

MIZRAHI TEFAHOT BANK LTD
No. with the Registrar of Companies: 520000522

To	<u>Israel Securities Authority</u>	To	<u>Tel Aviv Stock Exchange Ltd</u>	T125 (Public)	Date of transmission: July 11, 2019
	www.isa.gov.il		www.tase.co.il		Ref: 2019-01-071281

Immediate Report on the Rating of Bonds/Rating of a Corporation or Rating Cessation

On July 11th, 2019, *S&P Maalot* published:

A rating report/notice *updated*

A notice regarding rating cessation

1. Rating report or notice

Corporation's rating: *Maalot*
S&P ___ilAAA___stable

Comments/Notice summary: *other*
reaffirmation

Ratings history in the three years prior to the date of the rating/notice:

Date	Rating subject	Rating	Comments/Notice summary
January 14 2019	Mizrahi Tefahot Bank Ltd	<i>Maalot</i> <i>S&P ___ilAAA___stable</i>	<i>Other</i> <i>Reaffirmation</i>
January 22 2018	Mizrahi Tefahot Bank Ltd	<i>Maalot</i> <i>S&P ___ilAAA___stable</i>	<i>Other</i> <i>Reaffirmation</i>
October 24 2017	Mizrahi Tefahot Bank Ltd	<i>Maalot</i> <i>S&P ___ilAAA___stable</i>	<i>Other</i> <i>Reaffirmation</i>
January 4 2017	Mizrahi Tefahot Bank Ltd	<i>Maalot</i> <i>S&P ___ilAAA___stable</i>	<i>Other</i> <i>Reaffirmation</i>
January 21 2016	Mizrahi Tefahot Bank Ltd	<i>Maalot</i> <i>S&P ___ilAAA___stable</i>	<i>Other</i> <i>Reaffirmation</i>

Explanation: The ratings history should only detail the rating history of the company rating the subject of the immediate report

Rating of the corporation's bonds:

Name and type of security	Security number on the stock exchange	Rating company	Current rating	Comments/Notice summary
<i>Deferred bonds</i>	0	S&P Maalot	S&P Maalot <i>ilAA- stable</i>	Rating affirmation

<i>Series A Subordinated Capital Notes</i>	6950083	S&P Maalot	S&P Maalot ilAA- stable	Rating upgrade
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Ratings history for the three years prior to the rating/notice date:

Name and type of security	Security number on the stock exchange	Date	Type of rated security	Rating	Comments/Notice summary
<i>Deferred bonds</i>	0	<i>Jan 14 2019</i>	<i>Deferred bonds with a loss absorption capacity</i>	<i>S&P Maalot ilAA-stable</i>	<i>Rating affirmation</i>
<i>Series A Subordinated Capital Notes</i>	6950083	<i>Jan 14 2019</i>	<i>Subordinated capital notes</i>	<i>S&P Maalot ilA+ stable</i>	<i>Rating affirmation</i>
<i>Deferred bonds</i>	0	<i>Jan 22 2018</i>	<i>Deferred bonds with a loss absorption capacity</i>	<i>S&P Maalot ilAA-stable</i>	<i>Rating affirmation</i>
<i>Series A Subordinated Capital Notes</i>	6950083	<i>Jan 22 2018</i>	<i>Subordinated capital notes</i>	<i>S&P Maalot ilA+ stable</i>	<i>Rating affirmation</i>
<i>Deferred bonds</i>	0	<i>Oct 24 2017</i>	<i>Deferred bonds with a loss absorption capacity</i>	<i>S&P Maalot ilAA-stable</i>	<i>Rating affirmation</i>
<i>Series A Subordinated Capital Notes</i>	6950083	<i>Oct 24 2017</i>	<i>Subordinated capital notes</i>	<i>S&P Maalot ilA+ stable</i>	<i>Rating affirmation</i>
<i>Deferred bonds</i>	0	<i>Jan 4 2017</i>	<i>Deferred bonds with a loss absorption capacity</i>	<i>S&P Maalot ilAA-stable</i>	<i>Rating affirmation</i>
<i>Series A Subordinated Capital Notes</i>	6950083	<i>Jan 4 2017</i>	<i>Subordinated capital notes</i>	<i>S&P Maalot ilA+ stable</i>	<i>Rating affirmation</i>
<i>Deferred bonds</i>	0	<i>Jan 21 2016</i>	<i>Deferred bonds with a loss absorption capacity</i>	<i>S&P Maalot ilAA-stable</i>	<i>Rating affirmation</i>
<i>Series A Subordinated Capital Notes</i>	6950083	<i>Jan 21 2016</i>	<i>Subordinated capital notes</i>	<i>S&P Maalot ilA+ stable</i>	<i>Rating affirmation</i>

Explanation: The ratings history should only detail the rating history of the company rating the subject of the immediate report

Attached rating report ratingreaffirmation11072019_isa.pdf

2. On _____, _____ announced that it would cease rating _____

The above report was signed by Ms. Maya Feller, Bank Secretary

The reference numbers of previous documents on the subject (reference does not constitute incorporation by reference):

[2019-01-005835](#)

Securities of a Corporation Listed for Trading Form structure revision date: June 25, 2019
on the Tel Aviv Stock Exchange
Abbreviated Name: Mizrahi Tefahot
Address: 7 Jabotinsky Street Tel: 03-7559720 Fax: 03-7559923
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E-mail: mangment@umtb.co.il

Previous name of the reporting entity: United Mizrahi Bank Ltd.

