

RISK MANAGEMENT REPORT 2021



I'm not a robot



Advanced Banking Between People

This report includes supplementary information to the Bank's financial statements and is prepared in accordance with the Supervisor of Banks' directives, which include disclosure requirements from Basel Pillar III and additional disclosure requirements by the Financial Stability Board (FSB). The Israel Securities Authority's MAGNA website includes the following reports: The periodic report and the financial statements in XBRL format, the actuarial assessment regarding employee rights at the Bank, a detailed risk management report and additional supervisory information regarding supervisory capital instruments issued by the Bank. In conformity with the Supervisor of Banks' directives, these financial statements, including XBRL format, the Bank's "solo" financial statements, this risk management report and additional supervisory information, as stated, are also available on the Bank website at www.mizrahi-tefahot.co.il/en ► financial reports. In accordance with the Equal Rights for Persons with Disabilities (Service Accessibility Adjustments) Regulations, 2013, the website also includes accessible reports.

Bank Mizrahi Tefahot

2021 Risks Report

This report includes additional information to the Bank's financial statements and is compiled in conformity with directives of the Supervisor of Banks, which include disclosure requirements of Basel Pillar 3 and additional disclosure requirements of the Financial Stability Board (FSB).

The following reports are available on ISA's MAGNA website: The Periodic Report, actuarial assessment with regard to employees' rights at the Bank, this Risks Management Report and other supervisory information about supervisory capital instruments issued by the Bank.

In conformity with directives by the Supervisor of Banks, the financial statements, the Bank's solo financial statements, this Risks Report and other supervisory information are also available on the Bank's website:

www.mizrahi-tefahot.co.il >> about the bank >> investor relations >> financial statements.

Main Table of Contents

FORWARD-LOOKING INFORMATION	8
APPLICATION SCOPE	8
KEY SUPERVISORY RATIOS AND OVERVIEW OF RISK MANAGEMENT AND WEIGHTED RISK ASSETS	9
BANK APPROACH TO RISK MANAGEMENT (OVA)	11
GENERAL INFORMATION REGARDING MANAGEMENT OF VARIOUS RISKS AND THE RISK PROFILE	11
CAPITAL AND LEVERAGE	27
COMPOSITION OF SUPERVISORY CAPITAL	27
SUPERVISORY CAPITAL	28
CREDIT RISK	33
GENERAL INFORMATION REGARDING CREDIT RISK QUALITY (CRA)	33
CREDIT RISK MANAGEMENT – OBJECTIVES AND POLICIES	33
BUSINESS MODEL	34
APPROACH TO CREDIT RISK POLICY AND SETTING LIMITS	34
LINES OF DEFENSE FOR CREDIT RISK MANAGEMENT	34
CREDIT RISK MANAGEMENT TOOLS – RISK MEASUREMENT SYSTEMS	36
REPORTS TO MANAGEMENT AND TO THE BOARD OF DIRECTORS	36
CREDIT QUALITY OF CREDIT EXPOSURES (CR1) (NIS IN MILLIONS)	37
ADDITIONAL DISCLOSURE WITH REGARD TO CREDIT QUALITY OF CREDIT EXPOSURES (CRB)	37
CREDIT RISK ⁽²⁾ BY ECONOMIC SECTOR	40
CREDIT RISK MITIGATION (CRC)	44
CREDIT RISK – STANDARD APPROACH	47
STANDARD APPROACH – EXPOSURE TO CREDIT RISK AND EFFECTS OF CREDIT RISK MITIGATION (CR4)	48
STANDARD APPROACH – EXPOSURES BY ASSET TYPE AND RISK WEIGHTING (CRS) ⁽¹⁾⁽²⁾ (NIS IN MILLIONS)	49
ADDITIONAL INFORMATION ABOUT CREDIT RISK	50
COUNTER-PARTY CREDIT RISK	55
QUALITATIVE DISCLOSURE OF COUNTER-PARTY CREDIT RISK (CCRA)	55
MARKET RISK	59
GENERAL INFORMATION ABOUT MARKET AND INTEREST RISK	59
STRATEGIES, POLICIES AND PROCESSES	60
POLICY ON DETERMINATION WHETHER A POSITION IS DESIGNATED FOR TRADING	62
ORGANIZATIONAL STRUCTURE OF MARKET AND INTEREST RISK MANAGEMENT FUNCTION	62
SCOPE AND NATURE OF REPORTING AND MEASUREMENT SYSTEMS	63
MARKET RISK USING THE STANDARD APPROACH	63
ADDITIONAL INFORMATION ABOUT MARKET RISK	64
INTEREST RISK IN BANKING PORTFOLIO AND IN TRADING PORTFOLIO	64
QUANTITATIVE INFORMATION ABOUT INTEREST RISK IN BANKING PORTFOLIO AND IN TRADING PORTFOLIO	67
ADDITIONAL INFORMATION ABOUT INTEREST RISK	70
SHARES	72
LIQUIDITY RISK	73
LIQUIDITY RISK MANAGEMENT – OBJECTIVES AND POLICIES	73
BUSINESS MODEL	74
APPROACH TO OPERATIONAL RISK POLICY AND SETTING LIMITS	74
ORGANIZATIONAL STRUCTURE FOR LIQUIDITY RISK MANAGEMENT	74
REPORTS TO MANAGEMENT AND TO THE BOARD OF DIRECTORS	74
MEASUREMENT TOOLS AND BENCHMARKS	74
SCOPE AND NATURE OF REPORTING AND MEASUREMENT SYSTEMS	75
LIQUIDITY COVERAGE RATIO (LIQ1)	76
DEVELOPMENTS IN LIQUIDITY COVERAGE RATIO	78
NET STABLE FUNDING RATIO (LIQ2)	78
PLEGGED ASSETS (ENC)	80
ADDITIONAL INFORMATION ABOUT LIQUIDITY RISK AND FINANCING RISK	81
OPERATIONAL RISK	81
OPERATIONAL RISK MANAGEMENT – OBJECTIVES AND POLICIES	81
BUSINESS MODEL	82
APPROACH TO OPERATIONAL RISK POLICY AND SETTING LIMITS	83
ORGANIZATIONAL STRUCTURE FOR OPERATIONAL RISK MANAGEMENT	83
BUSINESS CONTINUITY	84
INFORMATION SECURITY AND CYBER DEFENSE	84
INFORMATION TECHNOLOGY RISK	85
LEGAL RISK	86
SCOPE AND KEY FEATURES OF RISKS MEASUREMENT SYSTEM	86
REPORTS TO MANAGEMENT AND TO THE BOARD OF DIRECTORS	86
OPERATIONAL RISK MITIGATION	87
CAPITAL ALLOCATION	87
OTHER RISKS	88
COMPLIANCE AND REGULATORY RISK	88
CROSS-BORDER RISK	88
AML RISK AND TERROR FINANCING	89
SCOPE AND KEY FEATURES OF RISKS MEASUREMENT SYSTEM	90
REPUTATIONAL RISK	90
BUSINESS-STRATEGIC RISK	91
ENVIRONMENTAL RISK AND CLIMATE RISK	92
REMUNERATION	93
ADDITIONS	98
ADDENDUM A – COMPOSITION OF SUPERVISORY CAPITAL	98
ADDENDUM B – LINKS BETWEEN FINANCIAL STATEMENTS AND SUPERVISORY EXPOSURES	100
GLOSSARY AND INDEX OF TERMS INCLUDED IN THE RISKS REPORT	105

List of tables included on the Risks Report

Key Data Relevant For The Bank Risk Profile	9
Lines Of Defense	14
Organizational Structure For Risk Management At The Bank	18
Mapping Of Risk Factors, Their Potential Impact On The Bank Group And Executives Appointed Risk Owners For Each Risk Factor:	23
Overview Of Weighted Risk Assets	26
Movement In Weighted Risk Assets During The Period, For Each Type Of Weighted Risk Asset	27
Composition Of Supervisory Capital	27
Report On Movements In Supervisory Capital Components During The Period, Including Changes To Tier I Equity, Tier I Capital And Tier II Capital	28
Analysis Of The Impact Of Changes On Tier I Equity Ratio	31
Comparison Of Assets On Balance Sheet And Exposure Measurement For Leverage Ratio	31
Composition Of Exposures And Leverage Ratio	32
Credit Quality Of Credit Exposures	37
Details Of Credit Risk By Economic Sector	40
Credit Exposures By Remaining Term To Maturity	42
Information Regarding 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	43
Credit Risk Mitigation Methods	46
Table Maps The Ratings By International Rating Agency S&P Used By The Bank	47
Composition Of Net Credit Exposure By Risk Mitigation Type	48
Standard Approach – Exposures By Asset Type And Risk Weighting (CRS)	49
Details Of The Provision For Credit Losses With Respect To Residential Mortgages For Which A Minimum Provision For Credit Losses Was Made By Extent Of Arrears, In Accordance With Appendix To Proper Conduct Of Banking Business Directive 314	51
Credit Risk In The Construction And Real Estate Economic Sector In Israel, By Real Estate Collateral Type	52
Information About Credit Risk In The Construction And Real Estate Economic Sector In Israel, By Asset Status	53
Analysis Of Exposure To Counter-Party Credit Risk (CCR) Based On The Supervisory Approach (CCR1)	56
Standard Approach – Exposures To Counter-Party Credit Risk (CCR) By Supervisory Portfolio And Risk Weightings (CCR3)	57
Exposures To Credit Derivatives (CCR6)	58
Exposures To Central Counter Parties (CCR8)	59
Capital Requirement Components Under The Standard Approach For Market Risk	63
Effect Of A Parallel Shift Of The Curve By 2% On The Economic Value Of The Bank's Portfolio In EVE Terms	66
VAR For The Bank Group	66
Net Adjusted Fair Value Of Financial Instruments Of The Bank And Its Subsidiaries	67
Impact Of Change Scenarios In Interest Rates On Net Adjusted Fair Value Of The Bank And Its Subsidiaries	68
Impact Of Change Scenarios In Interest Rates On Net Interest Revenues And Non-Interest Financing Revenues	69
Exposure Of The Bank And Its Subsidiaries To Changes In Interest Rates	70
Information About The Composition Of Equity Investments In The Banking Portfolio	72
Information About Liquidity Coverage Ratio	76
Details Of Liquid Assets By Level, As Required By Directive 221	78
Information About The Net Stable Funding Ratio	79
Composition Of Pledged And Un-Pledged Available Asset	80
Details Of Remuneration Paid	96
Information About Special Payments	96
Information About Deferred Remuneration	97

Risks Report

This risks report includes additional information to the consolidated financial statements of Bank Mizrahi Tefahot Ltd. and its subsidiaries as of December 31, 2021. This report provides complementary and additional information to the Bank's consolidated financial statements and to the Report of the Board of Directors and Management as of December 31, 2021, and should be used in conjunction with the information presented in those reports.

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

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

All of the financial statements and accompanying information, including the risks report, are also available on the Bank website at:

www.mizrahi-tefahot.co.il >> about the bank >> investor relations >> financial statements.

The financial statements and additional information to the financial statements, including the Report of the Board of Directors and Management, this Risk Management Report and other supervisory disclosures have been approved for publication by the Bank's Board of Directors at its meeting held on February 28, 2022.

In conformity with the Equal Rights to Handicapped Persons Regulations (Service Accessibility Adaptations), 2013, the website also provides accessible reports.



Moshe Vidman

Chairman of the Board
of Directors



Moshe Lari

President & CEO



Doron Klauzner

Vice-president, Chief
Risks Officer (CRO)

Approval date of the financial statements and the Risks Report:

Ramat Gan, February 28, 2022

Forward-Looking Information

Some of the information in the Risks 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 a large number of 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; expectation of changes and developments in the currency markets and the capital markets, forecasts related to other factors affecting the exposure to financial risks, forecasts of changes in the financial strength of borrowers, the public's preferences, changes to legislation and supervisory regulations, the behavior of competitors, the Bank's image, technological developments and human resources developments.

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, as mentioned above so that there is a possibility that events or developments predicted to be anticipated would not materialize, in whole or in part.

Application scope

The Group is supervised on consolidated basis by the Supervisor of Banks at the Bank of Israel. Consolidation of the consolidated entities and recording of the carrying amount of associates are in conformity with generally accepted accounting principles and in conformity with directives of the Bank of Israel. As of December 31, 2021, there were no differences between the consolidation basis based on accounting principles and the supervisory consolidation basis for capital adequacy purposes. As required by directives of the Bank of Israel, the data presented in conjunction with supervisory disclosure requirements in conformity with provisions of the Basel Committee included in this report, are only presented on consolidated basis and are based on the financial information presented on the financial statements, with adjustments mandated by application of the Basel Committee directives (such as: deductions from capital, debt instruments qualified for inclusion in regulatory capital, special treatment of accounting effect with respect to streamlining plan on Bank capital).

For more information about investees, see chapter "Major investees" on the Report by the Board of Directors and Management and in Notes to the financial statements as of December 31, 2021.

Key supervisory ratios and overview of risk management and weighted risk assets

Key supervisory ratios – key data

Below is key data relevant for the Bank risk profile:

	2021				2020			
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter
Key supervisory and financial ratios								
Available capital								
Tier I capital ⁽¹⁾	21,969	22,099	21,783	20,708	20,137	19,708	17,033	16,718
Tier I capital before effect of transitional provisions	21,935	22,045	21,709	20,607	20,017	19,571	16,956	16,653
Total capital	29,883	30,268	30,267	27,373	27,313	26,488	22,999	22,521
Total capital before effect of transitional provisions	29,402	29,767	29,746	26,825	26,300	25,458	22,029	21,563
Risk weighted assets								
Total risk weighted assets (RWA)	218,710	211,706	206,779	203,936	200,484	197,502	170,992	169,001
Capital adequacy ratio (in %)								
Tier I capital ratio ⁽¹⁾	10.04	10.44	10.53	10.15	10.04	9.98	9.96	9.89
Tier I capital ratio before effect of transitional provisions	10.03	10.41	10.50	10.10	9.98	9.91	9.91	9.85
Total capital ratio	13.66	14.30	14.64	13.42	13.62	13.41	13.45	13.33
Total capital ratio before effect of transitional provisions	13.44	14.06	14.38	13.15	13.11	12.89	12.88	12.75
Tier I capital ratio required by Supervisor of Banks	8.60	8.60	8.63	8.66	8.68	8.71	8.79	8.82
Available Tier I capital ratio, beyond what is required by the Supervisor of Banks	1.44	1.84	1.90	1.49	1.36	1.27	1.17	1.07
Leverage ratio								
Total exposure	423,950	411,555	406,235	401,308	388,370	376,614	317,759	309,863
Leverage ratio (in %) ⁽²⁾	5.18	5.37	5.36	5.16	5.19	5.23	5.36	5.40
Leverage ratio before effect of transitional provisions (in %)	5.17	5.36	5.34	5.13	5.15	5.20	5.34	5.37
Liquidity coverage ratio⁽³⁾								
Total high-quality liquid assets	88,141	91,377	88,745	84,754	78,145	59,709	53,992	49,568
Total outgoing cash flows, net	70,541	72,679	66,992	63,729	58,769	46,783	44,280	42,300
Liquidity coverage ratio (in %)	125	126	132	133	133	128	122	117
Net stable funding ratio								
Total available stable funding ⁽⁸⁾	259,631							
Total required stable funding	218,447							
Net stable funding ratio (in %)	119							
Performance benchmarks								
Net profit return on equity ⁽⁴⁾⁽⁵⁾	13.5	17.3	21.3	14.9	11.4	9.5	9.0	9.1
Profit return on risk assets ⁽⁵⁾⁽⁶⁾	1.27	1.63	1.94	1.34	1.02	0.89	0.85	0.86
Deposits from the public to loans to the public, net	113.4	117.0	115.8	117.7	115.8	114.2	108.1	106.2
Key credit quality benchmarks								
Ratio of balance of provision for credit losses to total loans to the public	0.77	0.83	0.86	0.96	0.98	0.95	0.96	0.91
Balance of provision for credit losses, including estimated credit losses in balance of loans to the public at Union Bank, as percentage of loans to the public	0.85	0.91	0.95	1.07	1.11	1.09	–	–
Ratio of impaired debts or debts in arrears 90 days or longer to loans to the public	0.98	1.06	1.07	1.23	1.18	1.20	1.34	1.41
Expenses with respect to credit losses to loans to the public, net for the period ⁽⁹⁾	(0.02)	(0.06)	(0.38)	0.02	0.19	0.59	0.50	0.66
Of which: With respect to commercial loans other than residential mortgages	0.11	(0.11)	(0.80)	0.16	0.49	0.87	1.17	1.55
Of which: With respect to residential mortgages	(0.09)	(0.02)	(0.14)	(0.06)	0.02	0.44	0.15	0.19
Ratio of net accounting write-offs to average loans to the public ⁽⁵⁾	0.09	0.03	0.04	0.06	0.06	0.13	0.15	0.16

Risks Report

As of December 31, 2021

	For the year ended December 31,	
	2021	2020
Performance benchmarks		
Net profit return on equity ⁽⁴⁾⁽⁵⁾	15.8	9.5
Profit return on risk assets ⁽⁵⁾⁽⁶⁾	1.53	0.89
Key credit quality benchmarks		
Expenses with respect to credit losses to loans to the public, net for the period ⁽⁵⁾	(0.10)	0.43
Of which: With respect to commercial loans other than residential mortgages	(0.15)	0.86
Of which: With respect to residential mortgages	(0.08)	0.18
Ratio of net accounting write-offs to average loans to the public ⁽⁵⁾	0.05	0.12

Financial ratios indicate as follows:

- Net profit return on equity reached 15.8%, against the background of higher revenues, due to increase in business, and to revenues with respect to decrease in provisions for credit losses.
- In 2021, revenues with respect to provision for credit losses amounted to NIS 278 million, primarily due to decrease in the group-based provision, against the background of improved macro-economic data and decrease in loan amount subject to repayment deferral.
- The ratio of Tier I capital to risk components increased to 10.04%. The minimum ratio required of the Bank is 8.60% (the minimum ratio without relief granted due to the Corona Virus crisis is 9.60%).
- The Bank efficiently manages its compliance with regulatory targets required for capital adequacy, liquidity and leverage.

- (1) The Bank has no capital instruments included in "Additional Tier I capital", so that total Tier I capital equals total Tier I equity. Capital and capital ratio before transitional provisions reflect capital before transitional provisions from initial application of accounting standards initially applied in the reported period (for more information see Note 1 to the financial statements) and before effect of streamlining plans (for more information see Note 25 to the financial statements).
- (2) Leverage Ratio – ratio of Tier I capital (according to Basel rules) to total exposure. This ratio is calculated in conformity with Proper Conduct of Banking Business Directive 218
- (3) Liquidity Coverage Ratio – ratio of total High-Quality Liquid Assets to net cash outflow. This ratio is calculated in conformity with Proper Conduct of Banking Business Directive 221, in terms of simple averages of daily observations during the most recent reported quarter. Furthermore, in conformity with Proper Conduct of Banking Business Directive 222 "Net stable funding ratio (NSFR)", as from December 31, 2021 the Bank revised the NSFR model. Calculation of the net stable funding ratio was adapted for the regulatory requirement. In conformity with reporting directives of the Supervisor of Banks, comparative figures are not required for this ratio.
- (4) Net profit attributable to shareholders of the Bank.
- (5) Calculated on annualized basis.
- (6) Net profit to average risk assets.
- (7) Including a capital requirement at 1% of the residential mortgage balance as of the date of the financial statements, excluding residential mortgages extended during the interim directive due to the Corona Virus crisis. For more information about the interim directive for addressing the Corona Virus crisis, see chapter "Capital and leverage".
- (8) Net stable funding ratio – a liquidity ratio stipulated by the Supervisor of Banks, in conformity with recommendations of the Basel Committee, designed to maintain a sustainable financing structure over time, in addition to the liquidity coverage ratio. The requirement to calculate and maintain a minimum net stable funding ratio and the required public disclosure apply as from December 31, 2021.

Bank approach to risk management (OVA)

The Bank's business activity is exposed to various financial and non-financial risks, whose materialization has potential to impact the Bank's financial results or image. The key financial risks managed by the Bank are: Credit risk, including concentration risk, liquidity risk and market and interest risk. Along with financial risks, Bank operations are also involved with non-financial risks, such as: compliance and regulatory risk, operational Risk (including IT risk and information and cyber security risk), legal risk, reputational risk and other risks, such as environmental risk, business model risk and competition in the sector.

Risks management and control processes at the Bank and at the Group are designed to identify, manage, monitor, quantify and mitigate all material risks associated with Bank operations and to support achievement of the Bank's business objectives.

This chapter describes how management and the Board of Directors assess and manage risks, in order to disclose to stake holders relevant and material information for understanding all significant risks to which the Bank is exposed, including an understanding of the Bank's risk tolerance / risk appetite with regard to major operations and to significant risks, the risk profile and material changes that took place in the reported period which have material impact on risks at the Bank and how they are managed.

General information regarding management of various risks and the risk profile

The Bank complies with directives concerning risk management and control, as stipulated by the Supervisor of Banks, and in particular with Proper Conduct of Banking Business Directive 310 "Risks Management", which is based on the Basel Committee recommendations, which 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 and control framework in line with regulatory requirements, the Bank's risk profile and its business targets. All policy documents for risk management and control at the Bank are based on these basic principles.

Risks management at the Group is conducted from a comprehensive viewpoint of Bank operations in Israel and at overseas affiliates and in conformity with regulatory requirements, so as to support achievement of the Group's strategic objectives, while assuming risks in an informed manner and maintaining a risk level in line with the overall risk appetite specified by the Bank's Board of Directors.

The risk appetite defines, at the highest level, the overall risk level which the Bank wishes to and can assume. The risk appetite defines where the Bank would like to be in terms of reward (proceeds/benefit) vs. risk (cost) from a forward-looking viewpoint. Risk appetite is defined in qualitative and quantitative terms in the normal course of business and under stress scenarios, and is based on the risk strategy and on basic principles of the Bank's business and strategic plan, on the required liquidity and capital for achieving the strategic objectives and on results of the various stress scenarios tested by the Bank.

Risk tolerance is a specific determination of risk levels for all risks to which the Bank is exposed. Risk levels are determined by a range of qualitative and quantitative benchmarks, in support of achieving the business goals, while keeping the Bank within the overall limits of the specified risk appetite and subject to strict regulatory restrictions. These risk restrictions, on aggregate, reflect the overall risk level which the Bank is willing and able to assume.

Key and emerging risks

Bank business exposes it to various financial and non-financial risks, which may impact the Bank's business results and reputation.

Top risks and evolving risks are derived from the Bank's business environment, which is impacted by the macro-economic environment, by risk associated with regulation and legislation, by changes to the business model and by social and consumer trends. In recent years, due to changes to the competitive environment, to the consumer environment, to the regulatory environment and to the technology environment, a trend of evolving non-financial risks is becoming apparent.

Top risks are risks arising from developments in the Bank's business environment, which may materialize over the coming 12 months which potentially may materially impact the Bank's financial results and stability. Furthermore, evolving risks are identified, which are risks that may materialize in the longer term and their nature and impact on the Bank are uncertain. Such risks include cyber and information security risk, IT risk and reputational risk.

As noted, the risks mapping is regularly reviewed to ensure that it encompasses all risk associated with business operations at the Bank, and risk arising from market conditions and regulatory requirements.

Below are the top risks and most significant emerging risks:

Strategic business risk – Strategic business risk is the risk, in real time or in future, to Bank profits, capital, reputation or status, due to erroneous business decisions, improper deployment of decisions by the Bank or inappropriate alignment of the Bank to changes in the business environment in which it operates.

Risks Report

As of December 31, 2021

Increased competition, changes to client behavior and to business models, that may result in material impact on the banking system over the medium to long range. Furthermore, regulatory changes may impact the Bank's business results. The impact of regulatory provisions in core areas of banking operations, including the potential impact of the Increased Competition and Reduced Concentration in Israeli Banking Act. The objective of this Act is to increase competition in retail banking services, with reference to both supply (adding new players) and demand (increasing consumer capacity to compare the costs of financial services).

Technological developments in the world of finance and changes to consumer preferences result in growing transition of banking activity to digital channels. The evolution of open banking may result in greater competition for pricing, in particular with regard to payments and money transfers. Given these developments, there is growing concern of a division of the basket of banking products and of increased competitive threat to the banking system due to non-bank financial entities and technology companies entering banking activity segments. The Bank is preparing for this changing world of technology by adapting the banking production function through, *inter alia*, investing in technology.

On April 26, 2021, the Bank's Board of Directors approved a new five-year strategic plan for 2021-2025 based, *inter alia*, on positioning the Bank as a key player in business banking, establishing the Bank Group's leadership position among households, providing personal, human banking services supported by advanced digital technology, including optimal combination of human and digital channels, with human service by expert bankers, including in digital, in accordance with client choice and needs, as well as offering personalized value propositions across all channels, which are customized for client needs, adapting the operating model to future challenges and further improvement in operating efficiency and leveraging the Union Bank merger to generate operating and business synergies and to realize economies of scale. For more information see Immediate Report dated April 27, 2021 (reference: 2021-01-071448).

Furthermore, this risk is impacted by the Corona Virus event which may potentially impact the Bank's entire risk profile, due to uncertainty as to further development of this risk and material macro-economic implications arising from it.

Macro-economic risk – Bank operations are affected by the macro-economic environment. The state of the global economy, significant changes in monetary policy and in interest rate curves, market volatility and changes in prices of financial assets in Israel and world-wide and in real estate prices and in the economic and geo-political situation of Israel and of the region may potentially impact Bank operations.

Geo-political tensions and the possibility of war breaking out between Russia and the Ukraine is a material risk factor, which could affect the global macro-economic environment.

The effect of the Corona Virus pandemic, which started in early 2020, and the uncertainty with regard to its conclusion and various effects, including in the coming years, is a significant global macro-economic risk, which may disrupt business and economic activity. Materialization of this risk may increase troubled debts and may negatively impact the Bank's business results. Progress made on vaccinating the population and improvement in resilience of healthcare systems in Israel and world-wide in 2021 resulted in more moderate impact of Corona Virus morbidity waves, and consequently to gradual lifting of restrictions imposed on economic activity. Consequently, in 2021 economic growth in Israel rebounded, but concurrently with economic improvement, certain inflationary pressures emerged in Israel and world-wide, in particular higher real estate prices and challenges to the global supply chain. There is still uncertainty with regard to future outbreaks of the virus, its future attributes and potential future impact on business and economic activity.

Information security risk – increasing cyber threats towards financial institutions. The Bank applies protective measures in order to limit the ability to conduct un-authorized transactions in client accounts. These actions were taken as part of debriefing processes and lessons learned by the Bank with regard to this emerging threat.

The Corona Virus crisis elevated cyber risk, both due to increase in working remotely, which provided more attack vectors for organizations and due to increased fraud attempts in the shadow of the outbreak. During the Corona Virus crisis, the Bank's information security team operates fully and continuously, improving and bolstering defense capabilities and mechanisms, in conformity with expansion of threats and challenging needs which the Bank is required to face.

Technology risk – technology evolution and the age of current systems at the Bank, as well as multiple requirements by banking regulators within short time frames, increase the potential damage that may arise from technology risk that are material for proper operations at the Bank. Throughout 2021, the Technology Division operated in providing full support for regular operations at the Bank and for technology needs required for Bank operations, including needs during Corona Virus emergency routine operations.

Compliance and regulatory risk – 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. 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 Economic Competition Act, 1988. Compliance with these laws is also addressed in conjunction with the "Internal Enforcement Program" for Securities Law and for the Economic Competition Act, respectively. Compliance risk also includes fairness issues and privacy protection laws.

Risks Report

As of December 31, 2021

Note that the Bank has practically 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, which includes required action for reducing compliance risk.

Environmental risk and climate risk – This is risk due to potential harmful impact of environmental changes on financial institutions. The Bank is exposed to potential loss 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 risk factors derived from this risk: goodwill, third party liability etc. Environmental risks include: air, water and land pollution, impact to biological diversity and de-forestation. Climate risk is risk due to increased frequency and intensity of weather events due to global warming. Climate risks include transition risks, arising from moves designed to reduce warming, including reduction of carbon emissions (such as: transition to renewable energy sources, carbon taxation, improved energy efficiency and so forth), as well as physical risks which materialize as direct consequence of climate change, such as: fire, flooding and so forth. The Bank sees great importance in promoting activity and risk management in this regard, and is preparing to expand its activity, to monitor and manage environmental risks, including climate risks, in conformity with expectations of the Supervisor of Banks and emerging global practice in this field.

For more information about management of these risks, see chapter "Other risks" (environmental risk and climate risk) below, and chapter "Environment, society and governance" in the Report by the Board of Directors and Management.

This information constitutes forward-looking information, as defined in the Securities Law, 1968, based on assumptions, facts and data (hereinafter jointly: "assumptions") brought before the Bank's Board of Directors. These assumptions may not materialize due to factors which are under the Bank's control.

Corporate governance of risks management at the Bank

Risks management at the Bank consists of all management and control layers at the Bank. These include: the Bank Board of Directors, management and business units, as well as internal control and audit functions. The Risks Control Division (headed by the Bank's CRO) is the overall entity tasked with risk management and control at the Bank.

The Bank has specified three lines of defense.

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

Lines of Defense

Line	Function	Reporting to	Role
First line of defense	Lines of business	Business line managers, reporting directly to the President & CEO	Unit management that is fully responsible for risks management and for implementing an appropriate control environment for its operations
Second line of defense	Risks Control Division, which is the primary control function, and other units.	President & CEO	The Risks Control Division, headed by the CRO, is independent of the business units, acts in concert with control functions of other divisions, including the Financial Information and Reporting Division and the Legal Division, in order to complete the risk management activities of the first line, and 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.
Third line of defense	Internal Audit	The Bank's Board of Directors	Acts independently, reviews the effectiveness and efficiency (mostly in retrospect) of work processes and risk management in conformity with a risk-based multi-annual program, identify weaknesses in internal controls which may impact the effectiveness of control and monitoring remedial action taken for such identified weaknesses.

Different interfaces have been specified between the lines of defense, including forums and reporting channels deployed under normal and emergency conditions. A strong risks management culture and risks communications between the three lines of defense are attributes of appropriate risks management governance. Communication about risks is designed to ensure the information flow which allows the Bank to address the material risks for its operations, or the potential for development of such risks, while achieving the Bank's business targets.

Corporate governance of risks management at subsidiaries

As part of overall Group risks management, risks management and control policy is coordinated with Bank subsidiaries. Supervision and control over subsidiaries are regularly applied. The subsidiaries manage risk in conformity with Group policy and report their exposures to various risks to the Bank.

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

The Bank's Board of Directors

The major roles of the Board of Directors with regard to risk management are: Setting risk strategy, determination of the Bank's risk appetite, approval of the risk management and control framework consistent with the risk management, control and mapping policy, and setting principles in specific policy documents for risk management for each risk, to guide the Bank in its day-to-day operations. The Board of Directors supervises and controls management actions and their consistency with Board policy, ensures that clear areas of responsibility and reporting paths are in place at the Bank, instills an organizational culture supportive of risk management which demands implementation of high standards of professional behavior, integrity and fairness, ensuring that the Bank is operating in compliance with the Law and regulation.

The Board of Directors operates through multiple professional committees, tasked with conducting comprehensive and in-depth discussion of the various matters before they are brought for discussion and approval by the Board plenum.

Risks Management Committee

A Committee advising the Board of Directors, discusses matters concerning risk management and control at the Bank, including current and future risk appetite, capital planning and management. The Committee also supervises how executive management implements the risk strategy.

The committee is responsible for approval of the Bank's risks mapping and approval of dedicated policy documents for each of the Bank's material risks. These documents specify the corporate governance, the nature of the risk and the risk

appetite adjusted for strategic operations, as well as the risk management and measurement processes and methods applied by the Bank to mitigate it, including effective monitoring and control processes.

The committee conducts a quarterly discussion of the Bank's risks document, which presents an overview of all risks and their evolution over time, with emphasis on events in the reported quarter, on the quarterly and annual risks document and on the annual ICAAP (Internal Capital Adequacy Assessment Process) document and results of the Bank of Israel Uniform Stress Scenario and its impact on Bank data, profitability and stability of Bank capital.

The committee regularly receives extended reviews on various topics. The committee also discusses new products subject to approval by the Board of Directors, new and revised regulatory directives and guidance with regard to risk management at the Bank, significant debriefs which took place with regard to risk management and any other topic of relevance to risk management at the Bank.

IT and Technology Innovation Committee

The Committee advises the Board of Directors on IT and technology innovation. The Committee discusses and advises the Board of Directors on matters of information and cyber security, technology infrastructure at the Bank Group, administration and use of data bases, technology innovation in support of business innovation, and aligning these with the overall strategy and policy of the Bank Group, including targets, annual work plans and resources, with regard to IT and technology innovation. The summary risk overview discussed by the Committee is reported semi-annually to the Board of Directors' Risk Management Committee.

Audit Committee

The Audit Committee is tasked with supervising the work of the Bank's Internal Auditor and that of the Bank's Independent Auditor. Thus, the committee discusses the Bank's financial statements and risks report and makes its recommendation to the Board of Directors with regard to its approval. The Audit Committee discusses work plans of internal audit and of the Independent Auditor, as well as 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 proposes to the Board of Directors ways to amend them.

Credit Committee

The committee is responsible for approval of the credit policy document (by joint discussion with the Board of Directors' Risks Management Committee) prior to bringing it for approval by the Board of Directors. It is also tasked with approval of credit applications which deviate from limits specified in the credit policy. The committee also discusses credit control reports and current credit reports, as well as general credit-related topics.

Committee to assist the Union Bank merger

An ad-hoc Board of Directors' committee, established to assist the Union Bank merger, being a material, complex and large-scale process associated with a wide range of risks.

Remuneration Committee

The committee discusses the remuneration policy and makes its recommendations to the Board of Directors. The committee also approves the terms and conditions of contracting with officers (prior to approval by the Board of Directors).

President & CEO

The Bank President & CEO is responsible for on-going management of Bank operations, subject to policies set by the Board of Directors and subject to guidance from it, in particular with regard to implementing the Bank's strategy and business plans. In this regard, the President & CEO is responsible for management of all risks at the Bank and for leadership of management and Risks Managers in comprehensive and integrative management of risks and capital and implementation of an effective internal controls system.

The Bank President & CEO receives regular, current reviews and reports at least about the Bank's risk profile in such layout and timing as stipulated by Board resolutions and in conformity with Proper Conduct of Banking Business Directives. The Bank President & CEO is responsible for reporting to the Board of Directors, in conformity with the outline specified in Bank procedures, including reporting concerning risks management by the Bank and, in particular, any unusual events and/or deviations from the risk appetite.

Bank management

Bank management is tasked with ensuring that Bank operations are in conformity with the business strategy and targets specified by the Board of Directors and within the specified risk appetite. Management is responsible for regularly managing the material risks facing the Bank. Each Risks Manager, in his own area, is responsible for implementation of the principles specified by the Bank Board of Directors for addressing such risks. Formulating risks management policy, setting limits and guidelines, deployment and implementation of risks management and control processes, reporting on the risk profile in the

Risks Report

As of December 31, 2021

normal course of business and under stress scenarios, and approval of new products and activities prior to the launch thereof.

The Bank's organizational structure is designed to support achieving the Bank's business targets while maintaining proper risks management and control processes.

Note that in similar fashion to business processes, risks management processes are not static, but rather change and evolve constantly, both due to local regulation and/or global practice and in conformity with business needs.

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.

