

**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: October 4, 2018
	www.isa.gov.il		www.tase.co.il		Ref: 2018-01-088417

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

On October 4<sup>th</sup>, 2018, *S&P Maalot* published:

A rating report/notice *initial*

A notice regarding rating cessation

1. Rating report or notice

Corporation's rating: *ilAAA*

Comments/Notice summary:

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

Date	Rating subject	Rating	Comments/Notice summary

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 (Series 48)</i>	0	Maalot S&P	Maalot S&P ilAA- stable	Initial rating

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

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

Attached rating report maalot04102018\_isa.pdf

2. On \_\_\_\_\_, \_\_\_\_\_ announced that it would cease rating \_\_\_\_\_

*Maalot's rating was given in connection with the issuance of the deferred bonds (Series 48), which is being examined by Mizrahi Tefahot Issuing Company Ltd, a subsidiary fully owned by the bank. It is hereby clarified that at the time of this report, there is no certainty regarding the execution of the issuance, its timing, its size and its conditions.*

*No change has been made to the bank's 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):

---

Securities of a Corporation Listed for Trading      Form structure revision date: September 4, 2018  
on the Tel Aviv Stock Exchange  
Abbreviated Name: Mizrahi Tefahot  
Address: 7 Jabotinsky Street      Tel: 03-7559720      Fax: 03-7559923  
Ramat Gan, 52520, Israel  
E-mail: [mangment@umtb.co.il](mailto: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:  
[mangment@umtb.co.il](mailto:mangment@umtb.co.il)

**Maalot**

**S&P Global** Ratings

# Mizrahi Tefahot Bank Ltd

# Mizrahi Tefahot Issuing Company Ltd

---

October 4 2018

## New Issuance

### Grant of an 'ilAA-' Rating to the Issuance of Bonds with a Loss Absorbing Capacity of up to ILS 300 Million N.V.

**Primary Credit Analyst:**

Lena Schwartz

972-3-7539716

[lena.schwartz@spglobal.com](mailto:lana.schwartz@spglobal.com)

**Additional Contact Person:**

Avital Koren

972-3-7539708

[avital.koren@spglobal.com](mailto:avital.koren@spglobal.com)

## New Issuance

# Grant of an 'ilAA-' Rating to the Issuance of Deferred Bonds with a Loss Absorbing Capacity of up to ILS 300 Million N.V.

S&P Maalot hereby announces the grant of an 'ilAA-' rating to deferred bonds from a new series, Series 48, with a loss absorbing capacity of up to ILS 300 million N.V., which Mizrahi Tefahot Bank Ltd (ilAAA/Stable) will issue through Mizrahi Tefahot Issuing Company Ltd.

In determining the rating of this type of the instrument, we implement, among other things, the methodology for rating banks' complex instruments and the methodology to determine regional scale ratings. The rating's starting point is the bank's stand-alone credit profile (SACP), and not the issuer's rating, which also includes state support, as we estimate that these instruments will not receive support from the state. We are removing two rating levels (notches) off the SACP as follows:

- One notch to reflect the loss absorbing capacity embedded in the instrument in the form of a principal write-off on the instrument, should any of the trigger events defined in its conditions occur, i.e. formative principal loss absorbency event, when the bank's tier 1 equity ratio falls below 5%, or a formative nonviability event, which is defined as the earliest between a written notice from the Supervisor of Banks to the bank that a write-off of debentures is necessary, since without it the bank would reach the point of nonviability, in the opinion of the Supervision of Banks; or written notice from the Supervisor of Banks to the bank regarding a decision to inject capital from the public sector, or support of equivalent value, without which the bank would reach the point of nonviability, as will be determined by the Supervision of Banks (insolvency).
- One notch to reflect the contractual deferral of the instrument, compared with the bank's more senior (deferred) debt.

The first rating level is removed off the bank's SACP, as determined by the global ratings scale, in order to reflect the insolvency risk, according to our methodology for rating banks' complex instruments. Afterwards, we convert to the regional rating, using the conversion tables. After the conversion to the regional ratings scale, we remove one more notch, in order to reflect the contractual subordination of the instrument, thus reaching the instrument's rating on the regional scale.

An examination of the instrument in light of our complex instrument methodology does not, in our assessment, reveal additional default risks that would justify removing more notches beyond those specified above. In particular, we note that the current creditworthiness of the bank does not lead us to think that the likelihood of regulatory intervention with respect to the aforementioned bonds, as described above, requires an additional removal of rating levels.