Name of the person reporting electronically: Feller Maya Position: Bank Secretary Name of
Employing Company:
Address: 7 Jabotinsky Street, Ramat Gan, 52520, Israel Tel: 03-7559720 Fax: 03-7559923 E-mail:
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Maalot

S&P Global

Ratings

Mizrahi Tefahot Bank Ltd

Mizrahi Tefahot Issuing Company Ltd

July 11 2019

Rating Reaffirmation

**Reaffirmation of 'ilAAA' Rating In Light of A
Supportive Business Environment and an
Improvement in Operational Results; Stable
Outlook**

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Rating Reaffirmation

Reaffirmation of 'ilAAA' Rating In Light of A Supportive Business Environment and an Improvement in Operational Results; Stable Outlook

Summary of the Rating Action

- We expect that the Israeli economy will continue to support improvements in the financial performance of local banks, which are characterized by a high asset quality and a historically-low credit loss provision rate.
- Macro-prudential measures and supply-side government programs have led to some stability in housing prices over the last two years and reduced the chances of economic imbalance.
- Israeli banks' credit portfolio is more balanced due to the diversification of credit exposures; and less concentrated due to decreased exposure to large borrowers, which lowers the risk of a negative scenario.
- At the same time, we see some risk due to a growing supply of commercial real estate in recent years and increased competition on the part of non-banking entities in the field of unsecured retail credit.
- Our assessment that the risk of economic imbalance has been reduced led us to reevaluate the banking industry as Risk Level '3', rather than '4', according to the Banking Industry Country Risk Assessment methodology (BICRA). The BICRA grade is the anchor of bank ratings in Israel, i.e. the rating's starting point.
- We are reaffirming Mizrahi Tefahot Bank Ltd's issuer rating as 'ilAAA' with a stable rating outlook. The rating's reaffirmation reflects the bank's strengthening within the 'ilAAA' rating group and our assessment of credit stability in the next two years.

The Rating Action

On July 11th, 2019, S&P Maalot reaffirmed Mizrahi Tefahot Bank Ltd's issuer rating as 'ilAAA' with a stable rating outlook. At the same time, S&P Maalot reaffirmed the rating of the bank's senior unsecured debts series as 'ilAAA'; the rating of the subordinated debt series as 'ilAA+'; and the rating of the complex subordinated debt with a loss absorption capacity as 'ilAA-'; and raised the rating of the subordinated capital notes to 'ilAA-' from 'ilA+'.

Main Rating Considerations

The high income level, the continued growth and the moderate leverage of the Israeli economy supported the banking industry and allowed for business opportunities and growth, profitability strengthening and asset quality improvement. Despite the banks' large exposure to the real estate industry, we believe that the risk deriving therefrom has decreased, as prices stabilized in the last two years and the regulator took macro-prudential measures. We believe that these improvements represent an overall strengthening of the banking industry in Israel, which we now evaluate as Group '3', according to the Banking Industry Country Risk Assessment methodology (BICRA), versus '4' previously.

The BICRA grade determines the anchor for rating banks whose activities and revenues are centered in Israel, i.e. the rating's starting point, and we have therefore raised the anchor for the rating of Israeli banks.

The Israeli economy has not experienced a recession in the past 15 years, the GDP in dollar terms has grown by 55% since 2010 to more than \$40,000 per capita, and the unemployment rate has remained at a historic low. Israel's foreign trade characteristics remained strong with a surplus in the current account and an improvement in its status as a net lender. At the same time, Israel, being a small and open economy in the Middle East, remains exposed to geopolitical shocks and protectionist tendencies in the global trade policy.

In the past five years, the banks diversified their credit portfolio and showed a limited appetite for growth, which led to a solid quality of assets. The industry's rate of non-performing assets declined to 2.1%, and the credit loss provision rate declined to 0.2% in 2018.