Chief management committees include: The weekly management forum, The Senior Credit Committee, the Asset and Liability Management Committee, the Overseas Affiliates Committee, the Management Committee for Operational Risks Management, the Management Committee for Risks Management, which discusses in particular the quarterly Risks Document and the steering committee for merger of Union Bank. The Chief Risks Officer and other representatives of the Risks Control Division, as the case may be, are also members of these committees. The committees operate in normal times and during emergency, in conformity with detailed procedures.

Chief Risk Officer (CRO)

The Manager, Risks Control Division serves as the Bank's Chief Risks Officer (CRO) and is responsible for the risk management and control function and for the risk management framework. The Risks Control Division is a key foundation of the Bank's second line of defense, acts independently of the risk-taking units and the CRO has direct access to the Bank President & CEO and to the Bank Board of Directors, as well as regulated, direct reporting processes. The CRO is responsible for maintaining appropriate risks management and control at the Bank, for maintaining a Bank-wide reporting platform, with active involvement in the capital planning process and responsibility to ensure that all processes are taken to ensure that the Bank's risk profile is compliant with the risk appetite, as specified by the Board of Directors.

The CRO is responsible for ensuring that effective processes are in place for identification, measurement, monitoring and control, mitigation and reporting of all risks inherent across all business operations at the Bank.

The CRO is responsible for specifying the Bank's risk appetite framework, including leading the creation of all policy documents on risk management and control, challenging material processes and risks at the Bank, including challenging capital planning, challenging work plans and challenging the strategic plan. Also analysis of material failure events and debriefing and learning lessons arising from such events.

The CRO is directly responsible for multiple risks associated with internal controls risks at the Bank. He is also responsible for control over credit risks and credit analysis, as an independent party to credit approval.

Compliance Officer

The Compliance Officer heads the Compliance Department (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 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, to deploy a compliance culture across the organization and to supervise implementation of appropriate compliance processes at subsidiaries and affiliates.

The Compliance Officer handles issues of Bank compliance with obligations arising from securities law, economic competition law and privacy protection in general, and in accordance with the enforcement program in particular.

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, the Compliance Officer maintains a control system in line with control plans. These controls are designed to verify compliance of the Bank with various statutory provisions, as well as the effectiveness of controls applied by the various business and headquarters departments.

Internal Audit Division

Internal Audit is the third line of defense within corporate governance for risks management, reporting directly to the Bank Board of Directors and acting to test the effectiveness of the internal control framework at the Bank. This is typically done in retrospect, using various tools in accordance with a multi-annual risk-focused work plan based, *inter alia*, on the outcome of the ICAAP process, Internal Audit reports, audit reports by external parties, as well as inquiries and reviews by various entities at the Bank, including risk surveys. The Audit findings and recommendations are sent to the Chairman of the Board of Directors, Chairman of the Audit Committee, Bank President & CEO, the CRO, the Chief Accountant and to relevant recipients at the Bank and implementation of these recommendations is monitored.

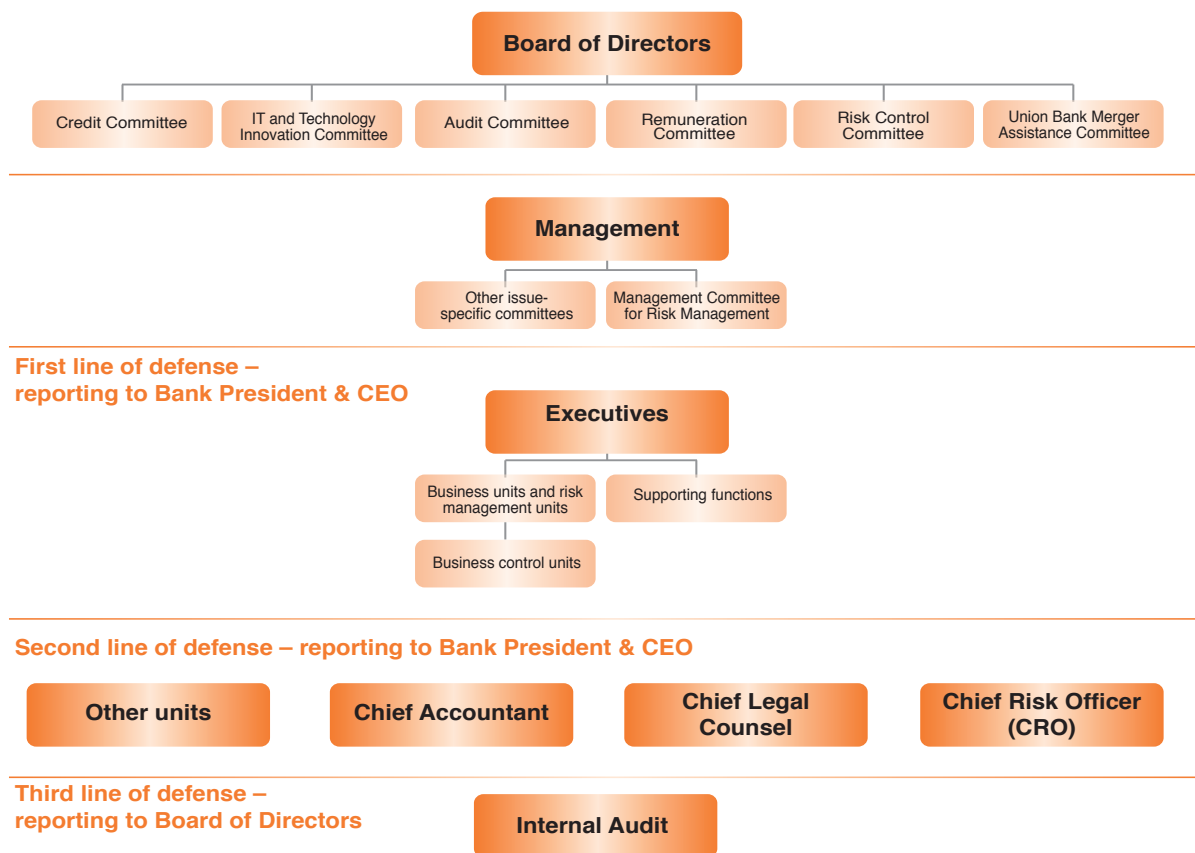
For more information about operations of the Internal Audit Division, see chapter "Corporate governance" in the financial statements.

Other forums for risks management and control operating at the Bank

As part of corporate governance for risks management and in line with the Bank's overall framework policy on risk management and control, the Bank has other forums for risks and capital management and control, including:

- Internal controls forum – maintaining integration of diverse Bank entities responsible for implementing an internal controls framework at the Bank.
- Capital planning and management forum – monitors the development of Bank capital in view of Bank targets.
- Risks monitoring forum – diverse risk-specific forums, led by the Chief Risks Officer together with business unit managers, tasked with approval of risks management methodologies, stress scenarios and their outcomes, overviews of regulation and common practices, model validation and implementation recommendations, approval of policy documents and procedures and aspects of operational risks, including the risks map, risks assessment surveys, significant events and lesson learning processes, and other various issues arising from risks management and internal controls of each business unit.
- Dedicated compliance-related forums, including cross-border risks management.
- Operational risks steering committee – advisory committee to the CRO on operational risks.
- Cyber and information security steering committee – advisory committee to the CRO on cyber and information security risks.

Organizational structure for risk management at the Bank:



Risk management culture at the Bank

Risk management culture at the Bank includes reporting between different entities which provide risks management, including the Bank’s Board of Directors, Bank President & CEO, executive management and the three lines of defense. The Bank constantly acts to develop and reinforce its risks management processes, to create a risks management culture in line with Bank operations and in support of achieving the Bank’s business targets. Risks management is an integral part of regular Bank operations and the Risks Control Division is involved in material processes at the Bank in all areas.

This activity is reflected, *inter alia*, in these processes:

- Challenging of business and strategic processes – The Risks Control Division challenges the annual work plans, the Bank’s strategic plan, as well as capital management planning.
The Division also monitors heat maps to identify major risks associated with operations of the various divisions, monitor and mitigate such risks and their impact on realization of business plans.
- Approval process for new product or a new activity at the Bank (and for revision of an existing product or activity) – A new product 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 specified, in the general framework policy on risk management and control, how the Bank addresses a new product or activity, used by the Bank to assess the impact of launching the new product or activity on all risks mapped by the Bank, including reference to business, operating, technology and compliance aspects associated with such launch. The effect of the new product / activity on the Bank’s current risk profile determines how it would be approved: products and activities having material effect on the Bank’s risk profile are approved by the Board of Directors.
- Risks surveys – periodic processes whereby risks surveys are conducted in various areas: both in operational and technological areas and those related to compliance and internal controls. These surveys are supporting tools for dynamic, active management of the risks map.
- Debriefs and ad-hoc tests – A continuous internal process maintained by the various lines of defense conducts debriefs and ad-hoc tests, following materialization of internal or external failure events, including events which occur in the global

banking system. Learning lessons from these events, to be applied by the Bank. Material debriefs conducted with regard to risks management are brought for discussion by the Bank's Board of Directors.

- Reporting chain – Risks communication is a key pillar of the Bank's capacity to manage its risks. The Bank has a specified set of reports, in the general framework policy on risk management and control, specifying the required reports under normal conditions, in case of an exceptional event and under stress (emergency) conditions between all lines of defense specified by the Bank, as needed and in conformity with potential situations.
- The quarterly risks document is a report used as a primary tool by the Board of Directors to maintain effective monitoring of Bank operations and compatibility of the risk profile with the specified risk appetite and risks management framework. This document includes the following: Developments in the risk profile vs. risk appetite, both quantitative and qualitative, risk meters showing the distance from the specified limit, reporting of exceptions and actions taken by management's to return to the outline, results of stress scenarios and forward-looking analysis to review Bank stability, material lessons learned with regard to various risks, monitoring of material issues raised in the ICAAP process, in conformity with risks identified in the risks map, and other quantitative / qualitative information with regard to anticipated developments at the Bank and/or in the banking system.
- Emergency conduct – The Bank has policy documents and structured procedures to ensure business continuity in times of emergency, both systemic emergencies, such as: geo-political event, earthquake, epidemic, cyber event etc. and Bank-specific events, such as failure of Bank systems. The Bank also has a procedure for business activity in case of a financial stress event in the markets, and special emergency forums that 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 liquidity risk.
- Training – Maintaining a comprehensive training system, consisting of different means, including: remote eLearning kits, custom training with regard to risks management, regulation and internal controls, dedicated seminars etc. In addition, constant contact is maintained between Risks Managers at headquarters and field units, in particular with representatives of each Bank unit appointed to be responsible for various risk areas, to disseminate operating principles and to communicate information to the various units.
- Information systems – risks management and monitoring using controlled, computer-based systems with minimal dependence on manual processes and with near-real time update frequency. The Bank has many measurement systems used to estimate all material risks to which the Bank is exposed, as well as IT systems to support risks monitoring and reporting.

The Bank's risk management policy and culture, as described in this chapter, apply to all risk types and to all Bank units. Later on in this report we include further specific references to each risk type individually.

For more information about remuneration policy for all Bank employees other than officers for the 3 years through December 31, 2023, approved by the Board of Directors in July 2021, see Note 22 to the 2021 financial statements.

For more information about remuneration at the Bank and its support for the risk culture, see chapter "Remuneration" below.

Deployment, limitation and enforcement of risk culture

The Bank has various action options and means to reinforce, deploy and enforce the risk culture across the different lines of defense, including, *inter alia*:

- regular reporting procedures in case of materialization of unusual events, including approaching the limits or deviation from the risk appetite. These procedures are in addition to the policy documents and include, other than the reporting chain, the management process for handling such events.
- Regular, structured mapping of all Bank of Israel regulations on various topics, the person in charge of each regulation and the various lines of defense in charge of proper handling of all of the risks.
- Maintaining regular contact between risks control functions in the second line, and the internal audit function, which is the third line, in the Internal Control Forum and by specific discussions to identify and discuss lateral risk hubs and material specific events.
- Internal Audit conducts, as part of the organized Audit work plan, specific audit of activity of the Risks Control Division, including over the ICAAP process, as part of the independent overview. These include a review of the effectiveness of control, deployment of the organizational culture across the lines of business, processes for handling events and so forth.
- Compliance Officer's Report – this report is quarterly discussed by management and by the Board of Directors' Audit Committee, and annually by the Board of Directors' plenum, highlighting activities in various compliance areas, including enforcement of securities laws and the Economic Competition Act. This report is from a Group-wide view point and combines operations of the Bank, its subsidiaries and overseas affiliates.
- The Chief Risks Officer conducts an annual discussion, in person, with the Board of Director's Audit Committee.
- The Compliance Officer conducts an annual discussion, in person, with the Board of Director's Audit Committee.

Hedging and risk mitigation

The organizational culture for risks management and corporate governance are the main means for risks mitigation existing at the Bank. Proper corporate governance supports the risks management culture and processes for risks management and control at the Bank are efficient, comprehensive and ensure its stability over time. A strong risk management culture and good communications between the three lines of defense are key features of appropriate risk management governance. All risks to which the Bank is exposed are regularly and effectively managed and monitored by the relevant units.

The Bank's business model is based on the business strategy and overall risk appetite principles of the Bank.

The Bank is acting in conformity with the outline of the five-year strategic plan for 2021-2025.

Bank management regular monitors the achievement of work plan targets. The Risk Control Division maintains regular processes to challenge the work plans and achievement of strategic plan targets. Rapid evolution of technological developments and client behavior in recent years has been changing the landscape of the financial world in terms of increased competition. These changes impact the survivability and nature of banks in future. Such technology changes, as well as growing competition in the financial world, may impact the Bank's business model in the long term.

To this end, the Bank acts in systematic fashion, in the permanent steering committee on innovation, designed to monitor activity in the banking system, mapping of technology gaps and regular review of alternatives to be recommended for Bank operations, in line with the Bank's strategic principles. This is based on a strategic perception of the client experience, reinforcing the trust-based relationship with clients, while providing the best service experience, with a choice of relevant products and services available.

The Bank has the business, legal and operating infrastructure to manage these exposures and to take proactive action to mitigate and/or hedge risk, in order to limit its exposure. The Bank has flexibility in management of physical assets as well as financial assets and liabilities, and in making changes to risk assets and capital, in the course of normal operations, so as to achieve the strategic targets.

Code of Ethics

Full transparency is a prerequisite of corporate governance, and in particular as it relates to efficient risks management. 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. The Bank's Board of Directors and management promote, throughout the organization, a high level of ethics and integrity. One of the key means for instilling ethics and integrity is the preparation of the Bank's Code of Ethics and its deployment among all Bank employees.

In late 2019, Bank management and the Bank Board of Directors revised the Code of Ethics. The key changes are as follows: Highlighting the values of excellence, professional and service-oriented approach, adding a new value – social and community responsibility, including activity regarding doing business from the viewpoint of social and environmental benefit through, *inter alia*, promoting recycling processes, improved energy efficiency and reducing consumption, reference to all stake holders at the Bank and reference to manager responsibility for ethical conduct at their units. The Bank also operates the Ethics Committee convenes monthly, consists of representatives from HQ units and branches, and acts to regularly deploy the Code of Ethics by publishing dilemmas to Bank staff, discussing dilemmas raised from the field and reviewing the deployment process of the Code of Ethics.

Scope and key features of risks measurement system

In general, it is Bank policy to manage and to monitor risks using controlled, computer-based systems with minimal dependence on manual processes and with near-real time update frequency.

The Bank has many measurement systems used to estimate all material risks to which the Bank is exposed, as well as IT systems to support risks monitoring and reporting, as described below in this report for each risk type separately.

Reporting risk information to the Board of Directors and to management

The risk management culture at the Bank includes the set of reports by various entities which comprise the risk management system, including: The Bank Board of Directors, Bank President & CEO and management, as well as the Bank's three lines of defense.

Below are the principles for the Bank's reporting system:

- Maintain effective communications processes between different pillars, for effective information sharing by reporting, stipulated in conformity with the nature of the risk and the needs of the Board of Directors and management, so as to allow them to make informed decisions.
- Reporting information in a complete, understandable and accurate manner, at the frequency and layout as specified.
- Individual reports on the individual risk level, and overview reports.
- Providing disclosure with regard to significant assumptions underlying the report, as well as any limits on risk estimates.
- Regular review of the volume and quality of information received by the Board of Directors, to ensure that risk-related information is conveyed in a concise, clear manner.

Specific policy documents for each risk faced by the Bank, including reference to the set of reports based on these principles, and based on the Reporting Framework, as follows:

- Current reports – current reporting processes at a specified frequency, as specified in risk control and management policy documents and in operating procedures for the various risks. These reports include, *inter alia*, reports for the quarterly risks document for the Board of Directors, reports for Bank management, reports for the Board of Directors' Risk Management Committee and for the Board plenum, as well as reports for various forums involved in risk management and control.

The Bank's quarterly risks document is the main reporting tool by Bank management with regard to the risk profile given the risk appetite. 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 limits, the implications of such closeness on the risk profile and action required in order to reduce the risk level.

- Exception reporting – material exceptional events, deviating from normal operations, which may impact Bank operations or reputation.
- Emergency reporting:
 - Business continuity – When the Bank is required to apply its Business Continuity Plan (BCP), the system is required to be used in line with existing action plan at the Bank, including unique reporting chains, customized for the situation, as specified in the Bank's BCP policy.
 - Financial emergency – a condition requiring special measures due to unusual changes in financial activity and/or financial or other unusual event, which may impact the markets, increasing the potential exposure to loss by the Bank due to various risks, should they materialize.
- The ICAAP document, which is presented annually and submitted to the Bank of Israel, includes qualitative and quantitative comments with regard to all risk aspects at the Bank.

Use of stress scenarios in risk management

Stress scenarios are risk management techniques used to assess Bank exposure to risks, both currently and from a forward-looking viewpoint. Stress scenarios allow the Bank to understand the impact of various stress events on Bank stability and provide an additional integral tool to approaches, benchmarks and models used in risk management. The outcome of stress scenarios are used by the Bank to challenge the risk appetite and capital planning, to identify significant risk concentrations and weaknesses in the portfolio, provide a tool to support business decision making and provide an additional tool for risks measurement in quantitative models for identification of risks not identified by the models. The Bank has a diverse range of methodologies for conducting stress scenarios, calculated to assess the potential impact of various risks to the Bank's business and financial targets.

System-wide scenario

The system-wide scenario is a uniform stress scenario delivered by the Supervisor of Banks to the banking system. In October 2021, the Bank of Israel issued a revised uniform stress scenario, including a macro-economic scenario which includes a global shock, reflected by slower economic activity and market declines in Israel and around the world. Interest rates rise due to higher inflation, with a sharp, concurrent drop in asset prices, higher unemployment and reduced private consumption. Moreover, concurrently in late 2022, a significant military operation starts in Israel, resulting in further deterioration in economic activity, which brings about a material lowering of Israel's credit rating (down to BBB), along with changes in the business environment and increased competition with new financial players. The Bank's results under this scenario, describing the anticipated development of the Bank's balance sheet and data for profitability, capital and leverage ratios, were provided to the Bank of Israel in February 2022.

ICAAP process (Internal Capital Adequacy Assessment Process)

ICAAP is a process for assessment of internal capital (Pillar 2 of capital assessment in conformity with the Basel directives), designed to ensure that overall capital at the Bank is in line with its risk profile, specified capital targets and business targets, in conformity with the work plan and with current capital planning. This is done both in the normal course of business and under stress scenarios. Moreover, this pillar includes qualitative assessment processes for the level of various risks, their management, creation of the risk map and identification of risk hubs.

The ICAAP document is extensively discussed and approved by Bank management, Board committees (Risks Management Committee and Audit Committee) and by the Board of Directors plenum. The document was submitted to the Bank of Israel in late 2021 and includes qualitative and quantitative references to all risk aspects at the Bank.

This document includes several chapters describing the corporate governance for risk management at the Bank, a concise qualitative and quantitative analysis of material risks to the Bank, capital targets, the current risk profile and looking forward to 2021, and developments during the year based on the risk self-assessment process and presentation of the Bank's overall risk map. Note that capital planning and risk assessment as part of the annual ICAAP document also include the impact of the Union Bank merger, as well as reference to the specific risk profile of Union Bank, as part of the Group risk view.

The core of the ICAAP document is the internal capital planning process conducted over a three-year planning horizon, from June 30, 2021 through June 30, 2024. This framework was used to calculate the required capital allocation with respect to

each of the risks, from the requirements specified in Pillar 1 with additional capital required with respect to Pillar 2. Pillar 2 includes capital allocation for risks not included in Pillar 1, such as: credit concentration risk and interest risk in the banking portfolio as well as additional capital allocation for risks included in Pillar 1, where the Bank assumes that additional capital allocation is required in respect thereof. The capital allocation is calculated both for normal conditions and for stress scenarios. Stress scenarios are applied at variable frequency, intensity and levels, from scenarios at the individual risk level, a system-wide scenario to test concurrent materialization of multiple risks, based on the Bank of Israel Uniform Scenario, and through to application of stressed scenarios. These scenarios are intended to ensure that the Bank has sufficient capital cushions to survive even stressed scenarios, with high impact and very remote likelihood of materializing, and that the Bank is in compliance with the limit on ratio of Tier I equity for the stressed scenario – minimum ratio of 6.5%. The Bank also applies Reverse Stress Tests ("RST") which review, based on the Bank's risk profile, which event is likely to bring the Bank closest to the Tier I capital limit under a stress scenario.

The annual internal assessment process at the Bank to review capital adequacy indicates that the Bank has sufficient capital to face the various risks associated with Bank operations, both in the normal course of business and under stress scenarios. Over the entire planning period, the Bank has available total capital higher than the total capital required by ICAAP, even after applying stress and stressed scenarios. Moreover, the Tier I capital ratio under the stressed scenario, for each year of the scenario period, does not drop below 6.5%.

Risk management and control policy documents

In 2021, Bank management and the Bank's Board of Directors approved all of the Bank's risk management and control policy documents. Updates mostly due to required adjustments to the Bank's new business strategy, Union Bank merger, updates to Bank of Israel directives and guidelines and regular reinforcement of risk management and mitigation processes by the various lines of defense.

Risk factor severity

The Bank has specified a framework for risks management and control by the Group, which includes mapping of material risks and their materiality threshold, as well as assignment of Risk Owners for all risks. For each risk, the potential impact to business operations over the coming year is assessed.

The table below lists the risk factors, executives appointed as Risk Owner for each one and management assessment of the impact of each risk factor, on a scale of five risk levels: low, low-medium, medium, medium-high, high.

The Bank assesses risk levels based on the estimated impact (potential impact) on Bank capital, during the year under scenarios of different magnitudes, under business as usual conditions and under stress conditions, based on the severity levels set forth in the framework policy on risk management. Note that the impact of potential damage to Bank capital is assessed by review of both quantitative and qualitative benchmarks, including risk management quality, existence of emergency plans and the Bank's capacity to rapidly and dynamically respond in order to minimize damage from materialization of stress events. The assessment of risk level for each risk is subjective, with some risks having clear quantitative benchmarks while for others, the subjective assessment is more significant. This is in line with the annual ICAAP process conducted by the Bank, including self-assessment of risk levels, quality of risks management and control processes, including the direction of the risks evolution for the coming year and alignment with work plans of the various departments. These results are extensively discussed by management and by the Board of Directors.

Risks Report

As of December 31, 2021

Below is a mapping of risk factors, their potential impact on the Bank Group and executives appointed Risk Owners for each risk factor:

Risk factor	Risk factor impact	Risk Owner
Overall effect of credit risks ⁽¹⁾	Medium	Manager, Corporate Division
Risk from quality of borrowers and collateral	Medium	
Risk from industry concentration ⁽¹⁾	Low-medium	
Risk from concentration of borrowers/ borrower groups	Low	
Risk with respect to mortgage portfolio	Low	
Overall effect of market risk ⁽²⁾	Low-medium	Manager, Financial Division
Interest risk	Low-medium	
Inflation risk	Low-medium	
Exchange rate risk	Low	
Liquidity risk	Low-medium	Manager, Financial Division
Overall effect of operational risk	Medium	Manager, Risks Control Division
Cyber and information security	Medium	Manager, Risks Control Division
Information technology risk	Medium	Manager, Mizrahi-Tefahot Technology Division Ltd.
Legal risk	Low-medium	Chief Legal Counsel
Compliance and regulatory risk ⁽³⁾	Low-medium	Manager, Risks Control Division
Reputation risk ⁽⁴⁾	Low	Manager, Marketing, Promotion and Business Development Division
Business-strategic risk ⁽⁵⁾	Low-medium	President & CEO

(1) Includes concentration in construction and real estate clients sector.

(2) Includes options and shares risk, primarily at Union Bank.

(3) Includes AML and terror financing risk and cross-border risk.

(4) The risk of impairment of the Bank's results due to negative reports about the Bank.

(5) The definition of business-strategic risk includes the capital planning and management process.

Below are major developments with regard to risk factors during the reported period:

The Bank's overall risk profile increased in 2020, due to increased credit risk. Since early 2021, the state of the economy has improved significantly, as reflected by key benchmarks (such as: decrease in unemployment, increase in business and slower execution rate in the State-guaranteed fund, as well as the number of applications for deferral and the number of deferrals), with the recovery seen across all economic sectors. However, due to the Omicron variant outbreak in the first quarter of 2022, there is still some uncertainty with regard to implications of the crisis and therefore the overall assessment of credit risks remains unchanged.

The overall impact of credit risk and risk associated with quality of borrowers and collateral was Medium, a risk level reflecting the risk of effect of the Corona Virus crisis on the private segment, and to a larger extent on the business segment, primarily small and medium businesses.

Moreover, the assessment of the total impact of credit risks and sector concentration includes the risk assessment with respect to Bank exposure to the construction and real estate sector. The Bank is mostly focused on extending credit for construction using the financial support method (closed assistance). Most of the credit risk in the construction and real estate sector is backed by real estate fully pledged to secure loan repayment, and for credit not secured by real estate collateral, there is other collateral in place, such as: deposits, securities etc.

In 2021, the Bank acted to expand its loan operations in the construction and real estate sector, as part of the trend of growing demand in this sector reflected, *inter alia*, in increased transaction volume. Consequently, the total credit exposure in the construction and real estate sectors increased by 13.8% in 2021 (similar to the growth rate in the mortgage portfolio), but the share of the construction and real estate sector in Israel out of total credit risk to the public at the Bank as of December 31, 2021 remained relatively low at 14.6% (compared to 14.1% at end of 2020). Continued growth in lending to the real estate sector is achieved while adhering to underwriting procedures and credit spreads to reflect the risk and is regularly monitored. Therefore, we believe that this activity has no material impact on the overall credit risk level at the Bank (and this risk is not assessed as a separate risk in the risk factors table). For more information about this risk, see chapter "Credit risk" in the Report of the Board of Directors and Management.

Risks Report

As of December 31, 2021

Technology risk and cyber and information security risk are material risks for the Bank and the potential damage due to materialization of such risk may be significant, during routine operations and even more so during an emergency. Technological activity is focused on changing needs in line with the Bank's business strategy, and taking most of the steps to mitigate potential risk in as much as possible. In actual fact, there were no material events related to technology nor to cyber and information security.

Liquidity risk remained low-medium. That is despite the fact that at the end of the fourth quarter of 2021, the Bank raised its alert level to High Alert, due to the significant increase in morbidity in Israel and world-wide due to the Omicron variant outbreak and due to market volatility. In practice, no events and/or indications were observed which would indicate realization of a liquidity event. In the fourth quarter and throughout 2021, the Bank maintained appropriate liquidity by investing excess liquidity in liquid assets of very high quality – Level 1 assets. The average liquidity coverage ratio (consolidated, including data for Union Bank) for the fourth quarter of 2021 was 125%.

Reputational risk remained Low, with the Bank constantly monitoring various benchmarks and indicators with regard to the Bank's reputation, including impact of the Union Bank merger, and the client conversion process which started in the first and second quarters of the year. There was no material impact on the Bank's reputational risk.

Crisis in the Ukraine

On February 24, 2022, a military confrontation broke out between Russia and the Ukraine. It is not possible to assess how this confrontation would develop nor its implications, if any, on markets and on economic activity, including of Bank clients. Bank management is monitoring the developments and would take action as required.

Developments in management of business operations

Strategic plan

On April 26, 2021 the Board of Directors approved a new strategic plan for 2021-2025, based on the following:

- Position the Bank as a key player in business banking, based on supporting action including: set up operations for investments in non-banking corporations, lead large and complex transactions and expand the Bank's international operations at its branches in London and in the USA in areas focused on business banking;
- Establish the Bank Group's leadership position among households: Maintain the leadership position in the mortgage market while introducing innovations in products and processes, and increasing synergies with commercial operations, expand operations among target populations and set up a desk for unique consumer credit products;
- Provide personal, human banking services supported by advanced digital technology, including optimal combination of human and digital channels, with human service by expert bankers, including in digital, in accordance with client choice and needs, as well as offering personalized value propositions across all channels, which are customized for client needs.
- Align the operating model with future challenges and improve operating efficiency through, *inter alia*, locating the Bank headquarters in the central Lod campus, align branch structure with future challenges and optimize use of real estate, automate banking operations and streamline the work environment.
- Leverage the Union Bank merger to create operating and business synergies and to realize economies of scale.

For more information see Immediate Report dated April 27, 2021 (reference: 2021-01-071448).

Union Bank merger

On September 30, 2020, the transaction whereby the Bank acquired the shares of Union Bank closed. The merger transaction is a material, large-scale and highly complex process which entails a wide range of risks. The merger process was launched in the fourth quarter of 2020 and is carried out by several extensive joint work teams of Bank Mizrahi Tefahot and Union Bank, managed by a steering committee headed by the Bank President & CEO, with administrations established to carry out the merger plan and a special Board committee established to supervise this process. Risk management is an integral and dynamic part of all work teams, and the Group's Chief Risks Officer reviews and integrates all risks of the merger process and the measures applied to reduce and manage such risk. The process of client transition started in the second quarter of 2021 and is gradual, as the number of branches and clients is expanded. The Bank's Risk Control Division and Internal Audit regularly accompany and conduct control and lesson learning processes. Accompanying the Union Bank merger process includes current management of the risk map, applying comprehensive second-line operating controls and regular quarterly review of the status of all comprehensive controls applied by the various lines of defense at Bank Mizrahi Tefahot and at Union Bank. Risks Control also conducts a comprehensive process of lesson learning upon completing each conversion round; the conclusions from this process are brought for discussion by Bank management, by the Union Bank Merger Board committee and are submitted to the Bank of Israel.

As part of preparations for the merger, both banks are acting to convert clients from Union Bank to the Bank, and to transfer various activities of Union Bank to the Bank. As a result of the merger, most Union Bank branches are expected to close.

Union Bank has a long-standing contract with Bank Leumi for obtaining IT and operating services, which has been extended from time to time. On May 12, 2020, the Board of Directors of Union Bank approved contracting an addendum to the agreement, whereby the parties agreed, *inter alia*, that the agreement would be extended through December 31, 2022.

The Technology Division runs a program consisting of multiple projects designed to transfer Union Bank activity that is based on Bank Leumi and Union Bank systems and integrating them with the Bank's systems. These projects include conversion of clients, products, historical information, reports and so forth.

The Bank manages the merger project gradually and separately from current business, in order to allow for achievement of the work plan targets concurrently with the merger process.

Macro-economic changes, including effect of the Corona Virus outbreak

The Corona Virus crisis currently affecting Israel and the entire world has real economic and financial implications, with a sharp decline in economic activity in certain periods, significant increase in the unemployment rate and volatility in financial markets. These events resulted in higher credit risk in the Israeli economy and world-wide. The higher risk level primarily applies to the business segment, especially small and medium businesses, due to reduced economic activity. In 2020, the Bank applied measures in response to client needs arising from the situation. Action taken by the Bank includes approval of deferral in current repayments for mortgage clients who needed this due to temporary hardship resulting from the crisis. The Bank also extended State-guaranteed loans from State-guaranteed foundations, as part of the economic assistance program announced by the State.

Progress made on vaccinating the population and improvement in resilience of healthcare systems in Israel and world-wide in 2021 resulted in more moderate impact of Corona Virus morbidity waves, and consequently to gradual lifting of restrictions imposed on economic activity. Consequently, in 2021 economic growth in Israel rebounded.

As from January 2022, due to the Omicron variant outbreak, the Bank applied measures to address this occurrence, including the following: Dissemination of work guidelines and maintaining hygiene and social distancing, splitting units and branches, transition to capsule-based work, creating an outline for working remotely by means of a fast, structured process, distribution of protective measures and so forth. Concurrently, the Bank monitors cases of morbidity or infection at branches and at headquarters units.

Business units continue to keep in close regular contact with clients, in order to help the business sector face the challenges resulting from this crisis. Note that early in the first quarter of 2022, the Bank launched a special outline for deferral of loan repayment for mortgage clients, for checking account holders and for small businesses. Despite the absence of a mandatory outline from the Bank of Israel, the Bank decided to take this action voluntarily, wishing to stand by its clients during these times.

In the fourth quarter, the Bank continued to address the Corona Virus and maintained work instructions derived from guidance issued by the Ministry of Health and by the Bank of Israel, including the following: Wearing masks indoors, maintaining hygiene and social distancing, barriers at public service counters and continued remote work as needed based on a rapid, structured process. During this quarter, the Bank continued to monitor the number of cases and isolations, and later in the quarter the Bank applied stricter monitoring and adherence to guidelines, due to reports of the Omicron variant outbreak.

In the fourth quarter, as in all of 2021, the Bank maintained business continuity with a high state of alert. The state of alert was raised in the first quarter of 2022 as the Omicron variant outbreak proliferated. As of December 31, 2021, the deferral period has ended for residential mortgages amounting to NIS 43.7 billion for which the Bank approved deferral during the Corona Virus crisis (estimated balance as of December 31, 2021: NIS 37.2 billion). Of these, NIS 7.4 billion chose the partial repayment track based on the Bank of Israel outline.

As of December 31, 2021, out of all other (non-housing) loans subject to deferral, NIS 4.1 billion resumed repayment and NIS 0.5 billion are still subject to deferral, mostly expected to end in 2022. As of December 31, 2021, out of all loans for which repayment has resumed, only NIS 0.1 billion are in arrears.

As of December 31, 2021, the balance of loans provided by the Bank from State-guaranteed funds amounted to NIS 4.6 billion. Against the loans extended, in conformity with the Bank of Israel outline, the Bank participated and obtained special-purpose monetary loans from the Bank of Israel, whose balance as of December 31, 2021 amounted to NIS 4.9 billion. Most of this amount is for 3 years bearing fixed interest at 0.1%.

Update to Proper Conduct of Banking Business Directive 451 regarding "Procedures for extending residential mortgages"

On January 31, 2022, the Bank of Israel issued an update regarding procedures for extending residential mortgages (update to Proper Conduct of Banking Business Directive 451), designed to enhance transparency and to aid clients in making informed decisions in the process of obtaining a mortgage. The update to the Directive refers to multiple aspects, including: Simplicity to enhance client understanding, transparency and uniformity of information for the client, to enable comparison of offers from multiple banks, online tools to be used by the client and shorter time frame for providing approval in principle.

The Directive specifies 3 uniform baskets which banking corporations are required to offer to clients in the approval in principle, and the bank is allowed to offer one or more tracks without restrictions imposed by the Bank of Israel based on the bank's discretion as to the mix appropriate for the client. The amendments to the directive also include an instruction to banking corporations to provide to the public an online calculator which allows for simulation of various loan mixes over various time frames, including the uniform tracks stipulated in the directive, so as to obtain an estimate of the impact of

Risks Report

As of December 31, 2021

changes to the loan mix on the monthly payment and total amount payable throughout the loan term. Calculation of loan repayments would include the estimated inflationary effects and interest rate revisions for variable interest tracks, based on forecasts derived from the capital market, with reference to future development of these parameter.

