

STANDARD AND POOR'S

MAALOT

McGRAW HILL FINANCIAL

Mizrahi Tefahot Bank Ltd

December 25, 2014

Rating Update

**Upgrade of Mizrahi Tefahot Bank's Rating to 'ilAAA'
Due to Improvement in Capital. Rating Outlook Stable.**

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Rating Update

Upgrade of Mizrahi Tefahot Bank's Rating to iIAAA Due to Improvement in Capital. Rating Outlook Stable.

Summary

- Our assessment of Mizrahi Tefahot Bank Ltd (Mizrahi)'s capital is supported by our assessment that the economic risks in the domestic banking sector lessened over the past years, as well as the lower risk weight attributed to mortgage operations under our RAC (Risk Adjusted Capital) model as a result.
- In addition, the bank is expected to increase its tier 1 capital ratio to 9.8% by the end of 2016 due to the Bank of Israel's instructions regarding the increase of the capital ratio as a derivative of the size of the bank's mortgage operations.
- We are of the opinion that Mizrahi's mortgage operations have been proven to have good credit quality in the past, and that this will continue in the future due to this credit's moderate leverage rates in LTV (Loan To Value) terms and the conservative rates of payment to disposable income.
- Likewise, we estimate that the bank's risk management and the stress scenarios it activates with respect to its mortgage operations are adequate, and – along with our base scenario for banking industry risk assessment in Israel (BICRA), which assumes stability in the domestic residential real estate market and in the unemployment rate – satisfactory in our opinion regarding this exposure.
- We are upgrading Mizrahi Tefahot's rating to iIAAA with a stable rating outlook.

Rating Action

On December 25th, 2014, *Standard and Poor's Maalot* upgraded Mizrahi Tefahot Bank's rating to iIAAA from iIAA+. Rating outlook stable.

Main Rating Considerations

The rating upgrade reflects our assessment that the economic risks in the Israeli banking sector lessened over the past years, and brought about an improvement in Mizrahi's capital, as reflected in the RAC ratio that we measure. The improvement in capital was also affected by the lower risk weight attributed to mortgage loans following a moderation in economic risks. We predict a further improvement in the bank's capital, as it is expected to increase its regulatory tier 1 capital ratio to 9.8% by the end of 2016 due to the Bank of Israel's directives regarding the increase of the capital ratio as a derivative of the size of the bank's mortgage operations. Note that in our estimation, any possible fines in connection with the American authorities' investigation of the bank are not expected to significantly change our assessment of the bank's capital.

We are of the opinion that Mizrahi's mortgage operations have been proven to have good credit quality in the past, and that this will continue in the future due to this credit's special characteristics in Israel, the moderate leverage rates of this credit in LTV (Loan To Value) terms and the conservative rates of payment to disposable income. Likewise, we estimate that the risks deriving from an economic imbalance of the housing prices are not expected to materialize in the coming year.

In addition, we see the bank's risk management and the stress scenarios it activates with respect to its mortgage operations as adequate, and – along with the base scenario in our BICRA, which assumes stability in the domestic residential real estate market and in the unemployment rate – we find them satisfactory in our opinion regarding this exposure.

Rating Outlook

The stable rating outlook reflects our assessment that the bank's business profile and risk profile will remain relatively unchanged in the coming 18-24 months, with a RAC ratio higher than 7%, despite potential economic instability, including a slowdown in the Israeli economy and a correction in the residential real estate sector.

The Negative Scenario

We may implement a negative rating action in case of a significant deterioration of the Israeli economy, accompanied by a sharp correction of housing prices or a significant increase in unemployment, which may occur due to global pressure or a significant escalation of the political situation in the area, which will put negative pressure on the bank's asset quality, but this scenario is not part of our base scenario. Additionally, considering the business credit concentration at the bank – which is still high, in our estimation – financial pressure on some of its large borrowers may harm the bank's asset quality and likewise cause a negative rating action.

Related Research

- "Banks: Rating Methodology And Assumptions", November 9, 2011;
- "Banking Industry Country Risk Assessment Methodology And Assumptions", November 9, 2011;
- "Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions", September 18, 2014;
- "Bank Capital Methodology And Assumptions", December 6, 2010;
- "Banking Industry Country Risk Assessment: Israel", December 17, 2014;
- "Israel-Based Bank Hapoalim and Leumi Upgraded To 'A-' Due To Lessening Domestic Economic Risks; Outlooks Stable", October 7, 2014.

Ratings List

	Current Rating	Previous Rating
Mizrahi Tefahot Bank Ltd		
Mizrahi Tefahot Issuing Company Ltd		
Issuer Rating	iIAAA/Stable	iIAA+/Stable
Bond Series 29, 33, 34, 35, 36,	iIAAA	iIAA+

37, 38

Subordinated Notes 27, 30, 31 iIAA+

iIAA

Upper Tier 2 Capital Series A iIA+

iIA+

[Standard and poor's maalot legal disclaimer]