Israeli bank's large exposure to the real estate industry continues to pose a potential risk. Construction industry and commercial real estate loans accounted for 16% of the total loans given by Israeli banks at the end of 2018 – an 11% increase compared to the end of 2017. The commercial real estate sector appears relatively stable and is supported by the growing demand for office space in the service industry, as well as the continued growth in private consumption. Simultaneously, the low interest rate supports the financial condition of the real estate companies. At the same time, in our estimation, the rapid growth in office construction during 2018, after a 16-year record in building completions, creates a risk of excess supply in the coming years. In addition, the shopping mall industry seems more vulnerable due to the growth of e-commerce, which harms retailers; and we believe that in some Israeli cities, there is a surplus of supply in commerce areas. However, we believe that institutional investors, such as insurance companies and pension funds, are more exposed to this sector than the banks.

We estimate that the exposure to mortgages involves a relatively low risk. The measures taken by the regulator to curb the risks in this industry included, *inter alia*, an additional capital requirement in respect of the exposure to mortgages; a limit on the rate of mortgages with a variable interest rate; and limiting the financing rate to 75% of the asset value. In our base scenario, we do not expect a sharp correction in housing prices, but rather a moderation in their growth rate compared to the last decade, given the measures taken by the government on the supply side.

The banks' exposure to a concentration of large borrowers has decreased significantly in recent years. Many holding companies have been gradually dismantled, moving to a more flat structure, while large corporations have either reduced their leverage or turn more to non-bank financing providers. Nevertheless, we still see certain risks associated with the concentration of the credit portfolio, in part because of the small size of the market and the centralization of the local economy.

In our estimation, the risk of unsecured consumer loans is currently low, given the low level of household indebtedness (approx. 42% of the GDP) and the moderate credit loss provision rate, which was 0.8% in 2018. However, in our estimation, Israeli households' aggregate financial stability covers large gaps in income and wealth.

Moreover, the increase in supply on behalf of new non-banking entities may lead to an increase in households' burden of debt, especially in the lower deciles. This situation may increase the financial vulnerability of Israeli households and lead to higher-than-anticipated credit losses in a negative scenario.

The trend of industry risk in Israel's banking system remained stable. We expect the banks' profitability to remain strong due to growth in business activities and an improvement in operational efficiency. We also expect revenues to grow gradually in the next two years, as a result of a slight increase in interest rates, from a steady growth of approx. 5% in credit to the private sector, and a slow improvement in profitability resulting from an improved loan mix. Banks are facing a historically-mediocre operational efficiency through processes of digitization, branch closures and reductions of manpower. The central challenges that banks in Israel currently face are the costs of investment in the fields of IT, compliance and regulation, as well as competition from the fintech market and non-banking credit companies, which could disrupt their business model. Many attempts are being made to increase competition in the fields of retail credit and credit to small and mid-size businesses, in which the large banks have maintained a dominant position. The two largest banks have recently separated from their credit card operations, but it is still too early to assess how the competition in this industry could develop. In our estimation, Israeli banks are now in a good position to deal with changes in the competitive environment, but it will continue to be a risk factor for them and for non-banking entities in the near future. Operational risks such as information security and cyber threats are increasingly occupying the center of attention, both for the banks and the regulator. We believe that Israel's banking system handles these matters carefully, assisted by a broad regulatory framework and skilled manpower.

The reaffirmation of the 'ilAAA' rating for Mizrahi Tefahot Bank reflects its established status, particularly as Israel's largest mortgage provider, even considering the intensification of competition in the mortgage market. As part of its strategic plan, the bank aspires to expand its activity in the medium-sized business and corporation sector. We believe that Mizrahi Tefahot should present high growth rates in these areas, considering the relatively modest starting point and despite the increasing competition in these sectors.

The decline in the economic risks faced by Israeli banks strengthens Mizrahi Tefahot, in our opinion, being a retail bank with a strong presence in the mortgage market. In particular, we believe that the economic environment will strengthen the bank's ability to generate profits. The bank's anchor score has risen, and we are now assessing an improvement in its capital base due to the decline in economic risk. We estimate that our main ratio to the assessment of the bank's capital adequacy, the risk-adjusted capital (RAC), will remain significantly higher than 10% over the next two years. At the same time, considering the bank's policy to distribute a 40% dividend and in view of maintaining a narrow 0.3% margin above the minimum regulatory requirements, we estimate that the bank's capital base will continue to be stable. We believe that the bank will continue to optimize its capital allocation through the occasional sale of assets.

Mizrahi Tefahot's exposure to the residential real estate sector is the highest among the local banks, mainly through its mortgage activity, but to a certain extent also through its activity in the construction industry. We believe that the exposure to these industries is well-managed, and the overall risk of mortgages is moderated, *inter alia*, by a low LTV rate (55%) and a monthly payment-to-income rate (PTI) of approx. 23.4%. However, compared to large and more decentralized banks operating in countries with similar economic risk, we believe that the risk exposure of Mizrahi Tefahot is more concentrated, reflecting the geographic focus in Israel and the relatively centralized nature of the local economy, with high exposure to the real estate field. We anticipate a slight increase in credit risk, despite the indicators that point to a good asset quality. In view of the high concentration in the real estate industry and in retail credit, negative developments in the real estate market or in the leverage of households could pose a risk to our profitability and capital outlooks. On the other hand, upon completion of the arrangement with the US authorities, the risk of capital assessment deriving from the uncertainty regarding the arrangement's implications for the bank's profitability has lessened.