The effective start date of the amendments to this Directive is August 31, 2022 and the Bank is preparing to apply the Directive in various business and operating aspects.

Preparation for discontinuation of publication of LIBOR interest rates

In conformity with the issue of the ICE (Intercontinental Exchange) notice of discontinuation of publication of LIBOR interest rates for all currencies other than USD at the end of 2021, and issue of the Bank of Israel directive (Proper Conduct of Banking Business Directive 250A) dated September 30, 2021, the Bank established a steering committee to address this issue (revise contracts, process existing contracts, proper disclosure to clients, conversion mechanisms, adoption of new anchors and so forth), and review of the expected impact of discontinued publication of LIBOR information, including review of potential alternatives for each of these currencies, potential financial implications due to the transition to using the alternative interest rate benchmarks and the required preparations in business, operating and risk management aspects. Note that discontinuation of the use of LIBOR and transition to alternative interest rate benchmarks has wide-ranging implications for all clients who hold instruments denominated in or linked to foreign currency and bearing variable interest.

The Bank has implemented the Bank of Israel directives on this matter and specified alternative underlying interest rates and has informed the clients of this, both through individual contact with relevant clients and through publications on the Bank website.

Overview of weighted risk assets (OV1) (NIS in millions)

	Risk weighted assets		Minimum capital requirements ⁽¹⁾
	December 31, 2021	September 30, 2021	December 31, 2021
Credit risk (standard approach) ⁽²⁾	196,527	189,811	22,599
Counter-party credit risk (standard approach)	1,149	1,459	132
Credit risk value adjustment (CVA) ⁽³⁾	529	494	61
Amounts lower than discount thresholds (subject to 250% risk weighting)	4,406	4,172	507
Total credit risk	202,611	195,936	23,299
Market risk (standard approach)	2,268	2,115	261
Operational Risk ⁽⁴⁾	13,831	13,655	1,591
Total	218,710	211,706	25,151

(1) The capital requirement was calculated at 11.5% of risk asset balances.

(2) Credit risk excludes counter-party credit risk, credit risk value adjustment and amounts lower than the deduction thresholds.

(3) Credit Value Adjustments – mark to market with respect to credit risk of counter-party, in conformity with Basel III provisions.

(4) Capital allocation with respect to operational risk was calculated using the standard approach.

The change in risk assets in the fourth quarter of 2021 was primarily due to growth in the residential mortgage portfolio and to growth in business loans.

For more information about links between financial statements and supervisory exposures, see Addendum B below.

Additional information about weighted risk assets

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

	For the year ended December 31,	
	2021	2020
Movement in credit risk assets		
Balance as of January 1,	185,392	150,878
Change in credit exposure risk assets	16,043	25,993
Change in securities exposure risk assets	(66)	1,217
Change in derivatives exposure risk assets	(660)	347
Change in off-balance sheet exposure risk assets	1,172	3,854
Change in CVA	42	103
Regulatory changes	–	–
Other effects	688	3,000
Credit risk assets at end of period	202,611	185,392
Movement in operational risk assets		
Balance as of January 1,	12,864	10,189
Change in revenues from financing operations (including commissions)	900	2,612
Change in non-interest financing revenues	23	(25)
Change in gross revenues of subsidiaries	44	88
Operational risk assets at end of period	13,831	12,864
Movement in market risk assets		
Balance as of January 1,	2,228	1,791
Change in equity risk	–	40
Change in basis risk	(448)	186
Change in interest risk – general market risk	518	180
Change in options risk	(30)	31
Market risk assets at end of period	2,268	2,228

Capital and leverage

Composition of supervisory capital

	December 31, 2021	December 31, 2020
Tier I equity before regulatory adjustments and deductions	21,250	19,352
Total regulatory adjustments to and deductions from Tier I capital	⁽¹⁾ (719)	(785)
Tier I shareholders' equity	21,969	20,137
Tier II capital	7,914	7,176
Total capital	29,883	27,313
Total weighted risk assets	218,710	200,484
Ratio of Tier I equity to risk components	10.04	10.04
Ratio of total capital to risk components	13.66	13.62
Minimum Tier I capital ratio required by Supervisor of Banks	8.60	8.68
Minimum overall capital ratio required by Supervisor of Banks	11.50	11.50

(1) Includes deferred credit balance from acquisition of Union Bank. For more information see Note 25.F. to the financial statements.

For more information and detailed composition of supervisory capital, in conformity with disclosure requirements of Basel Pillar 3, as of December 31, 2021 compared to December 31, 2020, see Addendum A below.

Risks Report

As of December 31, 2021

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

	December 31, 2021	December 31, 2020
Tier I capital		
Balance as of January 1,	20,137	16,520
Changes to capital components:		
Issuance of ordinary share capital and share premium	(1,155)	6
Change in capital reserve from benefit from share-based payment transactions	(11)	17
Net profit for the period	3,188	1,610
Dividends declared or distributed this year	(1,236)	(176)
Cumulative effect of initial application of US GAAP	–	51
Adjustments from translation of financial statements of associated companies	(1)	–
Capital reserve from securities available for sale	16	46
Capital reserve from cash flows hedging	(23)	3
Capital reserve with respect to employees' rights	(175)	(50)
Others, including regulatory adjustments	(2)	(25)
Non-controlling interests	15	(32)
Acquisition of a controlling interest in Union Bank	1,282	1,282
Changes to effect of supervisory adjustments and deductions		
Deferred taxes	140	(108)
Goodwill and intangible assets	20	(100)
Accumulated other comprehensive income with respect to cash flows of items not listed at fair value on the balance sheet	23	(3)
Accumulated gains or losses from changes to fair value of liabilities, arising from change to the Bank's credit risk	22	12
Others	(1,535)	90
Acquisition of a controlling interest in Union Bank	1,264	994
Balance as of end of period	21,969	20,137
Tier II capital		
Balance as of January 1,	7,176	5,515
Deduction of equity instruments	154	(69)
Movement in group provision for credit losses	(610)	768
Issue of debentures with contingent conversion	400	400
Acquisition of a controlling interest in Union Bank	794	562
Balance as of end of period	7,914	7,176

Supervisory capital

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 capital 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 capital 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 adjustments with respect to liabilities for derivative instruments, due to change in the Bank's credit risk (DVA) and other supervisory adjustments and deductions.

Additional Tier I capital consists of equity instruments which fulfill the requirements specified in the directives. As of December 31, 2021, the Bank had 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.

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.

Bank approach to capital adequacy assessment

As from January 1, 2014, the Bank applies Proper Conduct of Banking Business Directives 201-211 with regard to capital measurement and adequacy, as amended to align them with Basel III directives.

The Basel Committee directives require capital management in three pillars:

Pillar 1 – minimum capital – minimum capital allocation requirements with respect to credit risk, market risk and operational risk calculated by standard models.

Pillar 2 – Supervision and control process over capital adequacy, the Internal Capital Adequacy Assessment Process (ICAAP) conducted by the Bank, as well as the Supervisory Review and Evaluation Process (SREP).

Pillar 3 – "market discipline" – reporting and disclosure to the regulating authority and to the public.

These regulations are applied gradually, in line with transitional provisions specified in Proper Conduct of Banking Business Directive 299 with regard to "Capital measurement and adequacy – Supervisory capital – Transitional provisions", in order to allow for compliance with new supervisory capital requirements in applying Basel III and to specify a transition period pending full application. The transitional provisions refer, *inter alia*, to supervisory adjustments and deductions from capital, and to capital instruments that do not qualify for inclusion in supervisory capital based on the new criteria listed in the Basel directives. In particular, capital instruments that no longer qualify as supervisory capital were recognized up to 80% on January 1, 2014, and this cap is further reduced by 10% in each subsequent year, until January 1, 2022. In conformity with the foregoing, in 2020 and 2021, the cap for instruments qualifying as supervisory capital was at 20% and 10%, respectively.

Minimum capital ratio requirement

Capital ratios are calculated as the ratio of capital to weighted risk assets. Tier I equity ratio is calculated as the ratio of Tier I equity to weighted risk assets, and the total capital ratio is calculated as the ratio of total capital to weighted risk assets.

As per instructions of the Supervisor of Banks, the Bank is required to maintain a minimum Tier I equity ratio of no less than 9% and a minimum total equity ratio of no less than 12.5%. Furthermore, pursuant to Proper Conduct of Banking Business Directive 329 concerning "Restrictions on extending residential mortgages", banking corporations are required to increase their Tier I capital target by 1% of the outstanding residential mortgage balance as of the report date.

Circular concerning Proper Conduct of Banking Business Directive 250 "Adjustments to Proper Conduct of Banking Business Directives for addressing the Corona Virus (Interim Directive)"

On March 31, 2020, Proper Conduct of Banking Business Directive 250 "Adjustments to Proper Conduct of Banking Business Directives for addressing the Corona Virus (Interim Directive)" was issued, whereby the Supervisor of Banks reduced the minimum capital ratios to be maintained by banks in the normal course of business, by one percentage point, for as long as this interim directive is in effect.

Due to development of the Corona Virus pandemic and its economic implications globally and in Israel, on March 22, 2021 the Supervisor of Banks extended the interim directive by a further 6 months, through September 30, 2021. On September 30, 2021, the Supervisor of Banks issued another circular, extending the interim directive through December 31, 2021 (expiration date of this directive).

The relief provided for capital targets would expire 24 months after expiration of the directive, provided that the banking corporation's capital ratios would be no less than the capital ratios upon expiration of the directive, or the minimum capital ratios applicable to the banking corporation prior to the interim directive, whichever is lower. It was further stipulated that in the six months following expiration of the interim directive, a reduction of up to 0.3% in the capital ratios would not be considered deviation from the required capital ratios, subject to strict, conservative capital planning and reporting to the Supervisor of Banks.

Moreover, the interim directive stipulates that with respect to residential mortgages extended during the crisis period through expiration of the directive, the additional capital requirement of 1% of the balance of residential mortgages, as set forth in Section 14A. Of Proper Conduct of Banking Business Directive 329 concerning "Restrictions on provision of residential mortgages" would not apply. This directive was extended through September 30, 2021 in a circular dated March 22, 2021 extending the interim directive.

In conformity with a circular issued by the Supervisor of Banks on September 30, 2021, as from October 1, 2021 the additional capital requirement of 1% with respect to residential mortgages would be re-applied, but the relief with respect to residential mortgages other than for purchasing interest in real estate (general purpose loans) would remain in place.

Consequently, the Bank's minimum ratio of Tier I equity to risk assets, including the additional capital requirement of 1% of the balance of residential mortgages, as of December 31, 2021, would be at least 8.6%, and the total capital ratio would be at least 11.50%.

As from January 1, 2022, upon expiration of the relief for capital targets, the minimum Tier I equity ratio would be 9.6% and the minimum total capital ratio would be 12.5%.

Circulars issued by the Supervisor of Banks on July 26, 2021 and on September 30, 2021 allowed the banking system to resume dividend distributions, and stipulated that banks should apply a cautious, conservative approach when deciding on a dividend distribution or share buy-back. According to the Supervisor of Banks, a distribution in excess of 30% of bank profits

Risks Report

As of December 31, 2021

in 2020 and in 2021 would not be deemed cautious, conservative capital planning. The Supervisor of Banks further noted that failure to achieve the required leverage ratio and application of relief with respect to the leverage ratio would not preclude dividend distribution, subject to planning the total capital so as to return to the required leverage ratio.

Circular updating Proper Conduct of Banking Business Directive 203 concerning "Standard approach – credit risk"

On December 26, 2021, the Supervisor of Banks issued a circular updating Proper Conduct of Banking Business Directive 203 concerning "Standard approach – credit risk". In this circular, the measurement of capital requirements was modified with respect to exposures to insurance companies, provident funds and mutual funds.

Circular revising the directive with regard to the standard approach for calculation of counter-party credit risk exposure (SA-CCR)

In March 2014, the Basel Committee on Bank Supervision issued updates to the Basel III directives, including a new directive with regard to "Standard approach for calculation of counter-party credit risk exposure (SA-CCR)".

On December 1, 2021, the Supervisor of Banks issued a circular revising Proper Conduct of Banking Business Directives which include guidelines for handling of counter-party credit risk in conformity with SA-CCR; according to this circular, the directive applies as from July 1, 2022.

The standard approach for calculating exposure to counter-party credit risk replaces current approaches in Directive 203 for calculation of exposure to counter-party in case of default. The Bank is preparing to implement the directive and is reviewing its implications.

Capital planning and management

The Bank manages the capital adequacy ratio so as to comply with minimum capital requirements of the Supervisor of Banks. Bank capital is subject to changes due, *inter alia*, to the following:

- Growth in business activity.
- Actuarial changes due to changes to interest rates used to calculate Bank liabilities with respect to employees benefits, or other actuarial assumptions such as: mortality rates, retirement rates and so forth.
- Impact of changes to capital reserves from debentures available for sale due to changes in interest rates.
- Impact of changes to inflation and exchange rates on the Bank's risk asset balances.
- Impact of changes to the State of Israel's credit rating on the risk weighting assigned to Israeli corporations, which is based on the State rating.

The Bank regularly monitors its capital adequacy and leverage ratio, in order to ensure compliance with requirements of the Supervisor of Banks, as well as to prepare in advance to respond to evolution of risk assets and capital requirements at the Bank. To this end, the Bank's Board of Directors has specified a policies document which set the principles required for management of the capital adequacy ratio and the leverage ratio, as well as the Bank's capital targets ("risk appetite"), which provide a safety margin beyond the minimum regulatory requirements for capital and leverage. The policy document specifies the safety margins for planning, as well as the required reports and actions to be taken should the capital ratio drop below the minimum required. Capital management and planning is conducted by a special forum headed by the Manager, Finance Division (CFO) and including the Manager, Risks Control Division (CRO), Manager, Financial Information and Reporting Division (Chief Accountant) and managers of business divisions at the Bank. On-going capital planning is based on the assumptions in the Bank's work plan, subject to capital and leverage targets and to the dividend distribution policy

The Bank prepares a detailed, multi-annual capital planning forecast, taking the following into consideration: Expected growth rates of risk assets and profitability, the strategic plan, dividends distribution policy, capital targets and leverage, appropriate safety margins and other factors.

The Bank regularly monitors the actual results vs. the forecast, revises the forecast as required and reviews any necessary actions in order to achieve the specified capital targets.

The Risks Control Division conducts processes to challenge the capital planning which review, *inter alia*, the appropriateness of safety margins used in capital planning; the outcomes of these processes are brought for discussion by the Capital Management Forum, by Bank management and by the Board of Directors' Risks Management Committee.

Risks Report

As of December 31, 2021

Below is analysis of the impact of changes on Tier I equity ratio as of December 31, 2021:

	Impact of change by NIS 100 million in Tier I equity	Impact of change by NIS 1 billion in total risk assets
Bank (consolidated data)	0.05%	0.05%

Raising of capital sources

In conjunction with the Bank's work plan, which is set by the Board of Directors and includes growth objectives for the different operating sectors, an assessment is made of the impact of achieving these objectives on total risk assets for the Bank, and accordingly on its capital adequacy ratio. Accordingly, along with business and profitability objectives, a plan is set to raise capital sources in order to maintain capital adequacy, in accordance with instructions of the Board of Directors concerning capital adequacy.

The plan includes issue of contingent subordinated notes (Contingent Convertibles – CoCo) as needed and should ensure that the overall capital ratio would not be lower than the minimum capital ratio required by the Supervisor of Banks. This information constitutes forward-looking information, as defined in the Securities Law, 1968, based on assumptions, facts and data (hereinafter jointly: "assumptions") brought before the Bank's Board of Directors. These assumptions may not materialize due to factors which are under the Bank's control.

For more information on issuance of CoCo contingent subordinated notes with par value amounting to USD 600 million in April 2021, see chapter "Developments in financing sources" in the Report by the Board of Directors and Management.

Leverage ratio

The Bank applies Proper Banking Conduct Directive 218 with regard to leverage ratio, which 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 must maintain a leverage ratio of 5% or higher on a consolidated basis.

On November 15, 2020, the Supervisor of Banks issued a circular regarding "Adjustments to Proper Conduct of Banking Business Directives for addressing the Corona Virus (Interim Directive)", updating Proper Conduct of Banking Business Directive 250, whereby the leverage ratio shall be at least 4.5% on consolidated basis, compared to 5% prior to this change. In conformity with circulars dated March 22, 2021 and September 30, 2021, the Directive is effective from the issue date thereof through December 31, 2021. Moreover, with regard to reduced leverage requirements, it was stipulated that after expiration of the Directive, the relief shall remain in effect through December 31, 2023, provided that the leverage ratio would be no less than the leverage ratio as of June 30, 2022, or the minimum leverage ratio applicable to the banking corporation prior to the Interim Directive, whichever is lower.

The Bank's leverage ratio as of December 31, 2021 is 5.18%, compared to 5.19% as of December 31, 2020.

Comparison of assets on balance sheet and exposure measurement for leverage ratio (NIS in millions):

	NIS in millions	
	As of December 31, 2021	As of December 31, 2020
Comparison of assets on balance sheet and exposure measurement for leverage ratio (NIS in millions)		
Total assets in consolidated financial statements	392,271	360,140
Adjustments with respect to financial derivatives	333	(425)
Adjustments with respect to securities financing transactions	–	–
Adjustments with respect to off-balance sheet items	29,729	26,875
Other adjustments	1,617	1,780
Exposure for leverage ratio	423,950	388,370

Risks Report

As of December 31, 2021

Composition of exposures and leverage ratio (NIS in millions)

	As of December 31, 2021	As of December 31, 2020
Composition of exposures and leverage ratio (NIS in millions)		
Balance sheet exposure		
Assets on balance sheet	387,501	355,505
Amounts with respect to assets deducted to determine Tier I capital	(173)	(314)
Total balance sheet exposure	387,328	355,191
Exposure with respect to derivatives		
Cost of replacement with respect to all derivative transactions	3,808	3,694
Amounts added with respect to future potential exposure with respect to all derivative transactions	1,542	1,819
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	(1,638)	(1,866)
Exempt central counter-party leg of commercial exposure settled by the client	–	–
Effective adjusted nominal amount of credit derivatives written	249	257
Adjusted effective nominal offsets and deduction of additions with respect to credit derivatives written	–	–
Total exposure with respect to derivatives	3,961	3,904
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	2,932	2,400
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	2,932	2,400
Other off-balance-sheet exposures		
Off-balance sheet exposure at gross nominal value	105,760	97,326
Adjustments with respect to conversion to credit equivalent amounts	(76,031)	(70,451)
Off-balance sheet items	29,729	26,875
Capital and total exposure		
Tier I capital	21,969	20,137
Total exposure	423,950	388,370
Leverage ratio		
Leverage ratio in conformity with Proper Conduct of Banking Business Directive 218	5.18%	5.19%
Minimum leverage ratio required by the Supervisor of Banks	4.50%	4.50%

Credit risk

This chapter discusses credit risk, in conformity with disclosure requirements of the Basel Committee and the FSB; the chapter structure and topic order (adjusted for the nature of Bank operations) are also in conformity with these requirements. The chapter "Counter party credit risk" below includes qualitative and quantitative disclosures about the capital requirement with respect to this risk and adjustment to capital requirements with respect to credit risk (CVA).

General information regarding credit risk quality (CRA)

Credit risk is the risk that a borrower or counter-party of the Bank would not fulfill its obligations towards the Bank. Credit risk is a material risk to Bank operations. This risk is affected by multiple factors: Business risk due to client activities, concentration risk due to over-exposure to a borrower / borrower group and to economic sectors, geographic concentration risk, risk due to exogenous changes which mostly involve changes to the borrower's macro-economic environment, environmental risks and climate risks, overseas credit risks and operational risks which, should they materialize, would have implications for credit risks. Moreover, such risk is interrelated to multiple other risks, such as market and interest risk, liquidity risk, compliance risks and other risks.

Credit is at the core of banking operations and therefore, credit risk is the major risk addressed by the banking system. Accordingly, the lion's share of capital allocated in Tier I is with respect to credit risk.

Credit risk management – objectives and policies

Mizrahi Tefahot Group has a conservative, stable credit risk profile thanks, *inter alia*, to the composition of its credit portfolio, which is oriented more towards retail and mortgage operations, which account for more than 75% of credit activity at the Bank Group.

As noted above, in April 2021, the Bank's Board of Directors approved a new five-year strategic plan for 2021-2025. The Bank's strategic plan has material effect on the nature of credit operations, risk level and business focus on various segments. The credit risks management policy seeks to balance the desire to minimize risks in as much as possible against Bank objectives to maximize profit by extending credit to clients. This is done taking into account affecting factors, such as: the regulatory environmental, market conditions, overall economic conditions, product type and behavior of competing banks.

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 risks 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 Bank's Board of Directors annually approves the Bank's credit policy and reviews the need to revise this policy throughout the year, in view of development in the business environment in which the Bank and its clients operate. The credit policies includes other policy documents which 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; policy on client trading activity in derivatives and securities, which stipulates the principles for management and monitoring of Bank clients with activity involving derivatives and securities; collateral policy, which stipulates the principles required for management of client collateral, safety factors required by transaction type and risk factors; and the environmental risks policy.

Concentration – credit risk consists of multiple layers and requires various entities at the Bank to monitor and take action so as to allow the Bank to control such risk. Therefore, the Bank has specified different quantitative limits for activities involving main risk factors.

Business model

The Bank manages its credit operations in multiple segments, primarily: mortgages, business banking, commercial banking, households and small businesses. These segments differ by client attributes, credit types and credit volumes requested, and by the organizational unit which handles each of these segments. Credit provided to these segments includes business credit, including credit for foreign trade operations and exposure due to operations involving derivatives, retail credit and mortgages. For more information about client attributes in each segment, see chapter "Supervisory Operating Segments" in the Report by the Board of Directors and Management. The structure of lines of business with regard to credit is based on two divisions, reporting to the President & CEO, as follows:

- Retail Division – This division consolidates most of the bank credit activity of individual clients (including international private banking in Israel serving foreign residents) and mortgages and the activity of small business clients. Bank branches and business centers operate under this division in seven geographic regions.
- Business Banking Division – This division handles most banking activity of business clients (including from the construction and real estate sector) who are medium-sized and over and international operations overseas.

Approach to credit risk policy and setting limits

The Bank's credit risk management policies 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 reduce the inherent risk. This is done taking into account affecting factors, such as: the regulatory environmental, market conditions, overall economic conditions, product type and behavior of competing banks. The policy principles enable controlled management of the risks 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 credit policies includes other policy documents which 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; policy on client trading activity in derivatives and securities, which stipulates the principles for management and monitoring of Bank clients with activity involving derivatives and securities; collateral policy, which stipulates the principles required for management of client collateral, safety factors required by transaction type and risk factors; and the environmental risks policy for credit.

The credit policies document is discussed and approved by the Senior Credit Committee and then by the Board Credit Committee and by the Board Risks Management Committee, prior to being approved by the Board plenum. The Senior Credit Committee, headed by the Bank President & CEO, is the most senior forum for credit approval at the Bank. The Credit Risk Owner is the Manager, Corporate Division.

The Manager, Risks Control Division (CRO) is responsible for the policy document. The policy document specifies the risk appetite, consisting 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.

Credit risk is also monitored using a range of stress tests, which estimate the potential impact of stress events on the Bank's credit portfolio. This is done, *inter alia*, in order to review the stability of Bank capital to various stress events and as part of the ICAAP process.

Lines of defense for credit risk management

The Bank's risks management setup consists of all management and control layers at the Bank, from the Bank's Board of Directors, management and business units to control functions and Internal Audit. The Risks Control Division (headed by the Bank's CRO) is the overall entity tasked with risks management at the Bank, including credit risk management.

In this regard, and in conformity with Proper Conduct of Banking Business Directive 301, the Bank has specified these three lines of defense:

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

Credit at the Bank involves several key areas, supported by an organizational structure based on divisions and units with specific specializations, with credit extended to clients in various operating segments divided among different divisions (Retail, Business) and within those divisions, among different organizational units. Lines of business management are 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, control over clients capital market exposures and other control functions. A set of procedures ensures the actual implementation of policy guidelines.

- **Second line of defense**

Risks Control

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. Division operations and responsibilities include the following: With regard to credit risk management, the Division operates through multiple independent units:

- Credit risks control – *post-factum* assessment, independent of Bank entities which approve credit, of the borrower quality and quality of the Bank's credit portfolio.
- Analysis – a professional entity tasked with producing an independent opinion for credit to material clients, as part of the credit approval process.

Financial Information and Reporting Division – Chief Accountant

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

Legal Division

Responsible for statutory provisions and legislative changes that impact Bank operations and for providing current legal counsel to Bank units, as well as handling lawsuits brought against the Bank.

- **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 and multi-annual work plan.

As part of the credit granting process, transaction data is reviewed in accordance with criteria specified by the Bank. 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, as noted above, the credit granting process involves the Analysis Department, which is part of the Bank's risks management function. 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 purpose of the credit approval process is to review and assess the risk associated with extending credit to any client, primarily verifying that the requested credit is in fact appropriate for client needs and repayment capacity. This review is conducted both for approval of new credit and for renewal of or changes to existing credit.

The guidelines for the process of review and approval of credit applications, as listed in the Bank's credit policy, refer to **any** case where new credit approval is requested for a client or renewal of existing credit or changes to credit composition, collateral, AOC and covenants. The general process for review and approval of credit applications includes the following steps:

- Review of the credit objective and its alignment with the requested credit type.
- Review of client quality: borrower payment ethic, quality of owners and management. Business scope, sector situation, borrower standing in the sector, profitability, financial robustness and repayment capacity of existing liabilities and for repayment terms of the requested credit.
- Review of external information sources, as needed.
- Review of the quality of proposed and required collateral and alignment with the requested credit type.
- Review of existing exposure to the client and to the borrower group and profitability for the Bank at these levels.
- Specification of business terms and conditions, such as: interest rate, commissions etc. And testing of profitability and returns.
- Summary opinion of the business entity, including summary of credit risk associated with the application and how it is addressed / mitigated with reference to stress scenarios at transaction level and at borrower level.
- Recommendation – approve / reject / set conditions / modify in line with residual credit risk and client profitability.
- Decision.

Credit risk management tools – risk measurement systems

In general, it is Bank policy to manage and to monitor risks using controlled, computer-based systems with minimal dependence on manual processes and with near-real time update frequency.

The Bank constantly uses IT systems for management, detection, control and reduction of credit risk. The systems are used, inter alia, as computer-based control tools to locate changes in rating, flag deviations from credit facilities and collateral differences, and locate development in credit risk arising from various other parameters in development and management of the client account. There are many systems for control of credit management and risks monitoring, which play an important role in credit management, risks management and control processes. These are the key systems used to control credit management and for risks monitoring:

- System for flagging alerts at account level, such as deviation from maximum open credit.
- Central system for mortgage management, used to originate and manage residential mortgages and mortgages, including built-in controls over the process.
- System used to locate and flag clients with credit risk characteristics.
- Problematic debt system (HOVAV), used to locate, flag and classify problematic debt, management of provisions for credit losses and accounting, business and legal write-offs at the Bank, and to locate and monitor accounts on the watch list based on criteria specified in the system.
- Information system used to alert to business information of a negative nature, collected by D&B and by BDI, with regard to business clients of the Bank.
- Real Estate system for control and management of closed-assistance projects in the Construction and Real Estate Sector.
- System for recording and monitoring financial covenants applicable to clients.
- Custom system in the Cebron trading system, used to manage, locate and control exposure with respect to clients active on the capital market.
- IT control systems for international operations, used for management and monitoring of credit exposure at overseas affiliates.
- Criteria model – for business credit rating system used to rate all debt for a single borrower. The client credit rating is determined by a process of determination of the business quality of the borrower, which is then combined with the collateral coverage ratio to provide a rating that reflects the quality of credit extended to the borrower.
- MADHOM (advanced rating, underwriting and management system) for rating the retail credit portfolio for individuals and small businesses. The system has been deployed in branches and incorporated into lending processes, with credit authorizations specified for high-risk clients based on MADHOM ratings, and the system is being used for monitoring the portfolio.
- Credit application system for retail clients (corporations, private-business clients and individual clients) in the Retail Division – supporting credit application processes at Bank branches.
- Model for determination of differential risk premium – This model was developed by the Bank, based on past empirical data, for rating the individual borrower risk for residential mortgages.

Reports to management and to the Board of Directors

The Bank has specified two limit types for most of these areas. One is the Board of Directors' limit and the other – the management limit, based on the following approach:

Board of Directors' limit – The Board of Directors' limit on risk appetite reflects the maximum exposure allowed by the Bank Board of Directors for all risk areas. The Board of Directors' limit may be modified by the Bank Board of Directors, after discussion of the reasons for the required modification and its implications for the Bank's risk profile, based on developments in business directions of the Bank.

Management limits – Management limits are stricter than the Board limits and are designed to serve as a management tool for close monitoring of credit risk at the Bank and allowing exposures to be reduced even prior to exceeding the risk appetite specified by the Board of Directors. Management limits may be modified by the Bank's Senior Credit Committee, after discussion of the reasons for the required modification and its implications for the Bank's risk profile, based on developments in business directions of the Bank. The Bank regularly monitors compliance with risk appetite limits of the Bank. In case of any deviation from the limits specified by management, the relevant division reports, in conformity with reporting rules specified in the policy, to the various entities. The report includes the reasons for the deviation, implications of the deviation and steps taken, or recommended, in order to remedy the deviation.

No deviation from the Board of Directors' limits is allowed, without prior written consent of the Board of Directors or of a Board committee.

Risks Report

As of December 31, 2021

Credit quality of credit exposures (CR1) (NIS in millions)

	December 31, 2021			
	Gross balances ⁽¹⁾		Provisions for credit losses	Net balances
	Impaired or in arrears 90 days or longer	Others		
Debt other than debentures	2,667	362,598	2,104	363,161
Debentures	-	13,755	-	13,755
Off-balance sheet exposure ⁽²⁾	81	104,387	211	104,257
Total	2,748	480,740	2,315	481,173

	December 31, 2020			
			Provisions for credit losses	Net balances
	Impaired or in arrears 90 days or longer	Others		
Debt other than debentures	2,928	327,550	2,435	328,043
Debentures	-	15,453	-	15,453
Off-balance sheet exposure ⁽²⁾	108	97,264	232	97,140
Total	3,036	440,267	2,667	440,636

(1) Gross balances in conformity with reported carrying amounts on the financial statements for on- and off-balance sheet items, creating exposure to credit risk pursuant to Proper Conduct of Banking Business Directive 203.

(2) Off-balance sheet exposures are before credit conversion factors (CCF).

For more information about balances and analysis of changes to impaired debt, see chapter "Credit risk" in the 2021 Report of the Board of Directors and Management.

Additional disclosure with regard to credit quality of credit exposures (CRB)

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 Corporate Division and in the Retail Division. Identified clients are handled by the Special Client Sector of the Corporate Division (first line).

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 regional management and to special headquarter units, to conduct a structured, independent control process. The Chief Accountant forms a second line in the classification and provision setting process; he is responsible, in conformity with Proper Conduct of Banking Business Directive 311, for being the independent factor in charge of classification and setting the provision for credit losses.

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 debts under special supervision, inferior debt, impaired debt or debt in restructuring, as required.

Identification of residential mortgages (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.

Debt in arrears – The state of arrears for debt is determined with reference to the contractual repayment terms. Below are three potential states of arrears:

1. Debt, including principal or interest, not paid by 30 days after the specified payment date, with reference to the original debt terms.
2. Deviation from credit facility approved and reported in checking account.
3. Low turnover – for as long as no amounts were credited to the account to cover the debt within the specified period, even if the debt is within the credit facility.

Debt restructuring and treatment of problematic debt in restructuring – In general, when it is possible to reach agreement on debt repayment with no impact to collateral available to the Bank and without any legal action, the Bank gives preference to reaching agreement on debt repayment.

In order to improve loan collection and to avoid, in as much as possible, debt collection default – the Bank makes attempts to reach arrangements on debt repayment prior to taking legal proceedings or even during and after taking such action, which may include: Deferral of payment date, debt redeployment, reduced interest rates, changes to repayment schedule, changes to debt terms in order to align it with the borrower's financing structure, debt consolidation for the borrower, transfer of debt to other borrowers in a borrower group under joint control, renewed evaluation of financial covenants imposed on the borrower etc.

Debt which has been formally restructured as problematic debt 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 of the debt, designed to ease the burden on the debtor of cash payments in the near term (reduction or deferral of cash payments due from the debtor), or by way of receiving other assets as debt repayment (in whole or in part).

In order to determine whether a debt arrangement executed by the Bank constitutes problematic debt restructuring, the Bank conducts a qualitative evaluation of all terms of the arrangement and the circumstances under which it was made in order to determine whether: (1) the creditor is in financial duress; and (2) the Bank made a concession to the debtor in conjunction with the arrangement.

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 a 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 protected 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 will be unable to collect all amounts due pursuant to contractual terms of the debt contract. In any case, debt in excess of NIS 700 thousand 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 Conduct of Banking Business Directive 314 on problematic debt in residential mortgages.

Debts under NIS 700 thousand in arrears 90 days are assessed on a Group basis and in such case, classified as inferior debt.

Decisions with regard to debt classification are made based, *inter alia*, on assessment of the borrower's financial standing and repayment capacity, any collateral and its status, the financial standing of guarantors, if any and their commitment to support the debt and the borrower's capacity to obtain financing from third parties.

Differences between definitions of arrears and default for accounting and supervisory purposes

- Debt is defined to be "in arrears" for accounting purposes after being 30 days in arrears, and for measurement of capital adequacy, "loans in arrears" are so defined after being 90 days in arrears.
- Debt which has been restructured and classified as accruing would be deemed "impaired debt" for accounting purposes for as long as it has not undergone "subsequent restructuring", while for the purpose of capital adequacy measurement, such debt would not be classified as "loan in arrears" (i.e. would be treated as debt "in good standing").
- Off-balance sheet credit would be classified as problematic debt if realization of the contingent liability is "possible" and if debts recognized due to realization of the contingent liability may be classified as problematic. Conversely, off-balance sheet credit exposures would be classified as exposures in arrears for capital adequacy purposes consistently with classification of on-balance sheet exposures of the same borrower.

Impairment of securities

In each reporting period, the Bank reviews the need to recognize losses with respect to impairment of other-than-temporary nature of securities in the available-for-sale portfolio and in the held-to-maturity portfolio. This review is conducted if indications exist of potential impairment of the value of these securities. For more information about accounting policy for determination if an impairment is of other-than-temporary nature, see Note 1 to the 2021 financial statements.

Provision for credit losses – The Bank has a computer system used to locate and rate debt with existing or potential risk of credit losses. 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 specified in Bank procedures. The system also allows for handling problematic debts 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.

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 different types of guarantees). The 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 evaluation of debts in order to determine the provision and debt handling is consistently applied to all debts 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 evaluation track and the group-based evaluation track – unless in case of restructuring of problematic debt, as noted above.

For more information about individual provision, group-based provision, provision with respect to residential mortgages and provision with respect to off-balance sheet credit, see Note 1 to the 2021 financial statements.

Adoption of US GAAP with regard to provisions for expected credit losses (CECL).

As from January 1, 2022 the Bank would apply the new directives with regard to provisions for expected credit losses.

In December 2020, the Supervisor of Banks issued a circular regarding "Supervisory capital – Effect of implementation of accounting principles with respect to expected credit losses". This circular stipulates transitional provisions to be applicable to the effect of initial adoption of the new rules regarding expected credit losses, so as to reduce unexpected effects of application of these rules on supervisory capital. Furthermore, in February 2021 the Supervisor of Banks issued a circular with regard to "Expected credit losses from financial instruments" which, *inter alia*, eliminated the requirement to calculate a group-based provision at a minimum rate of 0.35% with respect to residential mortgages, eliminated the requirement to calculate a minimum provision by extent of arrears, and added a requirement to deduct from Tier I equity amounts with respect to residential mortgages classified over time as non-accruing loans.

