in conformity with treatment required prior to adoption of Directive 202, in conformity with Basel III	-	-	-	-	
60	Total risk weighted assets	129,453	-	129,486	-	
Capital ratios and capital conservation buffer						
61	Tier I capital	9.65%		9.50%		
62	Tier I capital	9.65%		9.50%		
63	Total capital	13.20%		13.30%		
64	Not applicable			-		
65	Not applicable			-		
66	Not applicable			-		
67	Not applicable			-		
68	Not applicable			-		
Minimum requirements stipulated by the Supervisor of Banks						
69	Minimum Tier I capital adequacy ratio required by Supervisor of Banks	9.42%		9.30%		
70	Minimum Tier I capital adequacy ratio required by Supervisor of Banks	9.42%		9.30%		
71	Minimum overall capital adequacy ratio required by Supervisor of Banks	12.92%		12.80%		
Amounts below deduction threshold (before risk weighting)						
72	Investments in capital of financial corporations (other than banking corporations and their subsidiaries), that do not exceed 10% of ordinary share capital issued by the financial corporation and that are below the deduction threshold	-	-	-	-	

		March 31, 2016		December 31, 2015		
		Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	Balance	Amounts not deducted from equity, subject to required treatment prior to adoption of Directive 202, in conformity with Basel III	References from step 2
						NIS in millions
73	Investments in Tier I capital of financial corporations (other than banking corporations and their subsidiaries , that do exceed 10% of ordinary share capital issued by the financial corporation and that are below the deduction threshold	2	-	2	-	
74	Mortgage servicing rights	-	-	-	-	
75	Deferred tax assets arising from temporary differences, that are below the deduction threshold	891	-	930	-	
Cap for inclusion of provisions in Tier II				-		
76	Provision eligible for inclusion in Tier II in respect of exposures subject to standardized approach, prior to application of cap	1,322	-	1,372	-	
77	Cap on inclusion of provisions in Tier II under standardized approach	1,501	-	1,502	-	
78	Provision eligible for inclusion in Tier II in respect of exposures subject to internal ratings-based approach, prior to application of cap	-	-	-	-	
79	Cap on inclusion of provisions in Tier II under internal ratings-based approach	-	-	-	-	
			-			
Equity instruments not eligible as regulatory capital subject to transitional provisions				-		
80	Current cap for instruments included in Tier I equity that are subject to transitional provisions	-	-	-	-	
81	Amount deducted from Tier I equity due to cap	-	-	-	-	
82	Current cap for instruments included in additional Tier I equity that are subject to transitional provisions	-	-	-	-	
83	Amount deducted from additional Tier I capital due to cap	-	-	-	-	
84	Current cap for instruments included in Tier II equity that are subject to transitional provisions	2,680	-	3,127	-	
85	Amount deducted from Tier II capital due to cap	475	-	65	-	

Below are supervisory capital components, as included on the Bank's consolidated balance sheet[(1)].

According to disclosure requirements of Pillar 3, the relationship between the balance sheet, as it appears on the Bank's financial statements, and supervisory capital components must be presented in the above table. The following table shows the Bank's consolidated balance sheet in detail, listing the balance sheet items which include the supervisory capital components:

	Consolidated supervisory balance sheet		References supervisory regulatory capital components
	March 31, 2016	December 31, 2015	
		NIS in millions	
Assets			
Cash and deposits with banks	38,193	30,489	
Securities	9,013	11,845	
Of which: Investments in equity of financial corporations, not exceeding 10% of share capital of each financial corporation	-	-	14
Of which: Investments in equity of financial corporations, exceeding 10% of share capital of each financial corporation, not exceeding the deduction threshold	-	-	
Of which: Other securities	9,013	11,845	
Securities loaned or purchased in resale agreements	151	71	
Loans to the public	163,451	160,604	
Provision for credit losses	(1,378)	(1,400)	
Of which: Group provision for credit losses included in Tier II	(1,247)	(1,271)	20
Of which: Provision for credit losses not included in regulatory capital	(131)	(129)	
Loans to the public, net	162,073	159,204	
Loans to Governments	323	316	
Investments in associates	36	36	
Of which: Investments in equity of financial corporations, exceeding 10% of share capital of each financial corporation, not exceeding the deduction threshold	2	2	
Of which: Investments in other associates	34	34	
Buildings and equipment	1,546	1,583	
Intangible assets and goodwill	87	87	
Of which: Goodwill	87	87	6
Of which: Other intangible assets	(0)	(0)	7
Assets with respect to derivative instruments	3,922	3,527	
Other assets	1,465	2,000	
Of which: Deferred tax assets	891	930	
Of which: Deferred tax assets, other than those arising from temporary differences	-	-	9
Of which: Deferred tax liability with respect to intangible assets	-	-	8
Of which: Other deferred tax assets	891	930	
Of which: Excess deposit over provision	-	-	12
Of which: Other additional assets	574	1,070	
Total assets	216,809	209,158	

(1) There is no difference between the consolidated balance sheet and the consolidated supervisory balance sheet.

	Consolidated supervisory balance sheet		References supervisory regulatory capital components
	March 31, 2016	December 31, 2015	
		NIS in millions	
Liabilities and Equity			
Deposits from the public	165,001	162,380	
Deposits from banks	1,416	1,166	
Deposits from the Government	55	58	
Securities loaned or sold in conjunction with repurchase agreements	-	-	
Debentures and subordinated notes*	26,859	23,719	
Of which: Subordinated notes not recognized as regulatory capital	2,351	2,083	
Of which: Subordinated notes recognized as regulatory capital	3,276	3,544	
Of which: Qualifying as supervisory capital components	596	417	16a,18a
Of which: Not qualifying as regulatory capital components and subject to transitional provisions	2,680	3,127	16b,18b
Liabilities with respect to derivative instruments	4,878	3,634	
Of which: With respect to internal credit risk	15	13	11
Other liabilities	5,928	5,786	
Of which: Deferred tax liability arising from retirement	-	-	13
Total liabilities	204,137	196,743	
Equity attributable to equity holders of the banking corporation	12,098	11,847	
Of which: Ordinary share capital	12,157	11,923	
Of which: Ordinary share capital	2,149	2,147	1
Of which: Retained earnings	9,993	9,746	3
Of which: Cumulative other comprehensive loss	(51)	(38)	4
Of which: Loss with respect to adjustments with respect to employee benefits	(70)	(40)	
Of which: Unrealized gain from adjustment to fair value of available-for-sale securities	9	(12)	
Of which: Net loss from cash flow hedges	10	14	10
Of which: Net change from translation of financial statements	-	-	
Of which: Capital reserves	67	67	2
Of which: Preferred share capital	-	-	
Of which: Qualifying as supervisory capital components	-	-	15a
Of which: Not qualifying as regulatory capital components and subject to transitional provisions	-	-	15b
Of which: Other equity instruments	-	-	
Of which: Qualifying as supervisory capital components	-	-	
Of which: Not qualifying as regulatory capital components and subject to transitional provisions	-	-	
Non-controlling interests	574	568	
Of which: Non-controlling interests attributable to Tier I equity	435	474	5
Of which: Non-controlling interest attributable to additional Tier I equity	-	-	17
Of which: Non-controlling interests attributable to Tier II capital	-	-	19
Of which: Non-controlling interests not attributable to regulatory capital	139	94	
Total shareholders' equity	12,672	12,415	
Total liabilities and equity	216,809	209,158	

Report on movements in supervisory capital during the period, including changes to Tier I equity, Tier I capital and Tier II capital (NIS in millions):

	March 31, 2016	March 31, 2015	December 31, 2015
Tier I capital			
Balance as of year start	12,299	11,273	11,273
Issuance of ordinary share capital and share premium	1	4	27
Change in capital reserve from benefit from share-based payment transactions	(1)	1	1
Net profit for the period	288	248	1,134
Dividends declared or distributed this year	(36)	-	(86)
Translation differences	-	-	(1)
Capital reserve from securities available for sale	21	38	(17)
Capital reserve from cash flow hedging	(4)	(10)	(4)
Capital reserve with respect to employee rights	(31)	(56)	(40)
Others, including regulatory adjustments	(50)	(20)	(38)
Non-controlling interests	7	2	55
Deductions			
Accumulated other comprehensive income with respect to cash flows of items not listed at fair value on the balance sheet	-	-	(2)
Accumulated gain or loss from changes to fair value of liabilities, arising from change to the Bank's credit risk	(4)	(4)	(3)
Balance as of end of period	12,490	11,476	12,299
Tier II capital			
Balance as of year start	4,916	4,883	4,883
Deduction of equity instruments	(447)	(447)	(447)
Movement in group provision for credit losses	(50)	49	63
Issue of debentures with contingent conversion	179	-	417
Balance as of end of period	4,598	4,485	4,916

Capital adequacy

The Bank assesses its capital adequacy in accordance with Basel II rules, as stipulated by Proper Conduct of Banking Business Directives 201-211. The Bank applies the standard approach in assessing exposure to credit risk (including counter-party risk), operating risk and market risk.

The Bank regularly monitors its capital adequacy ratio, in order to ensure compliance with requirements of the Supervisor of Banks and with restrictions set by the Board of Directors, as well as to prepare in advance to respond to evolution of risk assets and capital requirements at the Bank. For this purpose, the Board of Directors has created a policy document which specifies the measurement frequency of capital adequacy, the required reporting and actions to be taken if the capital ratio drops below the minimum levels specified; a capital planning and management forum has been operating for several years, attended by the Manager, Finance Division - CFO (chair), Risks Control Division - CRO, and the Manager, Accounting and Financial Reporting Division - the Chief Accountant, the Manager, Planning, Operations and Client Assets Division, the Manager, Business Banking Division and the Manager, Retail Division at the Bank. This policy document is an annex to the Bank's master policy on risks management, capital planning and internal control.

As part of implementation of Basel II Pillar 2, the Bank annually files its ICAAR document - which is a report highlighting action taken by the Bank during the year as part of the ICAAP process, which is included in Basel II Pillar 2. On December 31, 2015, the Bank sent its seventh ICAAR document to the Bank of Israel. The ICAAR report consists of several chapters which describe corporate governance for risks management at the Bank, the capital targets and targets of the strategic plan, as well as developments during the year in management of various risks identified and mapped by the Bank. At the core of this document is the capital planning process, conducted across a planning horizon of three years to come, in which the Bank challenges its strategic plan and its overall capital targets, using a long, diverse range of hypothetical stress tests which significantly impact Bank profitability and erode its capital. The outcome of the Bank's most recent capital planning indicates that the Bank has sufficient general capital to fulfill its strategic plan and capital targets specified by the Board of Directors.

Basel III

In late 2010, the Basel Committee adopted a new directive, known as Basel III. This directive, the result of the recent crisis in global markets, consists of multiple amendments to the Basel II directive, including: Strengthening of capital base, increase in minimum capital ratios, specification of new benchmarks and methodologies for handling liquidity risk, reinforced methodology for handling counter-party risk (including capital allocation for this risk as part of Pillar 1), specification of the leverage ratio as a new ratio as part of risk management benchmarks, reinforcing processes for conducting stress testing and other processes designed to improve risks management and control capacity at financial institutions. According to the Committee-specified schedule, this directive would be gradually applied world-wide starting in 2013.

As from January 1, 2014, the Bank applies provisions for capital measurement and adequacy, based on Basel III provisions, as published by the Supervisor of Banks and as incorporated in Proper Banking Conduct Directives 201-211.

Below are the major effects of implementation of these directives:

Deferred taxes due to temporary differences - Deferred taxes due to temporary differences (and up to 10% of Tier I equity) - weighted at 250% risk weighting.

Group provision for credit losses - The group provision would be recognized as Tier II capital up to 1.25% of weighted risk assets for credit risk. Conversely, the provision amount was added to weighted risk assets for credit risk.

Capital instruments not qualified as supervisory capital - recognition of 80% of the balance of such instruments as of December 31, 2013 and a 10% deduction annually through January 1, 2022.

Minority interest - The amount of minority interest recognized as capital has been limited, and excess capital of a subsidiary may not be recognized.

Capital allocation with respect to CVA losses (Credit Value Adjustments) - losses due to revaluation at market value with respect to counter-party credit risk – In addition to a capital requirement with respect to default risk arising from counter-party credit risk under the standard approach, an additional capital allocation is required to cover the risk of potential loss which may arise from marking to market value of OTC derivatives.

After the Supervisor of Banks issued its directives with regard to adoption of Basel III recommendations in Israel, the Bank's Board of Directors resolved, on August 14, 2013, to adopt a target for Tier I equity ratio to risk elements, as of December 31, 2014 of 9% or higher - while maintaining appropriate safety margins.

On September 28, 2014, the Supervisor of Banks issued a circular updating Proper Banking Conduct Directive 329, whereby the target Tier I equity ratio and the target ratio of total capital to risk elements ratio would include an addition equal to 1% of the housing loan portfolio balance. The equity targets would be increased by fixed quarterly steps from January 1, 2015 to January 1, 2017 (over eight quarters).

Following implementation of this directive, the target Tier I equity ratio to risk elements is expected to increase by 0.1%, according to data as of the report date, in each of the eight quarters as from the implementation date of this directive, for a total increase of 0.8% when implementation is complete.

This target may change based on actual data for the housing loan portfolio and for total risk assets.

Accordingly, the minimum Tier I capital ratio and the minimum total capital ratio required by the Supervisor of Banks, as of January 1, 2017, on a consolidated basis, in conformity with data as of the current reporting date, are 9.8% and 13.3%, respectively.

On December 23, 2014, the Bank's Board of Directors instructed Bank management to maintain proper safety margins so that the Bank's Tier I equity would not be lower than the aforementioned.

Composition of risk assets and capital requirements with respect to credit risk by exposure group are as follows (NIS in millions):

	As of March 31, 2016		As of March 31, 2015		As of December 31, 2015	
Exposure group	Weighted risk asset balances	Capital requirement(1)	Weighted risk asset balances	Capital requirement(2)	Weighted risk asset balances	Capital requirement(3)
Sovereign debt	637	82	704	88	520	67
Public sector entity debt	457	59	394	49	378	48
Banking corporation debt	775	100	1,354	169	726	93
Corporate debt	38,037	4,907	41,556	5,195	39,938	5,112
Debt secured by commercial real estate	2,249	290	2,435	304	2,310	295
Retail exposure to individuals	12,226	1,577	11,261	1,408	12,027	1,539
Loans to small businesses	6,031	778	4,784	598	5,177	663
Residential mortgages	55,293	7,133	49,976	6,247	54,529	6,980
Other assets	4,344	560	4,530	566	4,531	580
Total	120,049	15,486	116,994	14,624	120,136	15,377

Risk assets and capital requirements with respect to market risk, CVA risk(3) and operating risk are as follows (NIS in millions):

	As of March 31, 2016		As of March 31, 2015		As of December 31, 2015	
	Weighted risk asset balances	Capital requirement(1)	Weighted risk asset balances	Capital requirement(2)	Weighted risk asset balances	Capital requirement(3)
Market risk	957	123	871	109	950	122
CVA risk with respect to derivatives(4)	703	91	797	100	657	84
Operating risk	7,744	999	7,435	929	7,743	991
Total	9,404	1,213	9,103	1,138	9,350	1,197
Total risk assets	129,453	16,699	**126,097**	**15,762**	129,486	16,574

(1) The capital requirement was calculated at 12.9% of risk asset balances.
(2) The capital requirement was calculated at 12.5% of risk asset balances.
(3) The capital requirement was calculated at 12.8% of risk asset balances.
(4) Credit Value Adjustments - mark to market with respect to credit risk of counter-party, in conformity with Basel III provisions.

Below is capital for calculation of capital ratio after supervisory adjustments and deductions:

	As of March 31, 2016	As of March 31, 2015	As of December 31, 2015
Tier I capital	12,490	11,476	12,299
Tier II capital	4,598	4,485	4,916
Total capital	17,088	15,961	17,215

Development of Group ratio of capital to risk elements is as follows (in %):

	Ratio of capital to risk elements		
	As of March 31, 2016	As of March 31, 2015	As of December 31, 2015
Ratio of Tier I capital to risk elements	9.65	9.10(1)	9.50
Ratio of total capital to risk elements	13.20	12.66(1)	13.29
Minimum Tier I capital ratio required by Supervisor of Banks(2)	9.42	9.00	9.30
Total minimum capital ratio required by the Supervisor of Banks(2)	12.92	12.50	12.80
Significant subsidiaries			
Bank Yahav for Government Employees Ltd. and subsidiaries thereof			
Ratio of Tier I capital to risk elements	10.53	9.67	9.98
Ratio of total capital to risk elements	13.66	13.31	13.23
Minimum Tier I capital ratio required by Supervisor of Banks	9.00	9.00	9.00
Total minimum capital ratio required by the Supervisor of Banks	13.00	13.00	13.00

(1) Comparative figures for previous periods were restated. For more information about the Supervisor of Banks' directives concerning capitalization of software costs - see Note 1.B. to the financial statements.
(2) Capital ratios required by the Supervisor of Banks as from January 1, 2015.
To these ratios, as from January 1, 2015, an additional capital requirement would be added expressed as 1% of the housing loan balance as of the reporting date. This requirement is applied gradually through January 1, 2017. Accordingly, the minimum Tier I capital ratio and the minimum total capital ratio required by the Supervisor of Banks, as of January 1, 2017, on a consolidated basis, in conformity with data as of the current reporting date, are 9.84% and 13.34%, respectively.

Additional information about capital adequacy

Below is information about risk weighted assets by supervisory operating segment (NIS in millions):

											As of March 31, 2016
	House-holds	Private banking	Micro business	Small business	Medium business	Large business	Institu-tional investors	Financial mana-gement	Overseas operations	Total amount	Total percentage
Credit risk (including CVA)	70,565	16	5,612	6,412	5,762	22,168	2,812	3,910	3,495	120,752	93%
Market risk	-	-	-	-	-	-	-	957	-	957	1%
Operating risk	4,490	1	357	408	367	1,410	179	310	222	7,744	6%
Total	75,055	17	5,969	6,820	6,129	23,578	2,991	5,177	3,717	129,453	100%
Total percentage	58%	0%	5%	5%	5%	18%	2%	4%	3%	100%	100%

											As of March 31, 2015
	House-holds	Private banking	Micro business	Small business	Medium business	Large business	Institu-tional investors	Financial mana-gement	Overseas operations	Total amount	Total percentage
Credit risk (including CVA)	64,446	24	5,383	5,581	5,687	26,706	3,128	4,310	2,526	117,791	93%
Market risk	-	-	-	-	-	-	-	871	-	871	1%
Operating risk	4,038	1	337	350	356	1,673	196	325	159	7,435	6%
Total	68,484	25	5,720	5,931	6,043	28,379	3,324	5,506	2,685	126,097	100%
Total percentage	54%	0%	5%	5%	5%	23%	3%	4%	2%	100%	100%

											As of December 31, 2015
	House-holds	Private banking	Micro business	Small business	Medium business	Large business	Institu-tional investors	Financial mana-gement	Overseas operations	Total amount	Total percentage
Credit risk (including CVA)	69,413	29	4,193	6,018	6,775	23,585	3,185	4,285	3,310	120,793	93%
Market risk	-	-	-	-	-	-	-	950	-	950	1%
Operating risk	4,415	2	267	381	431	1,500	203	333	211	7,743	6%
Total	73,828	31	4,460	6,399	7,206	25,085	3,388	5,568	3,521	129,486	100%
Total percentage	57%	0%	3%	5%	6%	19%	3%	4%	3%	100%	100%

Below is the movement in weighted risk assets during the period, for each type of weighted risk asset:

	As of March 31, 2016	As of March 31, 2015	As of December 31, 2015
Movement in credit risk assets			
Balance as of year start	120,793	116,159	116,159
Change in risk assets with respect to credit exposure	327	1,290	5,212
Change in risk assets with respect to securities exposure	70	(70)	(75)
Change in derivatives exposure risk assets	(49)	(260)	(696)
Change in off-balance sheet exposure risk assets	(249)	455	114
Change in CVA	46	(89)	(228)
Regulatory changes	-	-	-
Other effects	(186)	306	307
Credit risk assets at end of period	120,752	117,791	120,793
Movement in operating risk assets			
Balance as of year start	7,743	7,383	7,383
Change during the period	1	52	360
Operating risk assets at end of period	7,744	7,435	7,743
Movement in market risk assets			
Balance as of year start	950	1,020	1,020
Change in basis risk	(9)	(22)	(155)
Change in interest risk - general market risk	3	(144)	84
Change in options risk	13	17	1
Market risk assets at end of period	957	871	950

Leverage ratio

On April 28, 2015, the Supervisor of Banks issued a new Proper Banking Conduct Directive 218 concerning "Leverage ratio". This directive adopts the Basel Committee recommendations with regard to leverage ratio, stipulated in January 2014.

The leverage ratio is reflected in percent, defined as the ratio of Tier I capital to total exposure. Total exposure for the Bank is the sum of balance sheet exposures, exposures to derivatives and to securities financing transactions and off-balance sheet items.

According to the directive, banking corporations shall maintain a leverage ratio of 5% or higher on consolidated basis, as from January 1, 2018. Banking corporations which comply with the requirement upon publication of the directive may not drop below the threshold stated in the regulation. Any banking corporation which does not meet the requirements of this directive is required to increase its leverage ratio at fixed quarterly steps by January 1, 2018.

Below is information about the Bank's leverage ratio:

Comparison of assets on balance sheet and exposure measurement for leverage ratio (NIS in millions)	As of March 31, 2016	As of December 31, 2015
Total assets on consolidated financial statements	216,809	209,158
Adjustments with respect to investments in banking, finance, insurance or commercial entities consolidated for accounting purposes but not within the scope of consolidation for supervisory purposes	-	-
Adjustments with respect to trust assets recognized on the balance sheet in conformity with Public Reporting Directives but not included in the exposure measurement of leverage ratio	-	-
Adjustments with respect to financial derivative instruments	137	467
Adjustments with respect to securities financing transactions	-	-
Adjustments with respect to off-balance sheet items(1)	20,587	20,482
Other adjustments	1,160	1,184
Exposure for leverage ratio	238,693	231,291

(1) Conversion of off-balance sheet exposures to equivalent credit amounts, in conformity with Basel rules for capital adequacy measurement.

Composition of exposures and leverage ratio (NIS in millions)	As of March 31, 2016	As of December 31, 2015
Balance sheet exposure		
Assets on balance sheet(1)	213,731	206,590
Amounts with respect to assets deducted to determine Tier I capital	(87)	(87)
Total balance sheet exposure(1)	213,644	206,503
Exposure with respect to derivatives		
Cost of replacement with respect to all derivative transactions	1,540	1,539
Amounts added with respect to future potential exposure with respect to all derivative transactions	1,800	1,695
Gross-up of collateral provided with respect to derivatives, deducted from assets on the balance sheet in conformity with Public Reporting directives	-	-
Deduction of debtor assets with respect to variable cash collateral provided in conjunction with derivative transactions	-	-
Effective adjusted nominal amount of credit derivatives written	660	710
Adjusted effective nominal offsets and deduction of additions with respect to credit derivatives written	-	-
Total exposure with respect to derivatives	4,000	3,944
Exposure with respect to securities financing transactions		
Gross assets with respect to securities financing transactions (without offsets), after adjustment for transactions accounted for as an accounting sale	462	362
Offset amounts of cash payable and cash receivable from gross assets with respect to securities financing transactions	-	-
Credit risk exposure for central counter-party with respect to securities financing assets	-	-
Exposure with respect to transactions as agent	-	-
Total exposure with respect to securities financing transactions	462	362
Other off-balance-sheet exposures		
Off-balance sheet exposure at gross nominal value	63,616	62,343
Adjustments with respect to conversion to credit equivalent amounts	(43,029)	(41,861)
Off-balance sheet items	20,587	20,482
Capital and total exposure		
Tier I capital	12,490	12,299
Total exposure	238,693	231,291
Leverage ratio		
Leverage ratio in conformity with Proper Banking Conduct Directive 218	5.23	5.32

(1) Excluding derivatives and securities financing transactions, including collateral.

The decrease in the leverage ratio is due to the significant increase in total assets, by 3.6%. For this matter, see debentures issued by Mizrahi Tefahot Issuance Company Ltd., in the chapter "Sources and Financing" (overview, targets and strategy) in the Report of the Board of Directors and Management.

Credit risk

Credit risk management

Credit risk is the risk that a borrower or counter-party of the Bank would not fulfill its obligations towards the Bank. By definition, credit risk is a material risk to operations of banks. Indeed, the lion's share of risk assets allocated by the Bank in Tier I are with respect to credit risk. The Bank's credit operations have material impact on Bank strategy and, in particular, credit risk is interrelated with several other risks mapped by the Bank, such as market and interest risk, liquidity risk and operating risk.

Group operations with regard to credit to the public are managed by client attributes and types of banking services these clients require.

For more information about client attributes in each segment, see chapter "Supervisory Operating Segments" on the Report by the Board of Directors and Management.

The Bank’s Board of Directors has specified policies for addressing credit risk. These policies specify the required principles for risk management and control and, in particular, the credit risk appetite. The policies document specifies the required organizational structure for management and control of credit risk, based on the lines of defense specified by the Bank in its master policy on risks management and control.