For further details regarding Mizrahi Tefahot Bank Ltd's rating and for additional regulatory requirements, see the rating report dated January 21<sup>st</sup>, 2018 and the notice dated September 3<sup>rd</sup>, 2018. For further details regarding the methodology behind the instrument's rating, please consult the list of methodology articles in the aforementioned rating report and the Q&A document "Rating of Complex Bank Instruments – Q&A" (November 29, 2015).

### 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
- Group Rating Methodology; November 19, 2013
- Bank Hybrid Capital and Nondeferrable Subordinated Debt Methodology and Assumptions; January 29, 2015
- Methodology For Linking Long-Term and Short-Term Ratings; April 7, 2017
- Methodology For National And Regional Scale Credit Ratings; June 25, 2018
- S&P Global Ratings Definitions; June 26, 2017; April 19, 2018
- Mapping Table – The Connection Between The Global Rating Scale And The Israeli Rating Scale; June 26, 2018

General details (as of October 4, 2018)	
<b>Mizrahi Tefahot Bank Ltd</b>	
<b>Issuer Rating(s)</b>	
Long term	iIAAA/Stable
<b>Issuance rating(s)</b>	
<u>Complex subordinated debt</u>	
Deferred capital notes (upper Tier-II capital) A	iIA+
Deferred bonds with loss absorbing capacity	iIAA-
<b>Issuer rating history</b>	
Long term	
December 23, 2014	iIAAA/Stable
November 15, 2010	iIAA+/Stable
September 14, 2009	iIAA+/Negative
May 28, 2007	iIAA+/Stable
October 01, 2003	iIAA+
<b>Mizrahi Tefahot Issuing Company Ltd</b>	
<b>Issuance rating(s)</b>	
<u>Complex subordinated debt</u>	
Deferred bonds with loss absorbency capacity Series 47	iIAA-
Deferred bonds with loss absorbency capacity Series 48	iIAA-
<u>Senior unsecured debt</u>	
Series 35, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46	iIAAA
<u>Subordinated debt</u>	
Deferred bonds 31	iIAA+
<b>Additional details</b>	
Time of the event's occurrence	October 4, 2018 14:44
Time at which the event first became known	October 4, 2018 14:44
Rating initiator	The rated company

[Standard and Poor's Maalot Legal Disclaimer]

## Maalot

S&P Global Ratings

# Mizrahi Tefahot Bank Ltd

# Yahav Bank for Government Employees Ltd

---

September 3, 2018

Notice from S&P Maalot

## No Change to the Rating of Mizrahi Tefahot Bank Ltd and Its Subsidiary Yahav Bank for Government Employees Ltd Following the ILS 425 Million Provision Made by Mizrahi Tefahot Bank Due to the Investigation of the US Department of Justice

**Primary Credit Analyst:**

Lena Schwartz

972-3-7539716

[lena.schwartz@spglobal.com](mailto:lena.schwartz@spglobal.com)

**Additional Contact Person:**

Ben Shiran

972-3-7539751

[ben.shiran@spglobal.com](mailto:ben.shiran@spglobal.com)

**Tel Aviv, September 3<sup>rd</sup>, 2018:** S&P Maalot announced today that the rating of Mizrahi Tefahot Bank Ltd (iIAAA/Stable) and its subsidiary Yahav Bank for Government Employees Ltd (iIAA+/Stable) have remained unchanged. This is pursuant to the publication of Mizrahi Tefahot Bank's financial reports on August 30<sup>th</sup>, 2018, which included the provision of ILS 425 million due to the investigation of the US Department of Justice. The bank made the provision after the US Department of Justice notified the bank on August 6<sup>th</sup> that it was prepared to reach an arrangement that would end the investigation, based on the payment of USD 342 million.

We believe that at this stage, this provision has no impact over the assessment of the bank's capital, considering the provision's amount relative to our assessment of the bank's ability to create profit; and given the bank's decision to stop dividend payments, at least until the end of 2018. Likewise, it is our understanding that the decline of the ratio between overall capital adequacy and risk components to 13.29% following the provision, compared to the minimum required capital ratio of 13.34%, will not provoke a response

from regulatory authorities, given the bank's intention to act towards raising the required capital ratio in the coming months.