The Bank intends to apply rating-based models (PD/LGD) to estimate the expected credit losses for the residential mortgage portfolio and for retail and small business loans. Moreover, with regard to large business loans, the Bank intends to apply a methodology based on historical loss rates for loans of similar risk attributes.

Bank preparations included, *inter alia*, setting methodologies for calculating the estimated provision for credit losses, model validation, making changes and adaptations to IT systems, revision of controls and preparations for compliance with disclosure requirements in conformity with the new regulations.

the Bank intends to adopt upon initial application certain relief, as allowed by the transition provisions, including recognizing the effect of initial application with regard to the effect on Tier I equity ratio over a 3-year period.

Application of the new directives should result in an increase by NIS 0.3 billion in the provision for credit losses, gross of tax, and overall in a decrease by NIS 0.5 billion in loans to the public, net. Furthermore, application of the new directives should result in deduction of NIS 0.1 billion, net of tax, from Tier I equity upon initial application, due to the requirement to deduct from Tier I equity amounts with respect to residential mortgages classified over time as non-accruing loans.

Risks Report

As of December 31, 2021

Credit risk⁽²⁾ by economic sector

As of December 31, 2021

Below are details of credit risk by economic sector (NIS in millions): Details of credit risk by economic sector

	Total credit risk ⁽¹⁾				Off balance sheet debts ⁽²⁾ and credit risk (other than derivatives) ⁽³⁾				Credit losses ⁽⁴⁾		
	Total	Of which: Credit performance rating ⁽⁴⁾	Credit in good standing other than at performing credit rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Debts	Problematic ⁽⁶⁾	Impaired	Expenses with respect to credit losses	Net write-offs	Balance of provision for credit losses
Borrower activity in Israel											
Public – commercial											
Agriculture, forestry and fishing	1,203	1,179	8	16	1,203	939	16	8	(1)	1	9
Mining and excavation	750	750	–	–	651	158	–	–	(6)	–	4
Industry and production	13,280	12,517	298	465	13,116	7,689	465	296	14	37	188
Of which: Diamonds	1,552	1,390	23	139	1,552	1,031	139	68	8	4	27
Construction and real estate – construction ⁽⁷⁾	44,695	43,288	1,004	403	44,603	19,881	403	235	43	(1)	265
Construction and real estate – real estate operations	7,562	7,271	178	113	7,360	6,228	113	89	(16)	1	43
Electricity and water delivery	7,686	7,637	36	13	7,427	4,655	13	1	11	(4)	35
Commerce	14,146	13,410	380	356	13,993	10,531	356	230	(42)	19	231
Hotels, dining and food services	2,082	1,773	142	167	2,082	1,577	167	72	(44)	8	55
Transport and storage	2,877	2,523	140	214	2,858	1,992	214	174	21	10	99
Information and communications	1,864	1,744	27	93	1,807	1,181	93	16	(2)	(2)	35
Financial services	16,457	16,387	28	42	13,165	8,143	42	23	(35)	(20)	129
Other business services	6,211	5,825	213	173	6,192	4,229	173	115	(12)	(8)	102
Public and community services	3,350	2,963	351	36	3,343	2,582	36	19	(13)	(2)	21
Total commercial	122,163	117,267	2,805	2,091	117,800	69,785	2,091	1,278	(82)	39	1,216
Private individuals – residential mortgages	195,368	193,185	883	1,300	195,368	175,599	1,300	36	(133)	7	803
Private individuals – other	38,707	38,201	306	200	38,617	24,842	200	92	(55)	45	254
Total public – activity in Israel	356,238	348,653	3,994	3,591	351,785	270,226	3,591	1,406	(270)	91	2,273
Banks in Israel	3,690	3,690	–	–	2,588	2,333	–	–	–	–	–
Government of Israel	11,827	11,827	–	–	74	74	–	–	–	–	–
Total activity in Israel	371,755	364,170	3,994	3,591	354,447	272,633	3,591	1,406	(270)	91	2,273
Borrower activity overseas											
Total public – activity overseas	5,869	5,452	373	59	5,431	3,305	59	26	(7)	37	41
Overseas banks	9,081	9,081	–	–	7,286	7,260	–	–	(1)	–	1
Overseas governments	2,438	2,437	–	1	403	403	1	1	–	–	–
Total activity overseas	17,388	16,970	373	60	13,120	10,968	60	27	(8)	37	42
Total	389,143	381,140	4,367	3,651	367,567	283,601	3,651	1,433	(278)	128	2,315

- (1) On- and off-balance sheet credit risk, including with respect to derivatives (NIS in millions): Debts⁽²⁾ – 283,601; debentures – 14,307; securities borrowed or acquired in conjunction with resale agreements – 1332; Assets with respect to derivatives – 3,652; and Credit risk of off-balance-sheet financial instruments as calculated for the purpose of determining per-borrower indebtedness limits – 86,251.
- (2) 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.
- (3) Includes with respect to off-balance sheet credit instruments (included on balance sheet under Other Liabilities).
- (4) Credit risk whose credit rating as of the report date matches the credit rating for new credit performance, in conformity with Bank policies.
- (5) Credit in good standing at a low rating, for which Bank policy includes specific restrictions on extending such credit.
- (6) On- and off-balance sheet credit risk which is impaired, inferior or under special supervision, including with respect to residential mortgages for which a provision was made by extent of arrears, and residential mortgages for which no provision was made by extent of arrears and which are in arrears of 90 days or longer.
- (7) Includes on-balance sheet credit risk amounting to NIS 1,699 million and off-balance sheet credit risk amounting to NIS 2,096 million, provided to certain purchase groups in the process of construction and includes off-balance sheet credit risk amounting to NIS 5,699 million for which insurance has been acquired to cover the portfolio of housing bonds and performance guarantees pursuant to the Sale Law from international re-insurers.

Credit Risk(2) by Economic Sector – Consolidated – continued

As of December 31, 2020

Details of credit risk by economic sector – Continued (NIS in millions):

	Total credit risk ⁽¹⁾				Off balance sheet debts ⁽²⁾ and credit risk (other than derivatives) ⁽³⁾						
	Of which:				Credit losses ⁽⁴⁾						
	Total ¹	Credit performance ⁽⁴⁾⁽⁸⁾	Credit in good standing other than at performing credit rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Debts	Problematic ⁽⁶⁾	Impaired	Expenses with respect to credit losses	Net accounting write-offs	Balance of provision for credit losses
Borrower activity in Israel											
Public – commercial											
Agriculture, forestry and fishing	1,168	1,139	20	9	1,168	905	9	6	2	–	10
Mining and excavation	698	652	6	40	597	345	40	–	6	–	10
Industry and production ⁽⁶⁾	13,593	12,724	317	552	13,324	7,795	552	389	73	34	208
Of which: Diamonds	1,528	1,379	18	131	1,527	1,013	131	91	5	3	23
Construction and real estate – construction ⁽⁷⁾	39,023	36,618	2,064	341	38,957	16,451	341	214	57	21	250
Construction and real estate – real estate operations ⁽⁸⁾	6,957	6,380	480	97	6,753	5,737	97	85	(10)	(18)	42
Electricity and water delivery ⁽⁶⁾	5,661	5,616	34	11	5,161	3,211	11	–	7	–	18
Commerce	15,033	13,643	901	489	14,791	11,122	489	387	117	81	245
Hotels, dining and food services ⁽⁶⁾	2,073	1,712	214	147	2,073	1,650	147	54	82	9	104
Transport and storage	2,533	2,207	82	244	2,489	1,497	244	104	70	7	92
Information and communications	1,966	1,782	109	75	1,870	1,169	75	10	34	10	36
Financial services	18,780	18,528	63	189	15,902	7,812	189	150	67	2	148
Other business services	5,900	5,489	248	163	5,892	3,969	163	118	69	35	107
Public and community services	3,429	3,093	304	32	3,421	2,721	32	18	18	4	30
Total commercial	116,814	109,583	4,842	2,389	112,398	64,384	2,389	1,535	592	185	1,300
Private individuals – residential mortgages	172,876	170,859	732	1,285	172,876	156,324	1,285	97	279	11	941
Private individuals – other	37,632	37,116	311	205	37,515	24,033	205	96	135	77	339
Total public – activity in Israel	327,322	317,558	5,885	3,879	322,789	244,741	3,879	1,728	1,006	273	2,580
Banks in Israel	2,179	2,179	–	–	556	512	–	–	–	–	–
Government of Israel	14,709	14,709	–	–	60	60	–	–	–	–	–
Total activity in Israel	344,210	334,446	5,885	3,879	323,405	245,313	3,879	1,728	1,006	273	2,580
Borrower activity overseas											
Total public – activity overseas ⁽⁶⁾	5,158	4,659	360	139	4,689	3,217	139	80	43	–	85
Overseas banks	13,723	13,723	–	–	11,843	11,755	–	–	1	–	2
Overseas governments	1,004	1,004	–	–	553	553	–	–	–	–	–
Total activity overseas	19,885	19,386	360	139	17,085	15,525	139	80	44	–	87
Total	364,095	353,832	6,245	4,018	340,490	260,838	4,018	1,808	1,050	273	2,667

- (1) On- and off-balance sheet credit risk, including with respect to derivatives (NIS in millions): Debts⁽²⁾ – 260,838; debentures – 16,864; securities borrowed or acquired in conjunction with resale agreements – 200; Assets with respect to derivatives – 4,543; and Credit risk of off-balance-sheet financial instruments as calculated for the purpose of determining per-borrower indebtedness limits – 81,650.
- (2) 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.
- (3) Includes with respect to off-balance sheet credit instruments (included on balance sheet under Other Liabilities).
- (4) Credit risk whose credit rating as of the report date matches the credit rating for new credit performance, in conformity with Bank policies.
- (5) Credit in good standing at a low rating, for which Bank policy includes specific restrictions on extending such credit.
- (6) On- and off-balance sheet credit risk which is impaired, inferior or under special supervision, including with respect to residential mortgages for which a provision was made by extent of arrears, and residential mortgages for which no provision was made by extent of arrears and which are in arrears of 90 days or longer.
- (7) Includes on-balance sheet credit risk amounting to NIS 2,068 million and off-balance sheet credit risk amounting to NIS 2,213 million, provided to certain purchase groups in the process of construction and includes off-balance sheet credit risk amounting to NIS 5,521 million for which insurance has been acquired to cover the portfolio of housing bonds and performance guarantees pursuant to the Sale Law from international re-insurers.
- (8) As from September 30, 2020 the Bank consolidates the financial statements of Union Bank. The consolidated statement of profit and loss for 2020 includes the financial results of Union Bank.

Risks Report

As of December 31, 2021

The following are credit exposures by remaining term to maturity (NIS in millions):

	As of December 31, 2021				
	Up to 1 year	1-5 years	Over 5 years	Without maturity	Total
On-balance sheet credit exposure:					
Commercial	39,037	24,500	8,423	1,186	73,146
Private individuals – residential mortgages	18,202	52,819	158,709	–	229,730
Private individuals – other	9,866	12,072	5,547	661	28,146
Assets with respect to derivative instruments ⁽¹⁾	2,974	322	35	–	3,331
Total public	70,079	89,713	172,714	1,847	334,353
Banks and governments	92,819	10,790	7,522	664	111,795
Total credit exposure on balance sheet	162,898	100,503	180,236	2,511	446,148
Of which: Debentures	1,632	8,049	6,043	–	15,724
Total off-balance sheet credit exposure	80,565	19,800	5,485	–	105,850
As of December 31, 2020					
On-balance sheet credit exposure:					
Commercial	40,308	21,477	3,801	448	66,034
Private individuals – residential mortgages	16,652	48,579	144,203	–	209,434
Private individuals – other	7,801	11,144	3,708	339	22,992
Assets with respect to derivative instruments ⁽¹⁾	3,604	578	141	–	4,323
Total public	68,365	81,778	151,853	787	302,783
Banks and governments	29,967	3,712	4,508	–	38,187
Total credit exposure on balance sheet	98,332	85,490	156,361	787	340,970
Of which: Debentures	4,816	6,624	6,404	143	17,987
Total off-balance sheet credit exposure	73,654	18,266	5,452	–	97,372

(1) Assets with respect to derivative instruments include derivative instruments of banks and governments.

Risks Report

As of December 31, 2021

Exposure to Foreign Countries – Consolidated⁽¹⁾

Part A – Information regarding 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 (NIS in millions):

Country	Balance sheet exposure ⁽²⁾							Off-balance sheet exposure ⁽²⁾⁽³⁾⁽⁵⁾					
	Cross-border balance sheet exposure			Balance sheet exposure of Bank affiliates in foreign country to local residents				Total balance sheet exposure	On-balance sheet problematic credit risk	Impaired debts	Total off-balance sheet exposure	Of which:	
	To governments ⁽⁴⁾	To banks	To others	Balance sheet exposure before deduction of local liabilities	Deduction with respect to local liabilities	Net balance sheet exposure after deduction of local liabilities	Maturing in under 1 year					Maturing in over 1 year	
													sheet problematic credit risk
	December 31, 2021												
USA	8,358	824	2,164	467	4	463	11,809	21	1	742	–	6,971	4,375
France	–	98	1,371	–	–	–	1,469	30	–	1,952	–	113	1,356
UK	–	734	771	1,945	294	1,651	3,156	21	–	1,086	–	384	1,121
Germany	–	41	39	–	–	–	80	–	–	2,434	–	22	58
Other	–	289	2,066	–	–	–	2,355	21	5	2,101	–	539	1,816
Total exposure to foreign countries	8,358	1,986	6,411	2,412	298	2,114	18,869	93	6	8,315	–	8,029	8,726
Of which: Total exposure to LDC countries	–	20	528	–	–	–	548	4	–	54	–	85	463
Of which: To Greece, Portugal, Spain and Italy	–	1	48	–	–	–	49	–	–	6	–	2	47
	December 31, 2020												
USA	10,626	358	1,860	352	352	–	12,844	13	–	581	–	10,638	2,206
France	–	116	1,470	–	–	–	1,586	20	–	2,255	–	221	1,365
UK	–	749	775	1,513	572	941	2,465	19	–	764	–	396	1,128
Germany	–	44	117	–	–	–	161	–	–	2,844	–	52	109
Other	71	694	2,552	–	–	–	3,317	56	–	1,845	–	1,245	2,072
Total exposure to foreign countries	10,697	1,961	6,774	1,865	924	941	20,373	108	–	8,289	–	12,552	6,880
Of which: Total exposure to LDC countries	10	17	489	–	–	–	516	37	–	142	–	79	437
Of which: To Greece, Portugal, Spain and Italy	–	2	42	–	–	–	44	–	–	39	–	6	38

- (1) Based on final risk, after effect of guarantees, liquid collateral and credit derivatives.
- (2) On- and off-balance sheet credit risk is stated before impact of provision for credit losses, and before impact of deductible collateral with respect to indebtedness of borrower and of borrower group.
- (3) Credit risk of off-balance-sheet financial instruments as calculated for the purpose of determining per-borrower indebtedness limits, in conformity with Proper Conduct of Banking Business Directive 313.
- (4) Governments, official institutions and central banks.
- (5) The balance of off-balance sheet exposure includes NIS 5,777 million with respect to acquiring insurance from international reinsurers for the portfolio of housing bonds for borrowers in the real estate sector in Israel. (As of December 31, 2020: NIS 5,653 million). For more information about revision of the Credit Conversion Factor (CCF) applied to guarantees to secure investments by apartment buyers pursuant to the Sale Act. See Note 25 to the financial statements.

Part B – Information regarding countries for which total exposure to each country is between 0.75%-1% of total consolidated assets or between 15%-20% of capital, whichever is lower (NIS in millions):

As of December 31, 2021 and December 31, 2020, there were no countries for which total exposure to each country is between 0.75%-1% of total consolidated assets, or between 15%-20% of equity.

Part C – Information regarding balance sheet exposure to foreign countries facing liquidity issues

As of December 31, 2021 and December 31, 2020, the Bank had no on-balance sheet exposure to foreign countries facing liquidity issues nor to foreign countries undergoing re-structuring.

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.

The row "Total exposure to LDC countries" includes total exposure to countries classified as "Less Developed Countries" (LDC) in Proper Conduct of Bank Businesses Directive 315 "Supplementary provision for doubtful debts".

Balance sheet exposure to a foreign country includes cross-border balance sheet exposure and balance sheet exposure of affiliates of the banking corporation in foreign country to local residents. Cross-border balance sheet exposure includes balance sheet exposure of Israeli offices of the banking corporation to residents of the foreign country and balance sheet exposure of overseas affiliates of the banking corporation to non-residents of the country where the affiliate is located.

Balance sheet exposure of affiliates of the banking corporation in a foreign country to local residents includes balance sheet exposure of affiliates of the banking corporation in that foreign country to local residents, less liabilities of these affiliates (deducted up to the exposure amount).

For more information about movement in balance of the provision for credit losses, aging of credit exposures in arrears and details of credit exposures which have been re-structured, see Note 30 to the 2021 financial statements.

Credit risk mitigation (CRC)

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.

Offset of assets and liabilities – The Bank applies the rules specified in the Supervisor of Banks' circular dated December 12, 2012.

In conformity with the directives, a banking corporation should offset assets and liabilities arising from the same counter-party and present their net balance on the balance sheet, when all of the following conditions are fulfilled:

- The banking corporation has an enforceable legal right to offset assets against liabilities with regard to said liabilities
- The banking corporation intends to repay the liabilities and realize the assets on a net basis or concurrently;
- Both the banking corporation and the counter-party owe each other amounts which may be determined.

According to the directives, a banking corporation should offset assets and liabilities with two different counter-parties and present the net amount on the balance sheet when all of the aforementioned conditions are fulfilled, and provided that the three parties have an agreement which clearly stipulates the banking corporation's set-off rights with regard to those liabilities.

It was further stipulated that a banking corporation should offset deposits whose repayment to the depositor is contingent on the extent of collection of borrowing against those deposits, when the banking corporation has no risk of credit losses.

Currently, it is Bank policy to present exposures with transactions on a gross basis, except for deposits whose repayment to the depositor is contingent on the extent of collection of borrowing, as described above. Accordingly, designated deposits for which repayment to the depositor is contingent upon the collection of the loan (when the Bank Group is not at risk of credit loss) were set off against the loans issued out of these deposits. The interest margins from this activity are presented in the statement of profit and loss under "commissions".

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. In general, clients are required to provide collateral types which match, to the extent possible, the credit extended based on parameters such as: Match with the transaction, amount and credit term.

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 are also other collateral types, 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 Senior Credit Committee and 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.

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 through 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.

Debts 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. In recent years, the Bank has established the business, legal and operational infrastructure for selling of credit risk.

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. The Bank has specified guidelines for 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.

Residential mortgages

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's 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. This credit insurance process is a key risk mitigator.

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 self-equity payment forms a safety cushion in case the property is realized during a down-turn in the real estate market. Furthermore, the rate of the borrower's participation is a further indication of the borrower's financial robustness.

Risks Report

As of December 31, 2021

Credit risk mitigation methods (CR3) (NIS in millions)

	As of December 31, 2021								
	Unsecured			Secured					
	Total on- balance sheet balance ⁽¹⁾	Total on- balance sheet balance ⁽¹⁾	Of which: Secured amount ⁽²⁾	Of which: By collateral		Of which: By financial guarantees		Of which: By credit derivatives	
Balance sheet balance				Of which: Secured amount	Balance sheet balance	Of which: Secured amount	Balance sheet balance	Of which: Secured amount	
Debt other than debentures	329,532	35,420	10,157	27,452	8,281	7,968	1,876	-	-
Debentures	13,755	-	-	-	-	-	-	-	-
Total	343,287	35,420	10,157	27,452	8,281	7,968	1,876	-	-
Of which: Accruing interest revenues, in arrears 90 days or longer	2,034	346	154	19	15	327	138	-	-
	As of December 31, 2020								
Debt other than debentures	293,598	34,445	9,945	26,126	8,198	8,319	1,747	-	-
Debentures	15,453	-	-	-	-	-	-	-	-
Total	309,051	34,445	9,945	26,126	8,198	8,319	1,747	-	-
Of which: Accruing interest revenues, in arrears 90 days or longer	2,136	464	94	226	74	238	20	-	-

(1) Balance sheet balance in conformity with reported carrying amounts on the financial statements, after provisions for credit losses.

(2) Balance sheet balance of part of the debt amount secured by collateral, guarantee or credit derivative, after accounting for safety factors.

Credit risk – standard approach

Calculation of credit risk using the standard approach is based on external credit ratings assigned by External Credit Assessment Institutions (ECAI). For the calculation, the Bank uses S&P rating data.

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 and public sector entities 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 agency S&P used by the Bank:

S&P
AAA to AA-
A+ to A-
BBB+ to BBB-
BB+ to BB-
B+ to B-
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.

Risks Report

As of December 31, 2021

Standard approach – exposure to credit risk and effects of credit risk mitigation (CR4)

Below is the composition of net credit exposure by risk mitigation type (NIS in millions)⁽¹⁾:

	As of December 31, 2021					
	Exposures before conversion factors and collateral deduction		Exposures after conversion factors and collateral deduction		Risk assets and density	
	On-balance sheet amount ⁽²⁾	Off-balance sheet amount ⁽²⁾	On-balance sheet amount ⁽³⁾	Off-balance sheet amount ⁽³⁾	Risk assets	Risk asset density
Sovereigns, central banks and national monetary authority	104,916	264	105,672	257	99	0%
Public sector entities (PSE) other than central Government	2,513	798	2,732	200	556	19%
Banks (including Multi-party Development Banks)	4,292	1,977	4,559	476	1,318	26%
Securities companies	550	1,836	415	348	153	20%
Corporations	44,677	56,609	43,849	21,852	60,353	92%
Retail exposure to individuals	25,018	13,998	23,507	1,967	19,102	75%
Loans to small businesses	14,114	5,675	11,488	1,101	9,442	75%
Secured by residential property	174,084	19,744	173,762	1,542	92,416	53%
Secured by commercial real estate	6,149	3,356	5,540	482	6,022	100%
Loans in arrears	2,394	81	2,394	16	3,055	127%
Other assets	6,068	109	6,068	54	4,011	66%
Total	384,775	104,447	379,986	28,295	196,527	48%

	As of December 31, 2020					
	On-balance sheet amount ⁽²⁾	Off-balance sheet amount ⁽²⁾	On-balance sheet amount ⁽³⁾	Off-balance sheet amount ⁽³⁾	Risk assets	Risk asset density
Sovereigns, central banks and national monetary authority	96,615	–	97,210	–	135	0%
Public sector entities (PSE) other than central Government	1,154	1,360	1,480	425	339	18%
Banks (including Multi-party Development Banks)	3,832	2,687	3,882	749	1,257	27%
Securities companies	503	1,711	376	326	139	20%
Corporations	40,913	52,784	37,795	20,051	53,214	92%
Retail exposure to individuals	23,794	13,514	22,311	1,936	18,186	75%
Loans to small businesses	14,812	5,262	12,320	1,013	10,000	75%
Secured by residential property	155,071	16,531	154,674	1,318	82,105	53%
Secured by commercial real estate	6,442	3,355	5,987	652	6,639	100%
Loans in arrears	2,456	108	2,440	22	3,065	125%
Other assets	5,982	46	5,982	23	3,703	62%
Total	351,574	97,358	344,457	26,515	178,782	48%

- (1) Balances in this disclosure include on- and off-balance sheet debt balances that reflect credit risk, excluding deferred tax amounts and investments in financial institutions below the discount thresholds (subject to 250% risk weighting), exposures with respect to counterparty credit risk and securitization exposures.
- (2) The balances reflect the supervisory exposure amounts, net of provisions and write-offs, before credit conversion factors and before credit risk mitigators.
- (3) The balances reflect the supervisory exposure amounts, net of provisions and write-offs, after credit conversion factors and after credit risk mitigators.

Risks Report

As of December 31, 2021

Standard approach – exposures by asset type and risk weighting (CRS)⁽¹⁾⁽²⁾ (NIS in millions)

Asset type / risk weighting	As of December 31, 2021									
	0%	20%	35%	50%	60%	75%	100%	150%	Other	Total credit exposures (after conversion factors and collateral deduction)
Sovereigns, central banks and national monetary authority	105,765	82	–	–	–	–	82	–	–	105,929
Public sector entities (PSE) other than central Government	168	2,756	–	6	–	–	2	–	–	2,932
Banks (including Multi-party Development Banks)	–	4,262	–	614	–	–	159	–	–	5,035
Securities companies	–	763	–	–	–	–	–	–	–	763
Corporations	–	6,426	–	420	–	–	58,855	–	–	65,701
Retail exposure to individuals	–	–	–	–	–	25,474	–	–	–	25,474
Loans to small businesses	–	–	–	–	–	12,584	5	–	–	12,589
Secured by residential property	–	–	57,437	42,318	39,247	34,787	1,515	–	–	175,304
Secured by commercial real estate	–	–	–	–	–	–	6,022	–	–	6,022
Loans in arrears	–	–	–	–	–	–	1,120	1,290	–	2,410
Other assets	2,314	–	–	–	–	–	3,492	312	4	6,122
Of which: with respect to shares	–	–	–	–	–	–	492	194	–	686
Total	108,247	14,289	57,437	43,358	39,247	72,845	71,252	1,602	4	408,281

Asset type / risk weighting	As of December 31, 2020									
	0%	20%	35%	50%	60%	75%	100%	150%	Other	Total credit exposures (after conversion factors and collateral deduction)
Sovereigns, central banks and national monetary authority	97,005	87	–	–	–	–	118	–	–	97,210
Public sector entities (PSE) other than central Government	252	1,627	–	25	–	–	1	–	–	1,905
Banks (including Multi-party Development Banks)	–	3,801	–	666	–	–	164	–	–	4,631
Securities companies	–	702	–	–	–	–	–	–	–	702
Corporations	–	5,510	–	466	–	–	51,870	–	–	57,846
Retail exposure to individuals	–	–	–	–	–	24,246	1	–	–	24,247
Loans to small businesses	–	–	–	–	–	13,329	4	–	–	13,333
Secured by residential property	–	–	55,220	38,010	23,996	37,561	1,205	–	–	155,992
Secured by commercial real estate	–	–	–	–	–	–	6,639	–	–	6,639
Loans in arrears	–	–	–	–	–	–	1,254	1,208	–	2,462
Other assets	2,414	–	–	–	–	–	3,467	119	5	6,005
Of which: with respect to shares	–	–	–	–	–	–	399	96	–	495
Total	99,671	11,727	55,220	39,167	23,996	75,136	64,723	1,327	5	370,972

(1) Balances in this disclosure include on- and off-balance sheet debt balances that reflect credit risk, excluding deferred tax amounts and investments in financial institutions below the discount thresholds (subject to 250% risk weighting), exposures with respect to counter-party credit risk and securitization exposures.

(2) The balances reflect the supervisory exposure amounts, net of provisions and write-offs, before credit conversion factors and before credit risk mitigators.

Additional information about credit risk

Risks in the residential mortgage portfolio

Residential mortgages account for a significant share of all credit risk at the Bank, but this segment is still highly diversified and has a Low-Medium risk level, due to extensive diversification of borrowers from various economic sectors, relatively low LTV ratios, extensive geographic diversification of pledged assets and use of various risk mitigators, including property and life insurance, to mitigate credit risk in this segment. The Bank's policies with regard to mortgages are based on a specific approach, limiting specific risk for each loan by reviewing various risk attributes. These attributes include: review of borrower quality and their capacity to make current repayments even under scenarios involving changes to interest rates, ratio of repayment to regular household income, review of transaction data and LTV ratio. The Bank sometimes requires reinforcements, such as guarantors for the loan, proven repayment capacity based other than on current borrower income and other diverse reinforcements.

The risk level in the residential mortgage portfolio decreased in the second quarter of 2021 to its pre-crisis level of Low risk, in view of the significantly lower volume of loans subject to deferral and with most of the clients subject to deferral resuming regular payments and the low, steady readings of key risk benchmarks. The Bank continued to monitor this activity and risk aspects with regard to the following: The outstanding deferral amount and the partial repayment rates, deferral period, borrower profile, LTV ratio and so forth. The Bank also monitors development of borrower behavior after expiration of the repayment deferral. For more information about loans subject to repayment deferral and loans extended from State-guaranteed funds, see chapter "Risks overview – Credit risk" in the Report of the Board of Directors and Management.

As part of its credit risk policies, the Bank has set various restrictions on residential mortgage 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. These limits, in total, form the Bank's risk appetite for mortgages, which is defined using multiple risk benchmarks, which apply to credit risk and concentration risk aspects at regular performance level. These benchmarks include: LTV ratio, property location (geographic risk), credit quality benchmarks, 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 acts regularly to control and manage the risk associated with residential mortgages, for which the Retail Division, the Risks Control Division and other Bank entities are responsible. This activity also includes portfolio analysis and monitoring by key risk factors and estimation of portfolio risk using an advanced model for rating residential mortgages, including rating of each loan and calculation of probability of default and potential loss given default, as well as conducting various stress scenarios to review the effect of changes to macro-economic factors on the portfolio risk level, primarily the impact of change in unemployment, change in housing prices and change in interest rates.

Constant monitoring of the risk profile of the mortgage portfolio and its development over time, in view of the specified risk appetite, reveals that leading risk benchmarks remain stable and relatively low. These benchmarks include: LTV ratios, repayment ratio, rate of obligation in default and, in particular, the rate of arrears for new loans (one year since origination), which is testimony to the high quality of underwriting at the Bank. Note that the average LTV ratio for the Bank's mortgage portfolio (at end of December 2021) was 53.4% (reflecting the LTV ratio upon loan origination – see more details below). The Bank also estimates the current and "actual" LTV ratio for the portfolio, based on changes to property values, based on estimates by the Central Bureau of Statistics against the outstanding portfolio balances. These ratios are lower than the original LTV ratio, due to decrease in loan value due to current repayments and the cumulative increase in housing prices, reflected by mortgages in the portfolio. These data support the Bank's estimate that the potential for loss due to the Bank's mortgage portfolio, even under a stress scenario involving material decline in housing prices, is low. In addition, the Bank regularly reviews its mortgage portfolio under stress conditions, including under significant change in macro-economic conditions, using multiple methodologies. The outcome of stress testing indicates that portfolio risk is low and that the potential impact of a severe stress event in the market is low.

Means for risk management in residential mortgages include:

- Underwriting process – residential mortgages are reviewed and approved by a process which includes the following:
 - Criteria specified in Bank procedures, reflecting the Bank's cumulative interest in residential mortgages. Loan approval criteria include: Nature of the transaction, borrower quality and repayment capacity, property collateral offered, including estimated credit risk in various regions of the country, and the guarantors.
 - Credit authorization – Specification of the party authorized to approve a loan is based on data in the credit application and the risk associated there with.
 - Model for determination of differential risk premium – This model was developed by the Bank, based on past empirical data, for rating the individual borrower risk.
 - Built-in controls in loan origination system – These controls include: Ensure information completeness; Control over transactions based on authorizations; Work flow process.
- Mortgage-related training – The Bank's Training Center delivers courses for training, development and improvement of all those involved in provision of residential mortgages.

Risks Report

As of December 31, 2021

- Professional conferences – 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 residential 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 applies multiple control types, including regular internal controls at branches, regions and headquarters.

Below are details of the provision for credit losses with respect to residential mortgages for which a minimum provision for credit losses was made by extent of arrears, in accordance with appendix to Proper Conduct of Banking Business Directive 314, as of December 31, 2021 (NIS in millions):

	In arrears 90 days or longer						Extent of arrears	
							Balance with respect to refinanced loans in arrears ⁽²⁾	Total
	In arrears 30 to 89 days ⁽¹⁾	90 days to 6 months	6-15 months	15-33 months	Over 33 months	Total over 90 days		
Amount in arrears	7	21	15	16	189	241	32	280
Of which: Balance of provision for interest ⁽³⁾	–	–	–	1	113	114	6	120
Recorded debt balance	519	776	212	84	133	1,205	59	1,783
Balance of provision for credit losses ⁽⁴⁾	–	–	34	37	99	170	29	199
Debt balance, net	519	776	178	47	34	1,035	30	1,584

- (1) In conformity with Public Reporting Directives, excludes the balance of residential mortgages in arrears up to 2 months.
 (2) 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.
 (3) With respect to interest on amounts in arrears.
 (4) Excludes balance of provision for interest.

Credit risk in construction and real estate economic sector

Credit operations in this area are managed by the Corporate Division and are a significant component of the credit operations in this division, as well as on a smaller scale by the Retail Division. Construction financing in this industry is focused mainly on residential construction in areas with strong demand in central Israel at 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). Loans are issued for financed projects only by business centers and 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, Construction, purchase groups, urban renewal, National Zoning Plan 38 etc.

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, credit operation at branches specialized in real estate. The unit also provides control and review with regard to rental real estate and provides control with regard to purchase groups.

In the construction and real estate sector, a computer system for control and management of closed-assistance projects in this sector. The system is designed for assistance and monitoring of closed projects, releasing funds, improving control over the real estate portfolio and project maintenance.

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.

Credit risk data for the construction and real estate clients sector as of December 31, 2021 show that 49% of the on-balance sheet credit risk and 69.2% of the off-balance sheet credit risk is associated with closed assistance to real estate projects, mostly for residential construction in areas of strong demand in Central Israel, Haifa, Be'er Sheva and Jerusalem. Most of the off-balance sheet credit is due to guarantees provided to home buyers pursuant to the Sale Act.

Most of the credit risk in the construction and real estate sector is backed by real estate fully pledged to secure loan repayment. Note that for credit not secured by real estate collateral, there is other collateral in place, such as: deposits, securities etc.

Risks Report

As of December 31, 2021

In 2021, the Bank acted to expand its loan operations in the construction and real estate sector, as part of the trend of growing demand in this sector reflected, *inter alia*, in increased transaction volume. Consequently, the total credit exposure in the construction and real estate sectors increased by 13.8% in 2021.

As described above, continued growth in lending to the real estate sector, even in view of competition, is achieved while adhering to appropriate underwriting procedures and credit spreads to reflect the risk and is regularly monitored. The risk level in this sector is also taken into account in the quarterly review process of the group-based provision.

In the second half of 2021, the Bank reviewed the calculation of the group-based provision for credit losses in this sector, and adjusted this provision so as to account, *inter alia*, for growth in the loan portfolio and the underwriting conditions.

Below is information about credit risk in the construction and real estate economic sector in Israel, by real estate collateral type (NIS in millions):

December 31, 2021								
Credit risk to the public ⁽¹⁾								
				Credit risk	Total problematic credit risk	Balance of provision for credit losses		
On balance sheet ⁽²⁾		Off balance sheet ⁽³⁾		Including	Impaired	Other problematic ⁽⁴⁾	Balance sheet credit risk	Off-balance sheet credit risk
		Guarantees to home buyers ⁽⁵⁾	Facilities and other commitments					
Secured by real estate:								
Housing	13,447	5,517	13,652	32,616	86	70	115	57
Commercial and industrial	6,982	83	2,139	9,204	118	22	40	7
Total secured by real estate	20,429	5,600	15,791	41,820	204	92	155	64
Not secured by real estate	5,677	219	4,249	10,145	127	94	52	33
Total for construction and real estate economic sector in Israel	26,106	5,819	20,040	51,965	331	186	207	97
Of which: Designated for project assistance	12,788	3,863	14,034	30,685	48	63	122	59
December 31, 2020								
Secured by real estate:								
Housing	12,084	17,254	29,338	53	33	96	52	
Commercial and industrial	6,715	1,762	8,477	92	4	56	7	
Total secured by real estate	18,799	19,016	37,815	145	37	152	59	
Not secured by real estate	3,654	4,511	8,165	154	102	43	38	
Total for construction and real estate economic sector in Israel	22,453	23,527	45,980	299	139	195	97	
Of which: Designated for project assistance	10,093	16,024	26,117	27	32	91	55	

- (1) On- and off-balance sheet credit risk, problematic credit risk and impaired loans to the public are stated before impact of provision for credit losses, and before impact of deductible collateral with respect to indebtedness of borrower.
- (2) Loans to the public, investment in debentures by the public, other debt by the public and other assets with respect to derivatives against the public.
- (3) Credit risk of off-balance-sheet financial instruments as calculated for the purpose of determining per-borrower indebtedness limits.
- (4) On- and off-balance sheet credit risk with respect to the public, which is inferior or under special supervision.
- (5) Off-balance sheet credit risk due to housing bonds, which are mostly backed by insurance purchased from international reinsurers.