The Bank’s Board of Directors is responsible for setting the Bank’s credit policies, which prescribe principles and rules for making credit available and for the management and control over the loan portfolio, in order to preserve its quality and mitigate its inherent risk. These principles and rules enable controlled management of the risk involved in granting loans to borrowers, at the level of the individual borrower, group of borrowers and the level of economic and business sectors - to the level of the entire portfolio. The need to revise the policies is reviewed throughout the year, in view of developments in the business environment in which the Bank and Bank clients operate, given changes to the risk profile in view of the risk appetite specified and in view of regulatory changes, if any. The Bank’s Board of Directors approves the Bank's credit policies at least once a year. Other policy documents discuss the relevant risks to the Bank's credit operations, including: Credit concentration policy, which ensures that the credit concentration level at the Bank is regularly managed and monitored; derivatives policy, which stipulates the principles for management and monitoring of Bank clients with derivatives activity; collateral policy, which stipulates the principles required for management of client collateral, safety factors required by transaction type and risk factor; and the environmental risks policy.

Risk appetite consists of a long list of benchmarks and risk factors relevant to the Bank's credit operations, including: Economic sectors, borrower groups, risk factors in the mortgage portfolio, unique activity types, quality of credit portfolio, overseas operations etc. and other risk factors relevant for the Bank's credit risk profile and its business operations. The credit risk appetite framework is also determined based on a range of stress tests, which review the Bank's credit portfolio under emergency conditions, in order to reduce impact to the Bank portfolio should any extreme market events occur.

The Board of Directors discharges its role with regard to credit through the Board of Directors' Credit Committee, the Audit Committee and the Risks Management Committee. The credit policy document is discussed by the Board Credit Committee and by the Board Risks Management Committee, prior to being approved by the Board plenum.

Bank management is responsible for ensuring that Bank operations with regard to credit are aligned with its business strategy and risk appetite - as specified by the Board of Directors.

In this context, Bank management is responsible for instilling the organizational culture related to risks culture in all Bank employees. Bank management is responsible for implementation of appropriate risks management systems, both from the financial risk aspect and from the operating risks aspect, internal controls and overall risks management. Bank management is responsible for implementing policy guidelines, as specified by the Board of Directors; to this end, management has specified in some cases management restrictions which are lower than those specified by the Board of Directors.

The Supreme Credit Committee is the most senior forum for credit approval at the Bank. This Committee, headed by the President & CEO, consists of managers of the Business Division, Finance Division, Retail Division, Risks Control Division and Legal Counsel Division, as well as sector managers in the Business Division.

First line of defense - credit-related business lines at the Bank

Line of business management is fully responsible for risks management and for implementing an appropriate control environment for its operations The professional units in each of these client segments are responsible for regularly verification, monitoring and control of exposure to clients and operating segments for which they are responsible. This line of defense includes specific control units, such as division controllers and other control functions. A set of procedures ensures the actual implementation of policy guidelines.

Second line of defense - Risk Control Division

The Risks Control Division acts as the Bank's independent risks management function, thus serving as the second line of defense within corporate governance for risks management.

The Division Manager is also the Bank's Chief Risks Officer (CRO).

With regard to credit risk management, the Division operates through multiple independent units, namely: Credit Risk Control Department, Analysis Depart, Capital Market Exposure Unit, Advanced Model Development and Deployment Department, Operating Risk Department and the Validation Department.

The Chief Accountant is responsible for credit classification and for determination of provisions for credit losses.

Third line of defense - Internal Audit

Internal Audit serves as the third line of defense within corporate governance for risks management, conducting audits of credit risk management as part of its annual work plan.

The Bank's credit policy also specifies the ways, methods, processes and systems required for risk management, given the business targets, under normal conditions and under emergency conditions and, in particular, specifies the required processes for monitoring the restrictions specified in the risk appetite.

Monitoring is performed by the business units in the first line, which are monitored by the Risk Control Division. Monitoring of risk appetite - given the specified risk appetite - is a major part of the Bank's quarterly risks document, which is brought for approval by the Bank's Board of Directors after being discussed by the Supreme Credit Committee and by the Board Risk Management Committee. The Bank's Board of Directors has specified the required reporting chain with respect to risks to which the Bank is exposed and specifically for credit risk, has specified the procedures required for reporting any deviations from the risk appetite, if any, as well as current reporting with regard to the Bank's risk appetite.

As part of the credit granting process, transaction data is reviewed in accordance with criteria specified by the Bank. The Bank reviews credit and clients based on borrower quality, the borrower's repayment capacity, the nature of the transaction, collateral and the borrower's free capital. The decision making process for granting credit is hierarchical, from branch level to Board of Directors level. Each unit which provides credit monitors on a regular basis credit repayment in accordance with terms agreed as well as the financial status of the client, based on their level of indebtedness. Any findings requiring action are reported to the relevant credit entity. In addition, the credit granting process involves the Analysis Department, which is part of the Bank's risks management function, which operates under the Risks Control Division. This involvement includes (with regard to major credit exposures and to economic sectors, as stipulated by Bank of Israel directives and Bank procedures) independent analysis of credit applications and presentation of conclusions and recommendations in a written document attached to the credit application and brought for discussion by the appropriate credit committee.

The Bank operates on multiple levels to monitor and mitigate credit risk in as much as possible, from the credit approval stage, required collateral and financial covenants specified in accordance with procedures, authorization and diversification policies specified by the Bank, through to regular control by business units and dedicated control units. This is done with constant effort invested in improving the professional expertise of those involved with credit, by means of banking courses and training, as well as professional seminars at all levels. Concurrently, the Bank invests extensive resources in improving its control mechanisms and IT systems available to decision makers in the credit sector.

Below is information about key processes involved in credit risk management and control at the Bank:

Considerations in extending credit – The considerations involved in granting credit are based mainly on the quality of the client, his reliability, financial strength, liquidity, repayment ability, seniority in the industry, length of time with the Bank, behavior in the account and on the quality of the collateral. Likewise, the Bank works to match credit type and terms to client needs. In cases in which loans are issued based solely on the quality of the borrower, without requiring full or partial collateral coverage, the Bank may specify certain covenants, such as maintaining certain financial ratios.

Procedures - Procedures for granting credit and for processing credit and collateral, as well as the relevant IT systems there for, are regularly reviewed and updated to adapt them to the changing business environment, while learning lessons from different events. These procedures serve to implement the policy principles set by the Bank's Board of Directors.

Risks diversification - The Bank's credit policies have been based for years on diversification and controlled management of risks. Risks diversification is reflected in different ways: Diversification of the loan portfolio across economic sectors, including increased exposure to specific sectors, diversification across client size groups, diversification across different linkage bases, geographic diversification if applicable (construction sector).

Authority to grant credit – In order to streamline the decision-making process as it relates to granting credit while minimizing risk, a ranking of authority was determined for officers and credit committees at different levels, up to the level of the Board of Directors and its Credit Committee.
Credit-granting decisions, beginning from the region level, are made by credit committees in order to minimize the risk in relying on the judgment of a single individual. The credit authorizations include restrictions on credit limit as well as on the percentage of unsecured credit that each authorized official is permitted to approve, and other guidelines were prescribed relating to the prerogative to exercise authority in certain situations.

Currency exposure in credit - Borrowers with currency exposure are offered means of safety and protection (hedging transactions) in order to reduce their exposure, in addition to other measures that the Bank adopts to minimize the risk of the Bank's exposure from the activities of these customers. Guidelines were prescribed to intensify the monitoring, control, and supervision of the activities of borrowers whose debts to the Bank are sensitive to exchange rate fluctuations, including the creation of simulations and future scenarios of changes in exchange rates. Special controls are also used for clients, when securities form a significant element of their collateral.

Credit in the construction and real estate sectors- In financing the construction and real estate industry, specific analysis and monitoring tools are used to assist the Bank in reaching decisions on the granting of financial support to the various projects. Construction financing in this industry is focused mainly on residential construction in areas with strong demand and mid-level prices. In addition, the financing is allocated between geographic regions, based inter alia on relevant demand. In providing credit for construction, the Bank focuses on the financial support method (closed assistance). The application of this method is designed to reduce the exposure to risks in the granting of the loans, because it incorporates current and close monitoring of the progress of the financed project, both before the loans are provided, and as the project receives the financial support, while maintaining a distinction between the financed projects and the business risk inherent in the other activities of the developer-borrower. The Bank is assisted by outside construction supervisors, and also relies on liens on the land in the project, to secure the loans. Loans are issued for financed projects only by branches with professional knowledge of the subject, and under the supervision of the construction and real estate sector. The Bank also sets policies and rules for financing other real estate transactions, such as financing for rental properties, purchase groups, National Zoning Plan 38 etc.

Borrower rating - The Bank has developed a system for rating business borrowers, based on a computer-based model that combines quantitative and qualitative assessments of borrower, which has been adapted for a range of business borrowers in various economic sectors. The Bank regularly maintains the different existing models and develops new models, and acts to adapt, update and improve them in line with changes in the business environment.

The objective of the rating system is to provide for credit risks management and to support decision making processes. The system determines the rating of a borrower as a function of the quality of the client, the collateral furnished and the amount of credit received. The Bank has developed its ability to rate clients in the mortgage segment and in the retail segment using advanced models. Each of these segment clients is assigned a credit rating which reflects the theoretical likelihood of the client being in default. The borrower rating models are subject to periodic validation, in conformity with Bank of Israel directives, which are carried out by the Model Validation Department of the Risks Control Division.

In the first quarter of 2016, the Retail Division started using a new computer system which is being gradually put into use, designed to allow the Division to manage its clients by different criteria, including client rating, and to use the new models for underwriting and client pricing.

Learning lessons – credit control processes are conducted from extending credit to credit repayment. However, sometimes credit is not repaid as required and special treatment is necessary. Learning lessons is a process designed to identify inappropriate credit behavior in order to avoid repeating mistakes. Lessons are learned with regard to clients by a team which includes representatives from all Bank divisions and led by the Special Client Sector in the Business Division. These findings are disseminated to relevant recipients at the Bank for implementation of the conclusions among those involved in extending credit at the Bank. In addition, the Bank has established a framework for learning lessons from operating failure events, which arise from credit-related business operations.

Monitoring and control - Control over credit operations is a key component in maintaining quality of credit extended by the Bank to clients, including maintaining the quality of collateral required to secure credit repayment. The Bank continuously acts to identify and locate, as soon as possible, any indications of impairment of borrowers' repayment capacity or any deterioration in the state of their collateral. The Bank applies different control mechanisms, including internal controls within the credit management chain - i.e. first line controls - which are regularly conducted by branches, regions, headquarters and specific units involved there with, and controls by entities external to the credit process, i.e. second-line controls.

Integrated forums for credit risks management and control

The Bank has established various forums for credit risks management, which integrate the Bank's three lines of defense. The forums related to credit at the Bank are:

Risks Monitoring Forum for credit and credit concentration – managed by the Manager, Risks Control Division - which discusses aspects related to the overall framework for addressing risk, including rating aspects, methodologies for conducting stress testing, results of model validation for assessment of credit risk.

Watch List Forum – This forum is for each of the business divisions (Business Division, Retail Division and Finance Division), for the Risks Control Division and for the Accounting and Financial Reporting Division - and is convened quarterly. The client population discussed by this forum includes clients with high risk attributes, such as those with low rating or with other risk attributes (such as: restricted / AML suspects), failure to comply with financial covenants etc. including cases proactively placed on the list by credit handling entities. These discussions include an individual review of each client, their financial condition and the issue of credit risk to the Bank and the steps to be taken to mitigate such risk.

Emergency Credit Forum – This forum, headed by the Manager, Business Division acts when unusual conditions evolve, providing a professional framework for addressing emergencies and realization of stress conditions.

Lessons Learned Forum – Includes representatives from the Special Client Sector, from headquarters of the Business Division, from headquarters of the Retail Division, representatives from the Risks Control Division and other relevant participants involved with specific credit. The team summarizes and analyzes material credit failure events, reaches conclusions and issues recommendations for implementation of the lessons learned - at client level and at Bank level.

In addition to the different forums operating at the Bank, the control mechanisms at branches, regions and headquarters are based on Bank procedures as well as internal procedures of these units, and are regularly followed as part of the normal business routine of the various levels. Each credit level controls the relevant credit decisions of those levels reporting to it, as well as the current credit behavior of these clients.

Concurrently, control is exercised by dedicated Bank units, including headquarter units of the Business Division. The Business Credit Control Department, of the Business Division, uses computer systems to discover and alert to unusual accounts and clients, including based on information external to the Bank. Control is applied to banking operations in accounts flagged due to risk indications, based on criteria specified by the Bank for the population defined as under control, as well as for all Bank clients by means of IT systems which provide alerts. In the Real Estate sector, a dedicated control unit operates to control and review various aspects with regard to handling of real estate transactions by the Bank. In the Mortgage sector, a nation-wide underwriting center operates to enhance control of complex loan approval or of special populations, where loan approvals are provided by a professional, specialized team working at the Mortgage headquarters. In addition, there is a National Review Center which reviews the borrower file and controls the correctness of the loan origination and collateral process. In addition, both the Business Division and the Retail Division include division controllers.

The Risks Control Division is a control entity for credit risk within the second defensive line. The Risks Control Division, includes the Analysis Department, which provides independent review of major credit applications (exposures in excess of NIS 25 million), presenting its recommendations for the credit approval process to senior forums at the Bank. This department and the Credit Control Department report directly to the Manager, Risks Control Division - the Bank's CRO. The Analysis Department participates in approval of credit applications - as an independent entity. The Department reviews all credit applications discussed by the Business Division's credit committee, by the Supreme Credit Committee and by the Board of Directors' Credit Committee - providing its independent opinion with regard to such applications. The analysis recommendations include a recommendation as to actual approval of the application, and as to any further conditions or restrictions to be considered as a condition for approval of the credit application. The department representative regularly attends meetings of the aforementioned credit committees.

The Risks Control Division also validates the Bank's rating model and other models related to credit risk assessment at the Bank, through its Validation Department. Another department in this Division is responsible for development of advanced models for risk management and control. The second line also applies controls for credit risk, through a dedicated credit control unit, in conformity with Proper Banking Conduct Directive 311, by rating borrower quality retroactively and by reviewing the quality of the Bank's loan portfolio, including stress testing, based on an annual work plan approved by the Board's Risks Management Committee and by the Board of Directors. The work plan of the Bank's Credit Control Department regularly includes the following:

- Monitoring low-rated borrowers.

- Credit control at London and Los Angeles branches via external entities which are professionally guided by the Credit Risks Control Department in Israel.
- Testing of reliability and quality of rating provided by the first line, with reference to quality of the model and rating results generated, and their implications for the Bank's loan portfolio.
- Analysis of the Bank's loan portfolio - and in particular, analysis of its mortgage portfolio - including evolution of housing loans granted and loan composition by various risk factors.
- Review of the Bank's loan portfolio in view of the credit policies and risk appetite restrictions adopted by the Bank.

As part of the second line, under the Risks Control Division, is the Operating Risk Department, which is responsible for addressing operating risk at the Bank and, in particular, operating risk related to credit operations. As part of addressing operating risk, the first-line units involved with extending credit have appointed internal control trustees, who are responsible for handing operating risk in their own unit and for reporting any realized (or nearly-realized) events to the Operating Risk Department.

Monitoring and control systems - the Bank Group regularly uses computer systems for management and control of credit risk. These computer systems provide control tools for personnel, including the specific unit assigned with identifying and controlling credit risks, to identify loans that exceed credit limits or are under-collateralized, as well as tools for identifying credit-risks developments resulting from the existence of various parameters in client-account development and management. There are several significant systems which play an important role in processes of credit management, risks management and control, including a system to calculate the required capital allocation with respect to credit risk, systems for identifying and alerting credit risks, for providing alert information, monitoring of financial covenants, automatic debt classification system and computer system for control and management of all accounts under legal proceedings.

Environmental risks – Environmental risk to the Bank is the risk of loss which may be incurred due to deterioration in the borrower's financial position due to high costs incurred as a result of environmental hazard and regulation concerning environmental protection, or due to impairment of collateral exposed to environmental risk or to the Bank being indirectly liable for an environmental hazard caused by a project funded by the Bank. Environmental risk also includes other risks derived from this risk (goodwill, third party liability etc.) In recent years, global awareness of the potential financial exposure arising from regulations related to environmental protection has grown.

In conformity with directives of the Supervisor of Banks, banks are required to act to incorporate management of exposure to environmental risk within all risks at the Bank, including specification of work processes for identification of significant risk when granting significant credit and inclusion of risk assessment, if any, within periodic assessment of quality of credit extended. The Bank's policy documents include dedicated environmental risks policies, including methodology for identification, assessment and handling of environmental risk with material impact.

Handling of non-performing loans and collection of debts – The handling of problem loans requires special focus and professionalism, other than the level that approved or processed the credit extended and collateral received. Initial identification is typically computer-based by designated departments for identification and control in the Business Division and in the Retail Division. Identified clients are handled by the Special Client Sector of the Business Division.

In order to identify credit risk materializing, or which may materialize, at the Bank, the Bank regularly conducts a process to review and identify debts, based on specified criteria. Some of these criteria require debt to be classified as problematic debt, while others provide a warning and allow the professional entity to exercise discretion. Debts are reviewed by a ranking of authorizations specified in Bank procedures. This authorization ranking includes individual authorizations, from branch and headquarters staff, to authorizations at higher levels with regard to classifications and provisions granted to committees headed by the Manager, Accounting and Financial Reporting Division and to the Bank management Problematic Debts Committee. Concurrently with the identification and classification process, a built-in, independent control process is conducted by regional management and by designated units at headquarters. Bank operations in this regard are carried out in conformity with Directive 314 of the Bank of Israel.

A computer system which supports application of measurement and disclosure provisions for impaired debts, credit risk and provision for credit losses, including in identification and control processes, carries out logical, criteria-based testing and determines defaults for debts classification as debt under special supervision, inferior debt, impaired debt or debt in restructuring, as required.

Identification of housing loans (mortgages) with risk attributes is automated by identifying criteria for arrears and other qualitative criteria. In early stages of arrears, the Bank mostly applies automated collection processes. Later on, the Bank applies proactive processes, both internal and external, including legal proceedings, if needed.

Identification and classification of problematic debts – The Bank classifies all problematic debt and problematic off-balance sheet credit items under: special supervision, inferior or impaired. Debt under special supervision is debt with potential weaknesses, which require special attention by Bank management. Should these weaknesses not be addressed, the likelihood of debt repayment may deteriorate. Inferior debt is debt insufficiently secured by collateral or by debtor repayment capacity, and for which the Bank may incur a loss if faults are not corrected.

In conformity with Bank policy, debt in excess of NIS 700 thousand is classified as impaired when, based on current information and events, it is expected that the Bank would be unable to collect all amounts due pursuant to contractual terms of the debt contract. In any case, debt is classified as impaired when its principal or interest is in arrears over 90 days, unless the debt is well secured and is in collection proceedings. Further, any debt whose terms and conditions have been changed in conjunction with restructuring of problematic debt would be classified as impaired debt, unless prior to and following such restructuring, a provision for credit losses by extent of arrears was made with respect to the debt pursuant to the appendix to Proper Banking Conduct Directive 314 on problematic debt in housing loans.

Provision for credit losses - upon application of the directive for measurement and disclosure of impaired debts, credit risk and provision for credit losses on January 1, 2011, the Bank implemented a computer system for identification and classification of debts where risk of credit losses exists or may emerge. The system is connected to various infrastructure systems at the Bank, combining data to allow for debts review designed to assess their robustness and expected cash flows. The new system applies automated processes for identification, review, classification and determination of provisions, including process documentation and hierarchical approvals based on authorities set in Bank procedures. The system also allows for handling problematic debt not identified by the automated identification processes, but rather using qualitative tests of the Bank's loan portfolio.

The decision about the amount of provision for credit losses is derived from the quality of credit and collateral, the financial and legal standing of the borrower and guarantors, as well as environmental and sector conditions in the client environment.

For information about the Supervisor of Banks' directives with regard to group provision and provision for credit losses, see Note 1.D.6 to the 2015 financial statements.

The Bank has put in place procedures for classification of credit and for measurement of provision for credit losses, in order to maintain an appropriate provision to cover expected credit losses with regard to the Bank's loan portfolio. Further, the Bank has put in place procedures to be followed, an appropriate provision to cover expected credit losses with regard to off-balance sheet credit instruments (such as: commitments to provide credit, unutilized credit facilities and guarantees).

The required provision to cover expected credit losses from the credit portfolio is estimated under one of the following tracks: "individual provision" or "group provision". Further, the Bank reviews the overall appropriateness of the provision for credit losses.

Such review of debt in order to determine the provision and debt handling is consistently applied to all debt in excess of NIS 700 thousand and in conformity with the Bank's credit management policy - and no transition is made, during the debt term, between the individual review track and the group-based review track - unless in case of restructuring of problematic debt, as noted above.

Individual provision for credit losses – According to Bank policies, this is applied for any debts determined to be impaired, whose contractual balance (including accounting write-offs, unrecognized interest, provisions for credit losses and collateral) is NIS 700 thousand or higher.

Individual provision is also applied to any debt whose terms and conditions have been changed in conjunction with restructuring of problematic debt, unless this debt is subject to provision by extent of arrears. The individual provision for credit losses is estimated based on expected future cash flows, discounted using the effective interest rate of the original debt. When debt collection is contingent on collateral, or when the Bank has determined that seizure of an asset is expected, the individual provision for credit loss is evaluated based on the fair value of the collateral pledged to secure such debt, after application of consistent, conservative multipliers to reflect, *inter alia*, the volatility in fair value of such collateral, the time it would take until actual realization and the expected cost for selling the collateral. For this matter, the Bank defines debt as debt contingent upon collateral, when it is expected to be entirely repaid by pledged collateral, or when the Bank expects repayment from an asset even with no specific pledge on such asset, provided that the borrower has no other reliable sources available for repayment.

The Bank regularly reviews the forecasted expected credit losses, based on actual cash flows, and adjusts the individual provision to the current forecast. Actual credit losses may differ from the Bank's original estimates upon classification of the debt as impaired.

Group provision for credit losses - This is applied for large, homogeneous groups of small debts (whose balance is below NIS 700 thousand, according to Bank policy) (such as: credit card debts, housing loans and consumer debts repaid by installments) as well as for large, non-impaired debts. The provision for credit losses with respect to debts based on group estimate, other than housing loans for which the provision has been calculated based on a formula specified by the Supervisor of Banks based on extent of arrears, is based on rules specified in FAS 5 (ASC 450) "Accounting treatment of contingencies" and other directives specified in Public Reporting Directives. The provision is based on historical loss rate in various economic sectors, divided into problematic and non- problematic debt, for the 5 years ended on the report date.

In addition to calculating the average range of historic loss rates for various economic sectors, as per the above, for determining the appropriate rate of provision, the Bank also accounts for relevant environmental factors, including trends in credit volume for each sector as well as sector condition, macro-economic data, general quality assessment of credit to each economic sector, changes in volume and in trend of balances in arrears and impaired balances and the effect of changes in credit concentration.

In conformity with directives of the Supervisor of Banks, the Bank has formulated a methodology for measuring the group provision, which takes into account both past loss rates and adjustments with respect to relevant environmental factors.

Furthermore, the rate of adjustment with respect to relevant environmental factors for group provision for credit losses with respect to individuals is not less than 0.75% of the non-impaired consumer credit balance (excluding credit due to receivables for bank credit cards without interest charge), in conformity with a specific directive by the Supervisor of Banks dated January 19, 2015.

Housing loans

A minimum provision with respect to housing loans is calculated based on the formula stipulated by the Supervisor of Banks, by extent of arrears, such that the provision rate is higher the longer the arrears. This directive applies to all housing loans, other than loans not repaid by periodic installments and loans used to finance activity of a business nature.

The Bank also applies Proper Banking Conduct Directive no. 329, as per the Supervisor of Banks' letter dated March 21, 2013 "Update to guidelines with regard to residential real estate".

In conformity with these directives, the Bank has set policies designed to ensure that the Bank would be in compliance with stipulations of this directive and that, as from June 30, 2013, the balance of group provision for credit losses with respect to housing loans shall be at least 0.35% of the outstanding balance of such loans as of the report date.

Off-balance sheet credit

The required provision with regard to off-balance sheet credit instruments is assessed as per rules specified in FAS 5. The provision estimated on group basis for off-balance sheet credit instruments is based on provision rates specified for total credit exposure (as stated above), accounting for expected credit realization rate for the off-balance sheet credit risk. The credit realization rate is calculated by the Bank based on credit conversion factors, as specified in Proper Proper Banking Conduct Directive 203 "Measurement and capital adequacy - Credit risk - Standard approach" with certain adjustments.

Credit losses with respect to housing loans

In conjunction with credit risks management, the Bank takes various actions to manage, control and mitigate risk associated with provision of housing loans. The Bank estimates the risk profile associated with provision of housing loans as low, relative to the inherent risk in the Bank's overall loan portfolio, due to the high level of client diversification, geographic diversification of borrowers, relatively low leverage, which recently has decreased even further due to Bank of Israel directives, intensive review procedures of borrower quality and their repayment capacity, and securing credit with property as collateral.

