

MIZRAHI TEFAHOT BANK LTD

No. with the Registrar of Companies: 520000522
Securities of a Corporation Listed for Trading on the Tel Aviv Stock Exchange
Abbreviated Name: Mizrahi Tefahot
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To
Israel Securities Authority
www.isa.gov.il

To
Tel Aviv Stock Exchange Ltd
www.tase.co.il

Immediate Report

Explanation: this form may not be used when there is
an appropriate form for the reported event
Issue results should be reported on a T20 and not on this form
Report in respect of bonds or corporate rating should be filed on T125
Nature of the event: Corporate governance aspects

Further to the immediate report of November 4, 2012, Mizrahi Tefahot Bank Ltd. hereby announces that on February 4, 2013, the Bank received the final review report of the Bank of Israel on the issue. Attached please find a copy of the full report.

The date on which the corporation first learned of the event: February 4, 2013 at 16:15.

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

The reference numbers of previous documents regarding the subject (reference does not constitute incorporation by reference): **2012-01-270483**

Previous names of reporting entity: United Mizrahi Bank Ltd.

Revision date of form structure: December 12th, 2012

Name of the person reporting electronically: Maya Feller; Position held: Company Secretary
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Mizrahi-Tefahot Bank: Corporate Governance Aspects

1. Introduction

Over the recent years, there has been a clear trend, which started shortly after the "MANO" audit report 201-09 regarding assessment of the effectiveness of the Board of Directors' work, improvement of the Board of Directors' work and the corporate governance in Mizrahi-Tefahot Bank Ltd. (the "**Bank**"). Recently, a number of indications accumulated at the Supervision of Banks which raised a concern for a change in this trend and the weakening of the corporate governance in the Bank.

In view of a sequence of events in August 2012, the Supervision of Banks decided to review certain aspects of the Bank's corporate governance, in collaboration with the Israel Securities Authority.

2. The Review

The review included:

- 2.1. Meetings with some of the members of the Board of Directors: Mr. Jacob Perry – the Chairman of the Board of Directors during the review period; Adv. Zvi Ephrat; Adv. Ron Gazit; Mr. Muzi Wertheim (of the controlling shareholders); Mr. Avi Zigelman; Mr. Dov Mishor; Mr. Yoav Nachshon; Mr. Gideon Siterman; Ms. Liora Ofer (of the controlling shareholders); Mr. Abraham Shochat; and Mr. Joseph Shachak.
- 2.2. Meetings with the Bank's CEO, the Chief Legal Advisor and the Chief Internal Auditor.
- 2.3. Reviewing minutes of meetings of the Board of Directors (19-21/2011 and 1-12/2012), the Audit Committee (1-13/2012), the Salary and Compensation Committee (1-10/2012) and the Credit Committee (17-29/2011 and 1-17/2012).
- 2.4. Review and consultation with the ISA.

3. The Composition of the Audit Committee and its Activity

3.1. The factual background

- 3.1.1. During the reviewed period, the Audit Committee in the Bank consisted of six members, among which were Messrs. Abraham Shochat, Dov Mishor and Joseph Shachak¹.
- 3.1.2. According to Section 36(f) of Regulation 301 of the Proper Conduct of Banking Business Regulations regarding the board of directors ("**Regulation 301**"), among the duties of the Audit

¹ Other than in the period between February 27, 2012-March 25, 2012, at which time the Committee consisted of seven members.

Committee is to discuss and approve "any transaction...of the banking corporation with another, in which an officer in the bank has a personal interest, at a sum which is higher than the amounts specified in Section 7(a)(1)-(3) of Regulation 312 of the Proper Conduct of Banking Business Regulations²...".

- 3.1.3. According to Section 116A of the Companies Law, 5759-1999 (the "**Companies Law**"), the legal quorum for discussion and adoption of resolutions by the audit committee will be the majority of the committee's members, provided that the majority of the persons present at the meeting are independent directors and that at least one of them is an external director. In addition, in accordance with Section 35(c) of Regulation 301, the legal quorum for the meetings and resolutions of the Audit Committee is the majority of its members, provided that the majority of them are external directors.
- 3.1.4. Mr. Abraham Shochat served as a Director in the Bank since 2006, Mr. Dov Mishor served as an external Director in the Bank since 2007 and Mr. Joseph Shachak has been serving as an external director in the Bank since 2010.
- 3.1.5. Mr. Shachak has been acting as a consultant for the Carasso Group (which includes Carasso Motors Ltd. and Pacific Vehicle and Transportation Ltd.) even prior to his role in the Bank. In addition, on August 10, 2011, Messrs. Shochat and Mishor were appointed as members of the Board of Directors in Carasso Motors Ltd.
- 3.1.6. Due to the position of Messrs. Shochat, Mishor and Shachak in the Carasso Group, each one of them had a "personal interest" in the Carasso Group, which required the approval of the Audit Committee with respect to transactions, in the sums provided in Regulation 312 of the Proper Conduct of Banking Business Regulations, as provided in Section 3.1.2 above, which the Bank wished to execute with Carasso Motors Ltd. and Pacific Vehicle and Transportation Ltd. (above and below: the "**Carasso Group**").
- 3.1.7. In view of the personal interest of these Directors in the Bank's transactions with the Carasso Group, they were precluded from participating in the discussion and the resolutions of the Audit Committee in respect of transactions with the Carasso Group. Since this refers to three Directors out of the six members in the Audit Committee, in their absence (whether they failed to appear for the meeting or were absent only from the part of the discussion regarding the Carasso Group), there was no legal quorum in the Audit Committee and the credit applications of the Carasso Group could not be approved.

² The banking corporation's business with related persons.

3.1.8. It shall be noted that at the time of the appointment of Messrs. Shochat and Mishor as directors in Carasso, the said three Directors were also members of the Board of Directors Credit Committee, and constituted three out of the six members in this Committee as well. In view of the fact that the Carasso Group constitutes over 5% of the vehicle sector in Israel, the said Directors were precluded from participating in the discussion and resolutions not only with respect to the Carasso Group, but also in respect of credit to the entire vehicle sector. This impediment caused the absence of legal quorum in the Credit Committee in matters regarding credit in the vehicle sector and the inability to approve transactions in the entire vehicle sector. In view of the above, and as Mr. Mishor told us, after consultation with the Chairman of the Board of Directors and the Bank's Chief Legal Advisor, each one of the said Directors announced, on September 21, 2011, his resignation from the Credit Committee "due to sector-related permanent conflict of interest". At this stage, it seems, the problem in the Audit Committee was not raised.