Risks Report

As of December 31, 2021

Below is information about credit risk in the construction and real estate economic sector in Israel, by asset status (NIS in millions):

	December 31,					
	2021			2020		
	Credit risk ⁽¹⁾			Credit risk ⁽¹⁾		
	On balance sheet	Off balance sheet	Including	On balance sheet	Off balance sheet	Including
Secured by real estate						
Real estate yet to be completely constructed:						
Raw land	8,795	1,276	10,071	5,500	916	6,416
Real estate under construction	5,690	18,855	24,545	7,299	16,909	24,208
Real estate completely constructed	5,945	1,261	7,206	6,000	1,191	7,191
Total credit secured by real estate	20,430	21,392	41,822	18,799	19,016	37,815
Not secured by real estate	5,677	4,468	10,145	3,654	4,511	8,165
Total credit risk for construction and real estate	26,107	25,860	51,967	22,453	23,527	45,980

(1) On- and off-balance sheet credit risk, problematic credit risk and impaired loans to the public are stated before impact of provision for credit losses, and before impact of deductible collateral with respect to indebtedness of borrower.

Credit risk to individuals

The individual client segment is highly diversified – by number of clients and by geographic location. Most clients in this segment are salaried employees with an individual account or joint household account. A recession in non-banking operations is a major risk factor for household activity and higher unemployment may increase the number of clients who face difficulties. Credit policies and work procedures with regard to extending credit, including to individual clients, include directives and guidelines with regard to credit underwriting and adapting credit to client needs and repayment capacity: Review of credit objective, requested LTV, loan term, analysis of client's repayment capacity and repayment sources, for all of their indebtedness. This includes review of various economic parameters of the client based, *inter alia*, on the client's regular income, pledged or unencumbered savings, knowledge of the client and past experience working with the client. There are also custom procedures and work processes and controls with regard to proactive offer loans to individual clients, in conformity with Bank of Israel directives.

The Bank regularly monitors the risk level in the credit portfolio for individuals using, *inter alia*, the internal credit rating model for individual clients, as well as through continuous monitoring and analysis of expenses with respect credit losses.

Capital market

Credit risk in the capital market is the risk of the borrower failing to meet their obligations towards the Bank, including the obligation to cover losses due to capital market activity conducted through the Bank.

Debt may arise from failure or loss from transactions made in the client's trading activity on the capital market, through the Bank.

Major exposures to trading activity on the capital market include exposure with respect to credit transactions, short selling and exposure with respect to transactions involving derivatives through the Bank.

There are three major risk factors associated with client activity on the capital market through the Bank:

- Credit risk for the Bank, arising from client transactions or from the client portfolio composition, which may result in exposures which the client is unable to cover.
- Concentration risk, arising from over exposure to a borrower / borrower group or to certain types of activities.
- Operational risk which, should they materialize, may impact credit risk.

Exposure frameworks for capital market trading activity are approved in conformity with the credit authorization ranking at the Bank.

The Bank provides its clients with a range of facilities for trading activity on the capital market (credit against securities, facility for short selling securities, facility for exposure to derivatives). These exposures are backed by monetary collateral and/or by securities.

Clients engaged in speculative trading – The Bank allows exposure by clients engaged in speculative trading, only if they are experienced and have proven specialization in this area, based on controlled activity and receiving appropriate collateral. The capital market exposure unit closely monitors the activity and exposure of such Bank clients, including on aggregate.

In conformity with Proper Conduct of Banking Business Directive 330 concerning management of client trading activity on the capital market, the Bank has specified an aggregate exposure limit for capital market clients, including an aggregate exposure

Risks Report

As of December 31, 2021

limit for clients with significant speculative activity, as well as limit on activity in the capital market for a single client. The exposure to credit risk inherent in trading activity of clients on the capital market, vs. the risk appetite, is reported on quarterly basis to management and to the Board of Directors.

Commercial credit

The Bank manages its business credit operations in multiple segments, primarily: large businesses, medium businesses, small businesses and households. The division into credit operating segments is supported by the Bank's organizational structure.

The decision making process with regard to extending commercial credit acts to minimize risk. To this end, an authorization ranking is specified for officers and credit committees at various levels, up to the Board of Directors' Credit Committee and the Board of Directors. The authorizations specify and limit the approving entity by credit volume, outstanding credit volume, collateral received, determination of the quality and value of collateral, as well as authorization to set interest rates.

The credit volume applicable for the authorization ranking is determined based on the aggregate credit volume for all components of the borrower group of which the borrower is part, not just for the individual borrower.

Branch managers and other officers in the business departments have authorization with regard to extending credit. More material credit-granting decisions are mostly made by credit committees in order to minimize the risk in relying on the judgment of a single individual.

The authorization procedures list the exposure amount that each of the credit extending entities and various credit committees is authorized to approve, subject to other Bank procedures with regard to extending credit.

Moreover, an authorization ranking has been specified with regard to approval of collateral to be received, authorization to determine the diversification, quality of collateral and authorization to determine the value of collateral.

Credit for medium and large businesses

Loans to medium businesses are typically highly diversified across clients, economic sectors and by geography. Financing is provided to this segment for current operations through financing of working capital, including financing of trade receivables and inventory, which is typically short-term financing, expansion and investment in the firm, which is typically medium- and long-term financing. This financing is backed by most existing collateral types, such as: deposits, securities, equipment, vehicles, current liens, various guarantees and personal guarantees. In addition, financial covenants are used for these clients, in order to mitigate risk.

Loans to large business clients is typically less diversified than in other segments. These clients typically have complex financial activities and diverse financing sources, both from the banking system in Israel and overseas, from institutional investors and from the capital market. Collateral for such loans is typically general collateral, such as a current lien, negative pledge along with financial covenants. These clients are involved with various credit products, including credit for the capital market.

The division control functions, operating on behalf of the Manager of the Corporate Division, are responsible for identification, assessment, measurement, monitoring, mitigation and reporting of risk inherent in products, activities, processes and systems under their responsibility, as well as for management of IT control systems and for maintaining an appropriate control environment with regard to risk management in the Division (hereinafter: "Control").

The control functions in the Corporate Division are responsible as follows:

- Division Control – responsible for control over credit extended to segments handled by the Division.
- Business Credit Control Department of the Corporate Division Headquarters Sector of the Corporate Division – responsible for control at the Corporate Division on several levels:
 - The division control function controls credit to clients of the Corporate Division. The division controller is also responsible for coordinating the Watch List Forum, to discuss accounts with risk characteristics, based on pre-determined parameters.
 - The Department is responsible for use of computer mechanisms to alert unusual accounts and clients, including based on information external to the Bank. The Department is responsible for control over banking activity in accounts flagged due to risk indications, including for elaborating any deviations with the relevant front line credit staff (branches, regions, centers, sectors) and monitoring the elimination of such deviations.
- The Capital Market Exposure Control Unit – operations involving derivatives requires specific specialization and real-time control. This is due to the special nature of such activities and the exposure arising there from. The unit is responsible for control over clients specified in advance by the Corporate Division or by the various credit committees, for compliance with covenants and facilities.
- Compliance control – providing a professional response to Corporate Division staff with regard to compliance provisions and applying controls regarding compliance.

The Bank constantly monitors the risk level in the business credit portfolio using, *inter alia*, the Bank's criteria rating system. This system rates all debt of a single borrower to the Bank. The client credit rating is determined by a process of determination of the business quality of the borrower, which is then combined with the collateral coverage ratio to provide a rating that reflects the quality of credit extended to the borrower.

Loans to small businesses

The micro and small business segment is highly diversified in terms of clients in various economic sectors, mostly in small industry, trade, business and financial services. Financing in the micro and small business segment is mostly provided for short terms, for current operations and for financing of working capital, covering gaps in cash flow, financing trade receivables, inventory and import activities. Such financing is provided against appropriate collateral, such as checks for collateral / checks receivable, invoices, pledging of contracts and current liens, and against external collateral if possible, such as deposits, real estate and owner's guarantees.

As part of the credit underwriting process, the Bank analyzes the merchant's business activity, including by comparison to their economic sector. In this regard, and subject to review of repayment capacity and repayment sources, the credit amount and type are customized for the client needs.

Major risk factors in operations of the small business segment are: macro-economic deterioration which would result in recession, which would have across-the-board impact on businesses operating in this segment; dependence on key persons in the business (primarily owners and managers); dependence on individual suppliers / clients who may face default. The Bank regularly monitors the risk level in the credit portfolio for micro and small businesses, including through custom credit rating models and by monitoring high-risk economic sectors and setting guidelines and differential credit authorizations for different management levels. In order to optimally support these operations, the Bank acts to improve infrastructure, banking processes and credit underwriting processes.

Counter-party credit risk

Qualitative disclosure of counter-party credit risk (CCRA)

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, including receipts with respect to any counter-party obligation. Economic loss would be incurred only when the transaction with the counter-party would have a positive economic value upon such default. Counter-party risk may be affected by other risks, including: credit risk, market risk, liquidity risk, operational risk and reputational risk of the counter-party to the transaction. Counter-party risk has been defined as a material risk at the Bank. The Risk Owner is the Manager, Finance Division.

The Bank has set specific policies on addressing counter-party risk for financial institutions and sovereigns and another document, which is part of the Bank's credit policies, concerns client activities in financial derivatives. 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. 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 financial institutions 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 rated A or higher and to major financial institutions in these countries. Operations are carried out while maintaining proper diversification of exposures to sovereigns and financial institutions. The Bank has very little business with less developed nations rated lower, primarily in response to client needs.

Risk measurement is based on 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 where a market price may not be quoted, pricing and exposure estimation are based on commonly used pricing models. For business with financial institutions and sovereigns, the Bank has developed a methodology for calculating facilities with each counter-party, based on the quality, rating and capital of such financial institutions 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 financial institutions relies on special reports created in the Bank's infrastructure system and exception reports generated to monitor business in Israel and overseas, including a Financial Institutions Report, which lists all exposures to banks as well as deviation reports, which reflect deviations from agreed facilities, if any. There are also automated mechanisms designed to flag deviations from trading limits with financial institutions and sovereigns, both in the trading room and in trading room control.

The Bank regularly adjusts its exposure to financial institutions 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. Other indicators based on market benchmarks are regularly reviewed to alert any events which may indicate change in the financial standing of major financial institutions to which the Bank is exposed.

The Bank's current risk profile indicates that most of the Bank's exposure to counter-party risk is to foreign corporations and financial institutions, with a non-material exposure level. The Bank also has low exposure to sovereigns.

The Bank regularly reviews and monitors the action required to mitigate this risk. Note that in 2020 and in 2021, the Bank emphasized monitoring of the effects of the Corona Virus on Bank operations with counter-parties exposed to such effects.

Risks Report

As of December 31, 2021

Restrictions and controls – The Bank has operations involving financial derivative instruments, 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 derivative instruments 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.

At the Bank, a limit restriction applies for financial institutions and sovereigns, including reference to derivatives. Furthermore, a restriction applies to customer facilities based on certain parameters. The Corporate Division includes a dedicated department, specialized in control of exposure arising from capital market operations, which daily reviews clients active in this field. Furthermore, as part of Risks Control Division operations, 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 financial institutions 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 addendums regulate funds transfer between parties to a transaction whenever exposure reaches a certain predefined level, thereby reducing counter-party exposure. In conformity with directives of the Supervisor of Banks (Appendix C to Directive 203), the Stock Exchange clearinghouse and of the MAOF clearinghouse are classified as qualified central counter-parties for calculation of capital requirements with respect to exposure to central counter-parties. Moreover, in conformity with the Europe Market Infrastructure Regulation (EMIR) legislation, the Bank operates through a central clearinghouse, LCH Ltd. In transactions settled in this way (whether mandatory or voluntary), Bank exposure is to LCH, rather than to the original counter party. Moreover, LCH delivers all payments and margin funds between counter parties to the transaction through leading financial institutions, authorized to conduct clearing transactions with LCH ("Clearing Members"). The Bank uses two Clearing Members for these operations.

Analysis of exposure to counter-party credit risk (CCR) based on the supervisory approach (CCR1) (NIS in millions)

	As of December 31, 2021			
	Subrogation cost	Future potential exposure	Exposure after deduction of collateral	Risk assets
Current exposure method	2,097	1,677	2,271	928
Comprehensive approach to credit risk mitigation (for securities financing transactions)	–	–	157	136
Total	2,097	1,677	2,428	1,064

	As of December 31, 2020			
	Subrogation cost	Future potential exposure	Exposure after deduction of collateral	Risk assets
Current exposure method	1,782	1,494	2,408	1,380
Comprehensive approach to credit risk mitigation (for securities financing transactions)	–	–	365	365
Total	1,782	1,494	2,773	1,745

Capital allocation with respect to credit risk valuation adjustment (CVA) (CCR2) (NIS in millions) Capital allocation with respect to credit risk valuation adjustment (CVA) (CCR2)

	As of December 31, 2021		As of December 31, 2020	
	Exposure after deduction of collateral	Risk assets	Exposure after deduction of collateral	Risk assets
Total – portfolios for which CVA is calculated using the standard approach	1,931	529	1,905	487

Risks Report

As of December 31, 2021

Standard approach – exposures to counter-party credit risk (CCR) by supervisory portfolio and risk weightings (CCR3) (NIS in millions)

Supervisory portfolio / risk weighting	As of December 31, 2021			Total credit exposures
	0%	20%	100%	
Sovereigns	11	–	–	11
Public sector entities (PSE) other than central Government	–	1	–	1
Banks (including Multi-party Development Banks)	–	763	–	763
Securities companies	–	672	–	672
Corporations	–	406	411	817
Supervisory retail portfolios	–	–	7	7
Other assets	–	–	–	–
Total	11	1,842	418	2,271

Supervisory portfolio / risk weighting	As of December 31, 2020			Total credit exposures
	0%	20%	100%	
Sovereigns	269	–	–	269
Public sector entities (PSE) other than central Government	–	144	–	144
Banks (including Multi-party Development Banks)	–	764	1	765
Securities companies	–	–	–	–
Corporations	–	42	1,183	1,225
Supervisory retail portfolios	–	–	5	5
Other assets	–	–	–	–
Total	269	950	1,189	2,408

Risks Report

As of December 31, 2021

Composition of collateral with respect to exposure to counter-party credit risk⁽¹⁾ (CCR) (CCR5)

Composition of collateral with respect to exposure to counter-party credit risk (CCR) (CCR5)

	As of December 31, 2021					
	Collateral used in derivatives transactions				Collateral used in securities financing transactions	
	Fair value of collateral received		Fair value of collateral deposited		Fair value of collateral received	Fair value of collateral deposited
	Disconnected	Not disconnected	Disconnected	Not disconnected		
Cash – local currency	–	666	–	–	1,051	–
Cash – other currencies	–	1,007	–	–	3	–
Local sovereign debt	–	15	–	–	12	–
Other sovereign debt	–	–	–	–	–	–
Government agency debt	–	–	–	–	–	–
Corporate debentures	–	6	–	–	8	–
Shares	–	743	–	–	369	–
Other collateral	–	–	–	–	–	–
Total	–	2,437	–	–	1,443	–

	As of December 31, 2020					
	Fair value of collateral received		Fair value of collateral deposited		Fair value of collateral received	Fair value of collateral deposited
	Disconnected	Not disconnected	Disconnected	Not disconnected		
Cash – local currency	–	921	–	11	1,592	–
Cash – other currencies	–	523	–	931	3	–
Local sovereign debt	–	152	–	–	33	–
Other sovereign debt	–	2	–	–	–	–
Government agency debt	–	–	–	–	–	–
Corporate debentures	–	54	–	–	23	–
Shares	–	376	–	–	184	–
Other collateral	–	–	–	–	–	–
Total	–	2,028	–	943	1,835	–

(1) Amounts refer to collateral deposited or received with respect to exposures arising from counter-party credit risk related to transactions in derivatives or to securities financing transactions, including transactions settled by a Central Counter-Party (CCP)

Exposures to credit derivatives (CCR6) (NIS in millions)

	December 31, 2021	
	Protection acquired	Protection sold
Stated amounts		
Single-name credit default swaps	41	249
Credit options	–	–
Other credit derivatives	41	41
Total – stated amounts	82	290
Fair value – values		
Positive fair value (asset)	9	–
Negative fair value (liability)	(5)	–

	December 31, 2020	
	Protection acquired	Protection sold
Stated amounts		
Single-name credit default swaps	76	257
Credit options	–	–
Other credit derivatives	42	42
Total – stated amounts	118	299
Fair value – values		
Positive fair value (asset)	12	3
Negative fair value (liability)	(8)	–

Risks Report

As of December 31, 2021

Exposures to central counter parties (CCR8) (NIS in millions)

	As of December 31, 2021	
	Exposure after deduction of collateral	Risk assets
Exposures to qualified central counter-party (total)	1,399	210
Exposures to transactions with QCCP (excluding initial collateral and transfers to risk reserve), of which:		
OTC derivatives	431	65
Transactions in derivatives traded on the stock exchange	16	3
Initial non-disconnected collateral	408	62
Funded transfers to risk reserve	275	6
Unfunded transfers to risk reserve	34	7
	659	132
	As of December 31, 2020	
Exposures to qualified central counter-party (total)	1,247	180
Exposures to transactions with QCCP (excluding initial collateral and transfers to risk reserve), of which:		
OTC derivatives	349	51
Transactions in derivatives traded on the stock exchange	73	15
Initial non-disconnected collateral	276	36
Funded transfers to risk reserve	286	6
Unfunded transfers to risk reserve	38	8
	574	115

Market risk

General information about market and interest risks

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).

Description of market risks to which the Bank is exposed:

Interest risk is the risk to Bank profit (change to revenues) or to Bank capital due to changes to interest rates. Interest risk consists of four major risk factors: Repricing risk, yield curve risk, basis risk and behavior risk, as explained below:

Repricing risk – This risk is due to timing differences in term to maturity (fixed interest) and in repricing dates (variable interest) of assets, liabilities and off-balance sheet positions. Mismatch of repricing dates may expose Bank profit and the value of Bank assets to unexpected fluctuations due to changes to interest rates.

Yield curve risk – This risk arises from unexpected shifting of the yield curve. Changes to links between interest rates for different terms are reflected in a change in curve slope (steepness) or shape (twist) and negatively impact the Bank's profit or economic valuation.

Basis risk – Risk arising from imperfect correlation in changes to interest rates in different financial markets, or in different instruments with similar repricing features. Differences in changes to interest rates may result in changes to cash flows and revenue spread between assets, liabilities and off-balance sheet instruments with a similar term to maturity, which are seemingly hedged.

Optionality risk – This risk is inherent in cash flows where the behavioral maturity differs from the contractual one. The risk arises from change in timing or extent of cash flow, due to changes in macro-economic conditions (such as changes to market interest rates). This risk is inherent in options embedded in the asset portfolio (such as early mortgage repayment), liability portfolio (such as deposit withdrawal at exit points) and in off-balance sheet instruments. These options entitle the client to buy / sell or modify the financial instrument.

Exchange rate / inflation risk – This is the risk to Bank profit, arising from fluctuations in exchange rates / in the Consumer Price Index (due to currency mis-match between assets and liabilities).

Position risk in shares – This is the risk to Bank profit, arising from impairment of investment in shares.

The Bank has no exposure to commodities and its exposure to equities is not material, hence its main exposure to market risk is due to basis risk and to interest risk.

Strategies, policies and processes

The Bank's Board of Directors and management have established, as part of the Bank's orderly risk mapping and identification process, that market risk is a material risk and that management of this risk is vital for stability of the Bank. Therefore, the Bank's Board of Directors has created a specific policy document for handling market and interest risks.

The policy document on handling market risk incorporates Bank policy on handling such risk, on management of the risk, risk appetite, risk measurement and risk mitigators. The document stipulates 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. This document is annually approved by Bank management, by the Board's Risks Management Committee and by the Board of Directors. 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.

Market risk and interest risk are managed at Group level, including the Bank's overseas affiliates and subsidiaries.

Management of market risk and interest risk at the Bank consists of two main risk focus points:

- Banking portfolio – This portfolio, which is the Bank's primary activity and risk, consists of all transactions not included in the trading portfolio, including financial derivatives used to hedge the banking portfolio. This portfolio is exposed to interest and inflation risk. The measure of 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 banking portfolio, which is reviewed by the Bank daily, 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. Management of this risk is designed to maintain a risk level in conformity with the risk appetite specified, while taking advantage of opportunities and constant monitoring of the risk profile, so that the Bank would not be exposed to significant losses.
- trading portfolio – The portfolio consists of positions in financial instruments held for trade or for hedging of other components in the trading portfolio. The consolidated portfolio (including Union Bank) includes portfolios managed by the trading room and portfolios of debentures held for trade and strategy in Israeli currency and in foreign currency – as well as derivatives designated for execution of strategies. The portfolio also includes hedging transactions for instruments included in the trading portfolio. This portfolio is associated with risk that is not high.

The Bank of Israel directives relevant for market and interest risks management are: Proper Conduct of Banking Business Directive 339 "Market Risks Management"; Proper Conduct of Banking Business Directive 333 "Interest Risk Management", which expands the regulations with regard to interest risk, mostly with regard to Bank activity in the banking portfolio; and Proper Conduct of Banking Business Directive 208 "Capital Measurement and Adequacy", with regard to definition of revaluation management and capital allocation under Pillar 1 with respect to the trading portfolio.

The Bank is required to allocate capital with respect to interest risk and equities in the trading 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 options 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.

Bank operations in the trading portfolio, as noted above, are subject to restrictions which reflect low risk appetite and therefore, the Bank's capital allocation with respect to market risk is very low.

The structure of the Bank's assets and liabilities portfolio, which is weighted towards the mortgage portfolio, produces medium-term uses for which the Bank requires sources. Due to incomplete alignment of the average duration of uses and the average duration of sources, the Bank's economic value is exposed to changes in interest rate curves.

The market and interest risks 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 risks profile in the banking portfolio is presented to the Bank's Board of Directors using the Bank's quarterly Risks Document. The discussion by the Board of Directors covers development of the risk profile, major action taken by the Bank in the different portfolios during the reviewed period 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 risks profile in the banking portfolio and Bank sensitivity to changes in risk factors. Any deviation, should it occur, is to be reported to the Board of Directors, along with action taken to eliminate it.

Tools for risk measurement and management

Measurement of market and interest risks is supported by a wide range of information systems, models, processes, risk benchmarks and stress tests. The models and information systems involved in the calculation are regularly reviewed, through internal controls processes at the Bank, including continuous validation processes.

Market risk in both portfolios (bank and negotiable) are managed overall by using the VAR model and stress tests. The Bank operates within the Board of Directors' specified risk appetite for and interest market risk in terms of VAR and stress tests.

The risk appetite stipulates that the VAR for all of the Bank's activities in one-month investments, will not exceed 11% of shareholders' equity, and that the maximum loss in stress tests, the highest of all calculation methods, will not exceed 13.5% of equity. Management has also specified guidelines for these two restrictions. The Bank maintains a risk profile that is within these restrictions. For application of these models, the Bank's available capital is defined as a non-linked NIS-denominated source.

The VAR model is a statistical model that estimates the loss expected for the Bank in a certain investment period and at a predetermined 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 applies a method that combines the historical method and the analytical method, for effective monitoring of risk factors. 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.

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, adjusted for specific risk concentrations existing in the portfolio, and therefore deemed by the Bank to be "the worst scenario", and the uniform scenario outline under stress scenarios, as periodically determined by the Bank of Israel, 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 4%.

As part of testing the left-hand tail of distribution of the Banking 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.

For more information about approaches to interest risk management, how this risk is managed and risk mitigators, see chapter "Management of interest risk in the banking portfolio" below.

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

The main models used by the Bank to estimate market and interest risks, as with all models, have restrictions which may be due to model assumptions, input values used or mismatch 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. Use of stress tests, which are mostly "forward-looking", i.e. do not rely on historical data, and review the risk under stress scenarios, completes the VAR model.

The risk benchmarks measure the change in overall value of the Bank (both the VAR benchmark and stress scenarios, and the EVE benchmark under the various scenarios), estimate risk under a static, rigid assumption of stable, one-time change across the life of all existing assets and liabilities at the Bank at the measurement point, without any management intervention to take any hedging action / make any changes to exposures. Addressing these assumptions means, first and foremost, understanding and disclosing the meaning of risk values across all management levels, and making business decisions given this assumption. Furthermore, to complement the economic capital approach, the Bank estimates the effect of interest risk using the earnings method as well, over a shorter term, and as part of management of the Bank's financing work plans.

another limitation is the use of behavioral models to create forecasted cash flows of instruments which include such components. The Bank, being a mortgage bank, significantly relies on behavioral models, for both attribution of future mortgage cash flows and for anticipated attribution of current account and deposit balances, with an option for early withdrawal by the client.

The Bank faces these limits both in continuous validation processes of models used by the Bank, which consider all model components, and in regular execution of sensitivity testing to the outcome of risk value estimation under various behavioral assumptions, including a complete collapse of such assumptions.

Exposures to linkage segments

Currency exposures – It is Bank policy to maintain minimal (operating) currency positions, except for specific strategic positions approved by the different committees and/or ForEx positions in the trading portfolio, managed by the Trading Room, subject to relatively low exposure limits specified. Foreign currency strategic positions are capped by a Stop Loss mechanism to restrict and reduce risk. The Bank's overall currency risk level is low.

Inflationary exposures – The Bank has inherent exposure to negative inflation due to Bank activity in the banking portfolio, including excess CPI-linked mortgages over CPI-linked sources. The risk management policy is in line with expected profit from holding a position and the Bank's capacity to reduce the exposure within a reasonable time frame, subject to the specified risk appetite. The actual exposure is estimated as part of the risk appetite benchmarks and models applied by the Bank to all market risks. Risk is assessed as Low-Medium, reflecting the exposure and expected inflation.

Policy on determination whether a position is designated for trading

The Bank operates in conformity with Proper Conduct of Banking Business Directive 208, which incorporates the Basel Committee directives with regard to definitions, management and revaluation of the trading portfolio. Inclusion of an instrument and/or position in the trading 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 set forth in the regulation, i.e. there is trading intent or hedging of other components in the trading portfolio, active portfolio management and frequent, accurate valuation of the portfolio.

Classification under the trading portfolio is part of Bank policy, and the trading portfolio consists of all portfolios managed by the Trading Room (debenture trading portfolio of the Interest Trade Unit (market maker), derivative transactions classified under Trading Room portfolios (and options), as well as trading portfolios of debentures held for trading and strategy in Israeli and foreign currency, managed by the Asset Management Department, as well as derivatives used for executing strategies. The portfolio also includes hedging transactions for instruments included in the trading portfolio. The trading portfolio is exposed, *inter alia*, to the following risk factors: Foreign exchange exposures, interest exposures and options-related exposures.

In general, all derivatives transactions are conducted by the Trading Room, with external counter-parties and are classified under the trading portfolio when contracted. The transactions classified to the banking portfolio are specific transactions which, prior to conducting them, a decision was made and documented to conduct them for the banking portfolio. In the fourth quarter of this year, there were no transfers between the portfolios after the transaction contracting date.

Organizational structure of market and interest risks management function

The Bank has put in place an organizational structure for management of market risks and interest risks in the banking 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 trading portfolio and in the banking portfolio.

Upon any unusual occurrence in the capital market, such as an unexpected change in interest rates, fluctuations 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.

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

Bank Board of Directors – The Bank Board of Directors approves, at least once per year, the policy documents which cover the management of exposures to market and interest risks in the banking portfolio. The policy on management of market and interest risks, management of the debenture portfolio and the specific policy on derivatives risk and OTC transactions, after discussion and approval by the Risk Management Committees of the Finance Division, the Risk Monitoring Forum headed by the CRO, by Bank management and by the Board of Director's Risk Management Committee. The documents outline, *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 risk appetite framework specified by the Board of Directors was broadened 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 banking portfolio and with respect to Bank activity in the trading portfolio. The Board of Directors restrictions and management guidelines reflect the risk appetite, which is consistent with the Bank's overall risk appetite, business strategy, liquidity planning, financing sources and capital planning at the Bank.

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 and interest risks. This committee generally meets once a month, or more frequently, when special developments in the various markets occur or are forecast. The Bank President & CEO is responsible for setting policy and guidelines for exposure, subject to exposure limits approved by the Board of Directors. This includes making business decisions with regard to management of market and interest exposures, approval of proactive exposure strategies, hedging and risk mitigation moves and new products for management of market and interest risks under the management approval track.

First line of defense – Lines of business management

The head of the Finance Division (CFO) manages all financial risk at the Bank, including market and interest risks. The internal 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. This committee is also attended by representatives of the Risks Control Division.

Risks Report

As of December 31, 2021

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.

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, serves as the advisory body to the Chief Risks Officer with regard to management of Bank exposure to market and interest risks in the banking portfolio, which is convened at least once every two months. The Forum, including inter alia representatives from the Financial division and from the Risks Control Division, regularly monitors the market and interest risks profile of both the Banking portfolio and the trading portfolio, including individual activity in the trading room, as well as the outcomes of stress scenarios and back-testing. They also discuss and approve methodologies for risk management and control, including measurement methods which could support portfolio monitoring operations, addressing the various aspects of risk management and control for market and interest risks, including conclusions derived from validation processes of the relevant models, conducted by the Risks Control Division. Control and monitoring of market and interest exposures is handled in the second line of defense by: A dedicated unit for control of market and liquidity risks, in the Risks Control Division.

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.

Scope and nature of reporting and measurement systems

Measurement of market and interest risks is supported by information systems, models, processes, risk benchmarks and stress scenarios. The information systems involved in the calculation are regularly reviewed, through internal controls processes at the Bank and continuous validation processes. The Bank has a central system used for management and control of market and interest risks. The system is used to calculate risk benchmarks and to review these vs. risk limits. Calculations are based on a central database of market and position data. Calculation is automated and is conducted at a daily level. The system is also used for calculation of capital allocation with respect to market risks and credit risks. Risk owners also use another system, as a complementary system for development and maintenance of calculations, ad-hoc analysis and risks management models. The Middle Office uses a custom system to monitor and control trading room activity; this system operates in real time to monitor and locate any unusual activity. This system allows for complete documentation of the activity with high-level analysis capabilities and trends with regard to risk and profitability, as well as a system for call analysis which generates alerts based on business rules.

Market risk using the standard approach

Below are the capital requirement components under the standard approach for market risk (NIS in millions):

	Risk assets as of:	
	December 31, 2021	December 31, 2020
Direct products		
Interest rate risk (general and specific)	2,037	1,519
Stock position risk (general and specific)	40	40
Exchange rate risk	178	626
Commodities risk		
Options	–	–
Delta Plus approach	13	43
Securitization	–	–
Total	2,268	2,228

As noted above, exposures in the trading portfolio are low, mostly arising from interest risk, and values of this risk were essentially unchanged during the year.

Additional information about market risk

Financial derivatives

Operations involving financial derivatives are conducted in the trading room, both for trading portfolios managed in the trading room and for various clients, including for the financial management sector, to hedge exposures in the banking portfolio. Operations involving financial derivatives pose a range of risks, primarily the following: Market risks, managed as part of market and interest risks management in the trading portfolio and in the banking portfolio, operational risk and compliance risk, managed under the overall management framework of operational risk and compliance risk, including administrative enforcement and counter-party credit risk. Counter-party credit risk vs. different entities is managed in conformity with Bank policy on counter-party credit risk management, as set forth above in chapter "Counter-party credit risk" and in chapter "Credit" with regard to the capital market segment.

Management of positions in trading portfolio

The trading portfolio mostly consists, as noted above, of portfolios managed by the trading room, subject to exposure limits by various risk benchmarks based, inter alia, on scenarios involving changes to risk factors. Risk is measured during the trading day and at the end of the trading day. Risk is managed by the trading room and is constantly monitored, intra-day and daily, by the Middle Office, the Financial Risks Department of Risks Control.

The Bank operates a committee for management of operational risk in the trading room, which discusses bi-monthly the operations of the trading room, compliance with risk limits, measuring profit vs. risk, unusual events and so forth. Reports of this activity are also presented to management's Asset and Liability Management Committee and in the quarterly Risks Document discussed by the Board of Directors.

Furthermore, activity in the trading debenture portfolio managed at Union Bank, subject to restrictions and guidelines, is controlled by the first and second lines of defense at Union Bank.

Developments in market risk

Risk values in the different benchmarks (analysis of interest risk in Banking portfolio) indicate exposure in economic fair value to higher interest rates, due to the position structure composed of uses for medium and long terms vs. sources for short to medium terms. Risk values were affected both by current mortgage performance and deposit operations, as well as proactively conducting transactions involving derivatives and activity in the debenture portfolio.

Overall market risk is categorized as Low-Medium.

The risk profile is within the specified risk appetite ranges. There were no deviations from the specified risk appetite in 2021.

Interest risk in banking portfolio and in trading portfolio

Targets and objectives in management of interest risk in the banking portfolio

Definition of interest risk in the banking portfolio for the purpose of risk control and measurement

As noted above, the banking portfolio constitutes most of the activity which generates interest risk for the Bank.

Management of interest risk in the banking portfolio and risk mitigation strategies

Management of interest risk is in conformity with Proper Conduct of Banking Business Directive 333. The directive requires the Bank to measure risk by several measurement methods (but one primary method may be chosen for regular management purposes), the measurement systems are required to support measurement of interest risk in the entire portfolio, as well as separately in the banking portfolio and in the trading portfolio. The directive requires banks to apply a range of scenarios to estimate risk, but also defines a "standard shock scenario", where exceptional results of such scenario must be immediately reported to the Supervisor of Banks.

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 key method for risk management – but has developed another model, based on the earnings approach.

The EVE (Economic Value of Equity) model is the Bank's main model for estimating interest risk in the banking portfolio. The EVE model reviews the effect of changes to interest rate curves on the economic value of the banking portfolio, the trading portfolio and the overall portfolio (negotiable + bank), under various assumptions with regard to changes in interest rate curves (by operating segment, such as: derivatives, deposits and mortgages, by linkage basis). Assumptions about changes to the interest rate curve under normal and stress situations, including corresponding upwards/downwards shifts of the interest rate curve at high rates and scenarios involving steeper, flatter and a brief shock to interest rate curves.

The Bank handles interest risk in the banking portfolio and overall additional capital allocation with respect there to, in conformity with Basel Pillar 2.

Earnings approach – calculation of a financing margin, i.e. 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 Owners at the Bank.

The earnings 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.

A major tool for management and mitigation of interest risk is setting Fund Transfer Prices (FTP) at the Bank (transfer pricing). Fund Transfer Prices (FTP) 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 of 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 the ability of 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.

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

Interest risk benchmarks in the banking portfolio and stress scenarios

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 interest rate scenarios. Future forecasting of financial instruments is made in conformity with generally accepted practice around the world for calculating fair value.