Yahav Bank's rating includes our assessment of support from the Mizrahi Tefahot Banking Group, in light of our evaluation of the bank as "strategically important" to the group. Accordingly, no change has been made to Yahav Bank's rating following the aforesaid.

We intend to follow developments in the investigation being conducted by the US authorities and may change our assessment if we see a material deviation from the scenario we have described.



[Standard and Poor's Maalot Legal Disclaimer]

**MAALOT**

**S&P Global Ratings**

# Mizrahi Tefahot Bank Ltd

---

January 21, 2018

**Primary Credit Analyst:**

Lena Schwartz

972-3-7539716

[lena.schwartz@spglobal.com](mailto:lena.schwartz@spglobal.com)

**Secondary Credit Analyst:**

Terence Klingman

972-3-7539708

[terence.klingman@spglobal.com](mailto:terence.klingman@spglobal.com)

## Contents

---

Strengths and Weaknesses

Rating Outlook

Main Rating Considerations

Rating Adjustments

Methodology and Related Articles

## Mizrahi Tefahot Bank Ltd

Issuer's Rating Affirmation	iIAAA/Stable
<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• The leading bank in the field of mortgages, strengthening its presence in its additional fields of operation;</li> <li>• A good asset quality and a decreasing concentration in the business credit field;</li> <li>• Growth in activities while maintaining a controlled increase of expenses.</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• High exposure to the local residential real estate sector;</li> <li>• A competitive business environment with limited possibilities for significant organic growth;</li> <li>• Uncertainty regarding the development of the investigation by US authorities.</li> </ul>

### Outlook: Stable

Our stable rating outlook for Mizrahi Tefahot Bank Ltd ("Mizrahi Tefahot") reflects the fact that the bank is rated at the highest rating level of the local ratings scale. Accordingly, any potential positive developments in the bank's business or financial risk profile, e.g. as a result of improvements in the estimated equity or business standing, will provide additional support to the bank's rating in the present rating category. On the other hand, we estimate that the likelihood of a negative rating action in the next 18-24 months is low.

We believe that a decline in the banking system's economic risk could strengthen Mizrahi Tefahot Bank's risk profile, particularly in light of its exposure to the residential real estate sector. Furthermore, if we were to estimate that a successful completion of the merger transaction with Union Bank would strengthen the bank's business standing, this could have a positive impact on the rating; however, we are not taking the possible merger into account in our base scenario.

#### The negative scenario

We see a low likelihood for a negative rating action in the next 18-24 months, but we will consider it should the positive economic trend reverse, e.g. as a result of a renewed imbalance in the housing market. Furthermore, we will consider a negative rating action if the acquisition of Union Bank causes a higher-than-expected volatility in Mizrahi Tefahot's capital adequacy or a deterioration in its asset quality.

### Main Rating Considerations

Mizrahi Tefahot's rating reflects our evaluation of the Israeli banking industry from a global perspective (BICRA – Banking Industry Country Risk Assessment), which is rated at 4 (on a 1 to 10 scale, with 1 representing the lowest risk). In addition, the bank's rating reflects its adequate business standing in the local banking system and its good credit quality, and on the other hand, the high concentration of its credit portfolio in the field of housing loans. According to its strategic plan, the bank aspires to strengthen its presence in other fields of operation, such as non-mortgage retail credit and business credit.

The merger transaction with Union Bank may help the bank in the plan's implementation, in light of the limited potential for organic growth in the domestic market and the high level of competition that characterizes these fields, in our estimation. Since this transaction is yet to be approved, we do not incorporate it into our outlooks; but its potential fulfillment could impact our evaluation of the business risk profile and the bank's equity and profitability estimations, depending on the manner in which it will be completed.

### **An improvement trend in the Israeli banking sector's risk assessment**

S&P's rating methodology for banking institutions is based on the BICRA as an anchor for the banks' rating; i.e. the rating's starting point. This assessment combines both the economic risk assessment and the sectorial risk assessment. The BICRA score for the Israeli banking system is 4 on a 1 to 10 scale, with 1 representing the lowest risk.

We are currently seeing a trend of improvement in the assessment of the economic risk which constitutes part of the BICRA. The positive trend reflects the ongoing growth of the Israeli economy's GDP, the ongoing growth of the GDP *per capita* - which is reaching the high level of approx. USD 40,000; and the low, approx. 4.5% unemployment rate anticipated for 2017, which we estimate strengthens household resilience. The decline in the business sector's leveraging likewise supports the positive trend. Furthermore, a combination of the Bank of Israel enacting macro-stability tools and government initiatives on the supply side of the housing market has, in the past year, led to a slowdown both in housing prices' acceleration rate and the growth of the volume of mortgages and other loans extended for the real estate sector.