Mr. Mishor, during the review, and Mr. Shachak, in his response to the draft of the review report, said, that they, as well as Mr. Shochat, approached the Chairman of the Board of Directors, shortly after the appointment of Messrs. Shochat and Mishor to Carasso's Board of Directors, presented the problem at the Audit Committee to him, and proposed to him to make a change in the composition of the Committees in the Bank.

3.1.9. On September 5, 2011, a meeting of the Audit Committee took place, in which credit to the Carasso Group were presented for approval. The applications were not discussed, due to the absence of a legal quorum as a result of the non-participation of the said three Directors in the part of the meeting in which the applications were supposed to be discussed.

3.1.10. In the course of the review it was established that although the three Directors resigned from the Credit Committee, they did not see fit to do so in respect of the Audit Committee³.

3.1.11. On September 26, 2011, a meeting of the Audit Committee took place, in which credit to the Carasso Group were presented for approval. Mr. Mishor chose not to participate in this meeting altogether. Messrs. Shachak and Shochat left the

³ Mr. Mishor stated during the review that in 2009-2011 he served as the Chairman of the Audit Committee and that he sees this role, and being a member of the Audit Committee in general, as the high point of his assignments for the Bank, and he believes that his contribution to this Committee is material and effective, and that this belief guided his conduct in the case at bar as well. Mr. Shachak stated during the review, that he thinks that his contribution to the Audit Committee, as an experienced CPA who has been working in the auditing and control field for 30 years, is important for the Bank.

meeting in the part were the transactions with the Carasso Group were discussed, and those were approved⁴.

Mr. Mishor clarified during the review and in his response to the draft of the review report that after reviewing the agenda, he decided not to participate in the meeting of the Audit Committee which took place on September 26, 2011, in order to allow a discussion and adoption of resolutions regarding the applications of the Carasso Group, while stating that as he understood from the Bank's Chief Legal Advisor, this was a possible solution.

3.1.12. In the meeting of the Board of Directors which took place on February 27, 2012, Ms. Sabina Biran was added to Bank's Board of Directors, and it was also decided on her appointment as a member of the Credit Committee and the Audit Committee⁵.

3.1.13. On March 5, 2012, a meeting of the Audit Committee took place, in which credit applications of the Carasso Group were discussed. In view of the addition of Ms. Sabina Biran as a member of the Audit Committee, it was possible to discuss and approve the said applications even in the absence of the said three Directors, and it was implemented as such.

3.1.14. At the meeting of the Board of Directors which was held on March 25, 2012, the Chairman of the Board of Directors stated that the appointment of Ms. Biran as a member of the Credit Committee and the Audit Committee at the previous meeting took place in order to solve "a functional inability of the Credit Committee and sometimes the Audit Committee, in the absence of one external director" and that he considered to include in the agenda the issue of the re-staffing of the Committees "which will be, to the extent possible, adequately balanced between the two controlling parties", but he chose not to do so, since the Committee had to undergo an overall change in accordance with the requirements of the Bank of Israel. Mr. Wertheim proposed to raise the issue on the agenda in order "to approve the agreements between the controlling shareholders".

⁴ It shall be noted that the applications were approved at a meeting in which the Bank's Chief Legal Advisor was present. The approval was probably based on the assumption that the majority of the members of the Committee who are present at the meeting constitute legal quorum. This assumption contradicts the specific provisions of the Law and the Proper Conduct of Banking Business Regulations (as provided in Section 3.1.3 above), whereby legal quorum constitutes the majority of the Committee's members (whether present or not).

⁵ It arises from the meeting's minutes that Adv. Gazit requested to hold the discussion regarding the staffing of the Committees at the next meeting, due to his absence from the meeting on February 27, 2012. In response to the review report draft, Adv. Ephrat stated that, as reflected in the minutes of the Board of Directors' meeting of March 25, 2012, "the appointment of Ms. S. Biran to the Committees, was decided upon by Mr. Zvi Ephrat as well". Mr. Ephrat clarified that he supported the appointment although it violated the "principle of balance" between the two groups which constitute the controlling block.

Adv. Ron Gazit (a Director who was recommended by the Wertheim group) expressed his opinion whereby the balance between the two groups which constitute the controlling block in the Bank was violated in the previous meeting with the appointment of Ms. Biran as a member of the Credit Committee and the Audit Committee⁶, and requested to make a proposal for the staffing of the Committees, which was prepared by him together with Adv. Zvi Ephrat (a Director who was recommended by the Ofer group), in order to get to the list of names composing the Board of Directors' Committees, that will coincide with the agreements between the groups which compose the controlling block, and proposed to approve it⁷. The Chairman of the Board of Directors read the agreed composition of the Committees, and it was approved by the Board of Directors. Ms. Biran was not included in the Audit Committee, which returned to be composed of the same persons as prior to the appointment of Ms. Biran.

3.1.15. In the course of the review, Mr. Mishor stated that in April 2012, after the meeting of the Board of Directors which was held on March 25, 2012, he approached Adv. Gazit requesting to solve the problem in the Audit Committee by replacing one of three of them with Ms. Biran and appointing that person to the Risk Management Committee instead of Ms. Biran. Alternatively, he offered to add an additional member to the Audit Committee and an additional member to the Legal Claims Committee, one of whom will be recommended by Ofer (in the Audit Committee) and the other will be recommended by Wertheim (the legal Claims Committee). Mr. Shachak stated as well, in his response to the review report draft, that he approached Adv. Gazit and Adv. Ephrat, who initiated the approved proposal for the staffing of the committees, several times, and demanded to resolve the problem in the Audit Committee, and that he was told that the matter would be resolved within a short while. Adv. Gazit, in his response to the review report draft stated that it was he who approached the

⁶ With respect to the Audit Committee, it consists of three Directors who were recommended by the Ofer Group and three directors who were recommended by the Wertheim Group. The appointment of Ms. Biran, who is an external director recommended by the Ofer Group, as a Committee member, resulted in there being three Directors in the Committee who were recommended by the Ofer Group versus three Directors who were recommended by the Wertheim Group.