The Bank acts regularly to control and manage the risk associated with housing loans, for which the Retail Division, the Risks Control Division and other Bank entities are responsible. This activity includes portfolio analysis by inherent risk factors (LTV, repayment ratio, geographic location, loan age, income decile etc.) and carrying out a variety of stress tests to review the impact of macro-economic factors on portfolio risk - primarily the impact of unemployment and interest rates. The Bank has developed an advanced model for rating housing loans, which includes a rating for each loan and calculation of potential loss in case of failure. This model is in addition to the Bank's existing monitoring tools.

Risk appetite in mortgage segment

As part of its credit risk policies, the Bank has set various restrictions on housing loan operations, to account for major risk factors. These factors are reviewed from time to time and additional restrictions are imposed as needed, i.e. based on the actual risk profile of the mortgage portfolio and its trend, as well as on regulatory directives from the Bank of Israel.

The key parameters used for specifying risk appetite in the mortgage segment are: results of the differential risk premium model (which reflects the risk associated with the mortgage borrower), LTV ratio of the loan, property location (geographical risk) and credit quality benchmark (see below under Credit Control). Over the past two years, the list of risk benchmarks has been extended within the Bank's policy document and additional restrictions were imposed on various parameters: loan repayment to income ratio, loan purpose, loan term, loan track mix, property type, document quality, normative interest rate, financial wealth and cross restrictions on combinations of multiple parameters.

The Bank constantly monitors the risk profile of the mortgage portfolio, in view of the specified risk appetite. In particular, this monitoring is conducted through the Bank's quarterly risks document which is approved by the Board of Directors.

Monitoring of the risk profile in the mortgage portfolio consists of over 40 risk benchmarks specified by the Board of Directors and management, which are presented in the Bank's quarterly risk document with a review of the resulting risk profile, which also reviews the evolution of these risk appetite benchmarks over time. This monitoring system is complemented by results obtained from use of advanced models. This monitoring indicates that the risk profile of the Bank's mortgage portfolio has been trending downwards in recent quarters, for most of the specified risk appetite benchmarks, including LTV and loan repayment ratio. In particular, default rates in the portfolio have been trending lower in recent years. In addition, as noted above, the Bank regularly reviews its mortgage portfolio under stress conditions, including under significant change in macro-economic conditions, using a variety of stress tests. This testing is part of testing of the portfolio risk profile. This review, too, indicates that portfolio risk has decreased and that the potential impact of a severe stress event in the market is low relative to Bank primary capital.

Means for risk management in housing loans

Underwriting process

Criteria for loan approval

The Bank has specified uniform, quantitative criteria for review and approval of housing loan applications. Along with the uniform criteria, decision makers at the Bank exercise their judgment. The guiding criteria for granting housing loans have been determined, inter alia, based on the following:

- Accumulated experience at the Bank with regard to housing loans, including lessons learned over time with regard to parameters which determine borrower quality and quality of loan collateral.
- Results of current credit reviews which include, inter alia, review of changes to credit quality in certain sectors.
- Assessment conducted, *inter alia*, through stress testing, of credit risks due to changing macro-economic conditions.
- Assessment of credit risks in different areas of the country, due to security-related and other events.
- During evaluation of the loan application, three key parameters are assessed: Borrower quality and repayment capacity, proposed collateral and nature of the transaction. For commercial banking, prime importance is usually assigned to the loan purpose. In the mortgage business, the main weighting in making credit decisions lies in assessment of borrower quality, because practically all of the loans are extended for purchase of real estate by households. However, for general-purpose loans, self-construction loans and non-standard loans, a weighting is assigned to the nature and quality of the transaction when making a decision.
- Collateral and guarantors form a safety net for the Bank in a specific transaction, in case the monthly repayment does not go according to plan.
- Decision making by the Bank involves a process of review of transaction data against predetermined criteria. Decision making with regard to credit is hierarchical and, to a large extent, corresponds to the Bank's management ranking. There are multiple approval levels and the application is routed to the required level based on application data.

These criteria are regularly updated in line with market developments and the portfolio's risk profile.

Credit authority

The Bank has created a ranking of authority for approval of housing loans (at branch, region and headquarters level). The authorized entity to approve the loan is determined based on data in the loan application and on inherent risk there of (data about borrowers, LTV ratio, risk premium and nature of the transaction). To enhance control over approval of complex, high-risk loans and loans to specific populations (such as: large loans, transactions between family members, acquisition through a Trust, loans with pledged collateral being a property in high-risk locations etc.), such applications are sent for approval by the Underwriting and Control Department operating in the mortgage headquarters sector.

In addition, a major part of the loan origination process is conducted by the National Review Center. This Center controls the appropriateness of the loan origination process, including compliance with Bank procedures and various directives.

Model for determination of differential risk premium

The Bank has developed a model for calculation of differential risk premium, based on past empirical data, for rating transaction risk at the loan application stage. For each application, an individual risk premium is calculated based on all risk factors identifiable in client information and attributes of the desired transaction.

This premium reflects an estimate of overall transaction risk, allowing for assessment of client odds of being in arrears on the loan or becoming insolvent - at the outset of the application stage. This premium is used for both credit decision making and for pricing of client interest rate.

Built-in controls in loan origination system

The Bank manages its mortgage operations using a dedicated computer system developed for this purpose, which includes the following built-in controls:

- Ensure information completeness required for loan and activities required in preparation of the material, review and approval of the loan.
- Rigid, real-time control over transactions by authorization. Use of this preventive control methodology significantly reduces the need for discovery controls after loan origination.
- Work flow process with real-time control over execution of all required tasks at each stage of the loan origination process, sending the application to the authorized entity for performing the required actions at each stage of the loan approval process.

Use of this system has resulted in improved control in different stages of the loan origination process, while achieving uniformity among different Bank branches.

Mortgage-related training

The Bank’s Training Center delivers courses for training, development and improvement of all those involved in provision of housing loans. Training content is determined in cooperation with the Mortgage Headquarters Sector, and staff at headquarters participates in training delivery to bankers. These courses include, inter alia, special emphasis on risks management. In addition, the mortgage operations are included within the Bank-specified framework for handling operating risk and staff at the mortgage headquarters take part in training designated for this area.

Professional conferences

The Retail Division regularly holds professional conferences for managers and bankers. In these conferences, extensive reviews of developments in the mortgage market are presented, along with steps to be taken to handle the risks associated with such developments.

Regular monitoring of borrower condition and of the housing loan portfolio

Credit control is a key factor in maintaining quality of credit provided by the Bank to its clients. Control over housing loans is exercised at the individual loan level as well as for the entire mortgage portfolio.

At the individual loan level, the Bank acts to identify as early as possible any symptoms indicating a decline in borrower repayment capacity, in order to identify as soon as possible any credit failure situation. The Bank operates various controls, including regular internal controls at branches, regions and headquarters, as well as additional controls by the second and third line of defense of the Bank's credit risk management system - the Risks Control Division and Internal Audit.

The Bank maintains control over quality of new credit provided by branches, by means of a monthly Credit Quality report, which includes all loans originated by the Bank between 6-18 months prior to the reported date which are over 3 months in arrears. This report is designed to assist branches in reducing the extent of arrears, and to increase awareness of troubled loans by those originating and approving loans in order to learn lessons for future credit approval. Along with the individual report, listing loans, details of arrears etc., a statistical report is also produced, showing the extent of arrears at each branch, compared to the region and to the Bank as a whole, and compared to previous months. Management of the Retail Division regularly monitors handling of debt in arrears, using this report.

For the entire mortgage portfolio, control is maintained of restrictions imposed by the Bank's risk appetite, both at the Retail Division and at the Risks Control Department and Credit Control Department of the Risks Control Division.

In addition, a credit control report is produced semi-annually by the Risks Control Division, containing an extensive review of the development of the housing loan portfolio's risk profile over the reviewed period. The report refers to the following:

- Risk appetite.
- Analysis of major risks and attributes.
- Review of state of arrears and credit quality
- Client debt collection
- Housing loan portfolio for special populations
- Stress testing
- Purchase groups.

Entities participating in risk management and control for housing loans

Mortgage Management Department of the Retail Division

This department handles different events which occur during the loan term, whether initiated by the Bank or by the borrower. One of the key tasks is monitoring of collateral provided. During loan origination, the Bank usually receives interim collateral, and the final collateral is expected to be received during the loan term. The department also monitors receipt of life and property insurance policies during the loan term.

Risks Control Division

The Risks Control Division monitors the quality of the Bank's loan portfolio and the evolution of the Bank portfolio's risk profile, in view of the specified risk appetite. As for mortgages, the portfolio is analyzed semi-annually, including analysis of developments in housing loan grants and our market share, as well as credit composition by various criteria. This report is discussed by the Supreme Credit Committee (a management committee) and by the Board of Directors' Risks

Management Committee and is then presented to the Bank's Board of Directors. The division is responsible for regular stress testing of the Bank's mortgage portfolio, in coordination with the Mortgage Headquarters sector, while challenging multiple risk factors in this portfolio. Some stress testing is conducted using advanced methods and using current data from advanced models developed by the Bank. The Bank recently upgraded its stress testing in conformity with Bank of Israel directives (the Bank of Israel uniform scenario – a uniform macro-economic scenario for the entire banking system). In this scenario, the potential loss by the Bank due to extreme changes in the current macro-economic situation are calculated, accounting for a very high level of unemployment compared to the current situation, an interest rate which is significantly higher than current interest rates as well as sharply lower housing prices. This stress testing indicates that the portfolio risk level is low and that the Bank has sufficient capital to withstand the risk level derived from such strict stress testing. The results of stress testing of the mortgage portfolio are regularly presented to the Risks Management Committee of the Board of Directors and to the Board of Directors plenum, *inter alia*, as part of the quarterly risk document and at specific discussions.

Credit risk and credit concentration monitoring forum

The Bank operates a forum for monitoring credit risk, headed by the Manager, Risks Control Division, which promotes issues such as: review of credit policy and, in particular, changes to the risk appetite specified there, analysis of credit portfolio risk level, application of advanced modeling approaches, specification of triggers for activating stress testing; supervision of design and application process of stress testing, and monitoring of the risk profile of the Bank's loan portfolio.

Legal Division

As part of the underwriting process, collateral for non-standard loans (such as: transactions involving family members) and high-value loans are reviewed by the Mortgage Advisory Department, a dedicated department in the Legal Division. This test complements the loan approval and review conducted at the branch and the regional underwriting department.

Collection Department

The Bank operates a dedicated Collection Department, which handles debts collection from borrowers in arrears and realization of properties. Processing is automatically launched once the client fails to make a mortgage payment for the first time. If this failure is not resolved, processing continues by the Telephone Collection Center (prior to filing a law suit), designed to reach payment arrangements with clients. If such an arrangement with borrowers cannot be reached, the debt is processed by the Bank's Collection Department, which includes a dedicated department for mortgage debtors. If needed, legal action is brought against debtors.

Arrears Forum

The Arrears Forum convenes monthly, headed by the Manager, Business Division, and reviews the current state of affairs with regard to collection in the previous month, implications on the financial statements and on the provision for credit losses. The Forum specifies targets for debt processing and for reducing arrears.

Internal Audit

The work plan for Internal Audit with regard to loans includes, inter alia, reference to review of entities involved in loan approval, origination, administration and control.

Credit risk analysis

Below is the composition of credit exposure by exposure group and by balance sheet item, before provision for credit losses (NIS in millions)(1):

As of March 31, 2016	Sovereigns	Public sector	Banking corporations	Corpora-tions	Secured by commercial real estate	Retail for individuals	Small business	Housing loans	Others	Gross credit exposure(2)	Average gross credit exposure
Loans(3)	35,974	484	952	26,663	2,356	16,524	9,253	107,953	-	200,159	194,741
Securities(4)	8,288	-	99	19	-	-	-	-	-	8,406	9,965
Derivatives(5)	39	354	1,053	1,778	-	14	5	-	-	3,243	3,211
Other off-balance-sheet exposures	-	229	43	40,334	462	11,020	3,003	7,815	-	62,906	62,625
Other assets(6)	-	-	-	-	-	-	-	-	4,529	4,529	4,583
Total	44,301	1,067	2,147	68,794	2,818	27,558	12,261	115,768	4,529	279,243	275,125

As of March 31, 2015	Sovereigns	Public sector	Banking corporations	Corpora-tions	Secured by commercial real estate	Retail for individuals	Small business	Housing loans	Others	Gross credit exposure(2)	Average gross credit exposure
Loans(3)	20,754	291	2,445	29,086	2,479	15,109	7,393	97,494	-	175,051	174,646
Securities(4)	12,633	-	345	66	-	-	-	-	-	13,044	13,082
Derivatives(5)	35	480	1,386	2,490	-	34	12	-	-	4,437	4,172
Other off-balance-sheet exposures	43	200	36	42,832	676	10,776	2,797	7,482	-	64,842	63,984
Other assets(6)	-	-	-	-	-	-	-	-	4,348	4,348	4,301
Total	33,465	971	4,212	74,474	3,155	25,919	10,202	104,976	4,348	261,722	260,184

As of December 31, 2015	Sovereigns	Public sector	Banking corporations	Corpora-tions	Secured by commercial real estate	Retail for individuals	Small business	Housing loans	Others	Gross credit exposure(2)	Average gross credit exposure
Loans(3)	27,845	280	1,064	27,696	2,465	16,258	8,059	105,656	-	189,323	179,820
Securities(4)	11,234	-	274	18	-	-	-	-	-	11,526	12,701
Derivatives(5)	41	373	776	2,023	-	18	4	-	-	3,235	4,040
Other off-balance-sheet exposures	16	273	43	40,339	377	10,954	2,990	7,352	-	62,344	63,217
Other assets(6)	-	-	-	-	-	-	-	-	4,637	4,637	4,535
Total	39,136	926	2,157	70,076	2,842	27,230	11,053	113,008	4,637	271,065	264,313

(1) After deduction of accounting write-offs and before provision for credit losses on individual and group basis.
(2) Balance of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, excluding impact of credit risk mitigation, conversion factors and risk weighting factors, as defined under Basel rules.
(3) Includes loans to the public, loans to governments, deposits with banks and borrowed securities.
(4) Excludes balances deducted from the capital basis and investment in securities in the negotiable portfolio.
(5) Includes face value of derivatives (including credit derivatives), after effect of add-on factors and positive fair value of derivatives.

(6) Excludes derivatives and balances deducted from the capital basis, including cash, investment in shares, fixed assets and investment in investees.

Composition of exposures by geographic region and - for significant regions - by major type of credit exposure (NIS in millions); This information lists total exposure to foreign countries and exposure to countries for which total exposure to each country exceeds 1% of total consolidated assets or 20% of capital, whichever is lower:

	Balance sheet exposure	Off-balance sheet exposure	Impaired debts
As of March 31, 2016			
USA	5,322	505	1
Other	6,421	1,084	-
Total exposure to foreign countries	11,743	1,589	1
Of which: Total exposure to LDC countries	561	65	-

	Balance sheet exposure	Off-balance sheet exposure	Impaired debts
As of March 31, 2015			
USA	3,330	3,441	2
UK	1,353	916	-
Other	2,649	2,700	-
Total exposure to foreign countries	7,332	7,057	2
Of which: Total exposure to LDC countries	653	105	-

	Balance sheet exposure	Off-balance sheet exposure	Impaired debts
As of December 31, 2015			
USA	4,848	407	1
Other	6,193	975	1
Total exposure to foreign countries	11,041	1,382	2
Of which: Total exposure to LDC countries	400	68	-

The exposure presented above represents, in accordance with directives of the Supervisor of Banks, exposure based on final risk. The party bearing the final risk is an individual, business, institution or instrument which provides "credit reinforcement" to the Bank, such as guarantees, collateral, insurance contracts or credit derivatives. When no "credit reinforcement" exists, the party bearing the final risk is the debtor.

For more information see "Exposure to Foreign Countries" in the Report by the Board of Directors and Management as of March 31, 2016.

Composition of credit exposure before provision for credit losses, by contractual term to maturity, by major gross credit exposure type, is as follows:

Gross credit (NIS in millions)[(1)]:

					As of March 31, 2016
	Up to one year	1-5 years	Over five years	Without maturity	Total[(2)]
Loans[(3)]	64,699	28,382	106,936	142	200,159
Securities[(4)]	608	5,943	1,855	-	8,406
Derivatives[(5)]	1,916	1,108	219	-	3,243
Other off-balance-sheet exposures	55,075	6,159	1,672	-	62,906
Other assets[(6)]	2,835	0	115	1,579	4,529
Total	125,133	41,592	110,797	1,721	279,243

					As of March 31, 2015
	Up to one year	1-5 years	Over five years	Without maturity	Total[(2)]
Loans[(3)]	51,417	26,493	97,012	129	175,051
Securities[(4)]	847	8,498	3,699	-	13,044
Derivatives[(5)]	3,078	969	390	-	4,437
Other off-balance-sheet exposures	55,073	8,159	1,610	-	64,842
Other assets[(6)]	2,630	-	128	1,590	4,348
Total	113,045	44,119	102,839	1,719	261,722

					As of December 31, 2015
	Up to one year	1-5 years	Over five years	Without maturity	Total[(2)]
Loans[(3)]	56,242	28,605	104,338	138	189,323
Securities[(4)]	533	8,181	2,812	-	11,526
Derivatives[(5)]	2,014	1,038	183	-	3,235
Other off-balance-sheet exposures	54,579	5,833	1,932	-	62,344
Other assets[(6)]	2,905	-	112	1,620	4,637
Total	116,273	43,657	109,377	1,758	271,065

(1) After deduction of accounting write-offs and before provision for credit losses on individual and group basis.
(2) Balance of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, excluding impact of credit risk mitigation, conversion factors and risk weighting factors, as defined under Basel rules.
(3) Includes loans to the public, loans to governments, deposits with banks and borrowed securities.
(4) Excludes balances deducted from the capital basis and investment in securities in the negotiable portfolio.
(5) Includes face value of derivatives (including credit derivatives), after effect of add-on factors and positive fair value of derivatives.
(6) Excludes derivatives and balances deducted from the capital basis, including cash, investment in shares, fixed assets and investment in investees.

Below are details of impaired credit risk and un-impaired credit risk by major sector (NIS in millions):

			March 31, 2016
	Impaired debt[1]	Non impaired debt	
		In arrears 90 days or longer[3]	In arrears 30 to 89 days[4]
Borrower activity in Israel			
Public – commercial			
Construction and real estate - construction[7]	87	8	24
Construction and real estate - real estate operations	125	-	51
Financial services	20	1	8
Commercial – other	501	29	138
Total commercial	733	38	221
Private individuals - housing loans	27	[7] 877	[6] 315
Private individuals – other	79	19	89
Total public – activity in Israel	839	934	625
Total public – activity overseas	13	-	8
Banks	-	-	-
Governments	-	-	-
Total	852	934	633

			March 31, 2015
	Impaired debt[1]	Non impaired debt	
		In arrears 90 days or longer[3]	In arrears 30 to 89 days[4]
Borrower activity in Israel			
Public – commercial			
Construction and real estate - construction[7]	97	4	11
Construction and real estate - real estate operations	240	-	6
Financial services	102	9	6
Commercial – other	287	23	125
Total commercial	726	36	148
Private individuals - housing loans	3	994	325
Private individuals – other	83	20	80
Total public – activity in Israel	812	1,050	553
Total public – activity overseas	8	-	10
Banks	-	-	-
Governments	-	-	-
Total	820	1,050	563

(1) Loans to the public, loans to governments, deposits with banks and other debts, except for debentures and securities borrowed or acquired in conjunction with resale agreements, except for deposits with Bank of Israel.
(2) Generally, impaired debt does not accrue interest revenues. For information about certain impaired debt restructured using problematic debt restructuring, see Note 13.B.2.c. to the financial statements.
(3) Classified as problematic non-impaired debt. Accruing interest revenues.
(4) Accruing interest revenues. Debt in arrears 30 to 89 days amounting to NIS 34 million was classified as problematic non-impaired debt (as of March 31, 2015: NIS 63 million).
(5) In conformity with Public Reporting Directives, excludes the balance of housing loans in arrears up to 2 months.
(6) Includes balance of housing loans amounting to NIS 161 million provided for by extent of arrears of borrower, for which an agreement has been signed for repayment of arrears by the borrower, where a change was made to the repayment schedule for the outstanding loan balance not yet due (as of March 31, 2015: NIS 190 million).
(7) Includes debt amounting to NIS 1,130 million, extended to certain purchase groups which are in the process of construction (as of March 31, 2015: NIS 1,138 million).

Below are details of impaired credit risk and un-impaired credit risk by major sector (NIS in millions) - continued:

			December 31, 2015
	Impaired debt[1]		Non impaired debt
		In arrears 90 days or longer[3]	In arrears 30 to 89 days[4]
Borrower activity in Israel			
Public – commercial			
Construction and real estate - construction[7]	83	10	14
Construction and real estate - real estate operations	124	1	2
Financial services	15	1	4
Commercial – other	476	26	136
Total commercial	698	38	156
Private individuals - housing loans	24	[6] 956	[5] 347
Private individuals – other	81	17	81
Total public – activity in Israel	803	1,011	584
Total public – activity overseas	14	1	-
Banks	-	-	-
Governments	-	-	-
Total	817	1,012	584

(1) Loans to the public, loans to governments, deposits with banks and other debts, except for debentures and securities borrowed or acquired in conjunction with resale agreements, except for deposits with Bank of Israel.

(2) Generally, impaired debt does not accrue interest revenues. For information about certain impaired debt restructured using problematic debt restructuring, see Note 13.B.2.c. to the financial statements.

(3) Classified as problematic non-impaired debt. Accruing interest revenues.

(4) Accruing interest revenues. Debt in arrears 30 to 89 days amounting to NIS 20 million was classified as problematic non-impaired debt.

(5) In conformity with Public Reporting Directives, excludes the balance of housing loans in arrears up to 2 months.

(6) Includes balance of housing loans amounting to NIS 161 million provided for by extent of arrears of borrower, for which an agreement has been signed for repayment of arrears by the borrower, where a change was made to the repayment schedule for the outstanding loan balance not yet due.

(7) Includes debt amounting to NIS 1,285 million, extended to certain purchase groups which are in the process of construction.

Provision by extent of arrears

Below are details of the provision for credit losses with respect to housing loans for which a minimum provision for credit losses was made by extent of arrears, in accordance with appendix to Proper Banking Conduct Directive 314 (NIS in millions):

As of March 31, 2016								Extent of arrears
		In arrears 90 days or longer					Balance with respect to refinanced loans in arrears[4]	Total
	In arrears 30 to 89 days[3]	90 days to 6 months	6-15 months	15-33 months	Over 33 months	Total over 90 days		
Amount in arrears	5	10	10	10	198	228	57	290
Of which: Balance of provision for interest[1]	-	-	-	-	97	97	6	103
Recorded debt balance	315	375	135	66	153	729	152	1,196
Balance of provision for credit losses [2]	-	-	19	31	111	161	77	238
Debt balance, net	315	375	116	35	42	568	75	958

(1) With respect to interest on amounts in arrears.
(2) Excludes balance of provision for interest.
(3) In conformity with Public Reporting Directives, excludes the balance of housing loans in arrears up to 2 months.
(4) Loans for which an agreement was signed for repayment of arrears by borrower, where a change was made in the repayment schedule for the loan balance not yet due.

Below is the movement in provision for credit losses for the three-month periods ended March 31 (NIS in millions):

						March 31, 2016
						Provision for credit losses
	Loans to the public					
	Commercial	Housing	Individual – other	Total	Banks and governments	Total
Balance of provision for credit losses at start of period	697	614	195	1,506	3	1,509
Expenses with respect to credit losses	-	(9)	13	4	(1)	3
Accounting write-offs	(49)	(2)	(33)	(84)	-	(84)
Recovery of debts written off for accounting purposes in previous years	22	-	16	38	-	38
Net accounting write-offs	(27)	(2)	(17)	(46)	-	(46)
Balance of provision for credit losses at end of period	670	603	191	1,464	2	1,466
Of which: With respect to off balance sheet credit instruments	78	-	8	86	-	86

						March 31, 2015
Balance of provision for credit losses at start of period	632	624	189	1,445	5	1,450
Expenses with respect to credit losses	32	(4)	6	34	1	35
Accounting write-offs	(28)	-	(28)	(56)	-	(56)
Recovery of debts written off for accounting purposes in previous years	21	-	16	37	-	37
Net accounting write-offs	(7)	-	(12)	(19)	-	(19)
Balance of provision for credit losses at end of period	657	620	183	1,460	6	1,466
Of which: With respect to off balance sheet credit instruments	96	-	9	105	-	105

Credit risk analysis using the standard approach

Calculation of credit risk using the standard approach is based on external credit ratings assigned by External Credit Assessment Institutions (ECAI). The Bank uses rating data from two rating agencies - Moody's and S&P.

Ratings from these rating agencies are used to determine the risk weighting of the following exposure groups:

- Sovereigns
- Public sector
- Banking corporations
- Corporations

The appropriate risk weighting is assigned based on counter-party data.

The risk weighting for banks is assigned based on the risk weighting of the country where the bank is incorporated and is one notch lower than the risk weighting for the rating of said country.

For investment in issuances with a specific issue rating, the risk weighting for the debt shall be based on this rating, unless the issuer is a banking corporation or a public sector entity. In such cases, the risk weighting would be based on the issuer rating, rather than on the specific issue rating.