Description of model assumptions

As noted above, the model actually used to measure interest risk at the Bank is the EVE model, based on the banking portfolio only, as opposed to the table below which refers to the Bank in its entirety. Moreover, capitalization curves are different, with EVE based on transfer price curves, because the Bank is only interested in managing changes to transfer price interest rates using this model, and not to credit / deposit spreads, as an example.

Hedging against interest risk in the banking portfolio

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. Hedge effectiveness is tested quarterly.

Derivatives in the banking 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 risks management committees.

At least once a year, the Bank reviews the underlying assumptions of models used to manage market and interest risks, including behavioral assumptions made in order to determine forecasting of certain instruments. The sensitivity of risk values to changes in behavioral assumptions are reviewed regularly.

Description of key assumptions in various models and parameters used for calculation

Calculation of net fair value of financial instruments:

- Fair value was calculated based on estimates with regard to the possibility of early repayment, based on statistical / empirical analysis.
- The early repayment assumptions in mortgages are based on empirical testing and on a borrower behavior model with regard to early repayment rate out of all mortgages, on annual basis. These assumptions are verified from time to time against actual early repayment, in each linkage segment and interest type, separately short and long original loan terms.
- Early repayment assumptions for deposits and savings plans with early withdrawal options (bearing fixed or variable interest, CPI-linked or non-linked), where interest terms are known in advance, are based on empirical analysis and are reviewed and revised from time to time.
- Checking account balances are attributed using a statistical model which reflects their nature as a stable source.

Change in interest revenues, net:

- This calculation reviews annual financing profitability (12 months ahead) under a scenario of change to risk-free interest rate and assuming re-financing of all balances maturing up to 12 months ahead.
- Assumptions for creating future cash flows in this model: Attribution refers to all Bank activity (on-balance sheet, derivatives and investment of excess liquidity) for a one-year horizon, based on behavioral options for early mortgage repayment, early withdrawal of deposits and attribution of credit balances in checking accounts. The change in revenues also includes an estimate for the early repayment commission.

Analysis of interest risk in banking portfolio

Below is the effect⁽¹⁾ of a parallel shift of the curve by 2% on the economic value of the Bank's portfolio in EVE terms (NIS in millions):

	December 31, 2021					
	Change in fair value					
	Israeli currency		Foreign currency			
	Non-linked	Linked to CPI	Dollar	EUR	Other	Total
2% increase	(905)	(1,187)	418	14	16	(1,644)
Decrease by 2%	(82)	427	(439)	14	(17)	(97)
	December 31, 2020					
2% increase	(369)	(1,558)	195	(10)	15	(1,727)
Decrease by 2%	(38)	1,254	(199)	52	(17)	1,052

(1) Calculated based on current data used for actual interest risk management.

In preparing the mortgage repayment cash flows forecast for the Bank, assumptions with regard to the prepayment rate and manner are taken into account. Credit balances in checking accounts are attributed in line with common practice in conformity with the Basel directives, i.e. over an average term of 3-4 years for different client types. In 2021, the Bank's VaR decreased, primarily due to an issuance.

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

	2021	2020
At end of period	592	770
Maximum value during period	810 (FEB)	1,055 (JUN)
Minimum value during period	521 (OCT)	443 (JAN)

Back-testing of the historical-analytic VaR model in the overall portfolio showed no profit/loss observations which deviate from the VaR model forecast in a number deviating from the criteria specified by the Basel Committee for review of the VaR model quality.

Risks Report

As of December 31, 2021

Quantitative information about interest risk in banking portfolio and in trading portfolio

Net adjusted fair value⁽¹⁾ of financial instruments of the Bank and subsidiaries thereof (NIS in millions):

	As of December 31, 2021				
	Foreign currency				
	NIS – Non-linked	NIS – CPI-linked	Dollar	Other	Total
Financial assets ⁽²⁾	287,860	72,625	20,176	6,106	386,767
Other amounts receivable with respect to financial derivatives, complex and off-balance sheet financial instruments	200,090	5,632	196,113	18,832	420,667
Financial liabilities	(254,768)	(54,862)	(48,666)	(8,600)	(366,896)
Other amounts payable with respect to financial derivatives, complex and off-balance sheet financial instruments	(228,211)	(8,718)	(167,195)	(16,644)	(420,768)
Net fair value of financial instruments	4,971	14,677	428	(306)	19,770
Effect of liabilities with respect to employee rights	(173)	(2,343)	-	-	(2,516)
Effect of attribution of on-call deposits to terms	922	-	172	69	1,163
Adjusted net fair value	5,720	12,334	600	(237)	18,417
Of which: Banking portfolio	3,270	11,085	3,278	(1,028)	16,605

	As of December 31, 2020				
	NIS – Non-linked	NIS – CPI-linked	Dollar	Other	Total
Financial assets ⁽²⁾	255,410	66,817	22,400	7,136	351,763
Other amounts receivable with respect to financial derivatives, complex and off-balance sheet financial instruments	154,693	5,197	146,914	17,241	324,045
Financial liabilities	(237,969)	(45,890)	(42,368)	(8,643)	(334,870)
Other amounts payable with respect to financial derivatives, complex and off-balance sheet financial instruments	(174,595)	(7,930)	(126,176)	(16,307)	(325,008)
Net fair value of financial instruments	(2,461)	18,194	770	(573)	15,930
Effect of liabilities with respect to employee rights	(15)	(1,192)	-	-	(1,207)
Effect of attribution of on-call deposits to terms	701	-	43	(4)	740
Adjusted net fair value	(1,775)	17,002	813	(577)	15,463
Of which: Banking portfolio	(20,220)	16,111	16,846	(643)	12,094

Risks Report

As of December 31, 2021

Impact of change scenarios in interest rates on net adjusted fair value⁽¹⁾ of the Bank and its subsidiaries (NIS in millions):

	As of December 31, 2021					As of December 31, 2020				
	Foreign currency					Foreign currency				
	NIS – Non- linked	NIS – CPI- linked	Dollar	Other	Total	NIS – Non- linked	NIS – CPI- linked	Dollar	Other	Total
Concurrent changes										
Concurrent 1% increase	254	(197)	57	77	191	357	(392)	103	(12)	56
Of which: Banking portfolio	252	(157)	68	72	235	336	(384)	123	(5)	70
Concurrent 1% decrease	(394)	97	(110)	(83)	(490)	(398)	363	(104)	5	(134)
Of which: Banking portfolio	(388)	55	(121)	(78)	(532)	(369)	359	(66)	(2)	(78)
Non-concurrent changes										
Steeper ⁽³⁾	(352)	112	(52)	20	(272)	(492)	93	(8)	–	(407)
Of which: Banking portfolio	(342)	131	(60)	19	(252)	(481)	95	(20)	–	(406)
Shallower ⁽⁴⁾	457	(146)	85	2	398	722	(98)	48	(2)	670
Of which: Banking portfolio	444	(158)	96	2	384	709	(100)	61	(2)	668
Short-term interest increase	618	(304)	120	43	477	661	(398)	88	(6)	345
Of which: Banking portfolio	599	(300)	134	41	474	647	(398)	108	(7)	350
Short-term interest decrease	(415)	500	(125)	(43)	(83)	(398)	620	(92)	5	135
Of which: Banking portfolio	(395)	496	(138)	(43)	(80)	(384)	619	(113)	7	129

- (1) Net fair value of financial instruments, except for non-monetary items, after effect of liability with respect to employee rights and attribution of on-call deposits to terms.
- (2) Excludes balance sheet balances of financial derivative instruments, fair value of off-balance sheet financial instruments and fair value of complex financial instruments.
- (3) Short-term interest decrease and long-term interest increase.
- (4) Short-term interest increase and long-term interest decrease.

The difference between Bank exposure to changes in interest according to net adjusted fair value and sensitivity of economic value (EVE) presented above, under a 1% concurrent shift of the curve, amounts to NIS 731 million.

Most of this difference is due to use of different capitalization curves. The capitalization curves used to analyze sensitivity of economic value (EVE) are transfer pricing curves, while discount rates used to present net adjusted fair value are possible discount rates for similar transactions on the balance sheet date, reflecting the inherent risk for a similar client.

See Note 33 to the financial statements for additional information.

Note that the internal rate of return and the average effective duration, as presented under Bank exposure to changes in interest rates below, are average data and therefore it is not possible to make deductions based on a linear change there to with regard to sensitivity of net adjusted fair value to changes in interest rates.

Risks Report

As of December 31, 2021

Impact of change scenarios in interest rates on net interest revenues and non-interest financing revenues:

	As of December 31, 2021			As of December 31, 2020		
	Interest revenues	Non-interest financing revenues ⁽³⁾	Total	Interest revenues	Non-interest financing revenues ⁽³⁾	Total
Concurrent changes⁽²⁾						
Concurrent 1% increase	1,291	30	1,321	1,145	145	1,290
Of which: Banking portfolio	1,291	47	1,338	1,148	125	1,273
Concurrent 1% decrease	(1,158)	(36)	(1,194)	256	(160)	96
Of which: Banking portfolio	(1,157)	(59)	(1,216)	256	(141)	115

Impact of change scenarios in interest rates on net interest revenues and non-interest financing revenues:

- (1) For a one-year term.
- (2) Changes to risk-free interest.
- (3) Includes the effect of fair value, gain (loss) from transactions in debentures and the effect of interest accrual f transactions in derivatives.

Below are the key assumptions and effects underlying the above data:

- Credit balances in checking accounts are attributed in line with common practice in conformity with the Basel directives, i.e. over an average term of 3-4 years for different client types.
- In calculating the sensitivity of interest revenues and non-interest revenues, the risk-free interest is not cut off for all segments (as opposed to being cut off at 0% applied in 2020 for the non-linked NIS-denominated segment and for deposits with central banks).
- In the lower interest scenario, the decrease in revenues in 2021 compared to 2020 is primarily due to elimination of the cut-off for all segments and activities.

For further details of assumptions used in calculation of the fair value of financial instruments, see Note 33 to the financial statements.

Risks Report

As of December 31, 2021

Additional information about interest risk

Exposure of the Bank and its subsidiaries to changes in interest rates – continued

Reported amounts (NIS in millions)

	As of December 31, 2021						
	On Call to 1 month	Over 1 month to 3 months	Over 3 months to 1 year	Over 1 year to 3 years	Over 3 years to 5 years	Over 5 years to 10 years	
Financial assets ⁽¹⁾	238,291	10,871	26,830	48,723	29,975	21,180	--
Other amounts receivable ⁽²⁾	160,106	69,898	128,326	25,534	27,839	8,077	-
Financial liabilities	166,146	27,150	59,633	52,102	32,815	25,744	-
Other amounts payable ⁽²⁾	160,659	69,802	129,275	23,890	28,159	8,887	-
Exposure to interest rate fluctuations	71,592	(16,183)	33,752	(1,735)	(3,160)	(5,374)	-
Additional details on exposure to changes in interest rates							
A. By nature of activity:							
Exposure in banking portfolio	69,196	(15,874)	(33,845)	(1,013)	(2,990)	(5,353)	-
Exposure in trading portfolio	2,396	(309)	93	(722)	(170)	(21)	-
B. By linkage basis:							
Israeli currency – non-linked	64,396	(21,939)	(22,511)	(12,977)	(8,649)	2,612	-
Israeli currency – linked to the CPI	(1,880)	2,290	(436)	10,429	7,991	(7,587)	-
Foreign currency ⁽⁴⁾	9,076	3,466	(10,805)	813	(2,502)	(399)	-
C. Effect on exposure to interest rate fluctuations							
Effect of liabilities with respect to employee rights	(9)	(14)	(148)	(411)	(256)	(529)	-
Effect of attribution of on-call deposits to terms	40,402	(4,465)	(7,298)	(10,473)	(9,006)	(7,654)	-
Effect of early repayment of residential mortgages	829	1,568	6,044	8,079	(676)	(1,694)	-
Effect of other behavioral assumptions	297	46	3,763	6,733	2,367	480	-

Specific remarks:

- (1) Excludes balance sheet balances of financial derivative instruments, fair value of off-balance sheet financial instruments and fair value of complex financial instruments. After effect of attribution of on-call deposits to terms
- (2) Amounts receivable and payable with respect to financial derivatives, complex and off-balance sheet financial instruments, after effect of employee rights liabilities.
- (3) Weighted average by fair value of average effective duration.
- (4) Includes Israeli currency linked to foreign currency.
- (5) Difference between effective average duration of financial assets and effective average duration of financial liabilities.

General remarks:

- In this table, data by terms represents the present value of future cash flows from each financial instrument, discounted using the interest rate which discounts them to the fair value consistent with assumptions according to which fair value was calculated for the financial instruments in Note 15 to the financial statements.
- Internal rate of return is the interest rate which discounts the expected cash flows from a financial instrument to its fair value recognized under Note 15 to the financial statements.
- Average effective duration of a group of financial instruments is an approximation of the change, in percent, in fair value of the group of financial instruments which would be caused by a minor change (0.1% increase) in the internal rate of return of each of the financial instruments.
- Certain transactions conducted by the Bank constitute complex financial instruments, which include embedded derivative elements not detached, in accordance with Public Reporting Directives. These transactions include, inter alia, loans with exit points, deposits bearing graduated interest rates with withdrawal dates, credit and deposits with guaranteed minimum and deposits with optional linkage. The Bank reflects the interest rate risk with respect to these instruments in a reasonable manner, by spreading maturities of the cash flows in accordance with contract dates, and with various assumptions based on past experience.

Risks Report

As of December 31, 2021

	Over 10 y ears to 20 years	Over 20 years	Without maturity	Total fair value	Internal rate of return In %	Average effective duration ⁽³⁾ in years	Total fair value	Internal rate of return In %	Average effective duration ⁽³⁾ in years
-	8,820	978	1,099	386,767	2.36	1.38	351,763	2.72	1.54
-	404	483	-	420,667		0.57	324,045		1.90
--	2,130	3	10	365,733	0.59	1.27	334,130	0.67	1.26
-	1,207	1,405	-	423,284		0.60	326,215		1.22
-	5,887	53	1,089	18,417			15,463		
-									
-									
-	5,445	(13)	1,052	16,605		0.10	12,094		0.41
-	442	66	37	1,812		2.11	3,369		4.06
-									
-	3,462	342	984	5,720		0.09 ⁽⁵⁾	(1,775)		0.10 ⁽⁵⁾
-	1,657	(149)	19	12,334		0.10 ⁽⁵⁾	17,002		0.74 ⁽⁵⁾
-	768	(140)	86	363		(0.10) ⁽⁵⁾	236		0.97 ⁽⁵⁾
-									
-	(676)	(473)	-	(2,516)	(0.08)	10.45	(1,207)	0.68	12.04
-	(343)	-	-	1,163	(1.10)	0.78	740	(1.22)	0.67
-	(12,060)	(4,568)	-	(2,478)	0.02	(1.67)	1,272	(0.12)	1.17
-	(11,198)	(4,549)	-	(2,061)	(0.10)	(1.28)	(407)	2.56	(0.75)

Shares

Policy on holding shares in the banking portfolio

Bank policy with regard to investment in shares is to realize the current portfolio and individually review any new investments. Shares in which the Bank invested were acquired for the purpose of earning capital gains, and are presented at fair value in the available-for-sale security portfolio and under investment in associated companies, where the Bank has a material investment in such entity.

Holdings with expected capital gain and holdings purchased for other purposes

Investments in non-banking corporations are managed by the Business Banking Division. The steering committee for investments in non-banking corporations convenes quarterly and advises Bank management on investments in non-banking corporations. The steering committee is responsible for management and maintenance of the existing portfolio, trying to improve it so as to allow for rational realization of this portfolio within a reasonable time frame but with no specified schedule, in order to allow for maximum returns.

Accounting treatment

About 45% of investments in shares by the Bank 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's assessment, a provision for impairment of the investment is recorded as a loss in the Bank's accounts.

For more information about equity investments in the banking portfolio, see chapter "Major investees" on the Report by the Board of Directors and Management. and Note 12 to the financial statements.

Below is information about the composition of equity investments in the banking portfolio (NIS in millions):

	December 31, 2021		December 31, 2020	
	Fair value	Capital requirement ⁽¹⁾	Fair value	Capital requirement ⁽²⁾
Shares	378	79	250	51
Venture capital / private equity funds	417	37	227	18
Total investment in shares in banking portfolio	795	116	477	69

(1) The capital requirement was calculated at 11.50%.

(2) The capital requirement was calculated at 11.50%.

Liquidity risk

Liquidity risk – risk resulting 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 a material and unique, due to the need to respond to it in the shortest possible time. Risk materialization may cause the Bank to incur significant loss and may even result in collapse of the Bank.

Liquidity risk management – objectives and policies

The objective of liquidity risk management is to identify financing needs and sources of the Bank, to establish procedures for monitoring liquidity and setting minimum requirements for liquidity management.

Liquidity risk is managed in conjunction with Proper Conduct of Banking Business Directive 310 "Risks management", Directive 342 "Liquidity risk management", Directive 221 "Liquidity coverage ratio" and Directive 222 "Net stable funding ratio". The 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.

Proper Banking Conduct Directive 221 "Liquidity coverage ratio" stipulates minimum liquidity ratios of 100% under stress scenario, for 30 days ("Regulatory LCR") of high-quality liquid assets to liquidity needs over this time period. As part of its risks management policy, the Bank's Board of Directors specified that additional safety cushions are to be maintained, beyond the regulatory minimum ratio; so that the target liquidity coverage ratio for the Bank and the Group would be 5% higher than the minimum required. This ratio is managed and reported for all currencies in aggregate and for NIS separately, both at Bank level and on Group basis. The ratio for the bank solo and the consolidated ratio are calculated daily and reported as the average of daily observations over 90 days prior to the report date.

Proper Conduct of Banking Business Directive 222 "Net stable funding ratio" stipulates a minimum net stable funding ratio of 100% ("Regulatory NSFR") of available stable funding and required stable funding. As part of its risks management policy, the Bank's Board of Directors specified that additional safety cushions are to be maintained, beyond the regulatory minimum ratio; so that the net stable financing ratio for the Group would be 5% higher than the minimum required. This ratio is managed and reported in total for all currencies, on consolidated basis. The reported ratio in the quarterly report is the ratio on consolidated basis as of December 31, 2021.

These directives are in addition to liquidity risk management using internal models and to qualitative requirements, as stipulated by Directive 342.

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.

Current and periodic management of liquidity risk is conducted on a Group basis, with due attention to legal, regulatory and operating restrictions on the capacity to transfer liquidity and 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 in 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 coverage ratio directive (Directive 221) and the net stable funding ratio (Directive 222) and compliance with targets for all business units at the Bank for raising and management of resources. The Risks Control Division also conducts regular, independent controls over risk benchmarks, risk development and event debriefs, as needed.

The Liquidity Department is responsible for intra-day management of liquidity in Israeli and foreign currency. Daily liquidity management is conducted while maintaining a minimal reserve, as determined from time to time, in order to make unexpected payments. Balances are managed in conformity with the Bank of Israel directives (liquid assets), which require the Bank to maintain liquid assets against deposits in Israeli and foreign currency, at rates as specified in the directive. Any failure to comply with these directives would be reported to Bank management and to the Board of Directors soon after its occurrence.

If unusual changes in balances are observed during the day, in Israeli or foreign currency, an evaluation is conducted in terms of compliance with limits of the liquidity risk management model, and a decision is made as to whether proactive steps should be taken in response. Such steps may include conducting proactive transactions, contacting major clients etc.

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.

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 launch them), also referring to management of communications, both internal and external.

Business model

The policy on liquidity risk management is an integral part of strategic business management at the Bank and the Group and is aligned with Proper Conduct of Banking Business Directives 310 (Risk management), 342 (Liquidity risk management) and 221 (liquidity coverage ratio) and 222 (Net stable funding ratio).

As noted above, the Bank's Board of Directors specified that additional safety cushions are to be maintained, beyond the regulatory minimum ratios, so that the target liquidity coverage ratio and the net stable funding ratio for the Bank and the Group would be 5% higher than the minimum required. Bank management has specified additional safety cushions as guidelines, so as to avoid deviation from the Board of Directors' targets. It is Bank policy to maintain a liquidity coverage ratio and a net stable funding ratio including an appropriate safety margin relative to the Board of Directors' limits, along with efficient management of excess liquidity, in order to achieve maximum return for the Bank.

Approach to operational risk policy and setting limits

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, net stable funding 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.

Organizational structure for liquidity risk management

The Liquidity Risk Owner at the Bank is the Manager, Finance Division.

Liquidity risk management is conducted in conjunction with the general risks management framework at the Bank. This framework includes the following:

- First line – risk managers at the Finance Division
- Second line – risk controllers at the Risks Control Division
- Third line – Internal Audit.

All Bank units have some impact on liquidity risk. The policy document stipulates the requirement for co-ordination between these units, in order to create a uniform methodology to be used by the Bank for regular management of liquidity risk, compliance with daily requirements of financing needs, and preparation for potential emergencies, including adoption of immediate actions to properly address such emergencies.

Reports to management and to the Board of Directors

The Bank's Board of Directors and management receive various reports on a daily, weekly, monthly and quarterly basis, including reporting of compliance with limits specified by the Board of Directors and management, states of alert, cost of sources, data with regard to changes in balance sheet balances for deposits and credit, and any other information which the liquidity risk owner deems relevant for the report, including unusual events in liquidity management and unusual developments in the Bank's liquid sources. In 2021 there were no recorded deviations from the Board of Directors' restrictions.

Measurement tools and Indicators

The Bank measures and monitors risk, primarily using the following models:

- Standard model – This model estimates the liquidity coverage ratio (LCR), which is the ratio of liquidity cushion to forecasted net outgoing cash flow. The forecasted net outgoing cash flow is defined as the difference between payments (cash outflows, with respect to liabilities) and receipts (cash inflows, with respect to assets) for a one-month term. This ratio is calculated under standard (uniform) coefficients specified by the Supervisor of Banks in Proper Conduct of Banking Business Directive 221 (Liquidity coverage ratio) and based on directives of the Basel III Committee.
- The dynamic liquidity coverage ratio (DLCR) is a key supporting tool for risk management and monitoring. For calculation of the DLCR, the daily LCR is calculated for 90 days ahead under multiple assumptions. The DLCR is calculated for the overall ratio and for the ratio in foreign currency, and is reported in the daily liquidity report.

- Internal model (minimum liquidity ratio – in conformity with Directive 342) – This model estimates the ratio of liquidity cushion to forecasted net outgoing cash flow, as required by Directive 342 and in conformity with Basel directives. In this model, stress scenarios were defined in Israeli and foreign currency, for different time horizons, based on behavioral attributes of depositors and on risk focal points, in line with the various scenarios.
- Standard model – This model estimates the Net Stable Funding Ratio (NSFR) – the ratio of stable funding sources (Available Amount of Stable Funding) – existing sources which are highly likely to be available to the banking corporation within 1 year or longer to total long-term uses (Required Amount of Stable Funding) – existing uses which the banking corporation is likely to be required to fund within 1 year or longer). This ratio is calculated under standard (uniform) coefficients specified by the Supervisor of Banks in Proper Conduct of Banking Business Directive 222 (Net stable funding ratio) which became effective on December 31, 2021 and based on directives of the Basel III Committee.
- Contractual liquidity differences – Review of balance sheet differences between inflows and outflows, with no behavioral assumptions and with no coefficients applied.

The Bank also applies tools for monitoring liquidity risk using endogenous and exogenous indicators, which may point to an increase in risk up to crisis status. 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.

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. In 2021 there were no recorded deviations from the Board of Directors' restrictions.

The Bank reviews liquidity ratios both in the normal course of business and under certain scenarios. In the normal course of business, the Bank assumes no difficulty in conversion transactions between currencies. Furthermore, excess liquidity available for investment for a period of one year ahead is calculated, with no assumptions on raising new funds.

The scenarios used to review the liquidity ratios consist of three main scenarios (specific, system-wide and combined) and three additional scenarios (short specific, overseas system-wide and long combined), as set forth below:

- Main stress scenarios:
 - Specific – specific operational event / material lowered rating (by at least three notches) – scenario of embezzlement and/or disruption of Bank operations, including a prolonged disruption to its IT Systems.
 - System-wide – scenario involving a market emergency due to war, unusual defense events or financial events, which disrupt the normal day-to-day life in Israel, including the local capital markets.
 - Combined – system-wide event with expected implication for the Bank that is more severe than its expected implication to other banks, such as a crisis in the real estate market.
- Other stress scenarios:
 - Short specific – scenario describing a very high pressure due to lowered rating of the Bank; in this scenario, the impact is short but more significant than in the main stress scenarios.
 - Overseas specific – scenario involving shock which impacts overseas affiliates of the Bank / of Israeli banks and also has a low-level impact on operations in Israel.
 - Long combined – scenario reflecting a prolonged event. In this scenario, the stress level is lower than in main stress scenarios, but its impact is longer lasting, hence this scenario would impact a wider client audience.

Scope and nature of reporting and measurement systems

Liquidity risk management system, used to calculate the overall liquidity, in Israeli currency and in foreign currency separately (including details in major currencies), including information about assets, liabilities and off-balance sheet liabilities of the Bank, compliance with limits specified by the Board of Directors and management, alerts with regard to trends in development of liquidity, the overall liability structure and in particular, liabilities to major depositors. The model results are displayed on a custom portal. The system is based on a daily database containing client mapping, updated daily, from the Bank's data warehouse, and activity data obtained from the mainframe computer. The system includes controls to ensure data integrity and reliability. This information system is also used for reporting to the Bank of Israel, as stipulated by reporting directives 827 and 889 of the Supervisor of Banks and by the Public Reporting Directives.

Liquidity coverage ratio (LIQ1)

Below is information about liquidity coverage ratio⁽¹⁾ (NIS in millions):

	For the three months ended December 31, 2021	
	Total unweighted value ⁽²⁾ (Average)	Total weighted value ⁽³⁾ (Average)
Total high-quality liquid assets		88,141
Outgoing cash flows		
Retail deposits from individuals and from small businesses, of which:	153,821	10,159
Stable deposits	43,357	2,168
Less stable deposits	60,520	6,493
Deposits for terms longer than 30 days	49,944	1,498
Unsecured wholesale financing, of which:	94,072	60,532
Deposits for operational needs (all counter-parties) and deposits with networks of co-operative banking corporations	3,657	914
Deposits other than for operational needs (all counter-parties)	89,646	58,849
Unsecured debts	769	769
Secured wholesale financing	–	210
Additional liquidity requirements, of which:	116,545	27,593
Outflows with respect to derivatives exposure and other collateral requirements	18,791	18,791
Credit lines and liquidity	61,900	5,707
Other contractual financing obligations	669	669
Other contingent financing obligations	35,185	2,426
Total outgoing cash flows		98,494
Incoming cash flows		
Secured loans	1,544	294
Inflows from regularly repaid exposures	13,603	10,174
Other incoming cash flows	23,156	17,485
Total incoming cash flows	38,303	27,953
		Total adjusted value⁽⁴⁾
Total high-quality liquid assets		88,141
Total outgoing cash flows, net		70,541
Liquidity coverage ratio (%)		125

- (1) Information is presented in terms of simple averages of daily observations during the reported quarter. The number of observations used in calculating the averages in the fourth quarter of 2021 is 79.
- (2) Unweighted values are 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 accounted for after applying appropriate security factors or inflow / outflow rates (for inflows and outflows).
- (4) Adjusted value are 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 Conduct of Banking Business Directive 221).

Risks Report

As of December 31, 2021

Below is information about liquidity coverage ratio⁽¹⁾ (NIS in millions):

	For the three months ended December 31, 2020	
	Total unweighted value ⁽²⁾ (Average)	Total weighted value ⁽³⁾ (Average)
Total high-quality liquid assets		78,145
Outgoing cash flows		
Retail deposits from individuals and from small businesses, of which:	148,396	9,526
Stable deposits	41,410	2,071
Less stable deposits	54,642	5,885
Deposits for terms longer than 30 days	52,344	1,570
Unsecured wholesale financing, of which:	83,017	50,718
Deposits for operational needs (all counter-parties) and deposits with networks of co-operative banking corporations	2,867	717
Deposits other than for operational needs (all counter-parties)	80,048	49,899
Unsecured debts	102	102
Secured wholesale financing	–	994
Additional liquidity requirements, of which:	106,705	22,600
Outflows with respect to derivatives exposure and other collateral requirements	15,210	15,210
Credit lines and liquidity	53,022	4,268
Other contractual financing obligations	382	382
Other contingent financing obligations	38,091	2,740
Total outgoing cash flows		83,838
Incoming cash flows		
Secured loans	2,081	1,036
Inflows from regularly repaid exposures	12,659	9,895
Other incoming cash flows	18,870	14,138
Total incoming cash flows	33,610	25,069
		Total adjusted value⁽⁴⁾
Total high-quality liquid assets		78,145
Total outgoing cash flows, net		58,769
Liquidity coverage ratio (%)		133

- (1) Information is presented in terms of simple averages of daily observations during the reported quarter. The number of observations used in calculating the averages in the fourth quarter of 2020 is 79.
- (2) Unweighted values are 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 accounted for after applying appropriate security factors or inflow / outflow rates (for inflows and outflows).
- (4) Adjusted value are 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 Conduct of Banking Business Directive 221).

Key factors that impact the results of liquidity coverage ratio

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. Cash outflows primarily consist of unsecured 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 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. There is some volatility between days of the month, due to current activity of clients and interchangeability between NIS and foreign currency, primarily due to activity in NIS / foreign currency derivatives.

Composition of high quality liquid assets (HQLA)

Below are details of liquid assets by level, as required by Directive 221 (NIS in millions):

	December 31,		Average for the fourth quarter	
	2021	2020	2021	2020
	Level 1 assets	89,128	84,248	88,020
Level 2a assets	158	91	121	106
Level 2b assets	–	–	–	–
Total HQLA	89,286	84,339	88,141	78,145

There is a regulatory limit applicable to the Los Angeles branch, with regard to use of liquidity reserve by this entity; Bank scenarios assume use of branch liquidity in conformity with this limit.

Developments in liquidity coverage ratio

In the fourth quarter of 2021, the Bank maintained appropriate liquidity by investing excess liquidity in liquid assets of very high quality – Level 1 assets. The average liquidity coverage ratio (consolidated, including data for Union Bank) for the fourth quarter of 2021 was 125%. In this quarter, there were no recorded deviations from ratio restrictions.

Net stable funding ratio (LIQ2)

On June 21, 2021, the Supervisor of Banks issued Proper Conduct of Banking Business Directive 222 regarding "Net stable funding ratio (NSFR)", which stipulates calculation of the ratio as specified in the Basel III Reform of the Basel Committee (BCBS).

In conformity with this directive, the objective of the net stable funding ratio is to improve stability of the liquidity risk profile of banking corporations over the long term, by requiring banking corporations to maintain a stable funding profile in conformity with the composition of on-balance sheet assets and off-balance sheet operations. The ratio limits over-reliance by banking corporations on short-term wholesale funding. The net stable funding ratio consists of two components: available stable funding items and required stable funding items.

As required in the directive, the net stable funding ratio should be 100% or higher on regular basis.

In conformity with the directive, "Available stable funding" is defined as the part of capital and liabilities that may be relied upon over the time horizon taken into account in the net stable funding ratio, of one year. The required stable funding amount for a given corporation is based on the liquidity attributes and time to maturity of various assets held by the corporation, as well as of off-balance sheet exposures.

Risks Report

As of December 31, 2021

Below is information about the net stable funding ratio⁽¹⁾ (NIS in millions) as of December 31, 2021:

	A	B	C	D	E
	Non-weighted value by term to maturity				Weighted value
	No maturity ⁽¹⁾	Up to 6 months	6-12 months	12 months or longer	
Available stable funding items (ASF)					
Capital:	22,994	2,120	158	6,889	29,962
Supervisory capital	22,994	–	–	3,203	26,197
Other capital instruments	–	2,120	158	3,686	3,765
Retail deposits from individuals and from small businesses	–	137,500	11,414	5,805	142,567
Stable deposits	–	52,770	2,019	1,151	53,201
Less stable deposits	–	84,731	9,394	4,654	89,366
Wholesale financing	–	145,074	26,686	44,351	95,906
Deposits for operational needs	–	4,139	–	–	2,069
Other wholesale financing	–	140,935	26,686	44,351	93,836
Liabilities with matching assets which are inter-dependent	–	2,119	–	–	–
Other liabilities:	1,489	8,593	3,152	1,383	2,959
Liabilities with respect to derivative instruments for net stable funding ratio	–	–	3,927	–	–
All other liabilities and capital not included in the above categories	1,489	4,666	3,152	1,383	2,959
Total available stable funding items (ASF)					259,631
Required stable funding items (RSF)					
Total high-quality liquid assets by net stable funding ratio (HQLA)					463
Deposits held at other financial institutions for operational purposes	–	–	–	–	–
Loans and securities in good standing:		66,970	26,493	193,933	198,815
Loans to financial institutions in good standing, secured by level 1 high-quality liquid assets	–	–	–	–	–
Loans to financial institutions in good standing, secured by high-quality liquid assets other than in level 1, and loans to financial institutions in good standing which are not secured	–	10,676	10,923	8,694	15,757
Loans to wholesale clients, other than financial institutions, which are in good standing, loans to retail clients and to small businesses and loans to sovereigns, to central banks and to public sector entities	–	47,719	7,041	27,043	49,808
Of which: With risk weighting of 35% or lower, pursuant to Proper Conduct of Banking Business Directive 203	–	6	4	76	55
Residential mortgages secured by mortgage in good standing, of which:	–	8,575	7,477	158,193	132,721
Of which: With risk weighting of 35% or lower, pursuant to Proper Conduct of Banking Business Directive 203	–	3,002	3,128	48,845	34,814
Securities not in default which do not qualify as high-quality liquid assets, including shares traded on the stock exchange	–	–	1,053	3	529
Assets with corresponding liabilities which are inter-dependent	–	2,119	–	–	–
Other assets:	2,477	3,923	992	11,707	15,281
Physically traded commodities, including gold	–	–	–	–	–
Assets deposited as primary collateral for derivative contracts and provided to default funds of central counter parties (CCPs)	–	–	1,259	–	1,259
Assets with respect to derivative instruments for net stable funding ratio	–	–	3,818	–	–
Liabilities with respect to derivative instruments for net stable funding ratio, before deduction of variable collateral deposited	–	–	25	–	25
All other asset categories not included in the above categories	2,477	2,305	973	7,804	13,558
Off-balance sheet items			98,837		4,328
Total required stable funding (RSF)					218,447
Net stable funding ratio (NSFR) (%)					119%

(1) Items reported under "No maturity" are items with no specified maturity.

Key factors that impact results of the net stable funding ratio

Net stable funding ratio on consolidated basis as of December 31, 2021 was 119%. Volatility of this ratio throughout the quarter was low; the main factors affecting the net stable funding ratio are: composition of Bank sources and uses by financing term, financing type and counter party. On the sources side – long-term liabilities are more stable than short-term liabilities,

Risks Report

As of December 31, 2021

and funding from retail clients and small businesses is more stable than wholesale funding with the same maturity. When long-term sources grow shorter on a large scale (such as with subordinated notes) to a term shorter than one year, this factor affects the resulting ratio; however, because this is a funding source which typically has scattered maturities, the impact on the resulting ratio is not material. On the uses side – the asset type, duration and quality and the liquidity value determine the amount of required stable funding.

Pledged assets (ENC)

Proper Conduct of Banking Business Directive 336 concerning "Pledging assets of a banking corporation" stipulates a guiding principle to balance the need of running a business and the need of protecting rights of depositors in case of insolvency. The directive stipulates that a banking corporation may only pledge assets if required by law, regulation or relevant market requirements.

In conformity with Public Reporting Directives, pledged assets are assets which the Bank is limited in or precluded from liquidating, selling, transferring or assigning them due to legal, regulatory, contractual or other restrictions, and which are not included under "Assets used as collateral for a central bank".