⁷ Adv. Ephrat stated at the meeting of the Board of Directors that he was of the opinion, that violating the balance does not breach the permit of control in the Bank, that their proposal does not obligate the Board of Directors to accept the proposal, and that it is a temporary arrangement which is changeable. In response to the review report draft, Adv. Ephrat clarified that the issue of maintaining the balance was always of minor significance to him, and complementary to the other considerations regarding the staffing of the Committees (complying with the provisions of the law and the Supervisor's instructions, choosing the appropriate directors according to their experience and qualifications) and not a necessary condition. However, having experienced in the past harsh disagreements between the groups of controlling shareholders and having been present in the severe consequences for the Bank as a result, he was of the opinion, that the importance of proper and adequate relationship between the two groups cannot be ignored.

said Directors, without knowing that there was an impediment to discuss credit to the Carasso Group in the Audit Committee, but because he knew that due to the parallel activities of the three Directors who were members of the Audit Committee (out of whom two were external) in the Bank and in the Carasso Group, there may be a difficulty to approve credit to the Carasso Group, a difficulty which is not unsolvable and does not lead to the inability of the Bank to approve credit as aforesaid, but such which would have better been avoided. According to him, the said three Directors refused to resign from the Board of Directors of Carasso or the Bank.

3.1.16. On April 2, 2012, the Audit Committee held a meeting, in which credit to Pacific Vehicle and Transportation Ltd. (which is part of the Carasso Group) was presented for approval. The applications were not discussed due to the inability of the said three directors to participate in the discussion and the resolutions regarding the said applications, and the absence of legal quorum as a result.

3.1.17. On August 12, 2012, the Audit Committee held a meeting, in which credit to Carasso Motors Ltd. (which is part of the Carasso Group) was presented for approval. The applications were not discussed due to the inability of the said three directors to participate in the discussion and the resolutions regarding the said applications, and the absence of legal quorum as a result.

During the meeting, the members of the Committee tried to examine the possibility to approve the transaction in the Board of Directors without approving it in the Audit Committee⁸. At this stage, Mr. Siterman asked to stop the recording and also said "I recommend telling Carasso to look for another bank" and "they should change banks"⁹.

3.1.18. The results of the meeting of August 12, 2012, and the contents thereof were reported to the Bank's CEO immediately after the meeting by Mr. Doron Klausner, the Head of the Corporate Division, who appeared before the Committee in order to present the credit application and the required details, as well as by Mr. Tomer Seltzer, assistant to the CEO. On the same day, the Bank's CEO sent a letter to the Chairman of the Board of Directors, with a copy to all of the members of the Board of Directors, in which he complained that since the appointment of Messrs. Shochat and Mishor to the Board of Directors of

⁸ In response to the review report draft, Mr. Zigelman stated that there was an informal pause at the meeting, as they waited for the Bank's Chief Legal Advisor, in order for him to examine whether there was a legal quorum for discussing the Carasso Group applications. During the pause, things were said lightheartedly and ideas were expressed regarding the legal quorum without profound thinking.

⁹ It shall be noted that during the review Mr. Siterman claimed that the things said about giving up the customer were said jokingly.

Carasso Motors in August 2011, it was not possible to discuss the Carasso Group credit applications in the Audit Committee and in the Credit Committee. In addition, he complained that this problem was not solved despite the long period of time which elapsed and the damage which was caused to the Bank due to this continuous conduct.

3.1.19. In response to the CEO's letter, Messrs. Mishor and Shochat sent a letter to him the next day, on August 13, 2012, with a copy to all of the members of the Board of Directors, in which they stated that the issue should be resolved without delay, and that there are solutions which had already been proposed by them and by Mr. Shachak a few months earlier. Also, they pointed out a number of inaccuracies in the letter, according to them there is a certain problem in the Audit Committee but not in the Credit Committee, and that the Bank has not suffered any damage, since (according to them), other than the last meeting of the Audit Committee, all of the transactions with the Carasso Group were duly approved.

3.1.20. In response to the letter of Messrs. Shochat and Mishor, on August 14, 2012, the CEO sent a letter to them, with a copy to all of the members of the Board of Directors, the Chief Legal Advisor and the Chief Internal Auditor, in which he expressed his opinion that Messrs. Shochat and Mishor should have chosen between their position in the Carasso Group and their position in the Bank, and not have waited until a solution was found, or find temporary solutions, and in addition he specified the cases in which the credit applications of the Carasso Group could not be approved.

3.1.21. On August 27, 2012, one year after the problem in the composition of the Audit Committee arose, a meeting of the Board of Directors was held in which it was resolved to appoint Ms. Biran as a member of the Audit Committee, in order to solve the inability to approve the Carasso Group transactions in the Audit Committee.

It shall be noted that it arises from the statements of Adv. Ephrat included in the meeting's minutes, that with respect to this meeting as well, Adv. Gazit (a director recommended by the Wertheim Group) requested not to adopt a resolution due to his absence. The resolution was adopted by a majority of votes, such that the director, Mr. Yoav Nachshon (a director recommended by the Wertheim group) voted against the appointment.

3.1.22. At the meeting of the Audit Committee of September 3, 2012, the Bank's Chief Legal Advisor, Adv. Shimon Weiss, announced that he erred in his interpretation, and that the quorum in the Audit Committee, whereby the transaction with

Carasso were approved on September 26, 2011, was unlawful. Therefore, a ratification of the resolution was required, and it was implemented as such.

3.2. Findings

3.2.1. The Chairman of the Board of Directors

3.2.1.1. According to Section 28(a) of Regulation 301, "the Chairman of the Board of Directors' duty is to take care of the proper and efficient operation of the Board of Directors and the fulfillment of the duties which are imposed thereon". This responsibility applies to the Chairman of the Board of Directors with regard to the Board of Directors Committees as well.

Within the framework of the above, the Chairman of the Board of Directors should have ensured that the composition of the Audit Committee allows proper and efficient operation, such that the Audit Committee will have the ability to fulfill the duties which are imposed thereon, *inter alia*, in approving transactions with another (the Carasso Group) in which the Bank's officers have personal interest.

For that purpose the Chairman of the Board of Directors should have examined alternatives which will lead to removal of the impediment which arose in respect of the composition of the Audit Committee and should have presented to the Board of Directors proposals for changing the composition of the Audit Committee. The Chairman of the Board of Directors failed to do the aforesaid, notwithstanding approaches by directors and by the CEO¹⁰. Indeed, at the end of February 2012, approx. half a year after the problem of the composition of the Audit Committee arose, the Board of Directors appointed, according to the proposal of the Chairman of the Board of Directors, an additional external director as a member of the Audit Committee, but a month thereafter the Chairman of the Board of Directors accepted, as did the other members of the Board of Directors, the position of the representatives of the Bank's controlling block, whereby this appointment should be cancelled, since it violated the balance between the

¹⁰ As arises from the statements made by the Chairman of the Board of Directors at the meeting of the Board of Directors held on March 25, 2012, and as arises from conversations which we held with Messrs. Mishor and Shachak and with the CEO.

controlling shareholders, and the problem in the Audit Committee returned¹¹.