The banking system is highly concentrated, with high entry barriers. The system is properly regulated and conservatively funded through local core deposits, mainly from the households. These characteristics have allowed the banks to present stable and consistent revenues since 2009, despite the fierce competition over credit to the business sector, which developed from the institutional investors and through the corporate bond sector.

**Table 1**

<b>Mizrahi Tefahot Bank Ltd. Key Figures</b>					
	<b>YTD Sept</b>	<b>--Year Ended Dec. 31--</b>			
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>(Mil. ILS)</b>					
Adjusted assets	239,491	230,368	209,071	198,426	179,526
Customer loans (gross)	180,512	173,109	160,920	149,219	140,185
Adjusted common equity	13,835	12,789	11,916	10,711	9,710
Operating revenues	4,400	5,640	5,392	4,992	4,959
Noninterest expenses	2,672	3,299	3,226	3,039	2,957
Core earnings	1,012	1,308	1,194	1,123	1,122

Data are based on S&P Global Ratings adjusted number and ratios

**Business standing: A slowdown in the growth of residential credit diverts the growth targets to other fields**

Our evaluation of Mizrahi Tefahot's "adequate" business standing reflects its good positioning in the local banking industry, as the third largest bank in terms of assets. As of the end of September 2017, the bank's total assets were approx. NIS 240 Bil, and its market share of the local banking industry at that time was approximately 18% of the total credit and 15% of the total deposits.

Our evaluation also reflects Mizrahi Tefahot being a leading player in the residential mortgage field, with a market share of approx. 38% of the sector's mortgage portfolio, as well as its business lines and diverse customer base, which support business stability and revenue visibility. These are offset by the bank's high exposure to the local real estate market, with housing loans constituting approx. 66% of the total credit to the public – a high rate compared to other local banks. The bank also has a high geographic concentration, with less than 5% of its assets being outside of Israel, whereas this rate is higher with some of its local competitors. The bank operates mainly in the retail banking field. As of the end of September 2017, household loans (including mortgages, other retail credit and private banking) constituted approx. 77% of the bank's total credit to the public and contributed approx. 56% of its revenues, same as the figure at the end of September 2016.

In recent years, Mizrahi Tefahot presented high credit growth rates compared to the local banking industry and compared to the growth of the GDP, due in part to the ongoing high demand for mortgages. However, the demand for mortgages had cooled down somewhat in the past year, primarily due to government programs aimed at reining in residential real estate prices, which cause a 22% decline in new mortgage executions during the first nine months of 2017, compared to the corresponding period the year before; so overall, residential credit grew by a mere 4% since the start of the year, compared with 8.5% in 2016. We believe that the bank will continue to maintain its leading position in the field of mortgages, per its strategic plan, but estimate that the growth rate in this type of credit will be considerably moderate compared to previous years, reaching approx. 4%. At the same time, we believe that the bank will act to expand its operations in the fields of credit to small and medium-sized businesses, business credit and consumer credit – fields which we estimate are characterized by a high level of competition. In the business credit field, we have seen a decline in the demand for banking credit among companies, along with competition from the capital market and financial institutions. In the fields of consumer credit and credit to small and medium-sized businesses, we have been identifying increased competition from non-banking credit companies and credit card companies, as well as several banking players who see these fields as future growth engines and contribute to the competition accordingly.

We believe that with the cool-down in the mortgage field's growth and increasing competition in other fields of operation, Mizrahi Tefahot may find it difficult to grow organically at the high rates of the past. Accordingly, we see the bank's intention to acquire and merge with Union Bank per the presented acquisition outline as a means of realizing its business strategy.

The merger of Union Bank's credit portfolio in the total sum of ILS 25 billion – half of which is business credit to corporations and small and medium-sized businesses – may improve Mizrahi Tefahot's business dispersal. However, this merger is yet to be approved, and at this stage we are not taking into account its possible impact on the bank's rating and its business standing.