Un-pledged assets are assets that do not meet the definition of pledge assets and are not included under "Assets used as collateral for a central bank".

Assets used as collateral for a central bank (central bank facilities) are assets used as collateral for transactions, or which may be used as collateral for transactions in any central bank facility, including those used for monetary policy, liquidity support or any other financing needs.

In conformity with Bank policy on pledging assets, the Bank's strategic business activity, which includes extensive financial activity, as well as flexible, efficient management of Bank liquidity, requires pledging some Bank assets in the course of such activity. Thus, for example, the Bank allows clients to trade on diverse markets (securities in Israel and overseas, interest and foreign currency derivatives) and offers an extensive range of products and services. This activity is also carried out through third parties and vis-à-vis clearinghouses, and sometimes requires assets to be pledged.

Below is the composition of pledged and un-pledged available assets (NIS in millions):

	As of December 31, 2021		
	Total balance on balance sheet	Of which: Pledged	Of which: Un-pledged
Cash and deposits with central banks	93,689	1,244	92,445
Debentures of the Government of Israel	10,421	872	9,549
Debentures of others in Israel	1,372	–	1,372
Debentures of foreign governments	2,035	256	1,779
Debentures of foreign others	479	19	460
Loans to the public, net	271,428	6,606	264,822
Total	379,424	8,997	370,427
	As of December 31, 2020		
Cash and deposits with central banks	84,450	339	84,111
Debentures of the Government of Israel	14,455	803	13,652
Debentures of others in Israel	1,390	–	1,390
Debentures of foreign governments	451	345	106
Debentures of foreign others	548	20	528
Loans to the public, net	245,525	2,057	243,468
Total	346,819	3,564	343,255

Additional information about liquidity risk and financing risk

Financing risk

Financing risk arises from shortage of financing sources or too high costs to raise 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.

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 issues of debentures and notes. The Bank sees the great importance of diversification of its financing sources and acts proactively to identify sources for longer terms, including through a wide range of deposits offered by the Bank to its clients, deposits with unique attributes, which allow clients to benefit from relatively high interest over the long term with optional liquidity during the deposit term. In 2020, the Bank continued diversifying its financing sources and reducing concentration risk.

Furthermore, exposure to derivatives is 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.

Concentration of financing sources

The Bank has specified the major risk concentrations for handling source concentration / structure. Handling of risk concentrations is focused on different levels, regularly conducted by means of Board and management limits as well as risk indicators.

The Board of Directors and management limits and the various key risk indicators with regard to financing source concentration are monitored across a wide range of sub-categories: Size, client type, individual depositor, number of clients, product, currency and average deposit term. A "comprehensive index" was defined, which averages all indicators related to concentration of financing sources. Current management of source composition includes setting policies 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 Board of Directors and management limits were specified as part of the Bank's overall risk appetite.

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

Operational risk

Operational risk is material, since it exists across all operating segments and Bank units. Operational risk may potentially impact earnings, revenues, capital and reputation of the Bank and is inter-related to other risks, such as: Market risk, credit risk, liquidity risk, reputation risk and other risks. Operating events sometimes occur which are not under control of the Bank, 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), plague and security event. Therefore, efficient management of this risk is required for risks management processes at the Bank.

Operational risk is inherent in all products, activities, processes and systems. 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.

Operational risk is defined as the risk of loss due to inappropriateness or failure of internal processes, people and systems or due to external events. Operational events are classified under seven risk categories, based on the Basel principles: Embezzlement (Bank defrauded by employees), external fraud (Bank defrauded by client), work practices and work environment safety (loss due to activity incompatible with laws or labor agreements), practices involving clients, products and businesses (failure to meet obligations to client), damage to physical assets, performance, distribution and process management, business disruption and system failures.

The Bank manages and monitors operational risk based on these categories as well.

Operational risk management – objectives and policies

The framework policy on operational risk management specifies the principles whereby the Bank manages operational risk, risk materiality, how it is managed, measurement and monitoring processes and actions taken by the Bank to mitigate such risk.

Policy principles were specified in line with Bank strategy with regulatory requirements (Proper Banking Conduct Directives of the Bank of Israel and relevant Basel Committee directives) and in line with globally accepted best practice.

The policy elaborates the corporate governance and the roles and responsibilities of the various lines of defense and stipulates the importance of deploying an appropriate culture for management of operational risks at the Bank and Group. Risk management at the Bank is carried out in conformity with Bank of Israel directives. Directive 350 "Operational risks

Risks Report

As of December 31, 2021

management" and Directive 310 "Risk management", which specify the overall risk management framework, and the Basel document "Principles for management of operational risk" (dated October 2014), which specify the rules for proper management of operational risk.

The Bank framework for handling operational 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, the operational risk map and the most material events which occurred during the quarter are also presented and analyzed.

The Operational Risk Manager at the Bank is the Manager, Risks Control Division – who is also the Bank's CRO, responsible for proper implementation of the operational risk handling framework, acting through the Risks Control Division. The framework stipulated also includes the framework required for handling fraud and embezzlement risks, which are part of the operational risk categories according to Bank of Israel directives.

Bank policy determined the Bank's operational risk appetite in multiple qualitative and quantitative aspects, under normal business conditions and under stress scenarios. The risk appetite is specified in conformity with basic principles of the strategic plan, which specify the overall risk appetite of the Bank. The risk appetite was specified with respect to actual losses and potential losses, at the overall portfolio level and by risk category. The policy document was approved by Bank management and by the Board of Directors in 2021, as part of the approval process of all policy documents for risk management and control.

This risk is regularly monitored by review of failure events which caused loss, which are managed based on the different operational risk categories.

The Bank acts to dynamically measure and identify operational risk on two levels: Measuring loss due to failure events that actually materialized, and measuring potential risk identified by the operational risk survey process and in the risk map. Operational surveys are conducted for all Bank operations, in conformity with a three-year plan. The Bank implements a three-year plan for conducting operational risks surveys for all Bank operations, to be concluded by end of 2022. This activity is an on-going process designed to generate a risk map, to increase the effectiveness of risk management and mitigation, while learning, re-assessing risk, including to due materialized events.

The Bank monitors and documents all operational failure events, including events for which a loss was incurred, as well as events with no loss or even events with a profit. Measurement of actual loss vs. the risk appetite in the normal course of business only includes loss events (without offset of profit events) and after accounting for any insurance coverage if actually realized.

The Bank conducts surveys to identify and map potential operational risks at various divisions, as a continuous process focused on mapping and assessment of material risks at each unit. The Bank has specified multiple key risk indicators (KRI) designed to identify potential risk prior to materialization. The survey results and action items (AI) 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.

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 operational risk. Such analysis serves the Bank in implementation of appropriate steps for parallel processes within the Bank.

The Bank is acting to improve the effective handling of fraud and embezzlement risk. As part of this effort, the Bank is implementing a system using business rules to flag and identify unusual activity. Handling of fraud and embezzlement is in conformity with a specific operational risks management framework policy document. The framework includes a combination of Bank entities: Risks Controls, information security and cyber, human resources and the Technology Division.

Business model

The Bank actively handles operational risk in order 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 reduce expected loss due to operational risk.

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 have increased legislator awareness and financial institutions' awareness of materiality of operating failure events, to the large potential for damage which may be caused by such operational risk event and to their main attributes, as follows:

- Operating events may occur in all areas of activity and in all Bank units.
- Operational risk may potentially impact earnings, revenues, capital and reputation of the Bank.
- Operational risk is correlated with other risks, including: Market risk, credit risk, liquidity risk, reputation risk and other risks. Thus, for example, materialization of an operational risk event may cause reputation risk to materialize, after which the Bank may face a liquidity event.
- Some operating failures have very low probability of materialization, but relatively large damage potential.
- Operational 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), plague and security event.

In 2021 there were no significant operating events.

Approach to operational risk policy and setting limits

The basic principles of the strategic plan specify the overall risk appetite of the Bank, include efficient branch deployment, business and technology innovation, hybrid banking management, operational efficiency targets, efficiency in capital and liquidity management, along with growth in commercial credit and continued leadership in the mortgage market, exposing the Bank to significant operational risk. Such risk requires active, forward-looking action to manage and to minimize the potential impact.

As noted, the Bank acts to measure and identify operational risk inherent in all products, activities, processes and material systems of the Bank, dynamically, on two levels:

- Measuring actual materialization of failure events.
- Risks assessment for damage potential with respect to failure events.

The activity on these two levels is a constant process designed to increase the effectiveness of risks management and mitigation, while learning, reassessing risks, including to due materialized events.

The Bank has a custom system for operational risks management (PSTL – Operational Risk Portal), used by the Bank to monitor and analyze failure events, risk surveys and generating the risk map, linking any actual materialized events to the risks map, regular monitoring of recommendations for implementation arising from surveys, failure events and lessons learned. And reports with regard to operational risk.

Fraud and embezzlement system – In 2020, the Bank started implementation and deployment of a new system for monitoring fraud and embezzlement. Alerts generated by this system are based on business rules specified for identifying events suspected of being fraud events (either external or internal).

The Bank reviews the capital held against operational risk under Pillar 1, calculated using the standard approach, vs. advanced Basel methodologies, in order to assess whether an additional capital allocation is required under Pillar 2, in the normal course of business. The Bank also applies a range of operational stress events, mapped in the Bank's operational risk map as events causing material damage to the Bank. Such potential loss is added to the internal capital allocation under Pillar 2, as part of the ICAAP process.

Organizational structure for operational risk management

The Bank has put in place an organizational structure and corporate governance for management of operational risks, which includes the Board of Directors, management and the three lines of defense. This structure is supported by dedicated committees and forums, created for management of operational risk.

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

First line of defense Includes all business and operational units at the Bank which are responsible for management of operational risk, and in particular, the Technology Division, which is the first line for management of cyber and information security risk, business continuity and IT, as well as Mizrahi Tefahot Security Services, which forms the first line for security and safety management.

Second line of defense The Risks Control Division through the Risks Control Department, acting to implement the required activity for management and handling of operational risk across all Bank units, from a general view point and in conformity with policy principles, is responsible for constant monitoring of operational risk vs. the risk appetite and for handling risk in view of activities of the first line, using a range of processes, tools and methods. The unit is also responsible for the risk assessment process, jointly with the business units, and for conducting surveys and for revision of the operational risks map, management of the central IT system used by the Bank with regard to operational risk, used to collect failure events, conduct operational surveys and to monitor the recommendations for implementation arising from surveys, failure events and lessons learned.

Other units in the second line of defense, to handle and manage operational risk:

- The Cyber and Information Security Department of the Risks Control Division, headed by the Bank's Information Security Officer. This Department works in tandem with cyber defense at the Technology Division, along with all Bank units.
- The Engineering Department of the Human Capital, Resources and Operations Division is responsible for overall business continuity management, i.e. Constant Bank readiness for business continuity in case of emergency.
- The Technology Division, constituting the first line for management of cyber and information security, responsible for management of operational risk arising from failures in IT systems, including DRP management as part of the business continuity policy.
- The Training Department, of the Human Capital, Resources and Operations Division, acts to reinforce professional knowledge and to reduce operating failures arising from lack of knowledge and awareness.

Risks Report

As of December 31, 2021

- The Human Capital, Resources and Operations Division, responsible for handling continuous rotation and paid leave to minimize operational risk (and in particular, fraud and embezzlement risk).
- The Bank Security Unit, operating in the Human Capital, Resources and Operations Division, supports handling of operational risk at various Bank units.
- The SOX Unit, of the Financial Information and Reporting Division, is responsible for effectiveness of controls and procedures concerning disclosure and effectiveness of internal controls over financial reporting at the Bank.
- The Legal Division, responsible for implementation of the framework for handling legal risk.

Third line of defense: Internal Audit acts independently to conduct audits of operational risk management in order to ascertain the effectiveness of handling such risk, in accordance with the multi-annual work plan. The operational 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 steering committees.

Below are key risk concentrations for operational risks:

Business continuity

The Bank applies Proper Conduct of Banking Business Directive 355 concerning "Management of business continuity". In the fourth quarter, the Bank continued to address the Corona Virus and maintained work instructions derived from guidance issued by the Ministry of Health and by the Bank of Israel, including the following: Wearing masks indoors, maintaining hygiene and social distancing, barriers at public service counters and continued remote work as needed based on a rapid, structured process. During this quarter, the Bank continued to monitor the number of cases and isolations, and later in the quarter the Bank applied stricter monitoring and adherence to guidelines, due to reports of the Omicron variant outbreak. In the fourth quarter, the Bank continued to implement its work plan and exercise plan for 2021, including: Conducting a second exercise for the backup site (DRP exercise), in co-operation with the Technology Division and the Business Continuity Unit. Exercise at core branches on operating emergency procedures, exercise on transfer of SWIFT orders under a computer failure scenario and so forth. As for the business continuity plan, in this quarter the Bank concluded comprehensive reiteration of critical services under emergencies, Business Impact Analysis (BIA) and revised the work plan including, *inter alia*, revision of procedures and revision of basic plan documents. During this quarter, as part of normal operations and work routines, the Business Continuity Unit maintains control and constant contact with business continuity units across the Group (at Bank Yahav and Union Bank), with current reports and updates also received from the Bank's overseas branches.

Information security and cyber defense

Directive 361 with regard to Cyber Defense Management provides guidelines for proper management of cyber risks, which require expansion and adjustment of the IT risks management framework with regard to the threat space perception and the required defensive capabilities. Accordingly, the Bank has approved strategy and comprehensive cyber defense policies and has specified the defense lines for their implementation, has appointed a Chief Information Security Officer, reporting to the Manager, Risks Control Division – responsible, *inter alia*, for setting policies 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 procedures, including reference to: information security, physical security, IT governance, IT operations, risks management, fraud, human resource management, business continuity, client relationship management, spokesperson operations and legal counsel.

Information security and cyber defense policies at the Bank are 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 and operational activity at the Bank – will ensure the consistency and integrity of the cyber security management concept over time.

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.
- Specifying mechanisms to protect client and business activities in the online domain, in conformity with Proper Conduct of Banking Business Directive 367.
- 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, stability and recovery capacity, conducting processes of investigation, 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.
- Improvement and enhanced controls among Bank suppliers, so as to reduce risk in the supply chain.

In addition, the Bank's On line Banking sector is certified under the information security management standard ISO 27001. The direct banking systems at the Bank include authentication processes and tools in conformity with Proper Conduct of Banking Business Directive 367.

In the fourth quarter of 2021, the Bank identified a few fraud attempts against clients (through fishing attacks) in which their account credentials were stolen in order to carry out un-authorized activity in their accounts, by carrying out social engineering activities targeted at clients. Thanks to defensive measures applied by the Bank, in these fraud attempts there were no unauthorized transactions in client accounts.

The Bank continues to reinforce the defense mechanisms applied in Bank systems, in order to further limit the ability to defraud clients and to conduct un-authorized transactions in client accounts. These actions were taken as part of debriefing processes and lessons learned by the Bank with regard to this emerging threat.

During the Corona Virus crisis, the Bank's information security team operates fully and continuously, improving and bolstering defense capabilities and mechanisms, in conformity with expansion of threats and challenging needs which the Bank is required to face.

We should note that the Corona Virus pandemic has elevated cyber risk across the world, both due to increase in working remotely, which provided more attack vectors for organizations and due to increased fraud attempts in the shadow of the outbreak. Bank operations during this period retained the risk level at the Bank unchanged.

Information technology risk

In recent years, the risks associated with IT management have increased, due to development and deployment of new technologies and evolution of new risk and threats. Other than under routine conditions, the IT management framework addresses system failures, such as: system faults and preparation for emergency situations. This is also intended to ensure that the Bank maintain business continuity during an alert or emergency. This may mitigate reputation risks and business risks which could arise under such conditions.

The Technology Division Manager is responsible for management of IT assets and the management framework is specified in a special policies document, in line with principles specified in policy documents on risks management and control at the Bank. The IT asset management policy is in line with requirements of the Supervisor of Banks and, in particular, with the principles stipulated in Proper Conduct of Banking Business Directive 357 "IT management"; Proper Conduct of Banking Business Directive 350 "Operational risk management"; Proper Conduct of Banking Business Directive 355 "Business continuity management" and Proper Conduct of Banking Business Directive 361 "Cyber security management".

Risk appetite is defined in quantitative and qualitative terms under normal and emergency scenarios, with the Bank's risk appetite in operational aspects for IT risk included under management of operational risk appetite. Risk appetite for technology aspects is defined by multiple benchmarks, including risk levels on the map of technology risk and specific risk appetite for diverse risk factors.

The Bank operates multiple measures to mitigate risk, including use of indicators (KRI) and support systems. Note that the SOC (Security Operation Center) operates 24/7 and is responsible for monitoring Bank infrastructure and systems, analyzing logs and identifying anomalies in real time, unusual behavior of users and systems in the network from information and cyber security aspects. Furthermore, the Bank operates a NOC (Network Operations Center), operating 24/7 as an operational unit for presenting the unified picture of enterprise infrastructure, capability for monitoring and forecasting faults, analyzing logs and identifying anomalies from technology risk aspects. In 2021, the Bank continued to reinforce its capabilities to identify malfunctions in the early stages, and expanded the use of bots for more effective monitoring of system availability.

Given current developments in the financial market and the age of current Bank systems, the Bank launched, in the first quarter of 2019, a project to replace the Bank's capital market core system based on a new platform.

Moreover, in 2019 the Bank launched a project to replace the CRM system, which would take place gradually over several years.

As part of the Union Bank merger process, the Bank's Technology Division is conducting a technology merger program, consisting of multiple projects designed to transfer Union Bank activity that is based on Bank Leumi and Union Bank systems and integrating them with the Bank's systems.

The risk level during this quarter and throughout the Corona Virus crisis remained unchanged. The Technology Division operated in providing full support for regular operations at the Bank and for technology needs required for Bank operations during emergency routine operations. There were no material events and/or malfunctions during this period.

Legal risk

Proper Conduct of Banking Business Directive 350 concerning "Operational risks" defines legal risk as including absence of potential for legal enforcement of an agreement and "including, but not being limited to exposure to fines or penalties arising from supervisory action, as well as from individual arrangements". Legal risk also includes risks arising from legal exposure due to Bank conduct with its various stakeholders (such as: clients, suppliers and other third parties).

Legal risk includes risks arising from legislative and regulatory provisions, rulings by judiciary or quasi-judiciary authorities as well as legal risks arising from regular Bank operations. The Chief Legal Counsel for the Bank has been appointed Chief Legal Risk Manager. The Bank constantly strives to minimize as much as possible the legal risks 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 and headquarters units, 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 Owner of the Bank with regard to any legal risks identified in these entities.

For more information about assessment of the current impact of legal risk, see table "General mapping of risk factors and their impact" above.

Scope and key features of risks measurement system

In general, it is Bank policy to manage and to monitor risks using controlled, computer-based systems with minimal dependence on manual processes and with near-real time update frequency.

The Bank has many measurement systems used to estimate all material risks to which the Bank is exposed, as well as IT systems to support risks monitoring and reporting, as stated below:

- A custom system for operational risks management (PSTL – Operational Risk Portal), used by the Bank to collect, monitor and analyze failure events, risks surveys and to generate a risk maps, linking any actual materialized events to the risk map, regular monitoring of recommendations for implementation arising from surveys, failure events, lessons learned and reports with regard to operational risk.
- System for monitoring fraud and embezzlement risk – The system provides alerts concerning suspect activity, based on definition of business rules.
- Information security center (SOC) system – systems that continuously monitor the Bank's computer environments, including all components thereof, to identify suspect events that require individual scrutiny.
- Permission management and control system – a computer system for management and control of permissions and credentials in various systems. The system applies computer-based processes for management of employee permissions in the various systems, based on their role and the employee life cycle. The system allows for application of time-based controls with regard to changes made to employee permissions in these systems.

Reports to management and to the Board of Directors

Bank policy specifies the channels for management and reporting of operational 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 operational risk:

- Management committee for operational risks – this committee serves as management's key managerial tool for management and monitoring of operational risks at the Bank. The Committee is part of the management committee for risks management.

- Operational Risk Steering Committee – serves as an advisory committee to the Chief risks officer with regard to operational risk management. The committee includes relevant representatives from business units, from control and audit units and an observer from the audit unit.
- Operational risks monitoring forums – Dedicated forums headed by the Chief Risks Officer, with each of the relevant Bank divisions. These forums are intended to discuss internal controls aspects, in particular aspects arising from the operational risk management framework, including results of risks assessment surveys, material events and results of debriefs.

For management of this risk at Bank units, operational risk trustees were appointed, most of whom operate in the first line of defense, are responsible for handling operational risk and IT risk at their unit. The trustees report any operational risk event that took place at their unit, using a special system – the Operational Risks Portal (PASTEL). This system is used by the Bank for analysis and reporting of operational risk by: Trustee reports are 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. There are over 200 operational risk trustees working at the Bank, most of them at Bank branches. They are in regular contact with the Operational Risk Department of the Risks Control Division.

Operational risk mitigation

Due to the significance of operational 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 operational risk, and of deployment of risk-mitigating processes. The operational risk trustees, across the Bank, are the long arm of the Operational Risk Owner in this process.

The Bank conducts special training sessions for these trustees including, *inter alia*, specific training with regard to debriefing and the lesson learning process. In 2021, virtual seminars took place to provide guidance to all operational risk trustees at headquarters and in branches.

Changes to existing business processes and/or new processes with potential for materialization of operational risk 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.

One of the tools used by the Bank for risk mitigation is debriefing and lesson learning flowing internal and/or external events. The conclusions formed in this process are incorporated into work processes, systems, training content and procedures.

The Bank has established policies and operating plans for a time 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 operational risk through 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 acquires 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 also has insurance coverage under a custom cyber insurance policy, an additional layer over the banking insurance policy, which adds coverage related to computer-based crimes to the banking insurance policy. The Bank has a specific policies document which governs insurance aspects related to Bank operations.

Capital allocation

The Bank allocates capital with respect to operational risk using the standard approach. According to this approach, Bank revenues were categorized 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 operational risk. Segmentation and treatment of the required capital allocation is incorporated in a specific policies document which governs the aspects required for capital allocation using the standard approach and, in particular, specifies the lines of business in Bank operations. Risk weightings range from 12% for retail banking to 18% for corporate financing. Bank operations are mostly in the retail segment, so that most of the operational risk assets are with respect to this line of business; the Bank's overall average risk weighting is 12.5%.

Other risks

Compliance and regulatory risk

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.

The Bank is acting in conformity with Proper Conduct of Banking Business Directive 308, which includes the obligations for compliance risk management to all compliance directives, including 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 Economic Competition Act, 1988. Compliance with these laws is also addressed in conjunction with the "Internal Enforcement Program" for Securities Law and for the Economic Competition Act, respectively.

Compliance risk includes, *inter alia*, the issue of fairness, privacy protection laws, AML and terror financing and cross-border risk, as elaborated below.

The Bank has minimal 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, which includes required action for reducing compliance risk.

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

First line of defense – Includes the business units, in charge of identification, assessment, mitigation and control of compliance risk in processes and systems for which they are responsible.

Second line of defense – The Manager, Risks Control Division and CRO of the Bank serves as the person in charge of enforcement of securities law and economic competition law. The Bank has a Compliance Officer, reporting to the CRO. Their role is to assist the Bank's Board of Directors and Bank management in effectively managing compliance risk. The Compliance Department is responsible for deployment of an organizational culture of compliance with procedures and with the Law and fair dealing with clients across all Bank departments, for identification of potential conduct risk, through implementation of risk-based controls over the relevant departments and through analysis of findings provided by departments in the second line of defense.

Third line of defense – Internal Audit, which conducts independent audit of the first line of defense and of the Compliance Function, including review of the appropriateness and effectiveness of the Compliance Function, and review of compliance aspects in branch operations and in processes audited thereby.

The Bank maintains effective enforcement programs for securities law and for economic competition law, adapted for the Bank and its unique circumstances, as part of overall risks management at the Bank. This is designed to ensure compliance with securities law and economic competition law and to avoid violation thereof.

The Compliance Department maps compliance risks in various areas, including fairness risk, and takes action in order to reduce them and carries out training to deploy the compliance policy across the Bank. In order to ensure compliance with all statutory provisions, as noted above, the Compliance Officer maintains a control system in line with control plans.

The compliance risk is assessed using a methodology which reflects the likelihood of materialization of a breach event, the expected damage in case of breach, while taking into account the existing risk mitigators, such as: quality of work processes and procedures, compliance culture, control quality and so forth. The Bank manages and monitors quarterly changes in quantitative / qualitative benchmarks relevant for compliance risks management.

Computer-based tools are used in implementing compliance programs. Computer-based controls, including rules for monitoring activity, exception reports etc. are applied to Bank databases and are regularly developed in line with the work plan.

In 2021, the Bank's overall compliance risk remained unchanged at Low-Medium.

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 also applies to the Bank's overseas affiliates.

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" and Qualified Intermediary – "QI"). This risk is also due to obligations stipulated by the Common Reporting Standard (CRS) issued by the OECD.

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

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

First line of defense – Includes the Retail Division, the Corporate Division and the Finance Division, which are responsible for monitoring and reducing cross-border risk in their activity with relevant clients, international operations, which is responsible for overseas Bank affiliates through local compliance units at each affiliate.

Second line of defense – the Compliance Department 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 Department is assisted by the Legal Division, the Human Capital, Resources 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.

Third line of defense – Internal Audit, which conducts periodic audit of the management of cross-border risk.

The Bank applies the statutory provisions for implementation of FATCA and CRS, and provides timely reports to the Israeli Tax Authority/ The Bank is compliant with terms and conditions of the QI agreement. International entities, including OFAC (of the US Department of Treasury) and the European Union have imposed international sanctions on countries, organizations and individuals. As part of management of its international financial operations and maintaining proper business relations with correspondent banks, the Bank is compliant with these sanctions, even though they do not apply directly to the Bank. 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.

In 2021, cross-border risk remained unchanged at Low-Medium. The Bank continues to maintain processes designed to improve the quality of risk management *inter alia*, by revising procedures, automating work processes, delivering training, activity of foreign residents in specialized branches and specification of work routines in processes required for reporting under both FATCA and CRS. The Bank also monitors regulatory updates from relevant countries for the Bank and its affiliates, once every quarter, to verify their relevance for Bank operations and to implement them if applicable.

AML risk and terror financing

AML and terror financing risk is the risk of financial loss (including due to legal proceedings, penalties or sanctions imposed by authorities in Israel and in other countries) and impact to reputation, which the Bank may incur due to breach of various statutory provisions regarding the Bank's obligations with regard to AML and terror financing. 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.

The Bank regards itself as a partner in the international AML and terror financing effort and takes part in the international effort against bribery and corruption, acting to identify, monitor and follow up on activities and clients that may be exposed to bribery and corruption. The Bank also avoids any activities opposed to the international sanctions regime of states and international bodies such as OFAC (of the US Department of Treasury) and of the European Union.

The Bank applies a risk-based approach to account opening and management, allocating resources in conformity with the risk level of the account and activity, reflected *inter alia* by enhanced controls and appropriate custom training.

The Bank has near-zero risk appetite with regard to AML risk.

The AML and Terror Financing Risk Manager for the Bank is the Manager, Risks Control Division.

AML and terror financing risk is managed by three lines of defense:

First line of defense – consists of branches and business units that apply immediate controls to their operations.

Second line of defense – the Compliance Department of the Risks Control Division, which is responsible for applying appropriate controls, for deployment of relevant statutory provisions and for delivering training designed to improve knowledge on this subject.

Third line of defense – Internal Audit, which conducts independent audit of the first line of defense and 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 Bank applies statutory provisions and regularly provides ordinary and extraordinary reports to the AML Authority. To this end, the Bank operates *inter alia* a computer system to identify extraordinary transactions and to monitor the processing of such reports.

The Compliance Department manages and monitors quarterly changes in relevant qualitative and quantitative benchmarks relevant for compliance risk management, and applies various controls to activity in various accounts, based on the risk profile thereof, concurrently with verification and improvement of data quality. The Department also provides ongoing advice to branches and business units, as well as delivering training customized for different Bank employees based on their role.

In addition, as part of bribery and corruption risk management, the Bank acts to identify clients that may be exposed to giving, receiving or brokering bribes, both during account opening and in the course of normal business operations.

The Compliance Department provides a semi-annual report to the Bank of Israel about exposure to compliance risk, in conformity with Reporting Regulation 825. Quarterly reports to Bank management and annual reports to the Board of Directors with regard to implementation of the policy and reference to all risks and exposures at the Bank with regard to compliance. Furthermore, in special cases with implications for AML or terror financing, the Compliance Officer immediately reports to the CRO, to the Bank President & CEO and to the Supervisor of Banks, as the case may be.

In 2021, the AML risk level remained unchanged, due to further intensive training and deployment activity, along with risk-focused controls, including monitoring of risk due to the Corona Virus crisis, improvement of documents and classifications, and taking effective action to avoid recurrence of unusual events and compliance failures, against the backdrop of business growth and further enhanced regulatory activity reflected, *inter alia*, in new directives issued more frequently, for which the Bank is preparing as required.

Scope and key features of risks measurement system

In general, it is Bank policy to manage and to monitor risks using controlled, computer-based systems with minimal dependence on manual processes and with near-real time update frequency.

The Bank has many measurement systems used to estimate all material risks to which the Bank is exposed, as well as IT systems to support risks monitoring and reporting, as stated below:

- Permission management and control system – a computer system for management and control of permissions and credentials in various systems. The system applies computer-based processes for management of employee permissions in the various systems, based on their role and the employee life cycle. The system allows for application of time-based controls with regard to changes made to employee permissions in these systems. AML and terror financing risk
- Compliance risk management system – this system is used for risk management, control management, task monitoring and for management and monitoring of decisions and processes. The system allows for dynamic specification, execution and monitoring of processes and displays a current overview of work processes for each stage, in real time, as well as the Bank's compliance risks map.
- The AML system (MEA) is used to monitor unusual activity which gives rise to concern with regard to AML. This system addresses the monitoring of transactions, review, debrief, transfer to the Compliance Department and, if needed, completing the processes by referring the case to the AML Authority. Reports generated by the system are in conformity with the AML Authority's new reporting directives (pattern-based reporting). The system has been deployed at all Bank branches and is used on regular basis, by bankers at these branches, by branch managers, by the AML Department and under the supervision, control, with regular assistance and calibration.

Reputational 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 operational 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, similarly to other risks, the Bank's Board of Directors has created a dedicated policy document for addressing reputation risk, which specifies guidelines for risk management, risk appetite, risk measurement and ways to mitigate risk. Accordingly, the Bank incorporated reputation risk into its regular risks 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 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 Reputational Risk Manager is the Manager, Marketing, Promotion and Business Development Division at the Bank.

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 Owner and stipulates how the risk should be addressed under normal conditions and in case of a stress event. The Risk Owner 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, online 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 Owner, 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 reputational 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.

Business-strategic risk

Business-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 business-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.

On April 26, 2021 the Board of Directors approved a new strategic plan for 2021-2025, based on the following:

- Position the Bank as a key player in business banking, based on supporting action including: set up operations for investments in non-banking corporations, lead large and complex transactions and expand the Bank's international operations at its branches in London and in the USA in areas focused on business banking;
- Establish the Bank Group's leadership position among households: Maintain the leadership position in the mortgage market while introducing innovations in products and processes, and increasing synergies with commercial operations, expand operations among target populations and set up a desk for unique consumer credit products;
- Provide personal, human banking services supported by advanced digital technology, including optimal combination of human and digital channels, with human service by expert bankers, including in digital, in accordance with client choice and needs, as well as offering personalized value propositions across all channels, which are customized for client needs.
- Align the operating model with future challenges and improve operating efficiency through, *inter alia*, locating the Bank headquarters in the central Lod campus, align branch structure with future challenges and optimize use of real estate, automate banking operations and streamline the work environment.
- Leverage the Union Bank merger to create operating and business synergies and to realize economies of scale. The new strategic plan is designed to achieve the following targets:
- Achieve in 2025, net profit return on equity attributable to equity holders of 14% on average equity, as well as double-digit, growing and stable return over the term of the strategic plan; these rates are based on the ratio of Tier I equity to risk components for the Bank at the minimum set by the Supervisor of Banks plus appropriate margin;
- Grow banking operations so as to increase the Bank's market share in the Israeli banking system;
- Grow revenues at an annual average rate of 8% (although non-linear), while controlling the average annual expenses at a 5% growth rate (also non-linear) over the term of the new strategic plan;
- Maintain high operating efficiency and leverage economies of scale due to the Union Bank merger, to achieve a cost-income ratio lower than 50% in 2025.

Risks Report

As of December 31, 2021

- Under the new strategic plan, the Board of Directors shall monitor execution of the plan, in order to consider potential increase of the dividend rate, from 40% of net profit attributable to Bank shareholders, up to 50% of net profit, upon conclusion of the Union Bank merger process; This would be subject to Bank compliance with the ratio of Tier I capital to risk components, as required by the Supervisor of Banks, maintaining appropriate margins and subject to approval by the Supervisor of Banks.

The Business-Strategic Risk Owner 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. In addition, the Financial Information and Reporting Division and the Risks Control Division regularly and independently monitor business-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. 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 business-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.

As noted above, developments in the business environment which may impact strategic risk include the Corona Virus global outbreak and its impact on global and local economic activity, technological developments in the world of finance and changes to consumer preferences, the impact of regulatory provisions in core areas of banking operations and completion of the Union Bank merger process.

This information constitutes forward-looking information, as defined in the Securities Law, 1968, based on assumptions, facts and data (hereinafter jointly: "assumptions") brought before the Bank's Board of Directors. These assumptions may not materialize due to factors which are under the Bank's control.

Environmental risk and climate risk

Environmental risk is risk due to potential harmful impact of environmental changes on financial institutions. The Bank is exposed to potential loss 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 risk factors derived from this risk: goodwill, third party liability etc. Environmental risks include: air, water and land pollution, impact to biological diversity and de-forestation.

Climate risk is risk due to increased frequency and intensity of weather events due to global warming. Climate risks include transition risks, arising from moves designed to reduce warming, including reduction of carbon emissions (such as: transition to renewable energy sources, carbon taxation, improved energy efficiency and so forth), as well as physical risks which materialize as direct consequence of climate change, such as: fire, flooding and so forth.

Awareness and importance of environmental risk and climate risk management increased, in Israel and world-wide. In December 2020, the Supervisor of Banks issued a letter regarding environmental risks, with emphasis on climate risk, designed to establish a framework for managing environmental risks and climate risks in the Israeli banking system, in conformity with world-wide regulation and practice. In March 2021, the banks received another letter, requesting them to complete a self-assessment questionnaire in aspects related to environmental risks and climate risks, with the results of this questionnaire forming the basis for discussion between banks and the Supervisor of Banks. In the fourth quarter of 2021, the Supervisor of Banks issued an update to Public Reporting Directives with regard to public disclosure of environmental, social and governance (ESG) aspects.

The Bank sees great importance in promoting activity and risk management in this regard, and is preparing to expand its activity, to monitor and manage environmental risks, including climate risks, in conformity with expectations of the Supervisor of Banks and emerging global practice in this field. To this end, the Bank established in late 2020 a dedicated team, headed by the CRO, to review this matter. The dedicated team includes representatives from all relevant Bank divisions and has reviewed during the year the various aspects of risk management at the Bank.

Based on insights gained from the team's work and supervisory expectations which are being formulated, the Bank has set milestones for actual progress and improvement in handling this matter. The 2022 work plan includes implementation of recommendations arising from insights of the dedicated team's work. In order to implement the team's conclusions and to carry out the work plan, the Bank established a strategic ESG team, consisting of managers of various divisions, tasked with leading policy, activity, control and reporting in conjunction with promoting ESG across all Bank operations.