The following table maps the ratings by international rating agencies used by the Bank:

Moody's	S&P
Aaa to Aa3	AAA to AA-
A1 to A3	A+ to A-
Baa1 to Baa3	BBB+ to BBB-
Ba1 to Ba3	BB+ to BB-
B1 to B3	B+ to B-
Caa1 or lower	CCC+ or lower

Note that the majority of credit risk at the Bank is not rated by an external rating.

Analysis and preparation of frameworks

As part of the Bank's business operations, in order to prepare operating frameworks for credit exposure and other risks with regard to foreign banks and financial institutions, the Bank uses ratings from leading international rating agencies: Fitch, Moody's and S&P, which are used by the Bank for analysis as well as for setting exposure limits.

When preparing the operating framework for Israeli banks, the Bank is also assisted by ratings from rating agencies S&P Ma'alot and Midroog.

Below is composition of credit exposure amounts[1] by exposure group and weighting, before and after credit risk mitigation[2] (NIS in millions):

Before credit risk mitigation

	As of March 31, 2016											
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	40,807	3,166	-	-	-	328	-	-	-	44,301	-	44,301
Public sector entity debt	-	-	-	1,068	-	-	-	-	-	1,068	-	1,068
Banking corporation debt	-	1,507	-	470	-	151	-	-	-	2,128	-	2,128
Corporate debt	-	8	-	112	-	-	-	-	-	120	-	120
Total	40,807	4,681	-	1,650	-	479	-	-	-	47,617	-	47,617
Non-rated exposures:												
Public sector entity debt	-	-	-	-	-	-	-	-	-	-	-	-
Banking corporation debt	-	7	-	12	-	-	-	-	-	19	-	19
Corporate debt	-	-	-	-	-	68,403	173	-	-	68,576	-	68,576
Debt secured by commercial real estate	-	-	-	-	-	2,788	18	-	-	2,806	-	2,806
Retail exposure to individuals	-	-	-	-	27,431	21	94	-	-	27,546	-	27,546
Loans to small businesses	-	-	-	-	12,146	19	68	-	-	12,233	-	12,233
Residential mortgages	-	-	56,163	21,684	36,350	1,314	257	-	-	115,768	-	115,768
Other assets	1,568	-	-	-	-	2,016	50	893	2	4,529	87	4,616
Total	1,568	7	56,163	21,696	75,927	74,561	660	893	2	231,477	87	231,564
Total	42,375	4,688	56,163	23,346	75,927	75,040	660	893	2	279,094	87	279,181

(1) Balance of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, after provision for credit losses, excluding impact of credit conversion factors and risk weighting factors, as defined under Basel rules.

(2) Mitigation using guarantees, credit derivatives and other qualified collateral.

After credit risk mitigation

	As of March 31, 2016											
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	41,657	3,173	-	-	-	3	-	-	-	44,833	-	44,833
Public sector entity debt	314	-	-	1,033	-	-	-	-	-	1,347	-	1,347
Banking corporation debt	-	1,506	-	470	-	151	-	-	-	2,127	-	2,127
Corporate debt	-	8	-	112	-	-	-	-	-	120	-	120
Total	41,971	4,687	-	1,615	-	154	-	-	-	48,427	-	48,427
Non-rated exposures:												
Public sector entity debt	-	-	-	22	-	-	-	-	-	22	-	22
Banking corporation debt	-	145	-	138	-	-	-	-	-	283	-	283
Corporate debt	-	-	-	-	-	58,224	149	-	-	58,373	-	58,373
Debt secured by commercial real estate	-	-	-	-	-	2,471	18	-	-	2,489	-	2,489
Retail exposure to individuals	-	-	-	-	25,202	9	93	-	-	25,304	-	25,304
Loans to small businesses	-	-	-	-	9,861	14	49	-	-	9,924	-	9,924
Residential mortgages	-	-	55,914	21,654	36,168	1,313	257	-	-	115,306	-	115,306
Other assets	1,568	-	-	-	-	2,016	50	893	2	4,529	87	4,616
Total	1,568	145	55,914	21,814	71,231	64,047	616	893	2	216,230	87	216,317
Total exposure	43,539	4,832	55,914	23,429	71,231	64,201	616	893	2	264,657	87	264,744

Before credit risk mitigation

												As of March 31, 2015
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	29,755	3,363	-	35	-	248	58	-	-	33,459	-	33,459
Public sector entity debt	-	-	-	971	-	-	-	-	-	971	-	971
Banking corporation debt	-	2,913	-	1,205	-	81	-	-	-	4,199	-	4,199
Corporate debt	-	20	-	199	-	-	-	-	-	219	-	219
Total	29,755	6,296	-	2,410	-	329	58	-	-	38,848	-	38,848
Non-rated exposures:												
Banking corporation debt	-	6	-	12	-	-	-	-	-	18	-	18
Corporate debt	-	-	-	-	-	74,084	117	-	-	74,201	-	74,201
Debt secured by commercial real estate	-	-	-	-	-	3,139	-	-	-	3,139	-	3,139
Retail exposure to individuals	-	-	-	-	25,777	54	79	-	-	25,910	-	25,910
Loans to small businesses	-	-	-	-	10,084	41	49	-	-	10,174	-	10,174
Residential mortgages	-	-	53,590	15,404	34,365	1,421	196	-	-	104,976	-	104,976
Other assets	1,286	-	-	-	-	2,064	53	942	4	4,349	87	4,436
Total	1,286	6	53,590	15,416	70,226	80,803	494	942	4	222,767	87	222,854
Total	31,041	6,302	53,590	17,826	70,226	81,132	552	942	4	261,615	87	261,702

(1) Balance of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, after provision for credit losses, excluding impact of credit conversion factors and risk weighting factors, as defined under Basel rules.

(2) Mitigation using guarantees, credit derivatives and other qualified collateral.

After credit risk mitigation

												As of March 31, 2015
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	30,268	3,367	-	35	-	21	-	-	-	33,691	-	33,691
Public sector entity debt	276	-	-	914	-	-	-	-	-	1,190	-	1,190
Banking corporation debt	-	2,904	-	1,206	-	81	-	-	-	4,191	-	4,191
Corporate debt	-	20	-	199	-	-	-	-	-	219	-	219
Total	30,544	6,291	-	2,354	-	102	-	-	-	39,291	-	39,291
Non-rated exposures:												
Banking corporation debt	-	145	-	140	-	-	-	-	-	285	-	285
Corporate debt	-	-	-	-	-	62,208	110	-	-	62,318	-	62,318
Debt secured by commercial real estate	-	-	-	-	-	2,805	-	-	-	2,805	-	2,805
Retail exposure to individuals	-	-	-	-	23,662	28	79	-	-	23,769	-	23,769
Loans to small businesses	-	-	-	-	8,050	32	43	-	-	8,125	-	8,125
Residential mortgages	-	-	53,590	15,404	34,160	1,420	195	-	-	104,769	-	104,769
Other assets	1,286	-	-	-	-	2,064	53	942	4	4,349	87	4,436
Total	1,286	145	53,590	15,544	65,872	68,557	480	942	4	206,420	87	206,507
Total exposure	31,830	6,436	53,590	17,898	65,872	68,659	480	942	4	245,711	87	245,798

Before credit risk mitigation

												As of December 31, 2015
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	36,224	2,573	-	16	-	323	-	-	-	39,136	-	39,136
Public sector entity debt	-	-	-	912	-	-	-	-	-	912	-	912
Banking corporation debt	-	1,613	-	392	-	123	-	-	-	2,128	-	2,128
Corporate debt	-	-	-	127	-	1	-	-	-	128	-	128
Total	36,224	4,186	-	1,447	-	447	-	-	-	42,304	-	42,304
Non-rated exposures:												
Public sector entity debt	-	-	-	-	-	14	-	-	-	14	-	14
Banking corporation debt	-	16	-	12	-	-	-	-	-	28	-	28
Corporate debt	-	-	-	-	-	69,653	196	-	-	69,849	-	69,849
Debt secured by commercial real estate	-	-	-	-	-	2,839	3	-	-	2,842	-	2,842
Retail exposure to individuals	-	-	-	-	27,114	25	81	-	-	27,220	-	27,220
Loans to small businesses	-	-	-	-	10,937	19	69	-	-	11,025	-	11,025
Residential mortgages	-	-	54,422	19,927	37,033	1,351	275	-	-	113,008	-	113,008
Other assets	1,630	-	-	-	-	2,014	51	932	10	4,637	87	4,724
Total	1,630	16	54,422	19,939	75,084	75,915	675	932	10	228,623	87	228,710
Total	37,854	4,202	54,422	21,386	75,084	76,362	675	932	10	270,927	87	271,014

(1) Balance of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, after provision for credit losses, excluding impact of credit conversion factors and risk weighting factors, as defined under Basel rules.

(2) Mitigation using guarantees, credit derivatives and other qualified collateral.

After credit risk mitigation

												As of December 31, 2015
	0%	20%	35%	50%	75%	100%	150%	250%	1250%	Gross credit exposure	Deducted from capital	Total
Rated exposures:												
Sovereign debt	37,029	2,580	-	16	-	-	-	-	-	39,625	-	39,625
Public sector entity debt	309	-	-	869	-	-	-	-	-	1,178	-	1,178
Banking corporation debt	-	1,610	-	392	-	123	-	-	-	2,125	-	2,125
Corporate debt	-	-	-	127	-	1	-	-	-	128	-	128
Total	37,338	4,190	-	1,404	-	124	-	-	-	43,056	-	43,056
Non-rated exposures:												
Public sector entity debt	-	-	-	23	-	14	-	-	-	37	-	37
Banking corporation debt	-	171	-	118	-	-	-	-	-	289	-	289
Corporate debt	-	-	-	-	-	59,370	186	-	-	59,556	-	59,556
Debt secured by commercial real estate	-	-	-	-	-	2,553	3	-	-	2,556	-	2,556
Retail exposure to individuals	-	-	-	-	24,874	8	80	-	-	24,962	-	24,962
Loans to small businesses	-	-	-	-	8,695	15	51	-	-	8,761	-	8,761
Residential mortgages	-	-	54,091	19,886	36,886	1,351	275	-	-	112,489	-	112,489
Other assets	1,630	-	-	-	-	2,014	51	932	10	4,637	87	4,724
Total	1,630	171	54,091	20,027	70,455	65,325	646	932	10	213,287	87	213,374
Total exposure	38,968	4,361	54,091	21,431	70,455	65,449	646	932	10	256,343	87	256,430

Credit risk mitigation using the standard approach

The Bank Group takes different actions to mitigate risks associated with extending credit and with credit concentration. Below is a description of major tools used to mitigate risk in conjunction with the Bank's credit policies.

Collateral – Collateral received by the Bank is designed to secure repayment of credit extended by the Bank to the client, in case of insolvency. The quality and extent of collateral required from the client is determined based on the basic borrower attributes, transaction attributes and materiality of the risk of the client being unable to repay the credit. The higher the risk, the larger and more liquid collateral required by the Bank.

Bank policies and procedures specify the asset types which may be recognized as collateral for providing credit. The commonly used collateral types at the Bank are: Deposits, securities, liens on real estate, vehicles, , credit vouchers, checks, bank guarantees and institutional, corporate or individual guarantees. As part of the collateral policies, rules and principles were prescribed as to the level of reliance on each type of collateral, with regard to its character, marketability, price volatility, promptness of realization and legal status, in addition to assessing the repayment ability of a client as a criterion for issuing the loans.

There is also intangible collateral, such as a floating lien, receivables and/or financial and operating covenants imposed on the client to secure their capacity to repay their debt to the Bank.

The collateral is matched, as far as possible, to the type of credit that it secures, while taking into account the period of time, types of linkage, character of loans and their purpose, as well as how quickly it can be realized. Collateral coefficients determine the extent to which the Bank is willing to rely on specific collateral to secure credit. The value of the collateral, with the use of safety factors, is, as far as possible, calculated automatically by the IT systems. The safety factors for different types of collateral are examined once a year and are approved by the Board of Directors' Credit Committee, by the Risks Management Committee and by the Board of Directors. There is also collateral in place which is not accounted for in calculating safety factors, but only used to reinforce existing collateral. The Bank also approves, on a limited, case-by-case basis, the granting of credit solely on the basis of the borrower's obligation.

Bank procedures specify rules for ongoing collateral management, including updates to the value of collateral: Deposits and bank guarantees are regularly updated based on the terms and conditions thereof; collateral consisting of negotiable securities is regularly updated based on their market value ; with regard to collateral consisting of real estate, the procedure determines the date for valuation by a licensed assessor in accordance with the type of credit secured by the property. This assessment is validated in cases specified in Bank policies, by the Bank's internal assessment unit. Valuation is also carried out in case of concern regarding material impairment of the collateral, which may cause the Bank to face shortage of collateral.

As stated above, including in the chapter on Basel Committee Recommendations, the Bank makes extensive use of collateral not recognized under credit mitigation rules of Basel II (real estate, liens on automobiles, personal guarantees) in order to mitigate credit risk.

Guarantors – Sometimes, the Bank requires clients to provide guarantees or guarantors to secure credit. There are different types of guarantees, such as personal guarantees, various bank guarantees, State guarantees, insurance policies or letters of indemnification.

Credit syndication – The Bank participates in syndication and in the last two years has established a professional department which allows the Bank to lead syndications of significant credit volumes. Syndicated financing allows the risk to be diversified among multiple financing providers in large credit transactions.

Debt sharing / sale – Another tool used to mitigate credit risk is sharing / selling parts of the Bank's credit portfolio in certain segments to financial institutions.

Hedges - Borrowers with currency exposure are offered means of safety and protection (hedging transactions) in order to reduce their exposure, in addition to other measures that the Bank adopts to minimize the risk of the Bank's exposure from the activities of these clients. Guidelines were prescribed to intensify the monitoring, control, and supervision of the activities of borrowers whose debts to the Bank are sensitive to exchange rate fluctuations, including the creation of simulations and future scenarios of changes in exchange rates. Special controls are also used for clients, when securities form a significant element of their collateral.

Concentration – The materiality of credit concentration risk for the Bank requires various entities at the Bank to monitor and take action so as to allow the Bank to control such risk concentrations.

To this end, the Bank specifies in its credit policies the risk appetite for various areas related to credit, including credit concentration.

The Bank's credit policies are based on diversification and controlled management of risks.

Risks diversification is characterized by several aspects:

- Diversification of the loan portfolio among the different economic sectors, including limiting exposure in certain sectors.
- Diversification of size groups of clients.
- Diversification of linkage segments.
- Restrictions on exposure to specific operating segments.
- Restrictions on exposure to individual borrowers and borrower groups.
- Geographic diversification where relevant (construction industry, mortgages).

Economic sectors – The Bank's Executive Management and Board of Directors hold discussions on the issue of credit to certain industrial sectors, as is necessary, mainly as it relates to industries that are sensitive to fluctuations in business cycles. Credit policies for the sensitive industries are set on the basis of an economic analysis of the developments forecast for these industries. The Bank maintains distribution of indebtedness among different sectors, so as not to create extraordinary indebtedness according to provisions of Proper Banking Conduct Directive 315. Credit to certain sectors, such as diamonds, construction (including sub-sectors thereof) is handled by professional units or by personnel specializing in these sectors. Specific rules and procedures have been prescribed for these specific sectors, beyond those relating to the issue of credit, in order to deal with their special credit risks. The Bank prefers to require collateral external to the sector, in order to mitigate and hedge the credit risk.

Major clients – The Bank provides credit to large clients through the Corporate sector, which operates teams with sector expertise. Occasionally the Bank limits its share of credit to a major client relative to total extent of credit to that client in the banking system, and in some cases, in order to participate in financing of certain transactions, the Bank requires a financing package to be put in place with participation of other banks (under consortium agreements). The Bank strictly complies with limits on indebtedness of a borrower and a group of borrowers, as well as on total indebtedness of major borrowers and groups of borrowers whose net indebtedness to the Bank exceeds 10%, pursuant to Proper Banking Conduct Directive 313.

Linkage sectors – This distribution is also reflected in providing credit in various linkage segments, so that part of the credit is more susceptible to fluctuations in the Consumer Price Index (CPI-linked credit), some is more susceptible to changes in the prime lending rate (non-linked NIS-denominated credit), and some – to foreign currency exchange rate fluctuations (foreign-currency denominated credit or linked to foreign-currency exchange rate).

Geographic diversification – The Bank maintains geographic diversification with regard to credit for construction and mortgages, in order to reduce over-concentration in extending credit.

Tools for risk mitigation in housing loans

Collateral

In accordance with Bank procedures for mortgages, loans are only provided if secured by property collateral. In some cases, the Bank demands guarantors for the debt, in addition to property collateral.

For verification of information about the property offered to the Bank as collateral and to determine its value, an assessor visit to the property is normally required, providing a report which describes the property, its location, physical condition and market value. Assessors are party to an agreement with the Bank and act in accordance with Bank guidance, including a structured procedure for conducting assessments, identifying exceptions etc.

The common practice for assessment in the mortgage sector is to use an abbreviated assessment. However, the Bank requires an extended assessment for some of the loans for purchase of existing apartments, self-construction or general-purpose loans with high-risk property types, which includes additional tests subject to criteria set for this matter.

Insurance

According to Bank procedures, all properties serving as collateral must be insured under property insurance. In addition, the borrowers are insured by life insurance assigned to the Bank in case of death prior to complete repayment of the loan.

For some loans (usually loans with LTV ratio higher than 75%), the Bank contracted with EMI Corp., which provides credit insurance in case the proceeds from realization of the property collateral for the loan should fail to cover the outstanding loan amount. This credit insurance process is a key risk mitigator.

As from November 1, 2012, the Bank of Israel restricted origination of housing loans with LTV over 75%, so that as of this date the Bank no longer approves new loans with credit insurance and LTV over 75% (except for loans exempted from this directive, such as refinancing loans).

Loan to Value (LTV) ratio

The maximum LTV ratio approved by the Bank is determined by the credit policies and is periodically reviewed. Generally, the Bank requires borrowers to contribute part of the financing for the acquisition. This equity payment forms a safety cushion in case the property is realized during a down-turn in the real estate market. Furthermore, borrower equity is a further indication of the borrower's financial robustness. As from November 1, 2012, the Bank restricted the LTV ratio for approval of applications for housing loans, pursuant to the Bank of Israel directive on this matter. The LTV ratio for loans to acquire rights to real estate constituting a "single apartment" (as defined in the directive) shall not exceed 75%, for an "alternative apartment" (as defined in the directive), the LTV ratio shall not exceed 70%, and for acquisition of an investment property, general-purpose loan or loan extended to foreign residents - the LTV ratio shall not exceed 50%. For more information see the section on Legislation and Supervision of Bank Group Operations under the chapter "Corporate governance" on the 2015 financial statements and Note 9.H to the financial statements for the current quarter.

Below is the composition of net credit exposure by risk mitigation type (NIS in millions):

					As of March 31, 2016
		Exposure covered by guarantees[2]			
	Gross credit exposure[1]	Amounts deducted	Amounts added	Exposure covered by qualified financial collateral	Net credit exposure
Sovereign debt	44,301	(311)	856	(13)	44,833
Public sector entity debt	1,068	-	336	(35)	1,369
Banking corporation debt	2,147	(1)	264	-	2,410
Corporate debt	68,696	(708)	-	(9,495)	58,493
Debt secured by commercial real estate	2,806	(10)	-	(307)	2,489
Retail exposure to individuals	27,546	(5)	-	(2,237)	25,304
Loans to small businesses	12,233	(421)	-	(1,888)	9,924
Residential mortgages	115,768	-	-	(462)	115,306
Other assets	4,529	-	-	-	4,529
Total	279,094	(1,456)	1,456	(14,437)	264,657

					As of March 31, 2015
		Exposure covered by guarantees[2]			
	Gross credit exposure[1]	Amounts deducted	Amounts added	Exposure covered by qualified financial collateral	Net credit exposure
Sovereign debt	33,459	(276)	516	(8)	33,691
Public sector entity debt	971	-	276	(57)	1,190
Banking corporation debt	4,217	(9)	268	-	4,476
Corporate debt	74,420	(559)	-	(11,324)	62,537
Debt secured by commercial real estate	3,139	(4)	-	(330)	2,805
Retail exposure to individuals	25,910	(1)	-	(2,140)	23,769
Loans to small businesses	10,174	(211)	-	(1,838)	8,125
Residential mortgages	104,976	-	-	(207)	104,769
Other assets	4,349	-	-	-	4,349
Total	261,615	(1,060)	1,060	(15,904)	245,711

					As of December 31, 2015
		Exposure covered by guarantees[2]			
	Gross credit exposure[1]	Amounts deducted	Amounts added	Exposure covered by qualified financial collateral	Net credit exposure
Sovereign debt	39,136	(309)	811	(13)	39,625
Public sector entity debt	926	-	332	(43)	1,215
Banking corporation debt	2,156	(4)	262	-	2,414
Corporate debt	69,977	(690)	-	(9,603)	59,684
Debt secured by commercial real estate	2,842	(10)	-	(276)	2,556
Retail exposure to individuals	27,220	(4)	-	(2,254)	24,962
Loans to small businesses	11,025	(388)	-	(1,876)	8,761
Residential mortgages	113,008	-	-	(519)	112,489
Other assets	4,637	-	-	-	4,637
Total	270,927	(1,405)	1,405	(14,584)	256,343

(1) Balances of on- and off-balance sheet balances, after on- and off-balance-sheet offsets, after provision for credit losses, excluding impact of credit risk mitigation, credit conversion factors and risk weighting factors, as defined under Basel rules.

(2) Mitigating credit risk by using guarantees results in exposures moving from their original exposure group to exposure groups with a lower risk weighting factor. Consequently, sometimes the extent of exposure in a given exposure group, after credit risk mitigation, is higher than the extent of exposure in this group before risk mitigation.

Counter-party credit risk

Counter-party credit risk (CCR) is the risk that the counter-party to a transaction will be in default before final clearance of the transaction cash flows. Economic loss would be incurred only when the transaction with the counter-party would have a positive economic value upon such default. The market value of the transaction, which may be positive or negative for either party, actually depends on volatility of market factors. Should the counter-party be in default, and the transaction have a positive fair value, this may cause the Bank to incur a loss, liquidity issues and difficulties in carrying out further transactions. Counter-party risk may be affected by other risks, including: credit risk, market risk, liquidity risk, operating risk and reputation risk of the counter-party to the transaction. Counter-party risk has been defined as a material risk at the Bank. The Risk Manager is the Manager, Finance Division.

The Bank's current risk profile indicates that most of the Bank's exposure to counter-party risk is to foreign corporations and banks. This exposure is small in relation to the Bank's capital. The Bank has low exposure to sovereigns.

The Bank has set specific policy on addressing counter-party risk for banks and sovereigns and another document, which is part of the Bank's credit policies, concerns client activities in financial derivatives. The risk appetite associated with activities in derivatives is reflected in restrictions imposed on instruments and currencies. The trading in derivative instruments is part of the Bank's management of assets and liabilities, and is subject to restrictions prescribed by the Board of Directors. The Bank trades in these derivative instruments, both for its clients and for its own account, as part of the management of basis and interest exposure in the various linkage segments. The risk appetite refers to operations of the Bank's Financial Management Sector. These investments are individually reviewed by the Risks Management Committee, headed by the Manager, Finance Division, and are submitted for approval by the Asset and Liability Management Committee headed by the President. Various procedures ensure that the Bank may offer to clients a wide range of financial instruments - while maintaining an appropriate framework for addressing such risk.

Exposure to banks and foreign countries involves multiple risk factors, including country risk with regard to economic standing, geo-political standing and transfer risk, arising from administrative restrictions on transfer of foreign currency. In these operations, the Bank's risk appetite, as included in the policy document, involves routing most of the proactive operations to developed nations and to major banks in these countries, rated A+ or higher. Operations maintain proper diversification of exposures to banks and sovereigns. The Bank has very little business with less developed nations rated lower, in response to client needs.

Risk measurement is based on benchmarks such as PV, VAR and various stress tests which are conducted regularly in view of specific restrictions imposed on activity with the counter-party as well as on aggregate, with restrictions on total portfolio exposure. In cases such as OTC derivatives, where a market price may not be quoted, pricing and exposure estimation are based on commonly used pricing models. These models are regularly validated by the Bank's Validation Department. For business with banks and sovereigns, the Bank has developed an internal model for calculating facilities with each counter-party, based on the quality, rating and capital of such banks and sovereigns.

In order to estimate exposure, the Bank uses diverse systems, as in its business operations, with control based on information available in these systems and on a special control system developed by the Bank to estimate client exposure and to alert any deviations. The control mechanism for operations with foreign banks relies on special reports created in the Bank's infrastructure system and exception reports generated to monitor business in Israel and overseas, including a Banks Report, which lists all exposures to banks as well as deviation reports, which reflect deviations from agreed facilities, if any. The Algorythmics system is another control layer, calculating VaR for the Bank's nostro activity, as well as taking part in a comparison report developed at the Bank, which reviews transaction pricing in the Bank's trading systems against the price given by the system. In addition, another control system is operated in the trading room, which includes a feature to present an overview of trading facilities with banks and sovereigns.