**Table 2**

<b>Mizrahi Tefahot Bank Ltd. Business Position</b>					
	<b>YTD Sept</b>	<b>--Year Ended Dec. 31--</b>			
<b>(%)</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Total revenues from business line (ILS millions)	4,400	5,640	5,392	4,992	4,959
Commercial banking/total revenues from business line	38.50	37.73	37.85	39.40	37.87
Retail banking/ total revenues from business line	55.45	54.31	52.30	54.97	55.19
Commercial & retail banking/ total revenues from business line	93.95	92.04	90.15	94.37	93.06
Trading and sales income/total revenues from business line	6.05	7.96	9.85	5.53	7.02
Investment banking/ total revenues from business line	6.05	7.96	9.85	5.53	7.02
Return on equity	10.03	10.31	10.02	10.58	11.55

Data are based on S&P Global Ratings adjusted number and ratios

### **Equity and profitability: a slowdown in growth and an increase in expenses slow the equity growth rate**

Our evaluation of Mizrahi Tefahot's equity and profitability as "adequate" is based on our forecast that the risk-adjusted capital (RAC) ratio before adjustments will remain below 10% in the next 18-24 months, having stood at 9.3% at the end of 2016. Several assumptions are at the base of this evaluation, among them a growth of approx. 5% in the bank's credit portfolio – slightly lower than in the past, but still high compared to the sector - and a dividend payment at 30% of the net profit, which may increase, according to the bank's strategic plan. Likewise, we are taking into account a certain increase in the operational expenses after the signing of the collective agreement with the employees, the considerable effect of which was expressed already in 2017's third quarter results. We estimate that this may have a negative impact on the operational efficiency ratio, which we estimate will rise to approx. 62% in 2017 compared with 58% in 2016. Nevertheless, we believe that the bank could keep presenting some of the best efficiency ratios in the local system, and also even when compared to some of the banks in the foreign comparison group. However, the gap with the local banks, which are working to reduce expenditure, may be reduced the more growth becomes moderate in the mortgage field, while the bank increases its presence in the fields of credit to small and medium-sized businesses and consumer credit. This is because these fields are more abundant in expenses compared to the mortgage field, which has a relatively short interface with the customer over the asset's lifespan.

In our base scenario, we assume that credit losses will increase from their current level over the next 18-24 months, both at the bank and in the banking system in general, but will remain at a reasonable level. As of September 2017, the bank's provision to credit loss rate is 0.10%, and we estimate it will increase to 0.18%-0.20% in the next two years.

The low interest rate environment and a negative CPI may pressure Mizrahi Tefahot's interest rate margins; but a re-pricing of risks, especially in the mortgage field, have raised margins in these areas in the entire system, as well as at the bank. A diversion of the credit growth focus into segments with higher margins could also support the bank's interest margin; but the increased competition in these segments could add pressure to the margins.

This forecast does not account for the possible impact of potential fines, or other expenses in connection with the U.S. Department of Justice's investigation of the activity of the bank and its subsidiaries, on the bank's equity, as the results of the investigation and its potential effect on the bank's capital are not known at this stage. However, our base scenario does not assume that this investigation will have a significant impact on the bank's anticipated RAC ratio. Likewise, as stated above, in our forecast we do currently take into account the impact of the acquisition and merger of Union Bank.

As of the third quarter of 2017, the bank reported a tier 1 equity ratio at a level of 10.16% in terms of Basel III, and a total equity ratio of 13.48%. Israeli banks, unlike banks in many other developed markets, use the standard and more conservative method for calculating risk assets, as prescribed by the Bank of Israel, in lieu of more advanced models. Consequently, the banks present lower equity ratios than their foreign peers, and surpluses above the required regulatory minimum, which are lower, and we do not expect these two variables to change in the near future.

**Table 3**

Mizrahi Tefahot Bank Ltd. Capital and Earnings					
%	YTD	--Year Ended Dec. 31--			
	Sept 2017	2016	2015	2014	2013
Tier 1 capital ratio	10.16	10.10	9.50	9.05	9.01
S&P RAC ratio before diversification	N/A	9.30	9.90	9.14	7.66
S&P RAC ratio after diversification	N/A	7.88	9.04	8.47	6.78
Adjusted common equity total/total adjustment capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	73.0	67.00	65.5	67.6	69.9
Fee income/operating revenues	24.0	25.4	26.4	27.9	29.4
Market-sensitive income/operating revenues	1.8	5.2	6.6	3.5	0.3
Noninterest expenses/operating revenues	60.7	58.5	59.8	60.9	59.6
Preprovision operating income/average assets	1.0	1.1	1.1	1.0	1.2
Core earnings/average managed assets	0.6	0.6	0.6	0.6	0.7