3.2.1.2. Section 100 of the Companies Law provides:

“(a) A notice of a board of directors’ meeting will be given to all of its members reasonable time before the time of the meeting...

(b) a notice in accordance with sub-section (a) will be given... and shall specify...reasonable detail of all of the issues on the agenda...”

(c) A public company will not be allowed to condition, in its articles of association, the duty to give reasonable detail of all of the issues on the agenda in the notice regarding the convening of the board of directors.”

Section 44 of Regulation 301 also provides: “the agenda of the meetings of the board of directors will include, *inter alia*, any issue that a director or the general manager requested from the chairman of the board of directors, reasonable time prior to the convening of the board of directors meeting, to include in the agenda.” **The provisions of the Law and the provisions of Proper Conduct of Banking Business Regulations are not merely formal, but are intended to ensure the making of the right and efficient decisions by the board of directors.**

Contrary to the aforesaid, the Chairman of the Board of Directors permitted, at the meeting which took place on March 25, 2012 to hold a discussion and to make decisions regarding the staffing of the Board of Directors Committees, without including the issue, according to the decision of the Chairman of the Board of Directors, in the agenda of the meeting of the Board of Directors as required, and with no background material being attached in advance¹². Thus, the members of the Board of Directors were

¹¹ In response to the report draft, Mr. Perry stated that the legal restrictions on the involvement of the Chairman of the Board of Directors in the affairs of the Audit Committee place a legal impediment on his ability to discover flaws in the Committee's work and act for the repair thereof, since they prevent him from receiving real time information regarding difficulties which the Audit Committee encounters in its work. We do not accept this position, both in view of the Committee's minutes which are transferred to the members of the Board of Directors and both, as turned out during the review, since the issue was raised before him by the directors with the personal interest in the Carasso Group, and also, according to the CEO – by him.

¹² It shall be noted that at the meeting, the proposed list of composition of the Board of Directors' Committees was not presented to the members in writing, but was read to them by the Chairman of the Board of Directors, without the Board of Directors' members being able to review it.

unable to prepare for the meeting, to learn the issue and the implications thereof, and to form an independent and informed opinion, as required according to the Companies Law and the Proper Conduct of Banking Business Regulations. As evidence therefor, Mr. Mishor stated, within the framework of the review, that when he received the staffing of the Committees from the Bank's Secretary (a number of days after the meeting), he understood that he was removed from the Risk Management Committee and that the problem in the Audit Committee was not solved. In response to the draft of the review report, the Chairman claimed that this was only a technical flaw, which if had been solved, would not have changed the directors' position. As provided above, we do not see this issue as a merely formal requirement. If the issue had been included in the agenda as required and would have included background material in advance, the problem of the composition of the Audit Committee could have been pointed out, presented to the members of the Board of Directors in a substantiated manner, rather than in inaccurate casual statements (as arises from the meeting's minutes), and it would have allowed the directors to consider their position and to form it in an informed manner.

- 3.2.1.3. It was found that the Board of Directors does not meet the requirements of Section 31(d) of Regulation 301, whereby the Board of Directors will set forth guidelines for cases with potential of permanent conflict of interest.

3.2.2. The Chairman of the Audit Committee

- 3.2.2.1. The Chairman of the Audit Committee has not initiated or took part in finding a solution which will allow the Audit Committee to perform its function.

During the review, the Chairman of the Audit Committee told us that his position was that the responsibility for the composition of the Ccommittee lied with the Chairman of the Board of Directors, and not the Chairman of the Audit Committee.

We are of the opinion, that indeed the final responsibility is of the Chairman of the Board of Directors; however, this does not exempt the Chairman of the Committee from his duty to take care of the proper and efficient operation of the Committee and the fulfillment of its duties, which is especially

true in view of the fact that the Chairman of the Audit Committee was practically aware of the problem, in light of the cases in which the credit applications of the Carasso Group could not be approved in the absence of legal quorum¹³. Moreover, even if there was a reason to accept the position of the Chairman of the Audit Committee to the effect that the responsibility for the solution lies with the Chairman of the Board of Directors, he should have reported to the Chairman of the Board of Directors and present the full scope of the problem to him and demand him to take actions towards solving the problem; however, he did not see fit to do so¹⁴.

3.2.2.2. In conversations with the Bank's Secretary it was clarified that any credit which is approved by the Credit Committee and which requires the approval of the Audit Committee is automatically transferred to the Audit Committee. We are of the opinion that the Chairman of the Committee should show greater involvement in determining the Committee's agenda, and in particular regarding issues of related persons.

3.2.2.3. The Chairman of the Audit Committee should have ensured the existence of guidelines in cases with potential permanent conflict of interest (see Section 3.2.1.3)¹⁵.

3.2.3. All of the directors

- According to Section 106(a) of the Companies Law "a director, in his capacity as such, will exercise independent discretion when voting in the board of directors, will not be a party to a voting agreement and failure to exercise such independent discretion or a voting agreement will be considered as breach of fiduciary duties."

¹³ In response to the review draft, Mr. Zigelman stated that until August 12, 2012, no one in the Bank warned him of actual damage which may be caused to the Bank due to the inability to approve the Carasso Group applications, and that the issue was not presented at the meetings of the Board of Directors in the relevant period, neither by the Chairman of the Board of Directors nor by the CEO.

¹⁴ In response to the review report draft, Mr. Zigelman stated several times that the Chairman of the Board of Directors was aware of the existing difficulty. We are of the opinion that it does not release the Chairman of the Audit Committee from requesting again from the Chairman of the Board of Directors to take steps to solve it, and that we have not found that it was done by the Chairman of the Committee.

¹⁵ In response to the review report draft, the Chairman of the Audit Committee claimed that the initiative to preparing such guidelines which will be approved by the Board of Directors is supposed to be of the Chairman of the Board of Directors. We are of the opinion that in view of the role of the audit committee in general, and as a committee which handles transactions with related persons in particular, the Chairman of the Audit Committee should have ensured that such guidelines existed and implemented in the Audit Committee.

- Section 254 of the Companies Law determines that "an officer owes a fiduciary duty to the company, will act in good faith and for the company's best interests. Moreover, sub-section (1) determines that "he will refrain from any action involving a conflict of interest between his role in the company and the fulfillment of any other role or his personal affairs".