Risk management is dynamic, through the trading systems, controls and dedicated reports. The Bank regularly adjusts its exposure to banks and countries and regularly reviews publications about ratings of financial institutions to which the Bank is exposed, through the Financial Institution Relations Department of the Finance Division.

Restrictions and controls - a limit restriction applies for banks and sovereigns, including reference to derivatives. Furthermore, a restriction applies to customer facilities based on certain parameters. The Risks Control Division includes a dedicated department, specialized in control of exposure arising from capital market operations, which daily reviews clients active in this field. As part of division operations, the trading room operations are controlled, including testing of compliance with various restrictions prescribed by the Board of Directors and Executive Management.

Risk mitigation - in order to participate in capital market activity, clients are required to provide collateral in accordance with Bank procedures. In its activities vis-à-vis banks and sovereigns, the Bank signs ISDA agreements and CSA annexes. This allows for setting off transactions, so that the amount exchanged between parties to the transaction is limited to the net exposure amount, thereby reducing exposure of either party. CSA annexes regulate funds transfer between parties to a transaction whenever exposure reaches a certain pre-defined level, thereby reducing counter-party exposure.

Below is the composition of exposures related to counter-party credit risk (NIS in millions):

						As of March 31, 2016
	Interest contracts	Foreign currency contracts	Contracts for shares	Commodity contracts	Credit derivatives[2]	Total
Par value of derivative instruments after impact of add-on factor	139	1,178	411	1	-	1,729
Positive fair value, gross, of derivatives[1]	1,751	1,779	415	1	-	3,946
Effect of offset agreements	(1,239)	(1,125)	(67)	(1)	-	(2,432)
Total exposure with respect to derivative instruments	651	1,832	759	1	-	3,243
Collateral with respect to derivative instruments (before safety factors)	(101)	(538)	(658)	(1)	-	(1,298)
Impact of safety factors on collateral	54	186	213	-	-	453
Total current credit exposure after credit risk mitigation	604	1,480	314	-	-	2,398

						As of March 31, 2015
	Interest contracts	Foreign currency contracts	Contracts for shares	Commodity contracts	Credit derivatives[2]	Total
Par value of derivative instruments after impact of add-on factor	137	1,320	486	1	37	1,981
Positive fair value, gross, of derivatives[1]	2,030	2,873	682	-	-	5,585
Effect of offset agreements	(1,547)	(1,482)	(100)	-	-	(3,129)
Total exposure with respect to derivative instruments	620	2,711	1,068	1	37	4,437
Collateral with respect to derivative instruments (before safety factors)	(112)	(904)	(669)	(1)	-	(1,686)
Impact of safety factors on collateral	41	340	198	-	-	579
Total current credit exposure after credit risk mitigation	549	2,147	597	-	37	3,330

						As of December 31, 2015
	Interest contracts	Foreign currency contracts	Contracts for shares	Commodity contracts	Credit derivatives[2]	Total
Par value of derivative instruments after impact of add-on factor	138	1,122	434	1	-	1,695
Positive fair value, gross, of derivatives[1]	1,633	1,354	371	1	-	3,359
Effect of offset agreements	(1,271)	(494)	(53)	(1)	-	(1,819)
Total exposure with respect to derivative instruments	500	1,982	752	1	-	3,235
Collateral with respect to derivative instruments (before safety factors)	(78)	(672)	(734)	(1)	-	(1,485)
Impact of safety factors on collateral	26	275	245	-	-	546
Total current credit exposure after credit risk mitigation	448	1,585	263	-	-	2,296

(1) Includes exposure arising from counter-party credit risk with respect to client activity on the stock exchange, calculated based on stock exchange rules.

(2) The Bank's credit derivatives operations are not classified as brokerage operations. For information about transactions to buy and sell credit protection, see Note 11.B. to the financial statements.

Securitization

The Bank does not operate in the field of asset securitization. It is Bank policy to avoid, in principle, investment in complex securitization instruments.

Market risk and interest risk

Market and interest risk management in the bank portfolio

Market risk – This is the risk of loss from on- and off-balance sheet positions, arising from change in fair value of financial instruments, due to change in market risk factors (interest rates, exchange rates, inflation, prices of equities and commodities). The Bank has no exposure to commodities and its exposure to equities is not material, so that Bank exposure to such risk is primarily due to basis risk - the risk exists when the Bank's assets and liabilities are denominated in different currencies or are in different linkage segments - and from interest rate risk, which the risk to Bank profit (change in revenues) or to Bank capital, primarily due to fluctuations in interest rates, fluctuations of various curves used by the Bank in its business operations or from the fact that a change in interest rates may result in a change in composition of the Bank's assets and liabilities due to exercise of options for early repayment due to change in market interest rates. Changes in interest rates impact Bank profits (change in revenues) and the value of Bank assets (change in fair value). The Bank manages its market risk and interest risk in integrated fashion, under the same organizational structure and using similar tools, data structures, methodology and systems.

Market risk and interest risk form an integral part of banking business and of management of Bank assets and liabilities. However, excessive market risk and/or interest risk may expose the Bank to loss and may pose a threat to Bank capital. Therefore, the Bank's Board of Directors and management have specified, in the Bank's structured process for risk mapping and identification, that market risk and interest risk are material risks and that management of these risks is critical for stability of the Bank, especially in view of the low interest rate environment and the potential for change in market interest trend. Therefore, the Bank's Board of Directors issued a special document on handling of market risk and interest risk, which stipulate the principles whereby the Bank should act in order to identify, measure, monitor, review and control the market risk and interest risk on a regular basis, both in the normal course of business and in times of stress. Management of these risks is designed to maintain a reasonable risk level, in conformity with the exposure caps, i.e. the risk appetite specified for these risks, while taking advantage of opportunities and constant monitoring of the risk profile, so that the Bank would not be exposed to significant loss.
Management of market risk and interest risk at the Bank consists of two main risk concentrations: the bank portfolio and the negotiable portfolio. The Bank's negotiable portfolio includes the portfolios managed as market maker in the trading room, other than for hedging purposes: The debenture portfolio for trade of the Interest Trading Unit, derivatives transactions managed by the Interest Trading Unit as part of the interest portfolio, as well as option portfolios (foreign currency, MAOF and interest) of the Foreign Currency Trading Unit, as well as portfolios of securities held for trade and transactions in derivatives conducted as part of a specific market strategy, managed by Financial Management under specific restrictions on exposure and profitability. This portfolio is small relative to activity in the bank portfolio and is associated with low risk.

The bank portfolio, which is the Bank's primary activity, consists of all transactions not included in the negotiable portfolio, including financial derivatives used to hedge the bank portfolio. This portfolio is exposed to interest risk, known as "interest risk in the bank portfolio". The exposure which the Bank wishes to retain is due to the Bank's business operations and is reflected in the Bank's financial statements. This exposure is limited by the risk appetite, specified individually for market risk and interest risk in the bank portfolio, which is reviewed by the Bank at least once a day, using various tools and models. Any deviation from or even getting close to the specified exposure limits are regularly reported and immediately addressed, in conformity with principles specified in the policy document created by the Bank. The Bank has operations involving financial derivatives, mostly vis-à-vis clients, which are required to maintain capital adequacy or to maintain collateral based on scenarios. These operations are regularly monitored by the Bank on intra-day basis by a dedicated control system developed by the Bank. The Bank has relatively little activity vis-à-vis clients who are mostly engaged in trading financial derivatives and short-selling or with clients who are not subject to capital requirements or collateral. These clients are closely monitored at a higher frequency than other clients.

Market risk and interest risk are managed at Group level, including the Bank's overseas affiliates and subsidiaries. Operations vis-à-vis Bank Yahav are regularly co-ordinated, in particular for setting the Group risk appetite, which requires monitoring of the Group-level risk profile. Policy principles were specified in line with Bank strategy and with regulatory requirements, i.e. Proper Banking Conduct Directives of the Bank of Israel, relevant Basel Committee directives and in line with globally accepted best practice. The Bank of Israel directives relevant for market risk management are: Proper Conduct of Banking Business Directive 310 - The master regulation for risk management, which stipulates principles for risk management which support the capacity of the banking corporation to identify evolving risk and to respond to it. Proper Conduct of Banking Business regulation 339 "Market Risk Management"; Proper Conduct of Banking Business regulation 333 "Interest Risk Management", which expands the regulations with regard to interest risk, mostly with regard to Bank activity in the bank portfolio; and Proper Conduct of Banking Business regulation 208 "Capital Measurement and Adequacy", with regard to definition of revaluation management and capital allocation under Pillar 1 with respect to the negotiable portfolio. The Bank reviews, in conjunction with its capital planning, as part of Basel Pillar 2, the capital required of the Bank with respect to interest risk in the bank portfolio, in conformity with Proper Conduct of Banking Business Directive 211.

As part of risk management, the Bank is required to allocate capital, as part of Basel II, Pillar 1, against risk in the negotiable portfolio, in conformity with Proper Conduct of Banking Business Directive 208 "Capital measurement and adequacy – market risk" which includes the Basel II directives with regard to definition, management and revaluation of the negotiable portfolio. The directive stipulates that inclusion of an instrument and/or position in the negotiable portfolio is subject to compliance with objective criteria (free of any treaty which restricts their negotiability or which may be fully hedged) and subjective criteria (trading intent or hedging of other components in the negotiable portfolio, active portfolio management and frequent, accurate valuation of the portfolio).

In conformity with Proper Banking Conduct Directive 208, the Bank is required to allocate capital with respect to interest and shares risk in the negotiable portfolio, for exchange rate risk for all banking activities and for options risk. The Bank uses the effective duration method in measuring interest risk, and the Delta Plus method in measuring option risk. This

method quantifies the risk associated with operations of the options portfolio based on the discounting values. These reflect the sensitivity of the options portfolio to movements in the underlying asset and in standard deviation.
Capital allocation for currency exposure (basis risk) is at 8% of the net open position in each currency. No capital allocation is made for inflation exposure (NIS / CPI position). As part of the provisions of this directive, the Bank also calculates specific risk in the negotiable portfolio. Capital requirements with respect to specific risk are intended to provide protection against negative change in the price of a single security due to factors related to the individual issuer. The capital requirement with respect to specific risk is in lieu of the capital requirement with respect to credit risks in the bank portfolio.
Due to the low level of risk inherent in the Bank's negotiable portfolio, the Bank's capital allocation with respect to market risk is very low.

The bank portfolio includes the positions not classified as negotiable positions in the negotiable portfolio. The Bank handles interest risk in the bank portfolio and overall additional capital allocation with respect to it, in conformity with Basel Pillar 2. Interest risk in the bank portfolio is monitored on a regular basis, both in managing interest risk for the overall portfolio in VaR terms, and in EVE (Economic Value of Equity) terms, as well as another range of scenarios which mostly reflect stress conditions. For more information about these models, their use and limitations - see below.

The additional total capital allocation by the Bank with respect to interest risk in the bank portfolio, in conjunction with Basel Pillar 2, is made in line with Bank methodology which assumes, in conformity with Bank of Israel directives, stress conditions in the market. The Bank reports its capital calculation s with respect to Basel Pillar 2 in its ICAAR document. Thus, the Bank completes the capital review it is required to perform with respect to market and interest risk in the bank portfolio.

Linkage segment management

Currency exposures – It is Bank policy to maintain minimal (operating) currency positions, except for specific strategic positions approved by the different committees and/or Trading Room positions, in conformity with approved risk restrictions. Foreign currency strategic positions are capped by a Stop Loss mechanism to restrict and reduce risk.
Inflation exposure – The risk appetite varies with expected profit from holding a position and the Bank's capacity to reduce the exposure within a reasonable time frame. This exposure is included among the risk appetite benchmarks and models applied by the Bank to all market risks. For more information about the Bank's financial capital and linkage status, see chapter "Risk overview" in the Report by the Board of Directors and Management.
Derivatives in the bank portfolio used for economic hedging of balance sheet activity, or which cannot be defined as an accounting hedge, impact accounting profit and loss. The gap derives from difference in accounting treatment between balance sheet items and derivatives other than accounting hedges. This effect is regularly monitored and managed subject to guidelines specified by management, by the Financial Management Sector and is reported and discussed by various risk management committees.

Means of supervision over and implementation of the policy

The Bank has put in place an organizational structure for management of market risk and interest risk in the bank portfolio, which includes the Board of Directors, management and the three lines of defense. This structure is supported by special committees and forums, created for such risks management and in order to create an internal controls system, designed to prevent deviation from Bank policy in its activity in the negotiable portfolio and in the bank portfolio.

Below is the organizational structure created at the Bank for management and control of market risk and interest risk:

Bank's Board of Directors – The Bank's Board of Directors approves, at least once a year, the policy document which incorporates how exposure to market risk and interest risk in the bank portfolio should be managed, after it has been approved by Bank management and by the Board Risks Committee. This document outlines, *inter alia*, the authority ranking for market risks management, the risk appetite (exposure restrictions) and the frequency of discussions and reporting of exposure status at different levels. The Board's Risks Management Committee is an advisory entity for the Board plenum with regard to market risk and interest risk in the bank portfolio. In the first quarter of 2016, there was no material change in the framework specified by the Bank and, in particular, in principles of the policy document on management of market risk and interest risk. In the first quarter of 2016, the Bank did not deviate from the risk appetite specified by the Board of Directors for market and interest risk and there were no material deviations of the actual policy applied and the planned policy. There were no significant events related to market risk and its management, after the balance sheet date.

The market and interest risk profile is monitored on a daily level by the Finance Division and the Risks Control Division; on a weekly level by the Risks Management Committee, headed by the Manager, Finance Division; and on a monthly level by the Management Committee for the Management of Assets and Liabilities, headed by the Bank President & CEO. The market and interest risk profile in the bank portfolio is presented to the Bank's Board of Directors using the Bank's quarterly Risk Document. The risk profile is monitored in view of the risk appetite specified by the Board of Directors. The discussion by the Board of Directors is focused specifically on these risks and covers the evolution of the risk profile, in view of the risk appetite specified by the Board, based on a range of diverse benchmarks - as required by the Bank of Israel - or based on Bank needs. Any deviation, should it occur, is to be reported to the Board of Directors, along with action taken to eliminate it. The Board of Directors receives a report, through the Risks Document, of major action taken by the Bank in the different portfolios during the reviewed period, of the profitability of these portfolios and of market developments, in particular risks in markets in Israel and overseas which may potentially impact the business profile of Bank operations and its market and interest risk profile in the bank portfolio. In particular, operating procedures and guidelines specify a range of KRIs, a change in which may indicate a change in markets and potential deterioration of the mix of Bank operations.

The risk appetite framework specified by the Board of Directors was enhanced by management guidelines (restrictions), set lower than the Board of Directors restrictions, in order to allow exposure to be reduced even before it deviates from the risk appetite specified by the Board of Directors. The risk appetite is specified under normal and stress conditions, by a range of benchmarks which restrict market risk; in addition, specific risk appetite benchmarks were specified with respect to interest risk in the bank portfolio and with respect to Bank activity in the negotiable portfolio. The Board of

Directors restrictions and management guidelines reflect the risk appetite, which is consistent with the business strategy, liquidity planning, financing sources and capital planning at the Bank.

As noted, the Bank maintains interfaces vis-à-vis subsidiaries with regard to setting risk appetite for the Group. Reports by Group entities about the risk profile in view of the risk appetite are presented in the Bank's quarterly Risks Document.

The Bank President & CEO – heads the Asset and Liability Management Committee (ALMC), which is the advisory entity to the President & CEO with regard to market risks. This committee generally meets once a month, or more frequently, when special developments in the various markets occur or are forecast. The President & CEO, in conformity with the Exposures Procedure and subject to restrictions imposed by the Board of Directors, has the decision-making authority with regard to management of market exposures. The Bank’s risks management policies are discussed, formulated, and monitored by the Management Committee for the Management of Assets and Liabilities.

Bank management – is responsible for implementation of the specified principles and for reporting to the Board of Directors on developments with regard to the framework for handling market risk and interest risk and for implementation of the specified principles - in particular, the development of these risk profiles, in similar fashion to reporting with regard to other risks, as identified and mapped by the Bank. Reporting with regard to the current risk profile and its development, is made, as noted, through the Bank's quarterly Risks Document and as part of the Bank's ICAAR document, as part of the ICAAP process - which is part of the Basel II, Pillar 2 directive.

The functions for management and control of market and interest risks at the Bank consist of three lines of defense, as stipulated by Proper Banking Conduct Directive 310 of the Bank of Israel:

First line of defense – Lines of business management

The Manager, Finance Division (CFO) is the manager of market, interest and liquidity risk at the Bank. The Risks Management Committee serves as the advisory body for the Division Manager. the Committee convenes weekly to discuss current aspects of the management of assets and liabilities. The Manager, Finance Division is empowered to reach decisions on issues relating to the management of exposure in all the linkage segments, in order to implement the policies prescribed by the Bank President & CEO, subject to the restrictions prescribed by the Board of Directors.

The Manager, Finance Division specifies guidelines for current operations of market and interest risks management, subject to restrictions specified by the Board of Directors and by management.

When a financial event is identified and declared, which requires special preparation, the Manager, Finance Division convenes - with approval of the President & CEO, a special forum to discuss and make decisions on how to handle the event. The operation of this forum is incorporated in a specific procedure.

The Financial Management Sector of the Finance Division is the entity which manages exposure to market, interest and liquidity risk on regular basis and acts to implement the policy and the decisions made, for management of these risks and control required based on operations of the first line of defense, in conformity with Bank of Israel directives.

Second line of defense - Risks Management Function

The Manager, Risks Control Division (the Chief Risks Officer - CRO) is responsible for the overall Risk Owner framework. The Risks Monitoring Forum for market, interest and liquidity risks and validation, serves as the advisory body to the Chief Risks Officer with regard to management of Bank exposure to market and interest risks in the bank portfolio, which is convened at least monthly. This Forum, which includes representatives from the Finance Division and from the Risks Control Division, discusses and specifies methodology for risks management and control, including measurement methods which can support portfolio monitoring activity and addresses various aspects arising from management and control of market, interest and liquidity risks, including conclusions from model validation processes, conducted by the Bank's Validation Unit which operates int he second line of defense, methodologies and usefulness of various stress tests. The Bank has created a unit for control of market and interest risks, under the Risks Control Division. This unit is independent of other entities responsible for management and trading of various instruments and is responsible, *inter alia*, for assessing the adequacy of models used by the banking corporation and is convened at least monthly, for measuring risk, for reviewing the alignment of actual operations and exposures with approved principles and exposure caps, for periodic review of actual results vs. model forecasting, for development of methodologies and conducting stress testing, for preparing risk quantification reports and for regular reporting of testing outcome. Thus, this unit provides another control circuit for control operations of the first line of defense.

Third line of defense - Internal Audit

Internal Audit serves as the third line of defense within corporate governance for risks management at the Bank, conducting regular control to review and assess the effectiveness of internal controls at the Bank, in accordance with the multi-annual work plan of the Internal Audit Division.

The three lines of defense maintain constant interfaces among them, through steering committees and other forums, to ensure constant communication which guarantees compliance with principles specified by the Board of Directors and by management, including constant monitoring of the risk appetite and in order to identify shortcomings in specified internal control, through various assessment processes, in order to strive for constant improvement of the specified framework for management and control for market and interest risk in the bank portfolio. The lines of defense serve for addressing these risks, using the key tools specified by the Bank as part of its internal control system, include: a reporting chain to ensure reporting under normal and emergency conditions, including to management and to the Board of Directors, as well as a structured process for approval of new (or revised) products or activities. The Bank has specified special policies for handling new (or revised) products or activities. Any new activity by the Bank (such as: new financial product, new exposure type, market making, new banking product etc.) is approved, based on a specific check list, after identification and review of risks associated with the new (or revised) product / activity, including market and interest risk in the bank portfolio associated with this activity and setting, as needed, restrictions and mechanisms for management, measurement and control of such risk.

Upon any unusual occurrence in the capital market, such as an unexpected change in interest rates, shake-ups in the foreign currency markets, changes in fiscal and/or monetary policies, the special committees and forums created by the Bank for such situations, convene for a special discussion in order to reach the decisions required by these occurrences.

The Bank's internal controls system includes a range of roles incorporated in the policy document and constantly monitored, including action taken to minimize exposure and to mitigate risk.

Hedging and risks mitigation policy

A major tool for management and mitigation of interest risk is setting shadow prices at the Bank (transfer pricing). Shadow prices are determined daily at the Bank by the Asset and Liability Management Department of the Financial Management Sector and reflect the needs for management of various exposures under the policy on risk / reward management.

Another tool is buying / selling government debentures. The Asset and Liability Management Department o the Financial Management Sector also manages the interest and/or basis position through forward contracts, swap transactions and options. The advantages of using these tools stem from rapid execution at large amounts, which allows the Bank to "move positions" within a reasonable time frame for asset and liability management. In addition, these transactions are unfunded, are highly liquid and are conducted through the Bank's trading room.

Derivatives transactions, which are identified as hedging balance sheet positions in accordance with accounting rules, are to be specified as hedge accounting transactions, in accordance with the Bank's hedging procedure. Hedge effectiveness is the degree of correlation between changes in fair value or between cash flows of the hedged item and of the hedging derivative. The hedge is considered highly effective if the changes in fair value or cash flows of the hedged item, are nearly fully set off by changes in fair value or cash flows of the hedging instrument. When hedging instruments and hedged items are not fully identical, hedge effectiveness is tested quarterly.

At least once a year, the Bank reviews the underlying assumptions of models used to manage market and interest risk, including behavioral assumptions made in order to determine forecasting of certain instruments.

The Bank reviews the concentration of interest risk by linkage segment and by major instrument type. The concentration map is discussed by risks management committees.

The Bank constantly acts to increase awareness of market and interest risk in the bank portfolio at Group level, both at headquarter units, at branches and at overseas units of the Bank, through operating procedures, training and seminars on this topic. Furthermore, constant contact is maintained with all relevant units for management of market and interest risk. Coordination between units is designed to achieve a uniform methodology for management of market and interest risk in the bank portfolio.

Developments in market and interest risk

Measurement of market and interest risks is supported by a wide range of information systems, models, processes, risk benchmarks and stress tests. The information systems involved in the calculation are regularly reviewed, through internal controls processes at the Bank, including specific surveys for monitoring activities and information and continuous validation processes, in order to ensure completeness and accuracy of data and calculations.

The models, calculation methodologies, input data, including market data and assumptions underlying the models, are validated and reviewed over time by the Bank's Validation Unit - operating in the Risks Control Division - which is part of the second line of defense for handling this risk.

The Bank has two major models for managing its market and interest risks: The VaR model and the EVE model. The Bank calculates these benchmarks, as well as other benchmarks used for management of such risk, at least once per day.

EVE (Economic Value of Equity) is a model which reflects the economic value approach. This is the Bank's main model for estimating interest risk in the bank portfolio, which reviews changes in economic value of the portfolio under various assumptions of changes to interest rate curves, under normal conditions and under stress conditions, including a concurrent increase / decrease in the interest rate curve. In addition, the Bank has various stress tests at different severity levels, designed to review its risk profile under stress conditions, in view of the risk appetite determined by the Board of Directors. The Bank also applies innovative methods to review interest risk in the bank portfolio under emergency conditions, including under stress scenarios of an economic outline. This scenario is based on the Bank's understanding as to development under stress conditions of macro-economic conditions relevant for these risks. The Bank also performs a scenario where the interest rate curve moves in non-parallel fashion. Such scenario complements the EVE approach, which is based on parallel move of interest rate curves.

The EVE model reviews the effect of changes to interest rate curves on the economic value of the bank portfolio, the negotiable portfolio and the overall portfolio (negotiable + bank), under various assumptions with regard to changes in interest rate curves (by segment, such as: derivatives, deposits and mortgages, by linkage basis). The economic value of the different portfolios is calculated as the present value of cash flows from Bank assets (exposed to changes in interest rates), net of the present value of cash flows from Bank liabilities (exposed to changes in interest rates).

The change in economic value due to changes in interest rate curves (the EVE benchmark) is calculated as the difference between future cash flows of asset and liabilities discounted at current interest rates, and the difference discounted at expected interest rates under several key scenarios, i.e. measuring the effect of changes in interest rate curves on the Bank's economic equity. Future forecasting of financial instruments is made in conformity with generally accepted practice around the world for calculating fair value. Financial instruments bearing fixed interest are forecast to final maturity, in conformity with the maturity schedule; financial instruments bearing adjustable interest are forecast to the nearest interest rate adjustment date. The fixed spread over the adjustable interest anchor is calculated and reviewed as part of overall management of interest risk. Cash flow discounting is applied using Zero Coupon (risk-free curves) for the various linkage bases.

In order to measure risk in the bank portfolio, six interest rate scenarios are applied to the bank portfolio, of which two are stress conditions, including PV02, i.e. parallel move of the curves by 2%. This scenario was specified by the Bank of Israel as a scenario which requires the Bank to report to the Supervisor of Banks in case its result reaches 20% of the Bank's core capital. As noted, the Bank’s Board of Directors specified a 15% restriction for this scenario, i.e. lower than the value subject to reporting to the Supervisor of Banks. The remaining four scenarios represent normal business conditions based on historical changes, which may not be parallel, in interest rate curves.

In order to measure risk in the overall portfolio, the Bank adds to interest risk in the bank portfolio (for each of the six interest rate scenarios) the restrictions for the negotiable portfolio under stress / normal conditions.