N/A – not applicable

Data are based on S&P Global Ratings adjusted number and ratios

Table 4

<b>Mizrahi Tefahot Bank Ltd. RACF [Risk-Adjusted Capital Framework] Data</b>					
<b>(Mil. ILS)</b>	<b>Exposure*</b>	<b>Basel III RWA</b>	<b>Average Basel III RW (%)</b>	<b>S&amp;P Global RWA</b>	<b>Average S&amp;P Global RW (%)</b>
<b>Credit risk</b>					
Government and central banks	52,559	1,189	2	565	1
Institutions and CCPs	3,111	770	25	969	31
Corporate	49,667	43,738	88	56,757	114
Retail	132,024	71,777	54	57,248	43
Of which mortgage	114,544	58,597	51	42,015	37
Securitization§	0	0	0	0	0
Other assets†	5,823	4,394	75	8,802	151
Total credit risk	243,185	121,869	50	124,341	51
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	636	--	0	--
<b>Market risk</b>					
Equity in the banking book	101	101	100	880	871
Trading book market risk		1,184		1,776	
Total market risk		1,285		2,656	
<b>Operational risk</b>					
Total operational risk	--	8,113	--	10,575	--
<b>(Mil. ILS)</b>		<b>Basel III RWA</b>		<b>S&amp;P Global RWA</b>	<b>% of S&amp;P Global RWA</b>
<b>Diversification adjustments</b>					
RWA before diversification		131,902		137,572	100
Total		--		24,720	18
<b>Diversification/Concentration Adjustments</b>					
RWA after diversification		131,902		162,292	118
<b>(Mil. ILS)</b>		<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>S&amp;P Global RAC ratio (%)</b>
<b>Capital ratio</b>					
Capital ratio before adjustments		13,318	10.1	12,789	9.3
Capital ratio after adjustments‡		13,318	10.1	12,789	7.9

\*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets include Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RAW—Risk-weighted assets. RW—Risk weight. RAC—Risk-adjusted capital. ILS—New Israeli Shekel. Sources: Company data as of Dec. 31, 2016, S&P Global.

#### **Risk profile: High exposure to the local residential real estate market, decreasing borrower concentration**

Our evaluation of Mizrahi Tefahot's risk profile as "adequate" reflects the high concentration



in its exposure to the residential real estate sector, which is high compared to its local competitors. This is the bank's primary risk factor, due to the possibility of deterioration in its asset quality as the result of a considerable rise in the unemployment rate; and to a lesser extent, in the event of a significant price correction in the housing market. However, these scenarios are not part of our base scenario for the next 18-24 months, and therefore we do not anticipate any significant change to its risk profile during this period.

We estimate that the bank is exposed to the local real estate market, and particularly to residential mortgages, at a higher rate of the credit portfolio compared to the large local competitors. This exposure was at 73% of the credit to the public, as of September 30, 2017. However, the bank has an appropriate credit underwriting policy, and good credit control and monitoring tools to reduce the possible risks deriving from its real estate credit activity. The bank's average loan-to-value (LTV) ratio, as measured at the time of the loan's granting, stands at approx. 54%; and given the rise in housing prices over recent years and the ongoing repayments, it is likely that as of today this ratio is actually lower. The rate of the monthly payment relative to the disposable income available in the bank's mortgage portfolio is less than 27%, and approx. 81.3% of the mortgages were granted to borrowers with a monthly-payment-to-disposable-income rate lower than 35%. Likewise, we estimate that the moderation in the bank's appetite for continued, accelerated growth in this credit, together with the cool-down in the residential real estate market and a moderation in the rise of home prices contribute to the risk management in this exposure. On the other hand, the rising margins increase the bank's compensation for its exposure to this risk.

We estimate that the concentration risk in exposure to large corporate credit borrowers is decreasing both in the economy and for the bank. The decreased concentration is largely attributed to regulatory directives, which led to a process of reduction in large holding groups and to a decline in the volumes of business credit in the system, which was partially replaced by credit from the capital market and financial institutions. We estimate that we will continue to see a similar trend in the future, albeit at a more moderate rate, so that the concentration risk will remain one of the risks in the banking system, as a reflection of the concentrated structure of the Israeli market, which is relatively small on a global scale. As of September 2017, the bank had no exposure to borrower groups at a rate exceeding 15% of the regulatory capital. We estimate that the bank's exposure to the 20 largest borrowers is decreasing, and that it is low compared to the local competitors.