3.2.3.1. The Board of Directors adopted the proposal for the staffing of the Committees which was prepared by Adv. Ron Gazit (a director who was recommended by the Wertheim Group) and Adv. Zvi Ephrat (a director recommended by the Ofer Group), who, according to Adv. Gazit, thoroughly prepared a list of names of the members of the Board of Directors Committees which coincided with the agreements of both groups which constitute the controlling block), notwithstanding the statements made by the Chairman of the Board of Directors at the beginning of the meeting, whereby the appointment of Ms. Sabina Biran in the previous meeting to the Credit Committee and to the Audit Committee was intended "to solve functional disability of the Credit Committee, and sometimes of the Audit Committee, in the absence of one external director" .Adv. Gazit also presented a position whereby violating of the balance between the controlling groups in the Board of Directors' Committees is considered a breach of the cooperation agreement, which constitutes an integral part of the Bank of Israel permit for the holding of the controlling block.

3.2.3.2. The Directors' decision raises doubt in respect of the independence of the discretion exercised in this regard, as required according to the provisions of Section 106(a) of the Companies Law. It is impossible to explain the change which took place only one month after their vote in favor of joining Ms. Biran as a member of the Audit Committee at the Board of Directors' meeting held on February 27, 2012, compared with their vote at the meeting which was held on March 25, 2012, which did not include Ms. Biran as a member of the Audit Committee, other than the consideration of not violating the balance between the controlling groups, and supporting the understandings which were obtained for that purpose (as spoken by Adv. Gazit and Adv. Ephrat at the meeting) of "a proper balance between the two controlling parties" (according to the Chairman of the Board of Directors at the meeting) and in order "to

approve the agreements between the controlling shareholders" (as spoken by Mr. Wertheim at the meeting).

- 3.2.3.3. The resolution of the Board of Directors at its meeting of March 25, 2012, regarding the staffing of the Board of Directors Committees, following which the composition of the Audit Committee returned to its composition prior to the appointment of Ms. Biran as a member of the Audit Committee a month earlier, allegedly constitutes a resolution which is not in the Company's best interests, since as a result it was not possible to approve credit applications of the Carasso Group¹⁶.
- 3.2.3.4. The resolution of the directors also raises doubt as to whether they acted in the company's best interests, as required by the provisions of Section 254 of the Companies Law, since it allegedly arises that in the resolution regarding the staffing of the Audit Committee, the directors preferred the principal of maintaining the balance between the two controlling groups over the Bank's best interests, and its ability to approve the Carasso Group credit applications.
- 3.2.3.5. It shall be noted that the opinion of Adv. Gazit, as expressed at the Board of Directors' meeting of March 25, 2012, whereby, violating the balance between the controlling groups in the Board of Directors' Committees means breaching the collaboration agreement between the groups which constitute the controlling block, which constitutes an integral part of the Bank of Israel control permit, is unacceptable, incorrect, and an interpretation whereby the control permit obligates a director to act in a manner which harms or may harm the Bank's best interests cannot be adopted¹⁷. The erroneous opinion of Adv. Gazit is evident by the cooperation agreement itself, which determines in Section 6.6 regarding the Board of

¹⁶ In response to the review report draft, Mr. Meir stated that from time to time directors terminate their service and new directors are appointed, and that it was a matter of routine to hear of such changes at the sidelines of meetings.

¹⁷ In response to the review draft report, Adv. Gazit emphasized that he had never claimed or was of the opinion that the interests of the controlling shareholders in the Bank will override the Bank's interests, and that he was and still is of the opinion that there is no contradiction between the Bank's interests and those of the controlling shareholders and that they integrate and support each other. The Bank's best interest is to maintain good and proper working relations between the controlling shareholders, and maintaining the balance between the controlling shareholders, is, in itself, the Bank's interest. Since, according to him, he was not aware of the problem in the Audit Committee at the time when the proposal for the staffing of the Committees was formed, his proposal did not give preference to the interests of the controlling shareholders over the Bank's interests.

Directors' Committees, that "the parties will make their best efforts, subject to the Bank's articles of association and the law (emphasis added) that the composition of the Board of Directors' Committees will be at the proportion according to which the directors were elected to the Board of Directors".

3.2.3.6. However, we are under the impression that during the relevant year, as well as in meetings in which the issue of the staffing of the Audit Committee was raised, not all members of the Board of Directors were aware of the problematic composition of the Audit Committee, which was the case at such time, and the inability to discuss and approve credit applications of the Carasso Group, and therefore, it is doubtful whether they indeed knew or should have known that adopting the proposal of Adv. Gazit and Adv. Ephrat as to the staffing of the Audit Committee did not solve the problem in the composition of the Committee and that they were not, in fact, giving priority to the Bank's best interests. The above arises both from statements given to us by the directors during the review and from the discussions at the Board of Directors' meetings. At the Board of Directors' meeting which took place on February 27, 2012, at which Ms. Biran was first appointed as a member of the Audit Committee, the issue which was sought to be solved through the appointment of Ms. Biran, was not presented to the Board of Directors, not in the background material which was sent in preparation for the meeting, and not in the discussion itself. The issue was not presented properly also at the meeting of the Board of Directors which was held on March 25, 2012, in which the re-staffing of the Board of Directors Committees, including the Audit Committee, was decided upon, other than an incidental remark by the Chairman of the Board of Directors at the beginning of his statement in respect of the appointment of Ms. Biran "in order to resolve the Audit Committee's functional inability from time to time due to the absence of one external director", which does not even present the problem as it is – since it arises from the above that the main difficulty was in the Credit Committee and not in the Audit Committee, and that it was caused due to the absence of one external director and not due to an overall impediment to approve any application of the Carasso Group in the current composition.

Later at the meeting held on March 25, 2012, the Chairman of the Board of Directors and the CEO mentioned the functional difficulty of the Credit Committee since it is advisable for it to include more external directors in case of absence, and a discussion was held in this regard, whereas in respect of the Audit Committee, the Chairman stated it is requested not to include Ms. Biran in the Audit Committee "but I have no problem in the Audit Committee, since I have four externals here". Neither did the Chairman of the Audit Committee, the other members of the Audit Committee, including Messrs. Shochat, Mishor and Shachak, the Bank's Chief Legal Advisor and the Bank's CEO present the issue to the Board of Directors nor corrected the Chairman of the Board of Directors, nor did they object to the proposed composition of the Audit Committee¹⁸. It is also possible that on this date (March 25, 2012), the extent of the problem in the composition of the Audit Committee was not yet understood, since until such date only two meetings of the Audit Committee in which the Carasso issue was raised, were held, in the first one, the Carasso Group credit applications were not approved due to lack of legal quorum as a result of the non-participation of Messrs. Shochat, Mishor and Shachak in the part of the meeting in which the applications were due to be discussed, however, in the subsequent meeting, the credit applications were approved, as at this point they were not aware that the approval was unlawful¹⁹.