The VAR model is a statistical model that estimates the loss expected for the Bank in a certain investment period and at a pre-determined statistical level of assurance. This model measures risk level in terms of money, where the Bank aligns the investment horizon for the portfolios reviewed using this benchmark. The Bank uses a method previously developed with assistance from overseas experts, which integrates multiple VaR calculation methods commonly used world-wide. The VaR calculation is in addition to a back testing calculation, designed to review the quality of its calculation estimates, i.e. review the model forecast, compared to actual results. The Bank has specified a risk appetite in VaR terms, for the entire Bank portfolio and for its activities in various options portfolios (for various underlying assets). VaR calculations for the Bank's overall portfolio are made daily, while calculations for the option portfolios are made hourly. The outcome of VaR calculation and other risk benchmarks at the Bank are made using a special system acquired by the Bank for management of its market and interest risk and are reported on a special portal. All data required for estimation of these risks is stored in a central database. This database is subject to automated controls applied regularly.

Stress testing – These are various methods designed to estimate the Bank's expected loss as a result of sharp fluctuations in prices of market risks factors. This model estimates, using different methods, the potential loss at the left tail of the distribution, i.e. beyond the significance level determined in calculating the VaR. The Bank's stress test methods are two-fold: Subjective methods, reliant on an economic outline specified by Bank experts, and objective methods, which rely, *inter alia*, on past stress events and scenarios as well as on scenarios stipulated by the Bank of Israel in Directive 333 for interest risk management, where the curve moves in parallel throughout its length at rates of between 1% and 3%.

The Bank has specified restrictions (risk appetite), including in terms of stress testing. As part of testing the left-hand tail of distribution of the Bank portfolio, the Bank reviews other benchmarks, such as Stressed VaR, which estimates the expected VaR in case of a return of market conditions during the 2008-2009 financial crisis, as well as the Expected Shortfall VaR, a benchmark which estimates the average loss, beyond the specified significance level (average for the left-hand tail), so as to assign a weight to extreme events which are beyond the significance level and are not reflected in the VaR calculation.

Market risks in both portfolios (the bank portfolio and the negotiable portfolio) are managed overall using the VaR model and stress tests. For application of these models, the Bank's available capital is defined as a non-linked NIS-denominated source. The Bank operates subject to the risk appetite specified by the Board of Directors for market and interest risk, in terms of VaR and stress tests, which stipulate that the VaR for all of the Bank's activities in one-month investments, will not exceed 6% of shareholders' equity, and that the maximum loss in stress tests, in the highest of all calculation methods, will not exceed 15% of equity. Management has also specified guidelines for these two restrictions. The Bank constantly maintains a risk profile which is lower than these restrictions.

Interest risk is managed using two approaches: The earnings approach and the economic value approach; the Bank has specified the economic value approach to be the main method for risk management, but has developed another model - based on the earnings approach - and the fact that a significant part of Bank earnings are derived from the interest spread between assets (uses) and liabilities (sources), the financing margin model.

The financing margin is the difference between (cumulative) interest revenues received across all uses and (cumulative) interest expenses paid across all sources. The financing margin model allows the Bank to review expected earnings under different operating assumptions (turnover under different balances, for both assets and liabilities, changes in interest rate curves, assuming operations in conformity with work plans), including sensitivity analysis to changes in various interest rate curves.

The calculation is made by advanced computer systems developed by the Bank, at the individual transaction level. This model serves as a decision support system for Risk Managers at the Bank. The calculation is made from the individual transaction level, which allows for segmentation and analysis by different criteria, such as: instrument type, linkage basis, term to maturity etc.

The profitability approach is applied at two levels: static and dynamic. At the static level – calculation of net financing revenues for the Bank at a certain point in time. At the dynamic level – calculation of financing revenues under different interest operating scenarios for the coming year.

Nature and scope of reporting systems for market and interest risk

The Bank uses a system which enables management and control of market and interest risk, using a single system, as well as calculating the required capital adequacy with respect to market risk. All calculations of market risk values are automatically generated by the system, on a daily basis, with calculations of risk values for option portfolios generated on intra-day (hourly) basis - Intra-day VaR. The Bank has a comprehensive database or market data and positions, used for these calculations. This database allows all those who take part in risk management and control, i.e. the three lines of defense, to retrieve information and to calculate revaluations using the system. As part of the Bank's control operations, it has put in place a process of comparing derivative pricing by trading systems used by the Bank, against alternative pricing, calculated by the system.

Restrictions of models used by the Bank to manage market and interest risk

The main models used by the Bank to estimate market and interest risk, as with all models, have restrictions which may be due to model assumptions, input values used or mis-match between the models and market conditions, in particular with regard to stress conditions. The Bank is aware of these restrictions and therefore backs these models with other tools and processes. The VaR model is not appropriate for use under stress conditions, since it relies on historical data, which may not incorporate an estimate of the potential for an extreme market event. Furthermore, the VaR calculation methods generally accepted world-wide assume a normal distribution, which is not maintained under stress conditions. Therefore, as noted above, a few years ago the Bank made a change to its VaR methodology, abandoning the calculation which assumes a normal distribution - in order to align the calculations with variable market conditions and to alert when markets become volatile. In addition, the main way to overcome assumptions of this model is by using stress tests which are "forward-looking", i.e. do not rely on historical data and therefore complement the VaR model. The Bank has developed diverse methods for conducting stress tests to support the VaR calculations; in some of these methods, the Bank does not rely on any models or statistical assumptions, but rather on subjective assessment by Bank experts. The Bank also applies extensive approval processes for its stress testing methodology and constantly reviews the addition of other methods. The EVE model assumes, in most cases, a parallel move of the interest rate curve. This assumption may not be realistic. Therefore, the Bank has developed other scenarios (including a Twist scenario), where the interest rate curve is subject to a non-parallel movement. This scenario bolsters the capital equity calculations using the EVE method. The Bank also uses methods based on earnings analysis to provide another view of its risk profile, other than through a model based on economic value. A key component of the Bank's capacity to identify and handle model restrictions is the strict, constant validation process applied by the Bank to models being used, which reviews all model components: input, model calculations and use of the output. This validation process also reviews the models used by the Bank for pricing of derivative transactions.

Handling of inherent behavioral options in on-balance sheet instruments

Some instruments have inherent options which are sensitive to change in interest rates. Forecasting such instruments requires use of behavioral assumptions which are based on models and/or empirical calculations made by the Bank. These models are subject to constant validation, including back testing, designed to review the forecast vs. actual conditions.

Below is a mapping of major inherent behavioral options:

Early repayment of mortgages - behavioral model

Mortgages are spread over the contractual maturity, in addition to behavioral assumptions based on an empirical review of borrower behavior in the various linkage segments. Parameters of the behavioral model are reviewed monthly and brought for discussion by the relevant management committees.

Deposits – behavioral model

The Bank offers a wide range of deposits with inherent behavioral options: withdrawal at periodic exit points, regular exercise of liquid options and future deposits by standing order. The expected future cash flows with respect to these deposits is based on historical behavioral analysis of options exercise, withdrawal and deposit by depositors. These data are regularly reviewed, as part of testing the model assumptions.

Market risk analysis

Below is the capital requirement due to market risk by risk element (NIS in millions):

	As of March 31, 2016			As of March 31, 2015			As of December 31, 2015		
	Capital requirements(1)			Capital requirements(2)			Capital requirements(3)		
Risk element(3)	Specific risk	General risk	Total	Specific risk	General risk	Total	Specific risk	General risk	Total
Interest risk(4)	-	93	93	-	62	62	-	93	93
Equity risk	-	-	-	-	-	-	-	-	-
Foreign currency exchange rate risk	-	30	30	-	47	47	-	29	29
Total market risk	-	123	123	-	109	109	-	122	122

(1) The capital requirement was calculated at 12.9%.
(2) The capital requirement was calculated at 12.5%.
(3) The capital requirement was calculated at 12.8%.
(4) Risk associated with options activity is included under the different components, and was calculated using the Delta Plus approach, as defined in the Supervisor of Banks' directive.
(5) Calculated using the Effective Duration approach, as defined in the Supervisor of Banks' directive.

Below is the VaR for the Bank Group (NIS in millions):

	March 31, 2016	March 31, 2015	All of 2015
At end of period	245	310	195
Maximum value during period	(MAR) 245	(FEB) 320	(May) 379
Minimum value during period	(JAN) v	(JAN) 303	(OCT) 193

Back-testing of the historical-analytic VaR model shows one case in which the daily loss exceeded the forecasted VaR value. This deviation, amounting to NIS 5.5 million, was primarily due to a sharp increase in the CPI-linked curve, in response to the CPI being published and to lower inflationary expectations. This number of cases is within the criteria specified by the Basel Committee. Therefore, the Bank's VaR model is valid.

Below are exceptions during the reviewed period (NIS in millions):

Exception date	Exception value
July 17, 2013	5.5

Analysis of interest risk in bank portfolio

Below is the effect of a parallel shift of the curve by 2% on the economic value of the Bank's portfolio in EVE terms (NIS in millions):

						March 31, 2016
						Change in fair value
	Israeli currency		Foreign currency			
	Non-linked	Linked to CPI	Dollar	Euro	Other	Total
2% increase	(817)	330	125	(22)	(1)	(385)
Decrease of 2%	1,084	(498)	(125)	24	1	486

						March 31, 2015
						Change in fair value
	Israeli currency		Foreign currency			
	Non-linked	Linked to CPI	Dollar	Euro	Other	Total
2% increase	(1,502)	515	124	(8)	(4)	(875)
Decrease of 2%	1,682	(714)	(115)	9	4	866

						December 31, 2015
						Change in fair value
	Israeli currency		Foreign currency			
	Non-linked	Linked to CPI	Dollar	Euro	Other	Total
2% increase	(631)	83	(72)	(37)	(11)	(668)
Decrease of 2%	875	(198)	91	39	12	819

In preparing the mortgage repayment cash flows forecast for the Bank, assumptions with regard to the pre-payment rate and manner are taken into account. Market risk in the Bank's negotiable portfolio, primarily composed of portfolios managed in the trading room, is managed by means of quantitative limitations specified for each portfolio based on its activity.

Operating risk

Operating risk management

Operating risk is defined by the Bank of Israel as the risk of loss due to inappropriateness or failure of internal procedures, people, systems or due to external events.

The Bank applies a wider definition of operating risk, in accordance with the change in this definition by European and other banks. The revised definition would turn the framework for addressing operating risk into an active one, designed to support operations of the business units, to improve major business processes associated with their operations and thus, to increase business value, rather than only reducing the expected loss due to operating risk. The newly revised definition does not supersede the existing ones, which is supported by Basel and by the Bank of Israel, but rather expands it in order to create a framework for operating risk management, which analyzes processes, systems and other risks which may impact the business viability of the Bank.

With the developments in global markets and the higher complexity of financial activity and supporting technological infrastructure, an understanding has emerged, that Bank exposure to potential loss due to failures in regular operating activity may impact the business activity. Operating failure events which occurred at financial institutions in recent years have increased legislator awareness and financial institutions' awareness of operating failure events, to the large potential for damage which may be caused by such operating risk event and to their main attributes, as follows:

- Operating events may occur throughout the organization and are inherent to financial institution operations.
- Operating risk may potentially impact earnings, revenues, value and reputation of the Bank.
- Operating risk has inter-relationships with other risks, such as market risk, credit risk, liquidity risk, reputation risk and other risks. Thus, for example, an operating risk event may cause reputation risk to materialize, after which the Bank may face a liquidity event.
- A significant share of operating failures has very low probability but relatively large damage potential - which may even threaten Bank stability.
- Operating risk has diverse instances, from human error, malfunction in technological systems, fraud, embezzlement, war, fire, robbery etc.
- Operating events sometimes occur which are not under control of the financial institution, and may develop as a result of external events, some of which are unforeseen, with chances of occurring which cannot be estimated in advance, such as: natural disaster (earthquake, flooding), security event.

Bank management and the Board of Directors attach great importance to managing operating risk, due to its materiality, as part of the Bank's overall framework for risk management and control. The Board of Directors and management have determined that management of operating risk requires creation of an appropriate culture within the organization, by means of training, dissemination of related content and application of elevated standards of internal control at all levels.

The Bank has a special policy document for addressing operating risk. The operating Risk Owner at the Bank is the Manager, Risks Control Division - who is also the Bank's Chief Risks Officer. The framework stipulated for handling this risk includes the framework required for handling fraud and embezzlement, which are part of the operating risk categories according to Bank of Israel directives.

The framework for handling operating risk is based on three lines of defense:

- **First line of defense** The Bank's approach is that risk management is based, first and foremost, on the business units, which review the major business processes and put in a continuous effort of self-assessment of the risk associated there with.
- **Second line of defense** The Risks Control Division, and in particular the Operating Risk Department of the Risks Control Division, is tasked with a comprehensive view and monitoring of the operating risk handling framework and with responsibility for handling risk in view of activities in the first line, through a range of processes, tools and methods: Locating major risk hubs in business operations of the first line, through collection of actual operating failure data and conducting specific surveys for identification of potential future failures, as well as adapting the operating risk handling framework to Bank needs, in line with business development at the Bank and with regulatory requirements. The Division also strives for integration between various entities at the Bank, which have monitoring roles for risks adjacent to operating risk (compliance, business continuity, technology, information security and cyber security, SOX) as part of the deployment of the Bank's internal control system.
- **Third line of defense:** Internal Audit conducts audits of operating risk management in order to ascertain the effectiveness of handling such risk, in accordance with the work plan.

Bank policy specifies the Bank's operating risk appetite at 1% of the Bank's core capital. This appetite is constantly monitored by follow up on any default events which caused a loss, managed by category of operating risk, in conformity with Bank of Israel directives and also includes loss due to legal risk, information security and cyber risk, including fraud and embezzlement. The policy also stipulates the risk appetite for potential loss upon occurrence of a stress event. The Bank acts to specify a high-quality risk appetite, primarily by creating forward-looking risk indicators which can indicate a potential for development of operating risk, in addition to collection of actual losses, i.e. losses which have already occurred. The Bank is in the process of arranging KRI (Key Risk Indicators) on its major IT systems as well.

The policy specifies the channels for management and reporting of operating risk, designed to ensure proper risk management for all products, activities, processes and material systems of the Bank. To this end, the Bank operates forums at all levels, tasked with handling operating risk:

- **Management Committee for Operating Risks and Control:** Receive periodic reports about operating risks and review progress made by the Bank with regard to handling operating risk and other internal controls aspects.
- **Steering Committee for Management of Operating Risk, Information Security and Cyber Security:** A wider forum, consisting of managers of business line, operations and risk control. The forum discusses, *inter alia*, current reports, monitoring of material events and risks, constant monitoring of the handling framework and approval of changes to work processes in order to minimize the operating risk inherent therein.
- **Risks Monitoring Forum in operating and business divisions:** Forum consisting of unit managers and discusses unique aspects of risk for these divisions, conducts focused monitoring of the risk profile in the divisions, by discussion of failure events, if any, at the division and the outcome of the risk survey conducted at the division or at units operating within the division.

- **Stress Testing Forum:** Forum consisting of professional control entities and business entities, acting to formulate stress scenarios of high severity and to bring them for approval by management and by the Board of Directors, as part of capital planning at the Bank.
- **Fraud and Embezzlement Forum:** Forum for monitoring and management of fraud and embezzlement risks and for monitoring implementation of the framework for handling such risks at the Bank.
- Because operating risk is closely linked to the required internal control framework, the Bank operates an internal controls forum, which is the key component for integration of the different control entities - in particular for operating risk, including: information security and cyber, business continuity, accounting and financial reporting, security, compliance, legal risk and Internal Audit. This forum operates in conformity with specific procedures, to provide an overview of all the aforementioned internal control risks.

For risk management at Bank units, the Bank appointed internal control trustees. The internal controls trustees, most of whom operate in the first line of defense, are responsible for handling operating risk and IT risk at their unit. Trustees report any event related to operating risk into a special system created at the Bank - the Operating Risk Portal (PASTEL). This system is used by the Bank for analysis and reporting of operating risk by different criteria. In most cases, this system operates automatically, with trustee reports disseminated to a pre-specified list of managers at the Bank and each event is assigned a severity level, in addition to the event description. Currently there are over 150 internal control trustees working at the Bank, most of them at Bank branches. Other than the constant connection between the Operating Risk Department, operating at Bank HQ, and the trustees, internal control trustees also participate in a specific forum, which is convened semi-annually.

The Bank conducts surveys in order to identify and map operating risk in different divisions, as an on-going process. Over the past year, these surveys have been expanded and they include mapping of material risk for each unit, stress tests, Key Risk Indicators, testing of IT systems in the relevant area and fraud and embezzlement risk. The Bank acts to define, where possible, key performance indicators (KPI) in order to form a tighter link between business targets and the level of operating risk inherent therein, in conformity with the Bank's revised definition as described above. The survey results and action items are discussed, as part of self-assessment processes, by specific forums, attended by managers of the surveyed units and representatives from the Risks Control Division. Recently, the Bank has been reviewing the capacity to conduct operating risks surveys integrated with other internal control risks, so that these surveys may provide an overview of all risks to which the reviewed entity is exposed and the extent of their impact on the entity's business targets.

In addition to these surveys, the Bank also analyzes external events in Israel and overseas, which may provide information about potential circumstances and damage which may result in materialization of operating risk. Such analysis serves the Bank in implementation of appropriate steps for parallel processes within the Bank. As part of the integrated view of all internal controls risks, the Bank launched in the past year a process to create and deploy a new module in the operating risk portal, to include all information and actions relevant for the unit with regard to such risk.

The Bank allocates capital with respect to operating risk using the standard approach. According to this approach, the Bank was segmented into eight lines of business, as stipulated by the Bank of Israel, with a standard risk weighting assigned to each line of business, reflecting its sensitivity to loss with respect to operating risk. This segmentation and addressing the required capital allocation are incorporated in a specific policy document which governs the aspects required for capital allocation using the standard approach and, in particular, specified the lines of business in Bank operations.

The Bank framework for handling operating risk is reviewed quarterly, as part of the Bank's Risks Document. The risk profile is presented in this context, i.e. the actual loss level, in view of the risk appetite and the most material events which occurred during the quarter are also presented and analyzed.

In recent years, the Bank has prepared to put in place comprehensive infrastructure for addressing fraud and embezzlement risk. As part of this effort, the Bank operates a range of laws designed to identify anomalies and is currently in the design process of a central data base, which would allow the Bank to develop new, advanced methods for identification of anomalies. Handling of fraud and embezzlement is in conformity with a specific policy document, using a framework which integrates several entities at the Bank: Risks Controls, information security and cyber, human resources and the Technology Division.

The third line of operation in the area of operating risks is that of internal audit, which acts independently. The operating risk policies specifies the role of Internal Audit as the entity in charge of carrying out periodic audits of risk management processes, debriefing of fraud and embezzlement events, participation as observer on committees and involvement with the Internal Control Forum.

Operating risk mitigation

Due to the significance of operating risk, the Bank takes different steps to mitigate this risk. The most important step is to instill a corporate culture which promotes strong awareness of operating risk, and of deployment of risk-mitigating processes. The internal controls trustees, across the entire organization, are the long arm of the operating Risk Manager in this process. As noted above, the Bank initiates delivery of in-person and technology-based training about operating risk to new employees and to units and populations within such units which were identified as being associated with high operating risk.

Other than arranging for handling of operating risk when launching new or revised products, as part of the Bank policy for handling new products, the Bank also arranged another process for approval of changes to new and revised processes with a potential for materialization of operating risk. These processes undergo a structured process of approval by business entities and by control entities, prior to launch, using a checklist - and are sent for approval by the Steering Committee. This mechanism is used to review all aspects of the change, ensuring a professional review of the root risk and how to mitigate it.

The Bank is currently completing development of a mechanism designed to empower Bank units with tools for learning lessons from events, in addition to lesson learning processes regularly conducted by the Bank. Conclusions formulated by these processes are incorporated into work processes, systems, training content and procedures - and are also disseminated using the operating risk system to internal control trustees for deployment at their units.

The Bank strongly emphasizes reporting related to operating risk - both reports from internal controls trustees and reports to Bank management and to the Board of Directors, designed to enable continuous monitoring of the Bank's operating risk profile. As noted above, the Bank operates special forums in different divisions for monitoring the risk profile and mitigation plan.

The Bank has established policies and operating plans for case of emergency, for backup, recovery and business continuity in case of physical damage to Bank infrastructure. This plan, supported by emergency procedures and pre-appointed officers, is exercised annually and the conclusions from such exercises is incorporated into the action plan.

Mitigating operating risk via insurance - the Bank is insured under a banking insurance policies, against damage which may be incurred in the course of normal operations, as a result of human error, fraud, embezzlement etc. The Bank obtains an officers' insurance policies, which applies to all officers at the Bank and at the different Bank Group companies, which provides insurance coverage for personal claims which may be filed against officers with respect to their actions in the course of their position with Group companies. Obtaining such an officer liability insurance policy is subject to approval by the General Meeting of Bank shareholders.

The Bank has obtained specific insurance policies for property damage and liability, which provide insurance coverage of Bank property and liability. The Bank has a specific policy document which governs insurance aspects related to Bank operations.

Business continuity

The Bank applies Proper Banking Conduct of Directive no. 355. In the first quarter of 2016, the Business Impact Analysis (BIA) processes were refreshed and adjustments were made to the business continuity plan based thereon.

The Bank diligently maintains and conducts a multi-year training and drill program which includes conducting technology-related drills and trials to test and improve the readiness and awareness of Bank management and employees to dealing with disaster scenarios. In the first quarter of 2016, the Bank started delivering training at banking courses of the Training Center, to continue throughout the year.

In accordance with the Bank's multi-annual training plan, in this quarter the Bank started making progress on the annual exercise, scheduled for May, which this year would include an exercise of war scenarios and a material computer malfunction.

Information security and cyber security

Directive 361 with regard to Cyber Defense Management provides guidelines for proper management of cyber risk, which require expansion and adjustment of the IT risk management framework with regard to the threat space perception and the required defensive capabilities. Accordingly, the Bank has an approved strategy and comprehensive cyber defense policy and has specified the defense lines for implementation thereof, has appointed an Information Security and Cyber Defense Manager, reporting to the Manager, Risk Control Division - responsible, *inter alia*, for setting policy on information security and cyber defense at the Bank, development of a cyber defense work plan, monitoring the implementation of this work plan and review of the effectiveness of systems and processes for information security and cyber defense.

The relationships and information flow between these units have been specified in writing, including reference to: information security, physical security, IT governance, IT operations, risk management, fraud, human resource management, business continuity, client relationship management, spokesperson operations and legal counsel.

Information security and cyber defense policies at the Bank is implemented, inter alia, by the Mizrahi Tefahot Technology Division Ltd. As part of this effort, the management concept applied includes guidelines for management of cyber security. Application of these guidelines and ensuring that they are current while incorporating them into strategic decisions and business activity at the Bank - would ensure the consistency and integrity of the cyber security management concept over time.

In conformity with directives of the Supervisor of Banks, the Bank is preparing to secure cloud services as required.

The information security and cyber security policy is based on the following principles:

- Mapping and identifying cyber risks.
- Establishing an effective set of controls with cross-organizational integration of technology, human resources, processes and procedures.
- Maintaining a set of controls applied through managerial, operational and technical mechanisms.
- Establishing mechanisms for protection of on line presence.
- Proactive cyber security implemented through mapping and knowledge of the environment, forecasting and study of threats, weighting of the current situation report, development of responsiveness processes, use of techniques for deception, diversion and delay, cyber resilience and recovery capacity, conducting processes of inquiry, debriefing and execution of judgment.
- Implementation of multi-layer security in several circles and disciplines (both logical and physical), from the external system accessible to clients and through to internal systems, information and intelligence sharing.
- Using a system for monitoring, control and response for management of cyber events with integrated, corporate-wide view of components such as human resources, means of communications and procedures.
- Periodic and current reporting of risks management as a whole.
- Current analysis and assessment of cyber threats and exercising all those involved in handling cyber events.
- Development of stress scenarios related to information security and cyber.

In addition, the Bank's On line Banking sector is certified under the information security management standard ISO 27001.

In the first quarter of 2016 there were several attempted cyber attacks on the Bank. The prevention and control mechanisms have alerted and prevented these attacks, These events were duly reported and caused no financial damage to the Bank.

Legal risk

Proper Banking Conduct Directive no/ 350 concerning "Operating risks" defines legal risk to include, inter alia, exposure to fines or penalties arising from supervisory action, as well as from individual arrangements.

The Bank regards legal risk in its wider definition, with regard to Bank conduct in its relationships with various stake holders (clients, suppliers, other third parties etc.) Legal risk includes risk arising from legislative and regulatory provisions, rulings by judiciary or quasi-judiciary authorities as well as legal risk arising from regular Bank operations.

The Chief Legal Counsel for the Bank has been appointed Chief Legal Risks Manager. The Bank constantly strives to minimize as much as possible the legal risk associated with its current operations, and acts to disseminate a practical culture leading to identification and mitigation of legal risk in all its different aspects.

The Bank's Legal Division regularly analyzes the legal risk components, the risk boundaries (arising, for example, from the counter-party identity, from creation of collateral etc.) as well as specific risk attributes while reviewing its risk level and exposure with attention to the different lines of business at the Bank.