The Bank's credit loss rate was 0.1% in September 2017, lower than the average of the five large banks, which was approx. 0.19%. In view of its focus on the field of mortgages, the bank has consistently presented low credit loss rates compared to the system. However, in recent years, the provision rates in the banking system have declined, backed mainly by the recovery of money in respect of credit (usually business credit) that was issued in the past, reducing the provision rates gap between the bank and the entire system. We estimate that this recovery will not continue at the same rate in the future, which may increase the provision rates in the system; however, we also estimate that we will be seeing a rise in Mizrahi Tefahot's credit loss rate to approx. 0.18-0.2% in the years 2017-2019. This is mainly due to the diversion of the bank's growth to the channels of consumer credit and credit to small and medium-sized businesses, in which the provision rates are higher compared to the mortgage field. Nevertheless, since most of the bank's credit is still expected to come from

the mortgage field, we estimate that the average provision rates at the bank will continue to be low compared with the sector.

The rate of the bank's problem loans (non-performing, restructured and at arrears of more than 90 days) in the bank's balance sheet out of the total credit to the public was 0.97% in September 2017, compared to 0.93% in September 2016 – a lower level than the average among the large local banks, and compared to most global banks operating in countries with similar economic risks. We attribute the low rate to Israel's stable economic environment in Israel in recent years, and to the bank's higher exposure to the household sector compared to its local peers, which is less leveraged than the business sector. We expect that the problem loans rate will increase somewhat over the next 18-24 months, to a level of approx. 1.1%, but will remain manageable and low compared to the competitors.

The bank's provision coverage ratio (provision for credit losses as a percentage of problem loans) stood at 84% in the third quarter of 2017, in the middle of this ratio's range among the large local banks, which was 70%-108% during that time. We believe that this ratio at the bank is affected by the relatively high coverage ratio of mortgage loans, the provisions for which are done according to the Bank of Israel ratio and according to the depth of the arrears and without a discretionary component.

**Table 5**

<b>Mizrahi Tefahot Bank Ltd. Risk Position</b>					
	YTD Sept 2017	--Year Ended Dec. 31--			
		2016	2015	2014	2013
%					
Growth in customer loans	5.70	7.57	7.84	6.44	7.37
Total diversification adjustment/S&P RWA before diversification	N/A	17.97	9.50	7.92	13.04
Total managed assets/adjusted common equity (x)	17.3	18.0	17.6	18.5	18.5
New loan loss provisions/average customer loans	0.1	0.1	0.1	0.1	0.2
Net charge-offs/ average customer loans	0.0	0.1	0.1	0.1	0.4
Gross nonperforming assets/customer loans + other real estate owned	1.0	0.9	1.1	1.2	1.7
Loan loss reserves/gross nonperforming assets	83.6	87.7	76.5	75.4	55.4

N/A – not applicable

Data are based on S&P Global Ratings adjusted number and ratios

#### **Funding and liquidity: average funding profile and adequate liquidity**

Mizrahi Tefahot's funding profile is "average", and the liquidity status is "adequate" in our estimation - similar to these characteristics in general in the local banking sector.

The bank's funding base is diverse, with a 97% loan-to-deposit ratio as of September 2017 – higher than the sectorial range of 75%-85%, and reflecting this ratio's management by the bank in accordance with its credit needs.

The stable funding rate stood at 116% compared to the sectorial range of 112%-134%. The bank relies primarily on local customer deposits, which constituted approx. 97% of the total deposits from the public as of September 2017. Out of the total deposits from the public, retail deposits rose by 5.2% at the start of the year, but amounted to approx. 47% of the total deposits from the public, without any significant change compared to last year. Mizrahi Tefahot is attempting to increase the weight of retail deposits, which are considered more stable and to extend their duration even further, which we estimate is longer compared to the system, for the purpose of funding its long-term assets, at the expense of institutional and business deposits, which are not as supportive of liquidity ratios. Institutional customers' deposits constituted 21% of the total deposits from the public and business customers' deposits amounted to approx. 29%. The rate of institutional customer deposits is slightly higher compared to the large local banks, but it has been on the decline in recent years. Accordingly, the Basel III liquidity coverage ratio was 117% in September 2017, above the required regulatory minimum, but low compared to most local banks.

