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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: August 22, 2021
	www.isa.gov.il		www.tase.co.il		Ref: 2021-01-135513

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

On August 22, 2021, *Midroog* published:

A rating report/notice *updated*

A notice regarding rating cessation

1. Rating report or notice

Corporation's rating: *Midroog Aaa.il*
stable

Comments/Notice summary: *Other*
reaffirmation

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

Date	Rating subject	Rating	Comments/Notice summary
September 10 2020	<i>Mizrahi Tefahot Bank Ltd</i>	<i>Midroog Aaa.il stable</i>	<i>Other Reaffirmation</i>

August 1 2019	<i>Mizrahi Tefahot Bank Ltd</i>	<i>Midroog Aaa.il stable</i>	<i>Other Reaffirmation</i>
September 6 2018	<i>Mizrahi Tefahot Bank Ltd</i>	<i>Midroog Aaa.il stable</i>	<i>Other Reaffirmation</i>

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

Rating of the corporation's bonds:

Name and type of security	Security number on the stock exchange	Rating company	Current rating	Comments/Notice summary
<i>Contingent convertible bonds</i>	0	Midroog	Midroog <i>Aa3.il stable</i>	Rating affirmation
<i>Deferred capital notes</i>	6950083	Midroog	Midroog <i>Aa2.il stable</i>	Rating affirmation

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

Name and type of security	Security number on the stock exchange	Date	Type of rated security	Rating	Comments/Notice summary
<i>Contingent convertible bonds</i>	0	<i>September 10 2020</i>	<i>Contingent convertible bonds (CoCo)</i>	<i>Midroog Aa3.il stable</i>	Rating affirmation
<i>Series A Deferred Capital Notes</i>	6950083	<i>September 10 2020</i>	<i>Deferred capital notes</i>	<i>Midroog Aa2.il stable</i>	Rating affirmation
<i>Contingent convertible bonds</i>	0	<i>August 1 2019</i>	<i>Contingent convertible bonds (CoCo)</i>	<i>Midroog Aa3.il stable</i>	Rating affirmation

<i>Series A Deferred Capital Notes</i>	6950083	<i>August 1 2019</i>	<i>Deferred capital notes</i>	<i>Midroog Aa2.il stable</i>	Rating affirmation
<i>Contingent convertible bonds</i>	0	<i>September 6 2018</i>	<i>Contingent convertible bonds (CoCo)</i>	<i>Midroog Aa3.il stable</i>	Rating affirmation
<i>Series A Deferred Capital Notes</i>	6950083	<i>September 6 2018</i>	<i>Deferred capital notes</i>	<i>Midroog Aa2.il stable</i>	Rating affirmation

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

Attached rating report [followupreport isa.pdf](#)

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

Details of the signatories authorized to sign on behalf of the corporation

	Signatory's Name	Position
1	<i>Ofer Horwitz</i>	<i>Other Bank Secretary & Head of the Bank's Headquarters</i>

Explanation: According to Regulation 5 of the Securities (Periodic and Immediate Reports) Regulations, 5730-1970, a report filed under these regulations shall be signed by those authorized to sign on behalf of the corporation. The position of the senior staff on the matter (in Hebrew) can be found on the ISA's website: [Click here](#)

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

Abbreviated Name: Mizrahi Tefahot

Address: 7 Jabotinsky Street, Ramat Gan, 52520 Tel:03-7559720 Fax:03-7559923

E-mail: mangment@umtb.co.il Company website: <https://www.mizrahi-tefahot.co.il>

Previous name of the reporting entity: United Mizrahi Bank Ltd

Name of the person reporting electronically:	Position:	Name of Employing
Horwitz Ofer	Bank Secretary	Company: Mizrahi Tefahot Bank Ltd

Address: 7 Jabotinsky Street, Ramat Gan, 52520	Tel: 03-7559207	Fax: 03-7559913	E-mail: management@umtb.co .il
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Mizrahi Tefahot Bank Ltd¹

Follow-Up | August 2021

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¹ Mizrahi Bank is the owner of the full issued and outstanding share capital of Union Bank of Israel Ltd, which (indirectly) holds 4.9% of Midroog Ltd's share capital via Igud Investments and Enterprise (A.S.Y.) Ltd. The company's share lack any means of control.