The Bank's Legal Division applies internal processes to ensure regular monitoring of developments in legislation, rulings and other regulatory provisions which could have implications for the day-to-day activities of the Bank Group. In this context, the Legal Division provides guidance to relevant Bank entities with regard to implementation of the implications arising from these developments. The Legal Division provides regular counsel to different Bank units, including to some subsidiaries. This is done, *inter alia*, by providing opinions, editing and updating legal documents, support for updates to procedures etc.

The Bank has specified procedures to help in minimizing legal risk, including regulating the interface between the Legal Division and different Bank departments. The Legal Division is also involved in training delivered to branches, at the Bank's Training Center and in compiling professional eLearning kits for imparting the legal knowledge required for regular Bank operations.

Similar reference is made for Bank affiliates overseas (branches and subsidiaries), with these affiliates receiving assistance from local external attorneys approved by the Bank's Legal Division. The Bank's overseas subsidiaries and affiliates have adopted similar procedures with regard to management of legal risk, and provide immediate and quarterly reports to the Legal Risk Manager of the Bank with regard to any legal risk identified in these entities.

For more information about an investigation by the US Department of Justice concerning Bank Group business with its US clients, see Note 10.B.4 to the financial statements.

Liquidity and financing risk

Management of liquidity and financing risk

Liquidity risk results from uncertainty as to the availability of sources and the ability to realize assets within a specified period of time and at a reasonable price. Liquidity risk is managed in conjunction with Proper Conduct of Banking Business Directive 310 "Risk management", Directive 342 "Liquidity risk management" and Directive 221 "Liquidity coverage ratio". Risk is managed subject to the limitations of the Board of Directors and Executive Management in an effort to minimize the losses deriving from an investment of surplus liquidity in assets that are highly liquid, but have a low yield.

Liquidity risk management is governed by a policies document submitted annually or more frequently for approval by the Board of Directors. The policies document covers how risk is managed, including roles and responsibilities of the various organs, the regular management of liquidity risk, all parameters used for risk measurement in the normal course of business and under various stress scenarios, restrictions specified by the Board of Directors and by management, including restrictions on source concentration and composition, as well as a detailed emergency plan for handling a liquidity crisis, including various states of alert for liquidity risk management and potential means under each scenario type and the estimated time for execution.

The Bank’s Board of Directors sets strategy for liquidity risk management and the risk appetite in conformity with regulatory requirements, using a range of restrictions on three risk dimensions: Normal course of business, scenarios (liquidity coverage ratio and minimum liquidity ratio - internal model) and concentration. Bank management has specified a further set of restrictions to serve as management guidelines - beyond those specified by the Board of Directors. Risk is regularly managed using endogenous and exogenous indicators of the Bank's situation in particular and of the state of the banking system. The Bank developed an integrated benchmark for monitoring financial markets in Israel, in order to identify any instability in the financial system in Israel - this benchmark is a decision-support tool for declaring a state of alert due to systemic failure.

Current and periodic management of liquidity risk is conducted on Group basis, with due attention to legal, regulatory and operating restrictions on the capacity to transfer liquidity. Management is conducted in conjunction with the general risk management framework at the Bank. This framework consists of the first line of defense - Risk Managers at the Finance Division; the second line of defense - risk controllers at the Risks Control Division; and the third line of defense - Internal Audit. Regular management includes monitoring of restrictions set by the Board of Directors and management as well as risk indicators, including with regard to financing source concentration, liquidity exposures at Bank and Group level as well as liquidity gaps resulting from on- and off-balance sheet operations.

The Bank's liquidity management is proactive and strict, including diverse tools for mitigating liquidity risk, both in using detailed models int different world situations, in strict maintenance of liquid means with minimal credit risk which may be immediately realized, and in active management of sources for diversification and extension of the term to maturity and diversification of sources. The Bank has a Liquidity Forum, which convenes daily, under the responsibility of the Finance Division, which discusses the liquidity situation and strives to align the liquidity "needs" of different Bank units with the liquidity "providers" and liquidity managers. In addition, a forum headed by the Finance Division Manager operates at the Bank, for regular monitoring of the implementation of the minimum liquidity ratio regulation (Directive 221) and compliance with targets for all business units at the Bank for raising and management of resources. In addition, the Risks Control Division performs back testing of model adequacy, as required by Bank of Israel directives.

The Bank has developed an internal model to estimate the liquidity needs and liquid resources, as required by Directive 342 and in accordance with Basel provisions, which specified internal, system and integrated stress scenarios for Israeli currency and foreign currency, from a one-month perspective, for calculating the minimum liquidity ratio – the ratio of liquidity cushion to net forecasted outflows under these scenarios. This is based on behavioral attributes of depositors and on risk focal points, in line with the various scenarios. The Bank also uses models for longer and shorter periods, such as the NSFR model for a one-year period. As noted above, restrictions have been specified by the Board of Directors and by management for liquidity ratios under various scenarios, including for terms other than one month and in the normal course of business. There were no deviations from the Board of Directors' limitations recorded in the first quarter of 2016.

The Bank's Board of Directors and management receive various reports at daily, weekly, monthly and quarterly frequency - including reports of unusual events in liquidity management and unusual developments in the Bank's liquid sources. There were no deviations from the Board of Directors' limitations recorded in the first quarter of 2016.

The Bank's emergency financing plans refer to management of each emergency and specify the management team responsible for handling it (by level). These plans include detailed specification of additional liquid means for use in emergency as well as a list of operative steps (and the entity authorized to lunch them), also referring to management of communications, both internal and external.

In the first quarter of 2016, the Bank raised the alert status to Higher Alert on several occasions; in all cases, the cause was external or systemic, such as the dramatic decline in European banking shares, when in actual fact, in all cases there was no impact to Bank liquidity.

Financing risk

Financing risk arises from shortage of financing sources or too high costs for such sources. This risk is managed, as part of the liquidity risk, using Board and management restrictions on concentration of financing sources and through reduced dependence on material counter-parties.

Concentration of financing sources is monitored through a wide range of restrictions set by the Board of Directors, management as well as by key risk indicators, classified into several sub-categories: Size, client type, individual depositor, number of clients, product and average deposit term. A "super-benchmark" was defined, which averages all indicators related to concentration of financing sources. Current management of source composition includes setting policy on source diversification and financing terms as well as setting specific targets for risk benchmarks. Concentration is monitored daily and is regularly managed and reported.

The Bank's main financing sources are stable and diverse sources for different time horizons - retail and business deposits, long-term deposits from financial institutions and debenture issues. The Bank acts proactively to identify sources for longer terms, including through a wide range of deposits offered by the Bank to its clients, deposits with uniques attributes, which allow clients to benefit from relatively high interest over the long term with optional liquidity during the deposit term. In the first quarter of 2016, concentration risk for financing sources remained low.

Furthermore, exposures to derivatives are regularly managed. In line with the exposure to each counter-party, counter-party collateral is immediately increased or collateral is immediately demanded from the counter-party.

For more information about financing sources, see chapter "Developments in financing sources" in the Report by the Board of Directors and Management.

Liquidity coverage ratio

As from April 1, 2015, the Bank applies Directive 221 which became effective on that date. This Directive stipulates minimum liquidity ratios for a one-month term (regulatory LCR), calculated based on uniform multipliers for the banking system, specified by the Bank of Israel based on Basel III directives. The minimum regulatory LCR was set at 60% as from April 1, 2015, 80% as from January 1, 2016 and 100% as from January 1, 2017. The Bank's Board of Directors specified a further safety cushion beyond the minimum ratio. This ratio is managed and reported for all currencies on aggregate and for NIS separately, both at Bank level and on Group basis. This regulation is in addition to liquidity risk management using internal models, as stipulated by Regulation 342, as described above.

The average (consolidated) liquidity coverage ratio for the first quarter of 2016 was 97% (the minimum ratio required by the Supervisor of Banks was 80%). As of March 31, 2016, the liquidity coverage ratio was at 99%. The increase in the average ratio over the previous quarter is also due to net sources in excess of added uses and further improvement of the composition of Bank sources structure, by raising stable financing sources. There were no deviations from the limitations for this ratio recorded in the first quarter of 2016.

The major factors affecting the liquidity coverage ratio results are composition of Bank sources and uses. High-Quality Liquid Assets ("HQLA") are Level 1 assets, which are typically highly negotiable and associated with low risk. These include cash, current accounts and deposits with central banks, debentures of sovereigns with a 0% risk weighting and debentures of the State of Israel. In the first quarter of 2016, the average balance of high-quality liquid assets amounted to NIS 31 billion, an increase from the previous quarter, when the average balance amounted to NIS 27 billion. Cash outflows primarily consist of un-secured wholesale financing - deposits which corporations and financial institutions deposited with the Bank, as well as outflows with respect to exposure to derivatives. Cash inflows primarily consist of credit receipts and inflows with respect to exposure to derivatives. The average balance of net cash outflows in the first quarter of 2016 amounted to NIS 32 billion, compared to NIS 30 billion in the previous quarter. The higher ratio compared to the previous quarter is due to continued improvement of the Bank's source structure, by establishing stable financing sources and diverting short-term financing sources to longer term ones.

The ratio is primarily cyclical and may be forecast based on internal estimates by the Bank. The key factor which affects evolution of this ratio over time is growth in Bank business, both in raising and management of source composition and increase in uses. The Bank regularly strives to increase this ratio, in conformity with the outline described in Proper Banking Conduct Directive 221, to achieve a minimum ratio of 80% in 2016 and a minimum ratio of 100% at the start of 2017, through dynamic management of source composition. The Bank's Board of Directors and management have specified an additional safety margin over and above the required minimum ratio, so that the effective restrictions used for current management are higher than stipulated by the aforementioned directive.

For more information about the Supervisor of Banks' directives with regard to liquidity risk management and liquidity coverage ratio - see section "Legislation and Supervision of Bank Group Operations" in chapter "Corporate governance" and Note 1 to the 2015 financial statements.

Below is information about liquidity coverage ratio (NIS in millions):

	For the three-month period ended March 31, 2016	
	Total un-weighted value[2] (Average)	Total weighted value[3] (Average)
Total high-quality liquid assets		
Total high-quality liquid assets		30,675
Outgoing cash flows		
Retail deposits from individuals and from small businesses, of which:	85,105	5,196
Stable deposits	26,128	1,306
Less than stable deposits	27,117	2,934
Deposits for terms longer than 30 days	31,860	956
Unsecured wholesale financing, of which:	42,380	27,006
Deposits other than for operational needs (all counter-parties)	41,776	26,402
Unsecured debt	604	604
Additional liquidity requirements, of which:	69,669	18,527
Outflows with respect to derivatives exposure and other collateral requirements	15,951	15,951
Credit lines and liquidity	30,299	2,169
Other contingent financing obligations	23,419	407
Total outgoing cash flows		50,729
Incoming cash flows		
Inflows from regularly repaid exposures	5,296	3,247
Other incoming cash flows	20,388	15,941
Total incoming cash flows	25,684	19,188
		Total adjusted value[4]
Total high-quality liquid assets		30,675
Total outgoing cash flows, net		31,541
Liquidity coverage ratio (%)		97%

(1) Information is presented in terms of simple average of daily observations during the reported quarter.

(2) Un-weighted values are to be accounted for as outstanding balances payable or which may be payable by the holder, within 30 days (for both inflows and outflows).

(3) Weighted values are to be accounted for after applying appropriate security factors or inflow / outflow rates (for inflows and outflows).

(4) Adjusted value are to be calculated after applying: Safety factors and inflow / outflow rates; and all applicable restrictions (i.e. restriction on High-Quality Liquid Assets and restriction on inflows, as specified in Proper Banking Conduct Directive 221).

Below is information about liquidity coverage ratio (NIS in millions):

	For the three-month period ended December 31, 2015	
	Total unweighted value[2] (Average)	Total weighted value[3] (Average)
Total high-quality liquid assets		
Total high-quality liquid assets		27,011
Outgoing cash flows		
Retail deposits from individuals and from small businesses, of which:	82,766	5,005
Stable deposits	25,131	1,257
Less than stable deposits	25,729	2,791
Deposits for terms longer than 30 days	31,906	957
Unsecured wholesale financing, of which:	39,967	25,231
Deposits other than for operational needs (all counter-parties)	39,759	25,023
Unsecured debt	208	208
Additional liquidity requirements, of which:	66,377	16,444
Outflows with respect to derivatives exposure and other collateral requirements	13,779	13,779
Credit lines and liquidity	31,441	2,306
Other contingent financing obligations	21,157	359
Total outgoing cash flows		46,680
Incoming cash flows		
Inflows from regularly repaid exposures	5,472	3,211
Other incoming cash flows	17,811	13,668
Total incoming cash flows	23,283	16,879
		Total adjusted value[4]
Total high-quality liquid assets		27,011
Total outgoing cash flows, net		29,801
Liquidity coverage ratio (%)		91%

(1) Information is presented in terms of simple average of daily observations during the reported quarter.

(2) Un-weighted values are to be accounted for as outstanding balances payable or which may be payable by the holder, within 30 days (for both inflows and outflows).

(3) Weighted values are to be accounted for after applying appropriate security factors or inflow / outflow rates (for inflows and outflows).

(4) Adjusted value are to be calculated after applying: Safety factors and inflow / outflow rates; and all applicable restrictions (i.e. restriction on High-Quality Liquid Assets and restriction on inflows, as specified in Proper Banking Conduct Directive 221).

Shares

The Bank manages investments in non-banking corporations. Shares of non-banking corporations in which the Bank thus invested were acquired for the purpose of earning capital gains, and are listed at fair value on the available-for-sale security portfolio and under investment in associates, where the Bank has a material investment in such entity. Investments in non-banking corporations are managed by the Business Banking Division.

About 2% of these investments in non-banking corporations are negotiable and presented at their market value. The remainder of these investments are presented at cost or at their carrying amount. In case of impairment of a non-temporary nature, in accordance with management assessment, a provision for impairment of the investment is made by the Bank.

Bank investments in non-banking corporations as of March 31, 2016 amounted to NIS 103 million, compared to NIS 101 million at end of 2015, as set forth below:

Under the available-for-sale securities portfolio:

- NIS 2 million (unchanged from end of 2015) is with respect to negotiable investments.
- NIS 64 million is with respect to participation units in various equity funds (NIS 61 million as of end of 2015).
- Investments in several different other corporations, which are stated at cost, the balance of the investment in which amounted to NIS 1 million as of March 31, 2016 (similar to the end of 2015).

Under investment in associates:

- NIS 15 million (NIS 16 million as of end of 2015) constituting the balance of Bank investment in mezzanine funds. A mezzanine fund is a fund for interim financing, providing companies in various sectors with financing complementary to bank credit. This financing is typically extended in return for interest, stock options and other equity instruments.
- NIS 19 million (same as of end of 2015) is the balance of Bank investment in Psagot Jerusalem Ltd., a private company which acquired land in the Jerusalem area for residential development. The carrying amount of Bank investments as of March 31, 2016 amounted to NIS 35 million, (same as of end of 2015).

NIS 2 million (identical amount as of end of 2015) is the balance of Bank investment in Rosario Capital Ltd., a private company engaged in underwriting, assistance and consulting on private and public issuance, mergers & acquisitions, investment in securities and distribution of securities.

	As of March 31, 2016	
	Fair value	Capital requirement(1)
Shares	58	7
Venture capital / private equity funds	79	10
Total investment in shares in bank portfolio	137	17

	As of December 31, 2015	
	Fair value	Capital requirement(2)
Shares	57	7
Venture capital / private equity funds	77	10
Total investment in shares in bank portfolio	134	17

(1) The capital requirement was calculated at 12.9%.
(2) The capital requirement was calculated at 12.8%.

For more information about equity investments in the bank portfolio, see Note 5 to these financial statements and Note 15.A to the 2015 financial statements.

Other risks

Compliance and regulation

Bank business operations are subject to regulation. Compliance risk is the risk of imposition of legal or regulatory sanctions, material financial loss or impact to reputation, which the Bank may incur due to its failure to comply with compliance provisions.

As from January 1, 2016, when the new Proper Conduct of Banking Business Directive 308 became effective, the scope of responsibility within compliance risk management was expanded; therefore, the compliance provisions include laws, rules and regulations (including positions stated by the Supervisor of Banks in conjunction with handling public inquiries), internal procedures and the Code of Ethics which apply to banking operations at the Bank.

Compliance provisions also include the following laws: ISA Enforcement Proceeding Streamlining Act (Legislative Amendments), 2011; Securities Law 1968; Mutual Investment Act, 1994; Arrangement of Engagement in Investment Consultancy, Investment Marketing and Management of Portfolios Act, 1995 (hereinafter: "the Advisory Act"); hereinafter jointly - "securities laws" as well as the Restrictive Trade Practices Act, 1988. Compliance with these laws is also addressed in conjunction with the "Internal Enforcement Program" for Securities Act and for the Restrictive Trade Practices Act, respectively.

Compliance risk includes cross-border risk, which is presented separately below.

The Bank has zero risk appetite for compliance and regulatory risk, with regard to compliance with statutory provisions applicable to the Bank. Therefore, the Bank has specified that any faults discovered in compliance with statutory provisions would be addressed by Bank units as a top priority. The Bank has specified a multi-annual work plan for the Compliance Function, which includes qualitative targets for reducing compliance risk across the Bank.

The compliance and regulatory Risk Manager for the Bank is the Manager, Risk Control Division. The Compliance Officer is responsible for continuous management of this risk.

Compliance and regulation risk is managed by three lines of defense:

The first line of defense includes business units and other risk-taking units at the Bank, which are responsible for reducing and controlling compliance risk.

The second line of defense includes the Risks Control Division and the Compliance Division, as well as other "second line" units (Human Resources and Administration Division, Accounting and Financial Reporting Division, Legal Division), which are responsible for some compliance areas.

The third line of defense includes Internal Audit, which conducts independent audit of the Compliance Function, including review of the appropriateness and effectiveness of the Compliance Function, including review of controls in line with estimated risk level.

The Manager, Risks Control Division and CRO of the Bank serves as the person in charge of enforcement of securities law and anti-trust law. As required by Proper Banking Conduct Directive 308 ("Compliance Officer"), the Bank appointed a Chief Compliance Officer and a Compliance Function reporting there to (reporting to the Manager, Risks Control Division) whose role is to assist Bank management and the Board of Directors in effective management of compliance risk.

The Bank operates in conformity with policies on compliance and regulation risk management, approved by the Bank Board of Directors. The Compliance Officer acts in conformity with a letter of appointment approved by the Board of Directors, to deploy a compliance culture at the Bank, its subsidiaries and overseas affiliates by implementing a Group policy and supervising the implementation of appropriate compliance processes at subsidiaries and affiliates. Compliance risk is managed by identification, documentation and assessment of compliance risk associated with business operations of the Bank, including developments related to new products, business conduct, lines of business or new clients, or to material changes to any of the above, through various measurement methods, including performance benchmarks.

The Bank also maintains effective enforcement programs for securities law and for anti-trust law, adapted for the Bank and its unique circumstances, as part of overall risk management at the Bank. This is designed to ensure compliance with securities law and to avoid violation thereof. The Chief Enforcement Officer, through the Compliance Officer, handles issues of Bank compliance with obligations arising from securities law in general and in accordance with the enforcement program in particular. The Chief Enforcement Officer is the person responsible, on behalf of Bank management, for on-going implementation of the enforcement program and its deployment across the Bank.

The Compliance Division maps compliance risks in various areas, conducts compliance surveys on different topics from time to time and delivers training to deploy the compliance policy across the Bank. The Compliance Officer is a member of different forums at the Bank, in order to ensure an enterprise-wide view of various compliance aspects. In order to ensure compliance with all statutory provisions, as noted above, the Compliance Officer maintains a control system in line with control plans. These controls are designed to verify compliance of Bank branches and departments with various statutory provisions, as well as the effectiveness of controls applied by the various business and headquarters departments.

Compliance risk has continued to decrease in the first quarter of 2016. The decrease is due to continued addressing of risk classified as High and continued reinforcement of control in both First Line and Second Line units. This is against the backdrop of continued increased regulation.

Cross-border risk

Cross-border risk is the risk of financial loss (including due to legal proceedings, fines or sanctions imposed by statutory authorities or others in Israel and in other countries) and of impact to reputation, arising from the Bank's failure to comply with statutory provisions originating in other countries - whether provisions binding on the Bank or provisions which are not binding, but failure to comply with them may cause the Bank to incur damage, or from overseas activities of Bank clients in contravention of any statutory provisions.

Cross-border risk includes, *inter alia*, risk of damage, including impact to reputation, due to lawsuits or other enforcement proceedings brought by authorities in other countries, with regard to foreign tax laws applicable to certain Bank clients, AML and terror financing laws, sanctions imposed by international bodies and foreign authorities or other laws. Cross-border risk applies primarily at the Bank's overseas affiliates; in transactions with clients who are foreign residents; in business operations conducted by Bank representatives in foreign countries; and with regard to funds of individual Israeli clients invested overseas.

Cross-border risk includes the risk arising from obligations arising from US tax laws applicable to Bank Group operations outside of the USA (the Foreign Account Tax Compliance Act - "FATCA"). For more information about FATCA, see "Legislation and Supervision of Bank Group Operations" in the chapter "Corporate governance, audit, other information about the Bank and its management" on the 2015 financial statements.

The cross-border Risk Manager for the Bank is the Manager, Risks Control Division. The Compliance Officer is responsible for continuous management of this risk.

The Bank has zero appetite for cross-border risk. Therefore, the Bank has specified that any faults discovered with regard to cross-border risk would be addressed by Bank units as a top priority. The Bank has specified a multi-annual work plan for the Compliance Function, which includes qualitative targets for reducing compliance risk across the Bank.

Cross-border risk is managed by three lines of defense:

The first line of defense includes business units and other risk-taking units at the Bank, is responsible for reducing and controlling cross-border risk. The first line of defense includes International Operations, which is responsible for operations of tourist and private banking branches in Israel and for overseas affiliates of the Bank, through the local compliance unit of each affiliate. The first line of defense also includes the Retail Division and the Business Division in their operations involving foreign resident clients.

The second line of defense is based on the Compliance Division under the Risks Control Division, which is responsible for deploying an organization-wide compliance culture with procedures and laws, for identification and assessment of cross-border risk, for delivering appropriate training and for specifying procedures. To this end, the Compliance Division is assisted by the Legal Division, the Planning and Operations Division which supports the implementation of processes and IT systems and the Technology Division, which develops computer-based tools for risk identification, monitoring and mitigation.

The third line of defense is Internal Audit, which conducts periodic audit of the management of cross-border risk.

As part of management of cross-border risk, the Bank especially monitors and reviews any monetary transactions where any party to such transaction is located in a country subject to international sanctions.

After an increase in risk intensity last year, cross-border risk moderately decreased in the first quarter of 2016. The moderate decrease is due to implementation of the first stages of preparation for risk management.

Prohibition of money laundering

The Chief Compliance Officer for the Bank Group, appointed in the Risks Control Division, is also in charge of implementation of the Prohibition of Money Laundering Act, and of the Prohibition of Financing Terrorism Act for the Bank Group, including Bank affiliates overseas.

The Compliance Division acts to deploy statutory provisions on this matter. The Division handles subjective reports of unusual activity reported to the AML Authority, and conducts various controls over activity in different accounts based on their risk profile, providing regular advice to branches on this matter and delivers training customized for Bank staff in different roles. Moreover, in line with Bank policies set by the Board of Directors in May 2010, a knowledge test is administered once every two years to all Bank employees. Such a test was conducted in 2014.

The Bank operates different computer systems for identifying unusual activity and for monitoring the handling of subjective reports.

The Bank applies on a Group basis, with required changes, its policies in this area as well as statutory provisions, at its subsidiaries and branches in Israel and overseas.
Following the amendment of the Prohibition of Money Laundering Act, which adds serious tax offenses to the list of original violations, making them subject to all requirements with regard to AML, the Bank is preparing to adjust work processes and infrastructure for compliance with this requirement.
AML risk increased in the first quarter of 2016, primarily due to addition of serious tax offenses, as noted, to the Prohibition of Money Laundering Act.

Reputation risk

The Bank has mapped reputation risk as a material risk, because past events indicate that impact to the reputation of a financial institution may result in significant loss of value. Reputation risk is a stand-alone risk, but may also arise from materialization of other risks at the Bank, such as materialization of an operating risk event. Furthermore, impact to Bank reputation may bring about the materialization of other risks, in particular liquidity risk - with growing demand by clients to withdraw deposits.

The Bank has defined its risk appetite for reputation risk as minimal. In recent years, the Bank took action to put in place a framework for handling reputation risk. The Bank considers that this risk should be addressed based on similar principles to those used to address other risks, such as credit risk or market risk - even though this risk is considered harder to quantify. Therefore, similar to other risks, the Bank has specified principles for risk management, risk appetite, risk measurement and ways to mitigate it. Accordingly, the Bank incorporated reputation risk into its regular risk management processes, including the process for approval of new products or activities and in self-assessment processes conducted by the Bank and has put in place a framework for regular measurement of this risk. The Bank emphasizes creation of a reporting chain and the required activity under stress conditions, in order to mitigate the impact of such risk, should it materialize. This activity requires identification of risk materialization at its early stages, in order to allow for qualitative and quantitative tools to be applied as early as possible, in order to address this risk.