As from the financial statements with respect to the fourth quarter of 2020, the Bank includes environmental risk, and in particular climate risk, on the list of emerging risks. At this stage it is too early to assess the potential long-term impact of climate change on the Bank.

In 2022, the Bank intends to further develop its capabilities with regard to climate risk, with due notice to developments in global and local banking regulation and developments in the economic and environmental arena in Israel and elsewhere.

For objectives and strategies with regard to environment and climate, see "Environmental risks" on the Report by the Board of Directors and Management.

Remuneration

On July 6, 2021, the General Meeting of Bank shareholders approved, further to approval of the Bank's new strategic plan, after approval by the Board of Directors and recommendation by the Remuneration Committee, the revised officer remuneration policy at the Bank (hereinafter "revised officer remuneration policy"), effective for three (3) years through December 31, 2023. The revised remuneration policy is in conformity with the Corporate Act, 1999, the Remuneration of Officers in Financial Corporations Act (Special Permission and Non-allowance of Expenses for Tax Purposes with Respect to Excessive Remuneration), 2016 ("the Executive Remuneration Act") and Proper Conduct of Banking Business Directive 301A "Remuneration".

In July 2021, the Bank's Board of Directors approved, after receiving the recommendation from the Remuneration Committee, a revised remuneration policy for 3 years through December 31, 2023 for all Bank employees, other than officers who are subject to the revised remuneration policy for Bank officers, as noted above.

Name, composition and authority of entity supervising remuneration

The Board of Directors' Remuneration Committee is the entity which supervises remuneration. This Committee consists of 4 Board members. All external Board members Committee are external Board members, and all external Board members are members of the Remuneration Committee (in conformity with the Companies Law and with Proper Conduct of Banking Business Directive 301 "Board of Directors")

The Remuneration Committee formulates remuneration policy for Bank officers and employees and makes its recommendations to the Board of Directors. The Remuneration Committee confirms the contracting terms of the Bank with its senior officers, including with regard to their remuneration (including officer liability insurance, indemnification and waiver), as well as the individual targets to be specified by the Bank President & CEO and their assessments on this matter (and of the Chairman of the Board of Directors and recommendation of the Audit Committee with regard to the Internal Auditor, respectively).

External consulting with regard to remuneration processes

For approval of the revised remuneration policy, the Remuneration Committee was assisted by various advisors. Legal advice by The law firm of Meitar Attorneys at Law, as legal counsel, and consulting on the impact of remuneration on corporate governance by Professor S. Henes.

Remuneration policy scope

As noted above, a revised remuneration policy was specified for Bank officers. In conformity with policy, the Remuneration Committee and the Board of Directors approved an officer remuneration plan.

Based on the remuneration principles specified by the Remuneration Committee and adopted by the Board of Directors, as reflected in the revised officer remuneration policy – the Remuneration Committee recommended and the Board of Directors approved in July 2021 a remuneration policy for all Bank employees other than officers ("the remuneration policy for all Bank employees").

The remuneration policy for all Bank employees applies Group-wide; it also applies to overseas affiliates of the Bank, to Bank subsidiaries other than Bank Yahav and bank Union – whose remuneration policy has been communicated to the Bank.

Employees considered senior officers and other key employees

The revised officer remuneration policy distinguishes between business officers and gatekeepers, for whom an "additional fixed component" was specified, *inter alia* – which is not contingent on performance – and individual performance benchmarks were specified – which are independent of the business which they supervise.

The remuneration policy for all Bank employees specifies remuneration terms of all key employees at the Bank, those of senior managers and other managers at the Bank and of other Bank employees for 2021-2023.

The group of key employees at the Bank, other than officers, consists in 2021 of 36 managers, of which 18 managers in subsidiaries (other than Bank Yahav).

Planning and structure of remuneration policy; key attributes and objectives of remuneration policy

The objective of the revised officer remuneration policy and of the remuneration policy for all Bank employees, is to ensure that remuneration of Bank employees, including key employees, would be consistent with the Bank's risks management framework, with its long-term objectives, with the Bank's strategic plan and its control environment, as well as with actual

Risks Report

As of December 31, 2021

employee performance over the short, medium and long terms. Accordingly, the goals underlying the remuneration policy were: create an incentive structure for Bank employees which maintains a proper balance between fixed and variable remuneration components and which promotes effective, well established risk management which does not encourage risk taking beyond the Bank's risk appetite and allows the Bank to maintain a solid capital base; align remuneration incentives payable to Bank employees with the Bank's strategic plan, with long-term objectives of the Bank, with the Bank's results over time and with actual contribution of Bank employees to achieving such Bank objectives; alignment of Bank contracting with Bank employees other than officers, in order to create balanced conditions which do not jeopardize the robustness and stability of the Bank, as well as preserving senior Bank employees and ensuring, in as much as possible, the Bank's capacity to recruit high-quality managers in future, allowing for organization-wide considerations such as cost of remuneration and desired remuneration gaps between various ranks of Bank employees, as well as the competitiveness in the banking sector, the Bank's size, scope of operations and nature of its business.

Remuneration components of Bank employees include fixed and variable remuneration, as customary at the Bank, as well as any other benefit, payment or commitment to make a payment, provided with respect to their employment at the Bank.

The great majority of Bank executives, including key employees, are employed by individual employment contract. As for officers, their terms of office and employment include waiver and indemnification and officer liability insurance, as customary at the Bank.

Remuneration of employees involved with risk and compliance is not dependent on the business results of the business areas whose operations they monitor, audit or supervise. Terms of office and employment of the Chief Compliance Officer are brought for approval by the Board of Directors, after approval by the Remuneration Committee, as stipulated by Proper Conduct of Banking Business Directive 301A. Furthermore, variable remuneration of managers in charge of the trading room, back office staff and staff involved in risk control, is not dependent on operating results of the trading room and is not derived from remuneration of trading room staff.

Risks

The annual key performance indicators (KPI) of senior Bank managers, which are challenged by the Bank's Chief risks officer, include reference to issues related to risk management, and in particular compliance risk and steps to reduce such risk, within the domain of the manager's activity.

Link between performance and remuneration; long-term performance; variable remuneration

Variable remuneration for key employees and other managers includes a monetary bonus and long-term equity-based remuneration. Variable remuneration is designed to align the interests of managers and key employees with those of the Bank and to reinforce the link between the Bank's overall performance and the key employee's contribution to achievement of such performance, and the key employee's remuneration – with consideration to the Bank's risk profile.

Variable remuneration is objective-dependent and performance-dependent and as such, encourages the senior executives, including the key employees, to generate economic value and to promote the Bank's medium-term and long-term objectives, while maintaining the Bank's risks management framework and risk appetite. Therefore, performance-based remuneration payable to key employees is contingent on Bank performance in the medium and long terms, considering the Bank's strategic plan – but would not encourage taking risks beyond the Bank's risk appetite and would maintain a proper balance between fixed and variable remuneration components.

Equity-based remuneration is typically awarded by way of options, as described in the outline of offering to employees, as approved by the Board of Directors on July 26, 2021, after approval by the Remuneration Committee. As well as a capped monetary bonus, such that the total value of variable remuneration would not exceed 85% of the key employee's total fixed remuneration, except under special conditions, where the maximum variable remuneration may not exceed 170% of the fixed remuneration. The Bank's Board of Directors also stipulated that the maximum variable remuneration for officers who are gatekeepers would not exceed 55% of fixed remuneration and that such officers would be eligible for a retention bonus equal to two months' salary, which constitutes fixed remuneration pursuant to the remuneration policy.

Key employees' eligibility for variable remuneration is contingent on fulfillment of all threshold conditions specified in the officer remuneration policy, in line with the officer remuneration policy, i.e.: on the Bank's total capital adequacy ratio and Tier I equity adequacy ratio, in conformity with the Bank's annual financial statements for that year, would not be lower than the minimum ratios stipulated by Bank of Israel directives and under special circumstances, should the rate of return be lower than the minimum stipulated or to be stipulated in Bank of Israel directives, but the second pre-requisite has been fulfilled, a special bonus of up to two monthly salaries may be awarded.

Eligibility of key employees and other senior executives to a monetary bonus is based on quantitative, company-wide criteria identical to those applicable for officers: return on equity, return on Bank shares relative to benchmark, operating efficiency ratio and average ratio of Core deposits

In addition, eligibility of senior managers, including key employees for a monetary bonus is based on qualitative criteria, consisting of individual performance benchmarks (specified annually, based on performance targets according to the work plan for each year) and which include objectives related to risks management and compliance and objectives with regard to risks handled thereby, depending on their occupation, as well as evaluation by their supervisors. In addition, a

threshold was specified for the evaluation criteria, below which the key employee would not be eligible for any annual monetary bonus. The individual performance benchmarks specified for managers, related to risk control and compliance, are related to development and implementation of risks monitoring mechanisms and to development and implementation of effective alerts to deviation from the definitions specified by Bank management and Board of Directors, as well as supervision and control of implementation of required statutory provisions, as the case may be. Individual performance benchmarks specified for managers involved in audits are related to the scope and quality of audits performed under their supervision with reference to coverage of major risk factors in their field, implementation of a clear professional policy in support of Bank objectives and deployment of high professional standards. These performance benchmarks are not contingent on performance of Bank business lines and units which they supervise or audit, as the case may be.

Eligibility of key employees for options, for each of the annual lots, would be determined based on the four Bank-wide benchmarks, as described above (for officers other than President & CEO or Chairman of the Board of Directors) In conformity with the revised officer remuneration policy, eligibility of officers to receive options would be determined based on company-wide benchmarks, with a weighting of up to 43% for gatekeepers, and up to 55% for other officers, as well as on individual performance targets, with a weighting of up to 57% for gatekeepers and up to 45% for other officers.

The Bank has specified steps ("minimum achievement", "target achievement", "maximum achievement"), the achievement of which would confer eligibility to receive variable remuneration at different rates.

In conformity with the remuneration policy, a key employee must reimburse, including by way of offset, any variable remuneration paid them – if paid based on data which turned out to be erroneous and were restated on the Bank's (consolidated) financial statements within three years following the end of the year for which the variable remuneration was paid, but no later than three years after termination of their employment by the Bank.

Furthermore, the remuneration policy stipulates – and option offerees have committed accordingly – that no private hedging arrangements may be entered into which would eliminate the effect of risk-sensitivity inherent in their remuneration.

For officers not employed by individual employment contract and for all other Bank employees – the monetary bonus consists of a general bonus and individual bonus, based on their department and with due consideration to objectives for revenues, risk management, compliance, compliance with regulatory requirements and internal audit findings, public complaints, service quality to clients, individual contribution of the employee and the supervisor's opinion.

The terms of office or employment of Bank employees include fixed and variable remuneration, as customary at the Bank, as well as retirement terms and any other benefit, payment or commitment to make a payment, provided with respect to the aforementioned office or employment.

Risks Report

As of December 31, 2021

Below are details of remuneration paid (NIS in millions):

		2021	
		Senior Officers	Other key employees
Fixed remuneration	Employee headcount	14	36
	Total fixed remuneration	25	34
	Of which: Cash-based	25	34
	Of which: Deferred	–	–
	Of which: Shares or other share-based instruments	–	–
	Of which: Deferred	–	–
	Of which: Other forms	–	–
	Of which: Deferred	–	–
Variable remuneration	Employee headcount	12	36
	Total variable remuneration	12	18
	Of which: Cash-based	6	11
	Of which: Deferred	–	2
	Of which: Shares or other share-based instruments	6	7
	Of which: Deferred	6	7
	Of which: Other forms	–	–
	Of which: Deferred	–	–
Total remuneration		37	52

		2020	
		Senior Officers	Other key employees
Fixed remuneration	Employee headcount	16	37
	Total fixed remuneration	27	36
	Of which: Cash-based	27	36
	Of which: Deferred	–	–
	Of which: Shares or other share-based instruments	–	–
	Of which: Deferred	–	–
	Of which: Other forms	–	–
	Of which: Deferred	–	–
Variable remuneration	Employee headcount	12	37
	Total variable remuneration	10	10
	Of which: Cash-based	5	6
	Of which: Deferred	–	–
	Of which: Shares or other share-based instruments	5	3
	Of which: Deferred	5	3
	Of which: Other forms	–	1
	Of which: Deferred	–	1
Total remuneration		37	46

Below is information about special payments (NIS in millions):

		2021					
Special payments	Guaranteed bonuses		Signing bonuses		Severance pay		
	Number of employees	Total remuneration	Number of employees	Total remuneration	Number of employees	Total remuneration	
Senior Officers	–	–	–	–	–	–	
Other key employees	–	–	–	–	–	–	
	2020						
Senior Officers	–	–	–	–	–	–	
Other key employees	–	–	–	–	1	1	

Risks Report

As of December 31, 2021

Below is information about deferred remuneration (NIS in millions):

Deferred remuneration and retained remuneration	2021					Total deferred remuneration paid out in the reported year
	Total unpaid amount of deferred remuneration balance	Of which: Total outstanding remuneration payable that is held and subject to retroactive adjustments, explicit or implicit	Total amount of revision made during the year due to explicit retroactive adjustments	Total amount of revision made during the year due to implicit retroactive adjustments		
Senior Officers						
Cash	1	1	–	–	–	
Share-based	14	14	–	–	6	
Cash-based instruments	–	–	–	–	–	
Other	2	2	–	–	–	
Other key employees						
Cash	4	4	–	–	–	
Share-based	12	12	–	–	6	
Cash-based instruments	–	–	–	–	–	
Other	2	2	–	–	–	
Total	35	35	–	–	12	

Deferred remuneration and retained remuneration	2020					Total deferred remuneration paid out in the reported year
	Total unpaid amount of deferred remuneration balance	Of which: Total outstanding remuneration payable that is held and subject to retroactive adjustments, explicit or implicit	Total amount of revision made during the year due to explicit retroactive adjustments	Total amount of revision made during the year due to implicit retroactive adjustments		
Senior Officers						
Cash	1	1	–	–	–	
Share-based	14	14	–	–	4	
Cash-based instruments	–	–	–	–	–	
Other	2	2	–	–	–	
Other key employees						
Cash	3	3	–	–	–	
Share-based	10	10	–	–	1	
Cash-based instruments	–	–	–	–	–	
Other	2	2	–	–	–	
Total	32	32	–	–	5	

Additions

Addendum A – Composition of supervisory capital

		December 31, 2021	December 31, 2020
Tier I shareholders' equity: Instruments and retained earnings			
1	Ordinary share capital issued by the banking corporation and ordinary share premium for shares included in Tier I capital	3,573	3,532
2	Retained earnings, including dividends proposed or declared after the balance sheet date	17,500	15,548
3	Accumulated other comprehensive income and retained earnings for which disclosure has been given	(270)	(160)
5	Ordinary shares issued by consolidated subsidiaries of the banking corporation, which are held by a third party (non-controlling interests)	447	432
6	Tier I capital before regulatory adjustments and deductions	21,250	19,352
Tier I shareholders' equity: Regulatory adjustments and deductions			
8	Goodwill, net of related deferred tax liability, if applicable	87	87
9	Other intangible assets, other than mortgage-servicing rights, net of related deferred tax liability ⁽¹⁾	80	100
10	Deferred tax assets that rely on future profitability of the banking corporation for realization, excluding those arising from temporary differences	6	127
11	Accumulated other comprehensive income with respect to cash flows hedging of items not listed at fair value on the balance sheet	(12)	11
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 derivative instruments, all debt value adjustments (DVA) arising from own credit risk of the banking corporation is to be deducted	5	10
16	Investment in own ordinary shares, held directly or indirectly (including commitment to purchase shares subject to contractual obligations)	–	–
21	Deferred tax assets arising from temporary differences, whose amount exceeds 10% of Tier I capital	–	–
25	Of which: Deferred tax assets arising from temporary differences	–	–
26	Regulatory adjustments and other deductions stipulated by the Supervisor of Banks	(885) ⁽¹⁾	(1,120) ⁽¹⁾
26.a	Of which: Additional regulatory adjustments to Tier I capital, not included in sections 25.A and 25.B.	–	–
28	Total regulatory adjustments to and deductions from Tier I capital	(719)	(785)
29	Tier I shareholders' equity	21,969	20,137
44	Additional Tier I capital	–	–
45	Tier I capital	21,969	20,137
Tier II capital: Instruments and provisions			
46	Instruments issued by the banking corporation (not included in Tier I capital) and premium on such instruments	2,006	258
47	Tier II capital instruments issued by the banking corporation, eligible for inclusion in regulatory capital during transitional period	447	894
48	Tier II capital instruments issued by subsidiaries of the banking corporation to third party investors	3,480	3,709
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	1,981	2,315
51	Tier II capital, before deductions	7,914	7,176
Tier II capital: Deductions			
57	Total deductions from Tier II capital	–	–
58	Tier II capital	7,914	7,176
59	Total equity	29,883	27,313
60	Total risk weighted assets	218,710	200,484

Risks Report

As of December 31, 2021

		December 31, 2021	December 31, 2020
Capital ratios and capital conservation buffer			
61	Tier I shareholders' equity	10.04%	10.04%
62	Tier I capital	10.04%	10.04%
63	Total capital	13.66%	13.62%
Minimum requirements stipulated by the Supervisor of Banks			
69	Minimum Tier I shareholders' equity ratio required by Supervisor of Banks	8.60%	8.68%
70	Minimum Tier I capital ratio required by Supervisor of Banks	8.60%	8.68%
71	Minimum overall capital ratio required by Supervisor of Banks	11.50%	11.50%
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	100	80
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	3	3
75	Deferred tax assets arising from temporary differences, that are below the deduction threshold	1,759	1,722
Cap for inclusion of provisions in Tier II			
76	Provision eligible for inclusion in Tier II with respect to exposures subject to standardized approach, prior to application of cap	1,981	2,315
77	Cap on inclusion of provisions in Tier II under standardized approach	2,533	2,317
84	Current cap for instruments included in Tier II capital that are subject to transitional provisions (pursuant to transitional provisions of Directive 299)	1,195	1,195
85	Amount deducted from Tier II capital due to cap	2,334	1,819

(1) Includes deferred credit balance from acquisition of Union Bank. For more information see Note 25.F. to the financial statements.

For more information about the link between the balance sheet and supervisory capital components, see Addendum B below.

Risks Report

As of December 31, 2021

Addendum B – Links between financial statements and supervisory exposures

Differences between accounting consolidation basis and supervisory consolidation basis, and mapping of financial statements by supervisory risk categories (NIS in millions):

	As of December 31, 2021					
	On-balance sheet balances as reported on published financial statements ⁽¹⁾	Subject to credit risk framework	Subject to counter-party credit risk framework	Subject to securitization framework	Subject to market risk framework ⁽²⁾	Not subject to capital requirements, or subject to deduction from capital base
Assets						
Cash and deposits with banks	95,267	95,268	–	–	–	(1)
Securities	15,033	14,463	–	–	570	–
Securities loaned or purchased under resale agreements	1,332	1,332	–	–	–	–
Loans to the public	273,531	271,955	1,576	–	–	–
Provision for credit losses	(2,103)	(313)	–	–	–	(1,790)
Loans to the public, net	271,428	271,642	1,576	–	–	(1,790)
Loans to Governments	477	477	–	–	–	–
Investments in associated companies	69	69	–	–	–	–
Buildings and equipment	1,734	1,734	–	–	–	–
Intangible assets and goodwill	208	–	–	–	–	208
Assets with respect to derivatives	3,652	–	3,652	–	3,123	–
Other assets	3,071	3,035	–	–	–	36
Total assets	392,271	388,020	5,228	–	3,693	(1,547)
Liabilities						
Deposits from the public	307,924	–	–	–	–	307,924
Deposits from banks	6,992	–	–	–	–	6,992
Deposits from the Government	81	–	–	–	–	81
Securities loaned or sold in conjunction with repurchase agreements	–	–	–	–	–	–
Debentures and subordinated notes	38,046	–	–	–	–	38,046
Liabilities with respect to derivatives	3,753	–	3,753	–	3,302	–
Other liabilities	13,746	–	–	–	–	13,746
Total liabilities	370,542	–	3,753	–	3,302	366,789

(1) Accounting consolidation basis and supervisory consolidation basis are identical.

(2) Amounts exclude balances used to calculate foreign currency risk, including structural positions in foreign currency; for these balances, see Note 31 "Assets and liabilities by linkage basis".

Risks Report

As of December 31, 2021

Differences between accounting consolidation basis and supervisory consolidation basis, and mapping of financial statements by supervisory risk categories (NIS in millions) – continued

As of December 31, 2020						
On-balance sheet balances of items:						
	On-balance sheet balances as reported on published financial statements ⁽¹⁾	Subject to credit risk framework	Subject to counter-party credit risk framework	Subject to securitization framework	Subject to market risk framework ⁽²⁾	Not subject to capital requirements, or subject to deduction from capital base
Assets						
Cash and deposits with banks	86,570	86,572	–	–	–	(2)
Securities	17,290	15,879	–	–	1,411	–
Securities loaned or purchased under resale agreements	200	200	–	–	–	–
Loans to the public	247,958	245,972	1,986	–	–	–
Provision for credit losses	(2,433)	(339)	–	–	–	(2,094)
Loans to the public, net	245,525	245,633	1,986	–	–	(2,094)
Loans to Governments	613	613	–	–	–	–
Investments in associated companies	31	31	–	–	–	–
Buildings and equipment	1,743	1,743	–	–	–	–
Intangible assets and goodwill	239	–	–	–	–	239
Assets with respect to derivatives	4,543	–	4,543	–	3,876	–
Other assets	3,386	3,302	–	–	–	84
Total assets	360,140	353,973	6,529	–	5,287	(1,773)
Liabilities						
Deposits from the public	284,224	–	–	–	–	284,224
Deposits from banks	3,779	–	–	–	–	3,779
Deposits from the Government	70	–	–	–	–	70
Securities loaned or sold in conjunction with repurchase agreements	–	–	–	–	–	–
Debentures and subordinated notes	33,446	–	–	–	–	33,446
Liabilities with respect to derivatives	5,506	–	5,506	–	4,382	–
Other liabilities	13,446	–	–	–	–	13,446
Total liabilities	340,471	–	5,506	–	4,382	334,965

(1) Accounting consolidation basis and supervisory consolidation basis are identical.

(2) Amounts exclude balances used to calculate foreign currency risk, including structural positions in foreign currency; for these balances, see Note 31 "Assets and liabilities by linkage basis".

Risks Report

As of December 31, 2021

Link between the balance sheet and supervisory capital components (NIS in millions):

	Consolidated supervisory balance sheet	
	As of December 31,	
	2021	2020
	NIS in millions	
Assets		
Cash and deposits with banks	95,267	86,570
Securities	15,033	17,290
Of which: Investments in equity of financial corporations, not exceeding 10% of share capital of each financial corporation	–	–
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	15,033	17,290
Securities loaned or purchased under resale agreements	1,332	200
Loans to the public	273,531	247,958
Provision for credit losses	(2,103)	(2,433)
Of which: Group provision for credit losses included in Tier II	(1,790)	(2,094)
Of which: Provision for credit losses not included in regulatory capital	(313)	(339)
Loans to the public, net	271,428	245,525
Loans to Governments	477	613
Investments in associated companies	69	31
Of which: Investments in equity of financial corporations, exceeding 10% of share capital of each financial corporation, not exceeding the deduction threshold	3	3
Of which: Investments in other associated companies	66	28
Buildings and equipment	1,734	1,743
Intangible assets and goodwill	208	239
Of which: Goodwill	87	87
Of which: Other intangible assets	121	152
Assets with respect to derivatives	3,652	4,543
Other assets	3,071	3,386
Of which: Deferred tax assets	1,759	1,722
Of which: Deferred tax assets, other than those arising from temporary differences	6	127
Of which: Deferred tax liability with respect to intangible assets	–	(52)
Of which: Other deferred tax assets	1,753	1,647
Of which: Excess deposit over provision	–	–
Of which: Other additional assets	1,312	1,664
Total assets	392,271	360,140

Risks Report

As of December 31, 2021

Link between the balance sheet and supervisory capital components (NIS in millions) – Continued:

	Consolidated supervisory balance sheet	
	As of December 31,	
	2021	2020
	NIS in millions	
Liabilities and Equity		
Deposits from the public	307,924	284,224
Deposits from banks	6,992	3,779
Deposits from the Government	81	70
Securities loaned or sold in conjunction with repurchase agreements	–	–
Debentures and subordinated notes	38,046	33,446
Of which: Subordinated notes not recognized as regulatory capital	4,740	5,812
Of which: Subordinated notes recognized as regulatory capital	5,933	4,861
Of which: Qualifying as supervisory capital components	5,486	3,967
Of which: Not qualifying as regulatory capital components and subject to transitional provisions	447	894
Liabilities with respect to derivatives	3,753	5,506
Of which: With respect to internal credit risk	5	11
Other liabilities	13,746	13,446
Of which: Deferred tax liability arising from retirement	–	–
Total liabilities	370,542	340,471
Equity attributable to shareholders of the banking corporation	20,770	18,804
Of which: Supervisory capital	20,803	18,920
Of which: Ordinary share capital	3,497	3,446
Of which: Retained earnings	17,500	15,548
Of which: Cumulative other comprehensive loss	(270)	(160)
Of which: Losses with respect to adjustments with respect to employee benefits	(355)	(255)
Of which: Unrealized gains from adjustment to fair value of available-for-sale securities	98	82
Of which: Net losses from cash flow hedges	(12)	11
Of which: Net losses from translation adjustments of financial statements	(2)	(1)
Of which: Capital reserves	76	86
Of which: Preferred share capital	–	–
Of which: Qualifying as supervisory capital components	–	–
Of which: Not qualifying as regulatory capital components and subject to transitional provisions	–	–
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	959	865
Of which: Non-controlling interests attributable to Tier I shareholders' equity	447	433
Of which: Non-controlling interest attributable to additional Tier I capital	–	–
Of which: Non-controlling interests attributable to Tier II capital	–	–
Of which: Non-controlling interests not attributable to regulatory capital	512	432
Total shareholders' equity	21,729	19,669
Total liabilities and equity	392,271	360,140

Risks Report

As of December 31, 2021

Key sources for differences between supervisory exposure amounts and carrying amounts on the financial statements (NIS in millions):

	As of December 31, 2021				
	Total	Credit risk framework	Counter-party credit risk framework	Securitization framework	Market risk framework
Carrying amount of assets according to supervisory consolidation basis	392,271	386,473	5,228	–	570
Carrying amount of liabilities according to supervisory consolidation basis	370,542	–	3,753	–	–
Total net amount according to supervisory consolidation basis	21,729	386,473	1,475	–	570
Off-balance sheet amounts	105,760	29,729	–	–	–
Differences due to no effect of fair value of derivatives with credit balance	–	–	–	–	–
Differences due to variance in calculating the fair value of negotiable derivatives for capital requirements	290	–	290	–	–
Differences caused by potential future exposure	1,677	–	1,677	–	–
Differences caused by differences in offset rules	(1,727)	–	(1,727)	–	–
Differences arising from variable cash collateral in derivatives operations	(1,638)	–	(1,638)	–	–
Differences caused by securities provided as collateral	597	597	–	–	–
Differences due to balances not subject to capital requirements or subject to deduction from capital base	1,547	1,547	–	–	–
Amounts with respect to market exposures	391	–	–	–	391
Other differences	1,044	(499)	1,543	–	–
Exposure amounts taken into account for supervisory purposes	500,212	417,847	5,373	–	961
	As of December 31, 2020				
Carrying amount of assets according to supervisory consolidation basis	360,140	352,200	6,529	–	1,411
Carrying amount of liabilities according to supervisory consolidation basis	340,471	–	5,506	–	–
Total net amount according to supervisory consolidation basis	19,669	352,200	1,023	–	1,411
Off-balance sheet amounts	97,326	26,875	–	–	–
Differences due to no effect of fair value of derivatives with credit balance	–	–	–	–	–
Differences due to variance in calculating the fair value of negotiable derivatives for capital requirements	181	–	181	–	–
Differences caused by potential future exposure	2,077	–	2,077	–	–
Differences caused by differences in offset rules	(2,315)	–	(2,315)	–	–
Differences arising from variable cash collateral in derivatives operations	(2,831)	(943)	(1,888)	–	–
Differences caused by securities provided as collateral	257	257	–	–	–
Differences due to balances not subject to capital requirements or subject to deduction from capital base	1,773	1,773	–	–	–
Amounts with respect to market exposures	1,420	–	–	–	1,420
Other differences	960	183	777	–	–
Exposure amounts taken into account for supervisory purposes	458,989	380,346	5,361	–	2,831

(1) Reclassified, so that under Total Exposures, data is presented before credit conversion factors.

Glossary and index of terms included in the Risks Report

Below is a summary of terms included on the Risks Report:

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

ABC	<p>ICAAP – Internal Capital Adequacy Assessment Process by the Bank. This process includes, <i>inter alia</i>, 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 directive.</p> <p>Back testing – A process for assessment of appropriateness of model results, which includes a comparison of model forecasts and actual results.</p> <p>CRM – Credit risk mitigation – Methods for reducing credit risks, such as: Insuring credit exposure through a guarantee or a deposit.</p> <p>Expected Shortfall VAR – A model which estimates the average loss for the VAR model, beyond the confidence level specified in the VAR model.</p> <p>HQLA – High-Quality Liquid Assets which may be easily and quickly converted into cash at a small loss (or no loss) under a stress scenario.</p> <p>KPI – Key Performance Indicators – used as a tool to formulate insights about the status of process execution across the Bank.</p> <p>Stressed VAR – Estimate of the Value at Risk (VAR) based on historical data which describe a relevant crisis period.</p> <p>VAR – A model used to estimate overall exposure to diverse market risk factors. The VAR (Value at Risk) obtained by the model is a statistical estimate of the maximum expected loss for the Bank due to materialization of market risks factors in a given time period at a pre-determined statistical confidence level.</p>
B	<p>Basel – Basel II / Basel III – Framework for assessment of capital adequacy and risk management, issued by the Basel Committee on Bank Supervision.</p>
C	<p>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.</p>
E	<p>Standard approach – An approach used to calculate the required capital with respect to credit risk, market risk or operational 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.</p> <p>Supervisory capital (total capital) – Supervisory capital consists of two tiers: Tier I capital, which includes Tier I equity and additional Tier I capital. Tier II equity: As defined in Proper Conduct of Banking Business Directive 202 "Measurement and capital adequacy – supervisory capital".</p>
J	<p>Minimum capital ratio – This ratio reflects the minimum supervisory capital requirements which the Bank is required to maintain in conformity with Proper Conduct of Banking Business Directive 201.</p>
K	<p>Subordinated notes – Notes whose rights are subordinated to claims by other Bank creditors, except for other obligations of the same type.</p>
M	<p>Stress tests – A title for various methods used to assess the financial standing of a banking corporation under a n extreme scenario.</p> <p>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 presented to the Board of Directors quarterly.</p>
N	<p>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.</p> <p>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.</p> <p>Risk assets – These consist of credit risk, operational risk and market risk, calculated using the standard approach as stated in Proper Conduct of Banking Business Directives 201-211.</p>
O	<p>CVA - Credit Valuation Adjustment – CVA is the component of the fair value of a derivative, which accounts for the credit risk of the counter-party to the transaction. CVA risk is the risk of loss due to mark-to-market with respect to expected counter-party risk for OTC derivatives. This means – loss due to impairment of fair value of derivatives, due to an increase in counter-party credit risk (such as: lower rating).</p> <p>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.</p>
S	<p>Loan To Value Ratio (LTV) – The ratio between the approved facility when extended and the asset value.</p>

Terms with regard to banking and finance

• A	Off-balance sheet credit – Contracting for providing credit and guarantees (excluding derivative instruments).
•	Debentures – Securities which are obligations by the issuer to pay to the debenture holder the principal issued plus interest, on specified dates or upon realization of a specified condition.
• E	ISDA – 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.
• H	Indebtedness – On- and off-balance sheet credit, as defined in Proper Conduct of Banking Business Directive 313.
•	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).
•	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.
•	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.
•	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 Conduct of Banking Business Directive 314 on problematic debt in residential mortgages. Problematic debt – Debt classified under one of the following negative classifications: special supervision, inferior or impaired.
•	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.
• J	Recorded debt balance – The debt balance, including recognized accrued interest, premium or discount yet to be amortized, net deferred commissions or net deferred costs charged to the debt balance and yet to be amortized, net of the debt amount subject to accounting write-off. Financial instrument – A contract that creates a financial asset for one entity and a financial liability or capital instrument for another entity.
• M	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.
• N	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.
• O	Syndication – A loan extended jointly by a group of lenders.

Terms with regard to regulatory directives

ABC	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).
	LCR – Liquidity Coverage Ratio – Defined 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.

Other terms

ABC	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.
-----	--

Index

A	L
AML, 20, 88	Legal Proceedings, 37, 38, 87, 88
C	Leverage ratio, 5, 10, 30, 31, 32
Capital, 7, 8, 10, 22, 23, 26, 27, 28, 29, 30, 31, 32, 34, 38, 55, 56, 60, 63, 71, 78, 82, 83, 86, 88, 89, 90, 91, 93, 99, 100, 102, 103, 104	Liquidity coverage ratio, 72, 73, 75, 76
Commissions, 27, 35, 44, 105	Liquidity risk, 11, 23, 55, 72, 73, 80, 81
Compliance and regulatory risk, 12, 23, 87	M
Credit, 10, 23, 24, 35, 52	Market risk, 26, 27, 29, 55, 59, 60, 63, 64, 80, 81, 99, 100, 103, 104
Credit risk, 5, 23, 26, 27, 29, 30, 32, 33, 36, 37, 40, 41, 44, 45, 46, 48, 50, 51, 52, 53, 55, 56, 58, 64, 72, 80, 81, 99, 100, 103, 104	O
Cross-border risk, 23, 87, 88	Operating segments, 34, 54, 64
D	Operational risk, 29, 55, 80, 81, 82, 85, 86, 89, 104
Derivatives, 11, 27, 28, 31, 32, 33, 34, 52, 53, 55, 56, 58, 59, 60, 62, 64, 65, 66, 69, 76, 78, 80, 99, 100, 101, 102, 103, 104, 105	P
Dividends, 29, 30	Provision for credit losses, 5, 37, 38, 39, 44, 51, 99, 100, 101, 105
E	R
Economic sectors, 5, 23, 33, 34, 40, 41, 55	Remuneration, 5, 15, 19, 92, 93, 94, 95, 96
F	Reputational risk, 11, 23, 80, 81, 89, 90
Fair value, 5, 28, 58, 65, 67, 68, 102, 103, 104	Residential mortgages, 5, 10, 25, 26, 29, 36, 37, 39, 45, 50, 51, 78, 105
Financing, 5, 10, 27, 31, 32, 38, 45, 50, 51, 54, 55, 56, 58, 65, 68, 72, 73, 74, 75, 76, 77, 78, 79, 80, 88, 89	Risk assets, 9, 26, 27, 30, 48, 56, 59, 63, 104
Financing risk, 80	S
I	Securities, 2, 8, 12, 13, 16, 19, 23, 31, 33, 34, 44, 45, 51, 53, 87
Interest expenses, 64	Shareholders' equity, 10, 22, 27, 28, 29, 31, 90, 91, 93, 102, 104
Interest revenues, 5, 64, 66, 68	Strategic risk, 23, 90
Interest risk, 22, 23, 59, 60, 63, 64, 67, 69	Subordinated notes, 31, 99, 100, 102, 104



מזרחי טפחות
MIZRAHI TEFAHOT

MIZRAHI TEFAHOT LTD.
Head office: 7 Jabotinsky st.
Ramat-Gan, 5252007
www.mizrahi-tefahot.co.il