- 3.2.3.7. The directors allegedly acted inadequately, when they agreed to discuss an issue which was not included in the agenda and without receiving background material on it. As provided in Section 3.2.1.2 above, a discussion of an issue which is not on the agenda and

¹⁸ We find that the CEO's position was expressed in respect of the Credit Committee, but not in respect of the Audit Committee. At the meeting of the Credit Committee which was held on August 22, 2011, shortly after the appointment of Messrs. Shochat and Mishor to the board of directors of Carasso Motors, the CEO said that "we do not want to lose Carasso as a customer". A month later Messrs. Shochat, Mishor and Shachak resigned from the Credit Committee. The full scope and significance of the problem in the Audit Committee, has probably not yet transpired at that time. At the meeting of the Board of Directors of March 25, 2012 as well, the CEO stated that he "intends to insist with respect to the Credit Committee" and we have found no reference by him to the Audit Committee. In response to the draft of the review report, the Bank's CEO claimed that he warned orally of the problem of the Directors' double roles many times, and that from the sequence of events, the Directors should have understood that there was a problem in the Audit Committee.

¹⁹ In response to the review report draft, Adv. Gazit stated that he and Adv. Ephrat presented their proposal, prior to presenting it in to the Board of Directors, to the Chairman of the Board of Directors and to the Bank's Chief Legal Advisor, and that the issue of the Audit Committee's inability to adopt resolutions due to the proposed composition or any other problem was not raised by them at all.

without reviewing background material in advance, does not enable the Directors to learn the issue and the implications thereof and to form an independent and informed opinion, as indeed happened in the case at bar. Moreover, since the Chairman of the Board of Directors referred, although not precisely, to the need to solve the problem in the Audit Committee as well, the Directors should have requested a clearer explanation of the issue or requested to postpone the discussion of the staffing of the Audit Committee, especially since the proposal which was presented included a change of a decision which was adopted by them less than one month prior thereto.

3.2.3.8. It shall be noted that the claim of unawareness of the problematic composition of the Audit Committee may not be used in order to explain the support of the Chairman of the Board of Directors of the decision to adopt the proposal of Adv. Gazit and Ephrat of the staffing of the Audit Committee, after he specifically stated the reason for the appointment of Ms. Biran as a member thereof already in the previous meeting, which was intended to resolve the functional inability of the Audit Committee, as well as the support of Messrs. Shochat, Shachak and Mishor, according to whom, they held conversations with the Chairman of the Board of Directors and proposed alternative solutions for the problem in the composition of the Audit Committee, and therefore, were aware of the problem and the importance of including Ms. Biran as a member in the Audit Committee. In addition, even if Adv. Gazit and Ephrat were not aware that there was an actual impediment to adopt resolutions in the Audit Committee with regard to the Carasso Group, the review shows that they were aware of the existence of a certain difficulty in the Audit Committee, both before they presented their proposal at the meeting of the Board of Directors of March 25, 2012, and surely after, when they held conversations with Messrs. Shochat, Shachak and Mishor. They may have gotten the impression that the issue was solvable on a point-by-point basis, based on the opinion of the Chief Legal Advisor (which at that time has not yet transpired to be erroneous) or in a different way of terminating the parallel functions of Messrs. Shochat, Shachak and Mishor, both in the Bank and in the Carasso Group²⁰, however this does not explain the

²⁰ As specified in Section 3.1.15, in response to the review report draft, Adv. Gazit stated that he approached Messrs. Mishor, Shachak and Shochat, but they continued to serve in their positions, both in the Bank and in the Carasso Group. Since in June 2012, the Bank already became aware that there

their failure to adopt or promote the solution of adding Ms. Biran as a member of the Audit Committee for almost additional six months until the events occurred as they did.

3.2.4. The Directors with the personal interest in the Carasso Group

In general, directors in a company should take into account the company's best interests rather than their personal interest. There is no doubt that the three Directors (Messrs. Shochat, Mishor and Shachak) being members of the Bank's Audit Committee simultaneously with their positions in the Carasso Group prevented the Bank from approving the Carasso Group credit applications. During the review, the above persons stated that they held conversations with the Chairman of the Board of Directors in this regard and that, after the decision of the Board of Directors on March 25, 2012, regarding the staffing of the Committees, they held conversations also with Adv. Gazit and Ephrat who formulized the proposals for the staffing of the Committees. Even had they not accepted the fact that they, or any of them, should have chosen between their position in the Bank and their position in the Carasso Group, surely not as a necessary or immediate solution, we have gotten the impression that even a temporary solution (which at such time has not yet transpired to be erroneous) of the absence of one of them from a meeting in which the agenda includes an application by the Carasso Group was not adopted by them. Except once, where Mr. Mishor was absent from such meeting, all three participated in the two additional meetings in which the agenda included credit applications of the Carasso Group. We are not satisfied with this conduct, of settling for holding such conversations, especially where the problem was not created due to a move initiated by the Bank or due to an event which was not depended on them.

3.2.5. The CEO

According to the Law, the CEO is under the supervision of the Board of Directors²¹, and not vice versa. It is appropriate that the CEO's letters of August 12, 2012 and August 14, 2012 will be addressed to the Chairman of the Board of Directors so that he will take the necessary measures for solving the issue or convene the Board of Directors for that purpose.

In response to the draft of the review report, the CEO stated that the organ vis-à-vis which the CEO works is the Board of

was no intention to recommend to the Bank to extend the service of Mr. Mishor in the Bank upon the termination of his service in January 2013, and in order not to create unnecessary shocks, he assumed that this was a reasonable solution.

²¹ Sections 92(a) and 121(c) of the Companies Law.

Directors, and that the Chairman of the Board of Directors is a member of the Board of Directors and has significant authorities regarding the conduct of the Board of Directors, but he is not an independent and separate organ from the Board of Directors, and that there is no written indication anywhere that the Chairman of the Board of Directors is a representative of all of the directors for the purpose of receiving letters or messages from the CEO or from any other party. The CEO also adds that not only does the statement whereby the CEO must communicate with the directors only through the Chairman have no grounds in the law or the Proper Conduct of Banking Business Regulations, it even contradicts the provisions of the Law and its objective, which see the Board of Directors and all its members as a collective and responsible body. The CEO also emphasizes that under the circumstances, the situation is even clearer, since the CEO's letters dealt with the composition of the Board of Directors Committees, and that the Chairman has no legal authority to change or compose the Board of Directors' Committees as he wishes, but the authority lies with the Board of Directors as an organ.