The Bank’s Board of Directors has specified specific policy for addressing reputation risk. The Reputation Risk Owner is the Manager, Marketing, Promotion and Business Development Division at the Bank. The policy refers to all Bank subsidiaries and stipulates mandatory reporting and the required actions in case of an event classified as a reputation event. The Bank regularly coordinates with Bank Yahav on this matter. The policy document stipulates that control of reputation risk management, i.e. second-line operations, are conducted by the Risks Control Division, headed by the Bank's Chief Risks Officer.

Reputation risk is managed in conformity with the policy on three levels: In advance (under normal conditions), in real time (alert condition) and in retrospect.

Bank policy also defines the roles of the Risk manager and stipulates how the risk should be addressed under normal conditions and in case of a stress event. The Risk Manager heads the Reputation Risk Committee, which regularly convenes quarterly and as needed, in case of concern about materialization of a stress event. The Committee routinely discusses the outcome of continuous monitoring of this risk which is conducted, *inter alia*, based on internal and external information sources, through surveys and studies, on line discourse, media review and reports by other Risk Managers at the Bank. The work process under stress conditions, i.e. in case of an event which may impact reputation, is incorporated in a specific reporting and action procedure. The objective of this procedure is to define how information is located, the reporting chain, including declaration of a reputation event, how to act during the event and how to declare the event ended, including debriefing and other assessment to review the impact of the event on Bank image, once the event has ended. The Bank has also specified, as part of its business continuity plan, the creation of a media command post, headed by the Risk Manager, which would allow the Bank to handle reputation risk in case of emergency.

The Bank routinely measures its reputation risk in the capital market, in the public and among clients and the business community. This measurement is based on specific quarterly studies which review public opinion (Bank clients and those of other banks), on monthly monitoring of on line discourse, on satisfaction surveys among Bank clients etc. Reports with regard to reputation risk are sent to Bank management and to the Board of Directors in the quarterly Risks Document - as is the case for all risks mapped by the Bank.

In the first quarter of 2016 there were no events which negatively impacted the Bank's reputation.

Strategic risk

Strategic risk is the risk, in real time or potentially in future, of impact to Bank profits, capital or reputation, due to erroneous business decisions, improper deployment of decisions or insufficient preparation for changes in the business environment. This means the risk that the Bank chose the wrong strategy or that the Bank would not be able to implement the business and strategic plan as planned. The materiality of strategic risk requires the Bank to take measures which would allow it to manage this risk and take steps for assessment and early identification of events which may preclude implementation of the strategy.

The Bank acts in line with the strategic outline and risk appetite approved by the Bank’s Board of Directors. Deviation from Bank strategy is subject to approval by the Bank’s Board of Directors. This risk is monitored by the Planning, Operations and Client Asset Division (hereinafter: "the Planning and Operations Division") and is challenged by the Risks Control Division.

The organizational structure for management of this risk includes the Board of Directors and management, the units which implement the strategic plan in business and operational procedures, the Planning and Operations Division and the Risks Control Division. Bank units are responsible for implementation of the strategic plan through annual work plans created in order to achieve the strategic objectives.

The Strategic Risk Manager is the President & CEO; based on his guidance, management periodically reviews the implementation of the strategy: monitoring of regulatory, economic or technology developments which affect the strategy and initiating annual work plans derived from and in conformity with the strategic plan. The Planning and Operations Division and the Risks Control Division independently monitor strategic risk from different control aspects, primarily the following: achievement of targets, risk mapping and identification, stress testing, threat tests and continuous monitoring of the risk profile in view of the Bank's risk appetite. The latter process is a continuous once, designed to apply diverse tools, primarily reporting tools, in order to ensure that the Bank has not deviated from the specified operating frameworks and exposure caps. In addition to continuous monitoring of the implementation of work plans and aligning them with the strategic outline, the Bank also monitors developments of external factors which may impact the Bank's strategic risk. The work plans of Bank divisions are adapted, when needed, to the changing business environment in order to achieve business targets and the strategic outline. The Bank is prepared for emergencies so as to reduce the impact to the Bank's business and strategic plan, should extreme economic or geo-political conditions evolve. In order to minimize the potential impact to the Bank's business plan, in recent years the Bank emphasized, *inter alia*, the approval process for new products or activities. As part of this process, the new products or activities are reviewed for their business value to the Bank, vs. their impact, if any, on the Bank's risk profile and strategic risk.

Developments in the business environment which may impact strategic risk

- In recent years, the global economy has been unstable and economic growth has been more moderate, along with a near-zero interest rate environment and moderate growth in global demand, as well as increased geo-political tension around the world, due to the emergence of Islamic fundamentalism. The economic growth rate in Israel has slowed down in recent years, due to stagnating exports. The Bank regularly monitors the potential implications of a global and local economic slow-down, which may lead to deterioration in the financial standing of households or may impact business activity in various economic sectors. In particular, the Bank is preparing for a potential change in the interest rate trends in the Israeli economy.
- Growing competition in the financial system, in view of expanded operations of non-banking entities, especially in the credit market and given the entry of technology companies into the financial brokerage area, in particular for the household and small business segments.
- The impact of regulatory provisions in core areas of banking operations, including the potential impact of recommendations made by the Committee for Increased Competition in Common Financial Banking Services in Israel ("the Shtrum Committee").

Remuneration

For more information about the Remuneration of officers in financial corporations act (Special permission and non-allowance of expenses for tax purposes with respect to excessive remuneration), 2016 - see chapter "Legislation and Supervision of Bank Group Operations" in the financial statements.

At this stage, the Bank is unable to assess the impact of this Act on any specific employees or officers, if any. Furthermore, the Bank expects no material impact to the Bank's financial statements due to the Act.

However, it is possible that departure of officers due to implications of this Act would pose a risk to the Bank.

Glossary and index of terms included in the Risk Management Report

Below is a summary of terms included in the Risks Management Report and and index for these terms

1. Terms with regard to risks management at the Bank and to capital adequacy

Term	Explanation	Index in the Risk Management Report
Back testing	A process for assessment of appropriateness of model results, which includes a comparison of model forecasts and actual results.	Chapter "Liquidity and financing risk"
Basel Committee	The Basel Committee is a forum for cooperation on matters of bank supervision. The Committee's objectives are to increase understanding in key supervision issues and to improve the quality of supervision over banking corporations around the world. The Committee is mostly known for the international standards on capital adequacy, core principles for effective supervision over banks and for coordination between different countries in order to create cross-border supervision over banks world-wide.	Chapter "Scope", chapter "Regulatory capital", chapter "Credit risk", chapter "Market and interest risk"
Basel II	A framework for assessment of capital adequacy and risks management, published in its final version by the Basel Committee on Bank Supervision in 2006.	This term appears many times.
Basel III	A framework for assessment of capital adequacy and risks management, initially published by the Basel Committee on Bank Supervision in 2010.	This term appears many times.
Basis (linkage) risk	The risk of capital erosion due to changes in exchange rates and inflation rate. The exposure to basis risk exists when the Bank's assets and liabilities are denominated in different currency or linkage segments.	Chapter "Regulatory capital", chapter "Market and interest risk"
Borrower rating	A rating which reflects the Bank's risk assessment for a borrower or a counter-party to a transaction.	Chapter "Credit risk"
Business continuity	A situation where the Bank operates continuously and with no disruption.	Chapter "Risk culture", chapter "Operating risk"
Compliance and regulatory risk	The risk of imposition of legal or regulatory sanctions, material financial loss or impact to Bank image, which the Bank may incur due to its failure to comply with compliance provisions (such as: statutory provisions, regulation, standards and conduct commonly expected from the corporation).	Chapter "Risk culture"

Term	Explanation	Index in the Risk Management Report
Counter-party credit risk	The risk that the other party to a transaction would be in default before final settlement of cash flows in the transaction.	This term appears many times.
Credit concentration risk	Concentration risk is any individual exposure or exposure group, with the potential to cause large enough loss (relative to Bank capital, assets or overall risk level) - even endangering the corporation's standing or capacity to continue its core operations. Credit concentration is the risk inherent in the link (correlation) between various credit exposures for the Group or exposure portfolio, due to shared attributes, such as: Borrower concentration, geographic concentration, sector concentration and collateral concentration.	Chapter "Scope", chapter "Credit risk"
Credit rating (score)	A credit rating is a score assigned to a borrower, as part of assessment of its capacity to fulfill its obligations when due and in full.	Chapter "Credit risk"
Credit risk	Credit risk is the risk that a borrower or counter-party of the Bank would not fulfill its obligations towards the Bank.	This term appears many times.
CRM - Credit Risk Mitigation	Methods for reducing credit risks, such as: Insuring credit exposure through a guarantee or a deposit.	Chapter "Credit risk"
CRO – Chief Risk Officer	Chief Risks Officer A member of Bank management, heads the Risks Management Division at the Bank. The CRO is responsible for the risks management function, for the comprehensive risks management framework across the Bank and for other roles as specified in the Supervisor of Banks' directives.	This term appears many times.
Cross-border risk	The risk of financial loss (including due to legal proceedings, fines or sanctions imposed by statutory authorities or others in Israel and in other countries) and of impact to reputation, arising from the Bank's failure to comply with statutory provisions originating in other countries - whether provisions binding on the Bank or provisions which are not binding, but failure to comply with them may cause the Bank to incur damage, or from overseas activities of Bank clients in contravention of any statutory provisions.	Chapter "Summary risk profile for the Bank", chapter "Risk culture", chapter "Other risk"
CSA - Credit Support Annex	An appendix to an ISDA agreement, designed to reduce exposure to counter-party risk, by establishing a way to transfer funds between counter-parties whenever the exposure reaches a certain pre-defined level.	Chapter "Credit risk"

Term	Explanation	Index in the Risk Management Report
Economic value approach – EVE - Economic Value of Equity	The economic value approach to analysis and estimation of the effect of changes in interest rates on the fair value of assets, liabilities and off-balance sheet positions of the Bank.	Chapter "Market risk and interest risk"
Expected Shortfall VaR	A model which estimates the average loss for the VaR model, beyond the confidence level specified in the VaR model.	Chapter "Market risk and interest risk"
External credit rating agencies	Rating agencies which provide external credit ratings and recognized by the Supervisor of Banks, in conformity with specified qualification requirements. Qualified external credit rating agencies are: S&P, Moody's and Fitch.	Chapter "Credit risk"
Financing risk	Financing risk, or funding liquidity risk, is the risk that the corporation would not be able to efficiently service its cash flows and collateral needs, both expected and unexpected, both present and future, without this affecting its day-to-day operations or its financial standing.	Chapter "Liquidity and financing risk"
HQLA - High Quality Liquid Assets	High-Quality Liquid Assets which may be easily and quickly converted into cash at a small loss (or no loss) under a stress scenario.	Chapter "Liquidity and financing risk"
ICAAP - Internal Capital Adequacy Assessment Process	Internal process for assessment of overall capital adequacy at the Bank. This process includes, *inter alia*, setting capital targets, capital planning processes and review of capital status under various stress scenarios. This process is part of Pillar 2 of the Basel II directive.	This term appears many times.
ICAAR - Internal Capital Adequacy Assessment Report	The summary report for the ICAAP process.	This term appears many times.
Inflation risk	Exposure to loss due to the effect of changes in the Consumer Price Index on profit or capital of the corporation, including through effect on off-balance sheet items.	Chapter "Market risk and interest risk"
Interest risk	The risk to Bank profit (change in revenues) or to Bank capital, primarily due to fluctuations in interest rates, fluctuations of various curves used by the Bank in its business operations or from the fact that a change in interest rates may result in a change in composition of the Bank's assets and liabilities due to exercise of options for early repayment due to change in market interest rates. Changes in interest rates impact Bank profits (change in revenues) and the value of Bank assets (change in fair value).	Chapter "Scope", chapter "Regulatory capital", chapter "Market and interest risk"

Term	Explanation	Index in the Risk Management Report
KPIs - Key performance indicators	Key performance indicators, used as a tool to formulate insights about the status of process execution across the Bank.	Chapter "Operating risk"
KRI - Key risk indicators	Key risk indicators are risk benchmarks and/or statistical benchmarks used to monitor key factors associated with key risks factors at the banking corporation, in order to try and diagnose risk materialization, as early as possible.	Chapter "Market risk and interest risk", chapter Operating risk
Legal risk	Legal risk is part of operating risk and includes the risk of loss due to exposure to fines, lawsuits and/or punitive action due to breach of contract or disagreements. Legal risk includes risk arising from legal exposure due to Bank conduct with its various interested parties (such as: clients, suppliers and other third parties).	Chapter "Operating risk"
Liquidity risk	The risk to profit and stability of the banking corporation, due to its inability to satisfy its liquidity requirements.	Chapter "Credit risk", chapter "Operating risk", chapter "Liquidity and financing risk"
Loan to Value (LTV) ratio	The ratio between the approved facility when extended and the asset value.	Chapter "Credit risk"
Market risk	This is the risk of loss in on- and off-balance sheet positions, arising from change in fair value of financial instruments, due to change in market risk factors (interest rates, exchange rates, inflation, prices of equities and commodities).	This term appears many times.
Minimum capital ratio	This ratio reflects the minimum supervisory capital requirement which the Bank is required to maintain in conformity with Proper Banking Conduct Directive 201.	Chapter "Regulatory capital"
Model validation	Model validation is a process designed to test and assess the model performance and the risk associated with using it. The model validation process includes review of various model components, principles and assumptions, input / output and processing.	Chapter "Credit risk", chapter "Market and interest risk"
Operating risk	The risk of loss due to inappropriateness or failure of internal processes, people and systems or due to external events. This risk is inherent in all products, activities, processes and systems.	This term appears many times.

Term	Explanation	Index in the Risk Management Report
Operating risks survey	An operating risks survey is conducted at least once every three years or over a period of up to three years. The survey may include identification of risks associated with various processes at the Bank, assessment of identified risk, recommendations for mitigation of such risk and prioritization of handling it.	Chapter "Operating risk"
Pillar 1	The first pillar of the Basel II project, includes calculation of minimum capital requirements with respect to credit risk (including counter-party risk), market risk (negotiable portfolio only) and operating risk.	This term appears many times.
Pillar 2	The second pillar of the Basel II project, refers to the Supervisory Review Process. This part consists of the following basic principles: - The Bank shall conduct the ICAAP process, as defined above. - The Supervisor shall conduct a process to assess the ICAAP process conducted by the Bank, to review the Bank's capacity to monitor and achieve supervisory capital ratios. - The Bank is expected to operate above the specified minimum capital ratios.	This term appears many times.
Pillar 3	The third pillar of the Basel II project, designed to promote market discipline by developing a set of disclosure requirements, which would allow market participants to assess the capital, risk exposure and risk assessment processes - and use these to assess the Bank's capital adequacy.	Chapter "Scope", chapter "Regulatory capital"
Regulatory risk	The risk to corporation profit, stability or to its capacity to achieve its objectives due to the effect of future regulation.	Chapter "Operating risk"
Reputation risk	Reputation is a set of concepts, ideas and beliefs by interested parties about the corporation, based on their experience and expectations. Reputation risk is the risk to corporate profit, stability or capacity to achieve its objectives, due to impact to reputation which may arise from practices applied by the corporation, its financial standing or negative publicity (whether true or false).	Chapter "Operating risk", chapter "Other risks"
Risk	Risk is the potential (likelihood) of impact to capital, profit, stability of the corporation or its capacity to achieve its business objectives.	This term appears many times.
Risk appetite	A decision made by the Bank with regard to the risk level which the banking corporation is willing to assume, given the risk / reward attributes.	This term appears many times.

Term	Explanation	Index in the Risk Management Report
Risk assets	These consist of credit risk, operating risk and market risk, calculated using the standard approach as stated in Proper Banking Conduct Directives 201-211.	Chapter "Summary risk profile for the Bank", chapter "Regulatory capital"
Risk profile	Assessment of the aggregate risk inherent in exposures and business operations of the Bank at a certain point in time.	This term appears many times.
Risks Document	A document which concisely presents the Bank's risk profile, in order to allow the Board of Directors to monitor action taken by management and to ensure that such action is in line with the risk appetite and with the risks management framework approved by the Board of Directors. The Risks Document is compiled and sent to the Board of Directors quarterly.	This term appears many times.
Risks management framework	A framework for risks management, which includes policy, procedures, measurement, risk appetite and controls for risk management.	Chapter "Corporate governance for risks management at the Bank Group"
Standard approach	An approach used to calculate the required capital with respect to credit risk, market risk or operating risk. Calculation of capital allocation is based on a formula, which is based on supervisory assessment components which have been specified by the Supervisor of Banks.	Chapter "Scope", chapter "Regulatory capital", chapter "Credit risk", chapter "Operating risk"
Strategic risk	Strategic risk is the risk, in real time or potentially in future, of impact to Bank profits, capital or reputation, due to erroneous business decisions, improper deployment of decisions or insufficient preparation for changes in the business environment. This means the risk that the Bank chose the wrong strategy or that the Bank would not be able to implement the business and strategic plan as planned.	Chapter "Other risks"
Stress tests	A title for various methods used to assess the financial standing of a banking corporation under a scenario.	This term appears many times.
Stressed VaR	Estimate of the Value at Risk based on historical data which describe a relevant crisis period.	Chapter "Market risk and interest risk"
Supervisory capital (total capital)	Supervisory capital consists of two tiers: - Tier I equity , which includes Tier I shareholder equity and additional Tier I equity. - Tier 2 equity. As defined in Proper Banking Conduct Directive 202 "Measurement and capital adequacy - supervisory capital".	Chapter "Scope", chapter "Summary risk profile for the Bank", chapter "Regulatory capital"

Term	Explanation	Index in the Risk Management Report
Three lines of defense	The risks management concept is divided into three lines of defense: First line – risks takers: Business line management is responsible for identification, assessment, measurement, monitoring, mitigation and reporting of the inherent risks. It is also responsible for management of an appropriate control environment for risk management. Second line – risk controllers: The risks management function is tasked with complementing the risks management activities by the line of business. Responsible, *inter alia*, for planning and development of a risks management framework and for challenging risks management by the lines of business. Third line – Internal Audit conducts an independent review and challenges the controls, processes and systems used for risks management.	This term appears many times.

2. Terms with regard to banking and finance

Term	Meaning	Index in the Risk Management Report
Asset and Liability Management (ALM)	A technique applied by organizations to align the composition of assets and liabilities in order to ensure an adequate return on equity. This means management of risks arising from gaps between the composition of assets and liabilities, at the business level. This includes processes for management of market and liquidity risks, setting shadow pricing etc.	Chapter "Corporate governance for risks management at the Bank Group", chapter "Credit risk", chapter "Market and interest risk"
Average effective duration	The average term to maturity of debentures. Measured in years, by weighting principal and interest payments for the debenture over its term to final maturity. The average effective duration of a debenture reflects the financial instrument's sensitivity to changes in interest rates. Average effective duration is calculated as the ratio between the weighted average debenture payouts to its price.	Chapter "Market risk and interest risk"
Banking portfolio / non-negotiable portfolio	The banking portfolio, which is the Bank's primary activity, consists of all transactions not included in the negotiable portfolio, including financial derivatives used to hedge the banking portfolio.	Chapter "Market risk and interest risk"

Term	Meaning	Index in the Risk Management Report
CDS - Credit Default Swap	A financial instrument which enables transfer of credit exposure to the instrument issuer between parties to a transaction. The buyer of this instrument obtains insurance from the seller in case of payment failure by the issuer of the securities, for payment of a periodic premium.	Chapter "Regulatory capital", chapter "Credit risk"
Credit control	A review process designed to assess performance of the team involved in extending credit and the overall status of the credit portfolio. This process is retroactively conducted by the Bank's Credit Control Department; the review includes a review of rating reliability and appropriateness of classification and provision.	Chapter "Risk culture", chapter "Credit risk"
Credit underwriting	A process which includes analysis and assessment of credit risk inherent in a transaction and approval of such transaction in conformity with policy and procedures, in order to extend credit.	Chapter "Scope", chapter "Credit risk", chapter "Equities"
Debt under restructuring	Problematic debt under restructuring is defined as debt for which, for economic or legal reasons related to financial difficulties of the debtor, the Bank has made a concession by way of modification to terms and conditions of the debt, designed to make it easier for the debtor to make cash payments in the near term (reduction or postponement of cash payments due from the debtor), or by way of receiving other assets as debt repayment (in whole or in part).	Chapter "Credit risk"
Debt under special supervision	Debt under special supervision is debt with potential weaknesses, which require special attention by Bank management. Should these weaknesses not be addressed, the likelihood of debt repayment may deteriorate.	Chapter "Credit risk"
Derivatives	A financial instrument or contract whose value changes in response to changes in the price of the underlying asset (a financial instrument, physical asset, index, credit rating or other underlying asset), requires a small or minimal initial investment, compared to other contract types, and is expected to be settled on a future date.	This term appears many times.
Financial covenants	Covenants agreed between lender and borrower in the loan contract, which specify suspensive conditions for extending credit, such as achieving certain financial ratios. Occasionally, a breach of such condition may give cause to demand immediate repayment of the credit.	Chapter "Credit risk"

Term	Meaning	Index in the Risk Management Report
Financial project assistance	A method for financial project assistance (closed assistance) is a financing method where the borrower expects to be repaid primarily from expected project receipts, which are both the repayment source and the collateral for exposure. As part of this method, the financed projects are closely monitored.	Chapter "Credit risk"
Impaired debt	Debt is classified as impaired when its principal or interest is in arrears over 90 days, unless the debt is well secured and is in collection proceedings. Further, any debt whose terms and conditions have been changed in conjunction with restructuring of problematic debt would be classified as impaired debt, unless prior to and following such restructuring, a provision for credit losses by extent of arrears was made with respect to the debt pursuant to the appendix to Proper Banking Conduct Directive 314 on problematic debt in housing loans.	Chapter "Regulatory capital", chapter "Credit risk"
Inferior debt	Inferior debt is debt insufficiently secured by collateral or by debtor repayment capacity, and for which the Bank may incur a loss if faults are not corrected, including debt over NIS 700 thousand which is 60-89 days in arrears.	Chapter "Credit risk"
ISDA agreement	An agreement which covers transactions in derivatives between banks and allows for aggregation and offset into a single amount of net obligations of either party to all transactions together, upon occurrence of a bankruptcy event or another event which qualifies for transaction closing, according to the agreement.	Chapter "Credit risk"
Liquidity cushion	The balance of liquid assets at the Bank, after applying appropriate predefined safety factors.	Chapter "Liquidity and financing risk"
Minimum liquidity coverage ratio	The ratio of liquidity cushion to net forecasted cash outflows for the next month, under various scenarios.	Chapter "Liquidity and financing risk"
Negotiable portfolio	The Bank's negotiable portfolio includes the portfolios managed as market maker in the trading room, as well as portfolios of securities held for trade and transactions in derivatives conducted as part of a specific market strategy, managed by Financial Management under specific limitations on exposure and profitability.	Chapter "Market risk and interest risk"

Term	Meaning	Index in the Risk Management Report
OTC - Over the Counter	Transaction involving financial instruments which is conducted over the counter and not on a stock exchange.	Chapter "Regulatory capital", chapter "Credit risk"
Problematic debt	Debt classified under one of the following negative classifications: special supervision, inferior or impaired.	Chapter "Credit risk"
Provision for credit losses	A provision designed to cover expected credit losses in the Bank's credit portfolio. These losses reflects the net write-off amount which is likely to materialize for a loan or loan group, given the facts and circumstances as of the evaluation date.	Chapter "Regulatory capital", chapter "Credit risk"
Securitization	Traditional securitization is a structure where cash flow from a collection of base exposures is used to serve at least two different layers of positions or risk layers, which reflect different credit risk levels. Payments to investors are contingent on the performance of the specific base exposures, as opposed to payments arising from the obligation of the entity which generated such exposure.	Chapter "Scope", chapter "Regulatory capital", chapter "Credit risk"

3. Terms with regard to regulatory directives

Term	Meaning	Index in the Risk Management Report
FATCA - Foreign Accounts Tax Compliance Act	The US Foreign Accounts Tax Compliance Act stipulates mandatory reporting to the US tax authority (IRS) of accounts held by US persons with foreign financial institutions (outside the USA).	Chapter "Other risks"
LCR - Liquidity Coverage Ratio	Liquidity Coverage Ratio is defines as the ratio of High Quality Liquid Assets and net cash outflow for the next 30 days, under a stress scenario. This ratio is a benchmark for the Bank's capacity to fulfill its liquidity needs for the coming month.	Chapter "Liquidity and financing risk"

4. Other terms

Term	Meaning	Index in the Risk Management Report
Corporate governance	The ensemble of relations between management, the Board of Directors, shareholders and interested parties which form the structure used to determine Bank objectives and the means to achieve and to monitor these objectives. Corporate governance also supports definition of roles and responsibilities as well as the decision-making process.	Chapter "Corporate governance for risks management at the Bank Group", chapter "Liquidity and financing risk", chapter "Other risk"
SOX	US legislation, partially adopted by the Bank of Israel, designed to regulate responsibilities and internal controls over financial reporting and disclosure at the organization.	Chapter "Operating risk"