

## Note 10 – Contingent Liabilities and Special Commitments – continued

4. Further to section 12 of Note 26 to the financial statements as of December 31, 2017, to section 4 of Note 10 to financial statements as of March 31, 2018 and to the letter received by the Bank in April 2018 in which the US Department of Justice ("US DOJ") informed the Bank of its intention to send a draft DPA (Deferred Prosecution Agreement) the US DOJ informed the Bank's US legal counsel, in a letter dated August 6, 2018, of its willingness to offer the Bank a settlement, based on payment of USD 342 million, to conclude the investigation. The US DOJ's letter indicates this amount, without any calculation details or principles on which it is based, therefore it provides no indication of the components included therein. Furthermore, a draft Statement of Facts was enclosed with the letter, for the first time, which may serve as basis for a potential DPA settlement, although the actual draft agreement was not provided to the Bank. In the letter, the US DOJ expresses its expectation of negotiations in order to reach an agreed resolution soon.

Soon after this letter was received by the Bank, the Board of Directors instructed the Bank's US legal counsel to immediately inform the US DOJ that their proposal is not acceptable to the Bank. In their notice to the US DOJ, the Bank's US legal counsel noted that they and the Bank consider that any reasonable calculation, based on the alleged behavior of the Bank Group through its employees, as described by the US DOJ itself in the draft Statement of Fact enclosed with their letter, would result in a very significantly lower amount than the one proposed to the Bank.

The Bank has started negotiating with the US DOJ; in discussions that took place in these negotiations, since the aforementioned letter had been received, the Bank's legal counsel asked to receive the calculations underlying the amount of USD 342 million indicated in the letter ("the proposed payment amount"), but such calculations have yet to be provided. Nevertheless, these discussions indicate that the proposed payment amount includes a significant penalty component and that the non-penalty component apparently relies on a calculation based on the loss of tax to US Tax Authorities with respect to US clients, as well as on revenues generated by the Bank Group from such clients ("the calculated payment component") which, as noted above, has yet to be provided to the Bank. Bank management estimates, based on the opinion of legal counsel, that with regard to the calculated payment component, relevant information has not been taken into account which, had it been taken into account, would have reduced said amount. As indicated in these discussions, the calculated payment component refers to a group of accounts more extensive than the group to be referred to according to the Bank and its legal counsel, which the Bank has used to date to calculate the exposure amount (without estimation nor inclusion of the penalty component, as noted by the Bank on its previous financial statements, since the Bank was unable to estimate it). The Bank's provision on its previous financial statements, which as of March 31, 2018 amounted to USD 46.1 million, was made in conformity with the opinion of the Bank's legal counsel with regard to data which may be relevant to the Bank Group's exposure, as reflected in prior arrangements made by the US DOJ with other banks, with regard to investigations concerning un-disclosed accounts of US taxpayers, and as reflected in various requests and demands made by the US DOJ of the Bank during this investigation.

Note that the draft Statement of Fact proposed by the US DOJ itself does not raise any facts to support the US DOJ's expansive approach to the scope of relevant accounts. Note also that, unlike the aforementioned difference with regard to the to the scope of relevant accounts, when it comes to calculation principles for the calculated payment component, it would appear that the US DOJ has taken a similar approach to the one applied by the Bank in quantifying its exposure on previous financial statements to date (excluding the penalty component), except with respect to accounts of US Clients with Mizrahi Switzerland, for which the provision on the previous financial statements was calculated based on the theoretical assumption, whereby Mizrahi Bank Switzerland was included under Category 2 in the Swiss Program (as was applied to a Swiss subsidiary of another Israeli bank).

Noting the US DOJ letter dated August 6, 2018, discussions there with and in conformity with the opinion of the Bank's legal counsel, the provision with respect to this investigation was increased by USD 116.5 million (NIS 425 million), and was set at USD 162.6 million (NIS 593 million). This amount includes the entire calculated payment component and the

minimum amount for the most reasonable penalty range, based on the opinion of the Bank's legal counsel and considering arrangements made by the US DOJ with other banks with regard to investigations concerning undisclosed accounts of US taxpayers. Note that the provision was increased despite the fact that the Bank does not agree with the investigation conclusions and their financial implications in general and on the US DOJ calculation being based on a wider scope of US accounts as noted above, in particular.

Note, however, that the Bank's legal counsel are of the opinion that they are unable to assess the outcome of negotiations with the US DOJ, as well as the real loss which the Bank Group may incur with respect to this investigation.

Given the foregoing and the uncertainty, in future it may emerge that the realized loss (primarily with respect to the penalty component) may be significantly higher than the provision made to date and the maximum potential exposure, as reflected by the US DOJ proposal, for which no provision has been recognized, amounting to USD 179.4 million (NIS 655 million) would increase as a consequence of providing further information to the US DOJ as requested thereby, referring to review of other accounts perceived to belong to US clients.

Considering the foregoing, the Bank Board of Directors has not declared any dividends with respect to earnings in the second quarter of 2018 upon approval of the financial statements for the current quarter.

Note that recording the provision or the Board of Directors' resolution not to make any dividend distribution, as noted above, do not constitute admission of the investigation conclusions nor any claim made by the US DOJ nor by any third party – and do not even constitute consent to pay the provision amount with respect to this matter.