We see fit to set the record straight. There is no argument that the Board of Directors is a collective body, but, contrary to the CEO's position which is provided above, the Companies Law specifically determines the manner of the CEO's conduct vis-à-vis the Board of Directors, *inter alia*, in Section 122(a) which provides that "the general manager will notify the chairman of the board of directors (and not all of the directors) of any irregular matter which is material to the company and in Section 122(d) which provides that "in case a notice or a report of the general manager requires an action by the board of directors, the chairman of the board of directors (and not the general manager) will convene, without delay, a meeting of the board of directors". Section 98 of the Companies Law determines that if a meeting of the board of directors was not convened within fourteen days from the day of the notice of the general manager as aforesaid, the general manager may convene a meeting of the board of directors which will discuss the issue specified in the notice. Section 99 of the Companies Law as well determines that the agenda of the board of directors' meetings will be determined by the chairman of the board of directors, and will include any issue which the general manager requested the chairman of the board of directors to include in the agenda, reasonable time prior to the convening of the board of directors' meeting. Therefore, notices and approaches of the said type should reach the board of directors through the chairman of the board of directors; the CEO, however, did not act accordingly.

During the review and in response to the review report draft, the CEO said that approaching the Chairman of the Board of Directors only, at the stage the letters were sent, would have yielded no result, and that without his letters the problem would not have been solved.

Even if we accept the CEO's position, to the effect that at the stage the letters were sent, approaching all of the members of the Board of Directors was the right thing to do, it shall be emphasized that not only was the style of the second letter, of August 14, 2012, not at all appropriate, but the decisive and unequivocal position of the CEO which puts the entire responsibility on Messrs. Shochat and Mishor, and which determines that the only solution is to choose between their position in the Bank and their position in the Carasso Group, is incorrect and deviates from the expected scope of relations of CEO-Board of Directors²².

4. **The Senior Management Compensation Plan**

4.1. **The factual background**

4.1.1. The Board of Directors appointed a Salary and Compensation Committee (below in this section: the "**Committee**"), in accordance with the guidelines in Section 33(b) of Regulation 301.

4.1.2. In the meeting of the Salary and Compensation Committee of February 13, 2012, the Committee decided to appoint an external advisor (PWC) in order to examine the senior management compensation plan²³. In the meeting, the Chairman of the Committee, Mr. Siterman, stated that the role of the advisor is to advise the Committee on the preparation of

²² This is the case in particular in view of the timing of the CEO's letter. The letter was indeed sent on the day when the discussion of the credit applications in the Audit Committee was postponed again, however, on August 12, 2012, the fact of the termination of Mr. Shochat's service in the Bank's Board of Directors within a few weeks, and the appointment of another director in his stead, who could be appointed as a member of the Audit Committee, was already known to him, and would surely have become clear to him if he discussed the issue with the Chairman of the Board of Directors. In response to the review report draft, the CEO claimed that Mr. Shochat announced his resignation only on August 15, 2012, and that this was not an immediate retirement but refraining from including his name as a director who is a candidate to be chosen at the general meeting which was scheduled for the last part of September, and at that time, it was even requested to postpone it. The CEO emphasized that it was his duty and responsibility as a CEO to report the problem.

²³ In response to the review report draft, the Chairman of the Committee stated that the Committee held 12 meetings during 2012, during which it was decided, *inter alia*, to appoint an external advisor who will accompany the Committee starting from the first discussions. Prior to the beginning of the discussions of the CEO's proposal and plan, the advisors reviewed the current state of the compensation plans of all of the big banks in Israel, reviewed various compensation plans worldwide, mainly in the US and Britain, including specific examples of international banks, as well as the meaning of the guideline set forth by the Supervisor of Banks on September 4, 2009. Both the advisors and the Committee invested many hours of work, during which they reviewed all of the plan's aspects and the various existing possibilities and the issues were challenged.

the senior management compensation plan. The CEO claimed that it is the management which prepares the plan, and in support of his claim stated that "...according to Regulation 301, there is no difference between members of the board of management, senior management, less senior management and the rest of the employees. The functionary appointed over the employment relations in the Bank are the CEO and the management...the Compensation Committee has a special authority only with respect to two organs: the directors and the CEO". It arises from the statements made by the CEO that Regulation 301 requires that the senior management compensation plan as well, will be prepared by the management, and that there is no other alternative to the preparation thereof. The resolution which was adopted at that meeting was that the advisors will be employed by the Committee in examining the plan which is proposed by the management.

4.1.3. At that meeting, the Bank's Chief Legal Advisor as well, presented to the members of the Committee an unequivocal position, whereby: "The roles of the Salary and Compensation Committee are to form a recommendation regarding the compensation policy. As part of forming the Committee's recommendations, it shall be entitled to consult advisors, insofar as it deems fit...the answer is unequivocal, the management prepares the compensation plan, that's its role."

4.1.4. Further to the said meeting, on March 7, 2012, the Bank's CEO approached in a letter to the members of the Salary and Compensation Committee, entitled "Forming Compensation Plan for Managers, the Senior Staff and the Bank's Management". In the letter, the CEO repeated his position, while stating that the said compensation plan would be prepared by the management and would be transferred to be reviewed by the Committee, which will forward its recommendation to the Board of Directors. In the letter, the CEO also refers to the guidelines of the Supervisor of Banks, which, according to him, support his opinion. In Section 3 of his letter, the CEO writes: "when referring to the manner of operation of the Salary and Compensation Committee in Regulation 301 (p.21), the Supervision demands from the Bank's management "to furnish to the Committee reasonable time prior to the time of the meeting...the main previous employment and retirement conditions and the main proposed employment and retirement conditions". The management proposes, and the Committee discusses, decides, changes, gives instructions and forwards its recommendation to be decided by the Board of Directors" (original emphasis). As an additional evidence, the CEO further states: "...the constitutive letter of the Supervisor of Banks of April 5, 2009, regarding the

compensation policy is addressed to the CEO and includes an instruction to the **CEO** regarding the manner of forming the compensation policy in the Bank – and not for nothing" (original emphasis).

- 4.1.5. The compensation plan which was formulized and proposed by the CEO, included, *inter alia*, the following principles: the structure of the compensation – which includes salary, annual bonus and equity compensation; setting a cap for the scope of annual monetary compensation for the offeree; setting the index which shall represent the Bank's performance; setting the threshold for bonus entitlement and setting a threshold for a negative bonus; the period of paying the bonus and the scheduling thereof, and capital adequacy targets; determining the type of equity compensation, the cap of the equity compensation, its indices and its exercise period.