The bank's issuer rating is one rating level (notch) higher than its stand-alone credit profile (SACP), which reflects our assessment of the fairly high probability that the State of Israel (AA-/Stable/A-1+) will provide it with exceptional support, if necessary. We classify Mizrahi Tefahot as having systemic importance and the State of Israel as a supporter of the local banking industry.

We are reaffirming the the rating of the bank's unsecured senior debt as 'ilAAA', same as the issuer's rating; and the rating of the subordinated debt as 'ilAA+', one notch below the issuer's rating. The rating of Series A subordinated capital notes rising to 'ilAA-' from 'ilA+' reflects the improvement in the bank's SACP following the improvement in the rating anchor for Israeli banks. The rating of the bank's hybrid instruments has remained unchanged, reflecting the bank's SACP as well as the risk of a principal write-off and subordination compared to other debt instruments.

Rating Outlook

The stable rating outlook of Mizrahi Tefahot Bank reflects our expectations that the bank's credit quality will not change in the next two years. We expect that the bank will maintain its strong branding as a leading provider in the mortgage market, while diversifying its exposure to the mid-sized business and corporation sectors. These moves, supported by positive economic conditions in Israel, are expected to allow the bank to generate stable profits from its operations and maintain good operational efficiency. The stable outlook also reflects our assessment that the RAC ratio will remain significantly higher than 10% in the next two years, while the bank will maintain a margin above regulatory capital requirements and manage its risk assets in a manner that will allow it growth.

The Negative Scenario

We will consider a negative rating action if there is a significant deterioration in the Israeli economy, especially in the real estate industry or in the robustness of the households, which leads to larger-than-expected credit losses and a significant weakening of the bank's profitability and capital base.

Such deterioration may result from global or local economic pressures or from a real escalation in the region's geo-political situation. A negative rating action may also occur if we assess that the bank's business status as a leading supplier in the mortgage market will weaken significantly due to increased competition, or if the bank finds it difficult to streamline its capital management, which will limit the growth potential and may lead to a decline in profitability.

Methodology and Related Articles

- Use Of CreditWatch And Outlooks; September 14, 2009
- Bank Rating Methodology; November 9, 2011
- Banking Industry Country Risk Assessment Methodology and Assumptions; November 9, 2011
- Quantitative Metrics for Rating Banks Globally: Methodology and Assumptions; July 17, 2013
- Methodology: Timelines of Payments: Grace Periods, Guarantees, And Use of 'D' and 'SD' Ratings; October 24, 2013
- Methodology For Linking Long-Term And Short-Term Ratings; April 7, 2017
- Risk-Adjusted Capital Framework Methodology; July 20, 2017
- S&P Global Ratings' Methodology For National And Regional Scale Credit Ratings; June 25, 2018
- Hybrid Capital Rating Methodology and Assumptions; July 1, 2019
- Group Rating Methodology; July 1, 2019
- S&P Global Ratings Definitions; October 31, 2018
- The Connection Between the Global Rating Scale and the Israeli Rating Scale; June 26, 2018

Rating List

General details (as of July 11, 2019)	
Mizrahi Tefahot Bank Ltd	
Issuer Rating(s)	
Local rating – long term	ilAAA/Stable
Issuance rating(s)	
<u>Complex subordinated debt</u>	
Contingent subordinated notes with loss absorption capacity	ilAA-
Subordinated capital notes (upper Tier-II capital) A	ilAA-
Issuer rating history	
Long term	
December 23, 2014	ilAAA/Stable
November 15, 2010	ilAA+/Stable
September 14, 2009	ilAA+/Negative
May 28, 2007	ilAA+/Stable
October 01, 2003	ilAA+
Mizrahi Tefahot Issuing Company Ltd	
Issuance rating(s)	
<u>Complex subordinated debt</u>	
Contingent subordinated notes with loss absorption capacity Series 47	ilAA-
Contingent subordinated notes with loss absorption capacity Series 48	ilAA-
Contingent subordinated notes with loss absorption capacity Series 50	ilAA-
<u>Senior unsecured debt</u>	
Series 37, 38, 39, 40, 41, 42, 43, 44, 45, 46	ilAAA
Series 49	ilAAA
<u>Subordinated debt</u>	
Subordinated bonds 31	ilAA+
Additional details	
Time of the event's occurrence	July 11, 2019 13:27
Time at which the event first became known	July 11, 2019 13:27
Rating initiator	The rated company

[legal disclaimer]