Bonds and subordinated debentures constituted approx. 13% of the bank's total liabilities in September 2017, a high rate compared to the local banks; however, these liabilities are mostly for a longer term and linked to the CPI, which fits the profile of the bank's assets.

The bank's asset profile is characterized by a longer duration than that of its local peers, mainly due to mortgage activities. The mismatch between the duration of the assets and the liabilities might expose the bank to changes in funding costs in the event of floating interest assets, when the margin on floating interest assets is "locked" for a longer period than that of the liabilities. The bank's floating interest mortgage rate was approx. 38% of the total mortgage portfolio in September 2017, while approx. 30% were prime-linked. We estimate that this risk is mitigated by the regulatory restrictions on the part of the mortgage taken linked to the prime interest rate.

Mizrahi Tefahot has an adequate liquidity profile on a global and local comparison, supported by its wide local funding base. In September 2017, cash and deposits at banks along with securities (most of which were issued by the State of Israel) constituted approx. 22% of the total assets. The liquid-asset-to-short-term-wholesale-financing ratio was 11.1x as of the end of September 2017 – a ratio which indicates low reliance on this type of funding.

Table 6

Mizrahi Tefahot Bank Ltd. Funding and Liquidity					
	YTD	--Year Ended Dec. 31--			
	Sept 2017	2016	2015	2014	2013
%					
Core deposits/funding base	85.7	86.2	86.7	87.3	88.4
Customer loans (net)/customer deposits	97.2	96.3	98.2	97.0	98.3
Long term funding ratio	98.2	98.3	98.5	96.3	96.5
Stable funding ratio	116.4	116.5	113.4	110.8	106.6
Short-term wholesale funding/funding base	1.9	1.8	1.6	3.9	3.7
Broad liquid assets/short-term wholesale funding (x)	11.1	11.6	11.6	4.9	4.0
Net broad liquid assets/short-term customer deposits	27.3	27.5	23.9	21.7	15.6
Short-term wholesale funding/total wholesale funding	13.0	12.9	11.7	30.8	32.2

Data are based on S&P Global Ratings adjusted number and ratios

#### External support: Systematically-important bank

The bank's issuer rating includes the addition of a notch which incorporates state support, reflecting the bank's "high" systematic importance in Israel and the government's "supportive" policy towards the local financial system, where necessary.

#### Additional factors affecting the rating: None

No further factors affected this rating.

#### Rating Adjustments

<b>Business standing</b>	Adequate
<b>Equity and profitability</b>	Adequate
<b>Risk profile</b>	Adequate
<b>Financing and liquidity</b>	Average and Adequate

## 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
- Group Rating Methodology; November 19, 2013
- National And Regional Scale Credit Ratings; September 22, 2014
- Bank Hybrid Capital and Nondeferrable Subordinated Debt Methodology and Assumptions; January 29, 2015
- Methodology For Linking Long-Term And Short-Term Ratings; April 7, 2017
- Risk-Adjusted Capital Framework Methodology; July 20, 2017
- S&P Global Ratings' National And Regional Scale Mapping Tables; August 14, 2017
- S&P Global Ratings Definitions; June 26, 2017
- Mapping Table – The Connection Between the Global Rating Scale and the Israeli Rating Scale; January 25, 2016

<b>General details (as of January 21, 2018)</b>	
Mizrahi Tefahot Bank Ltd	
Mizrahi Tefahot Issuing Company Ltd	
<b>Issuer Rating(s)</b>	
Local rating – long term	ilAAA/Stable
<b>Issuance rating(s)</b>	
<u>Complex subordinated debt</u>	
Subordinated capital notes (upper Tier-II capital) A	ilA+
Contingent subordinated notes with loss absorbing capacity Series 47	ilAA-
Contingent subordinated notes with loss absorbing capacity	ilAA-
<u>Senior unsecured debt</u>	
Series 35, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46	ilAAA
<u>Subordinated debt</u>	
Subordinated debentures 31	ilAA+
<b>Issuer rating history</b>	
Local rating – 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+
<b>Additional details</b>	
Time of the event's occurrence	January 21, 2018 14:45
Time at which the event first became known	January 21, 2018 14:45
Rating initiator	The rated company

[Standard and Poor's Maalot Legal Disclaimer]