4.2. Findings

- 4.2.1. We are of the opinion that the CEO and the Chief Legal Advisor erred in presenting an unequivocal opinion to the Committee, with regard to the manner of formulizing the compensation plan which will be brought for discussion, and that this opinion, especially in the manner in which it was presented by the CEO, allegedly harmed the Committee's work and the performing of its duties.

Contrary to the position which was presented by the CEO and the Chief Legal Advisor, Regulation 301 as well as the Supervisor's letter of April 5, 2009 (the "**Supervisor's Memo**") do not determine that the only way to form a compensation plan for the senior management is discussion and addressing the plan which was proposed by the management. It is possible and even appropriate that the principles of compensation for the senior management, of the type which are specified in Section 4.1.5, will be formed independently by the Board of Directors²⁴. If necessary, the Committee will consult external advisors and functionaries in the Bank in order to form its recommendations. It is clear that the CEO's opinion should be heard at the appropriate stages.

In response to the review report draft, the CEO emphasized that the Committee has not convened in order to discuss the compensation policy, but the specific compensation arrangements (determining the scope of salary, annual bonus and options for each senior manager according to the policy

²⁴ The specific reference in Regulation 301 and the Supervisor's Memo to the various categories of the Bank's employees (directors who are not external directors, CEO, senior officers and employees) and not to "employees" in general, can indicate that there is room to handle the various categories differently.

which was determined by the Board of Directors prior thereto), and that there was an error, which confused "compensation policy" (in the sense of determining appropriate guidelines, from which the compensation arrangements will be derived) with "compensation plan" (which is a specific compensation arrangement having contractual effect and establishing rights). The CEO as well as the Chief Legal Advisor, in response to the review report draft, emphasized that preparing a specified compensation plan, which includes the details and conditions of the compensation, "and which surely deviates from the outlining of the policy", is one of the CEO's duties and that the above is consistent with separating the authorities of the Board of Directors and its Committees from those of the CEO, as required according to law and according to proper corporate governance regulations²⁵.

We are of the opinion that the outlining of the compensation policy should include criteria and principles, and that such principles which are specified in Section 4.1.5. – the elements of the compensation and the relation among them, setting the compensation cap, setting the indices, the thresholds and the manner of scheduling the compensation etc – are elements of the compensation policy²⁶. After these are determined by the Board of Directors, the total compensation or any of its elements will be distributable among the various members of the Board of Management according to the CEO's recommendation and with the approval of the Board of Directors.

- 4.2.2. We are of the opinion that the Chief Legal Advisor and the Head of the Planning and Operation Division should have refrained from expressing their position or providing consultation to the Committee with respect to the compensation plan, since it involves them directly. Moreover, the members of the Committee, and particularly its Chairman, should have considered consulting an external legal advisor, in this case, where the Bank's Chief Legal Advisor had a direct personal interest in the case at bar.
- 4.2.3. We expect all of the members of the Board of Directors and the CEO to strictly maintain the holding of pertinent and adequate

²⁵ In this regard, it shall be noted that in the explanatory notes of the Companies Bill (Amendment No. 20) (Service and Employment Conditions in Public Companies and in Debenture Companies), 5772-2012, it is provided that the seniors' salary is strongly connected to determining the company's strategy, and therefore it should be determined by the Board of Directors.

²⁶ Supporting evidence for it can be also found in Amendment No. 20 to the Companies Law. The Law does not force a certain structure on the companies or certain caps on the terms of service and employment, and leaves it to the company's compensation policy. The Law also specifically determines that the compensation policy should include, *inter alia*, the proportion between the changing components and the permanent components, the cap for changing components, minimum holding or vesting period or equity compensation etc.

discussions, even when there are disagreements. The chairman who conducts the meeting has special responsibility in this regard. It shall be noted that the Chairman of the Salary and Compensation Committee and the CEO have not acted in order to ensure that the discussion will be properly conducted and at times even contributed to discussions which deviated from accepted norms.

5. The Non-extension of Mr. Shochat's Service in the Bank's Board of Directors

5.1. The factual background

- 5.1.1. At the meeting of the Board of Directors held on July 23, 2012, it was resolved to convene an annual general meeting, whose agenda shall include, *inter alia*, the reappointment of directors. In addition, the names of the directors whose appointment was presented for re-approval were approved, including Mr. Abraham Shochat²⁷.
- 5.1.2. Immediately after the meeting, Adv. Ephrat approached Mr. Shochat and told him that Mr. Eyal Ofer (the controlling shareholder who recommended the appointment of Mr. Shochat as a director) requested not to extend his service for an additional period.
- 5.1.3. In the following days, conversations between various functionaries were held in this regard, and once it transpired that the decision of the controlling shareholder was final, Mr. Shochat approached the Chairman of the Board of Directors and asked for the right to speak in the next meeting, in order to describe his position in respect of the discussion held in the Salary and Compensation Committee regarding the senior managers' salaries.
- 5.1.4. At the meeting of the Board of Directors which was held on August 15, 2012, Mr. Shochat announced the withdrawal of his nomination for an additional term of service at the Bank's Board of Directors, and, after having received the consent of the Chairman of the Board of Directors thereto, reported his position regarding the discussions held at the Salary and Compensation Committee regarding the senior managers' salaries.
- 5.1.5. During the meeting, the details started to leak to the press. The media presentation of the events suggested that the CEO had some involvement in the non-extension of Mr. Shochat's appointment; some of the news reports indicated that Mr.

²⁷ According to the Bank's articles of association, the appointment of the internal directors is reapproved each year at the annual general meeting.

Shochat was dismissed following his objection to the senior management compensation, and some indicated that it was following the inability to extend credit to the Carasso Group, due to the parallel functions of Mr. Shochat at the Bank's Board of Directors and Carasso's Board of Directors.

5.1.6. On September 20, 2012, Mr. Shochat's service at the Bank's Board of Directors was terminated.

5.2. Findings

5.2.1. In our review, we have not found indications for the CEO's involvement in the non-extension of Mr. Shochat's appointment for an additional term of service at the Bank's Board of Directors. It was explained to us that the controlling shareholder, who recommended Mr. Shochat in the past, asked not to extend his term of service due to considerations which were not related to Mr. Shochat's position regarding the senior managers' salary or the service of Mr. Shochat at the Carasso board of directors, and that the decision was made regardless of recent events.

5.2.2. We view with great severity any leaking of information and/or data from the meetings of the Board of Directors and are of the opinion that this may harm the Bank.