Mizrahi Tefahot Bank Ltd

Baseline credit assessment (BCA) for the bank	aa2.il	
Long-term deposits & bonds	Aaa.il	Outlook: stable
Deferred capital notes (upper tier 2 capital)	Aa2.il (hyb)	Outlook: stable
Contingent convertible bonds with contractual loss absorption (CoCo)	Aa3.il (hyb)	Outlook: stable
Short-term deposits	P-1.il	

Midroog is maintaining the baseline credit assessment (BCA) of Mizrahi Tefahot Bank Ltd (the “Bank”) at aa2.il. The BCA’s direction of development is stable.

The ratings of the Bank’s long-term deposits and senior debt has remained Aaa.il with a stable outlook, and they continue to embody the assumption of a high external support from the state, at two rating levels (notches) relative to the BCA.

The ratings of the Bank’s subordinated and hybrid debts have remained unchanged, as follows: Aa2.il (hyb) with a stable outlook for deferred capital notes (upper tier 2 capital). This rating reflects the structural subordination of these debts relative to the Bank’s senior debt, the seniority scale among the subordinated debts themselves, the impact of the loss-absorption mechanisms embodied therein and the assumption of state support.

The rating of the contingent convertible bonds with contractual loss absorption (CoCo²) through a write-off or partial write-off (classified as tier 2 capital) has remained Aa3.il (hyb) with a stable outlook. This rating is one notch lower than the BCA and three notches below the senior debt and reflects the instrument’s conditions, including the structural subordination and loss-absorption mechanisms of this instrument and without an assumption of external support.

Midroog is likewise determining a P-1.il rating for short-term deposits.

² Contingent convertible.

The main considerations behind the baseline credit assessment (BCA) and the Bank's ratings

The Bank's baseline credit assessment (BCA) is supported by its good positioning in the local banking system, which is based on a strong brand name, a significant market share and leadership in the housing credit sector, alongside a broad, dispersed customer base, which support the Bank's good profitability, despite the concentration of the income sources. The Bank is a universal bank, providing its customers with a variety of banking and financial services. The Bank is characterized by a conservative risk management policy which supports the Bank's risk profile, as reflected also by the credit quality indicators, which are standing out positively relative to the BCA and the comparison group³ over time. In our assessment, the rate of impaired debts within the portfolio is likely to rise, but still remain at a favorably positive level relative to the BCA, in view of the portfolio quality characteristics on the eve of the crisis. Thus, problem debts' rate within the portfolio will stand in the range between 1.6%-1.7% in the forecast years, in our assessment. The Bank is characterized by a sectorial credit concentration relative to the capital buffer, which is high relative to the BCA (on par with the system), which weighs down the Bank's risk profile. The Bank's profitability rates have been improving in recent years, in view of the high asset quality and outstanding operational efficiency over time, and improvement in the Bank's financial margins as a result of the implementation of its strategic plan.

In the base scenario for the years 2021-2022, Midroog anticipates that the Bank's profitability indicators - the core yield on risk weighted assets and the return on assets – will move in the range between 1.9%-2.2% and 0.6%-0.7%, respectively. We are of the opinion that the buffer relative to the Bank's regulatory threshold will return to its level after the end of the aforesaid temporary ordinance⁴, and be low relative to the system, as part of the Bank's capital management strategy, which may, from time to time, limit the Bank's business flexibility. Moreover, the Bank's leverage level is high relative to the BCA and the comparison group average and hinders the Bank's risk profile, as reflected by a capital to balance sheet ratio of approx. 5.5%, as of March 31, 2021, compared with an average of approx. 6.6% in the comparison group. In its base scenario, Midroog projects that the capital buffer will continue to accumulate, as the capital adequacy ratios will marginally erode in the forecast range, so that the capital adequacy ratio will be in the range between 10.0%-10.2%. We note that regarding Midroog's extreme scenarios, the Bank's capital buffer absorbs unexpected losses appropriately and supports the Bank's stability throughout the economic cycle.

³ The four major banks in the system.

⁴ As of this report's date, the temporary ordinance reducing banks' capital requirements is in effect until September 30, 2021.

The Bank's liquidity profile stands out positively relative to the BCA and supported by a comfortable, wide and dispersed source structure, based on stable (retail) deposits and a substantial inventory of low-risk liquid assets. All the same, the liquidity profile might be affected by a relatively high wholesale deposits component, which in our assessment is less stable throughout the cycle. The liquidity coverage ratio (LCR) is significantly higher the regulatory benchmark (100%), which supports business flexibility.

The ratings of the Bank's long-term deposits and senior debt were set at two rating levels (notches) above the BCA, embodying our assumption of a high probability of external support from the state, if necessary. The rating of the Bank's subordinated debt which is not eligible for Basel III likewise reflects an assumption of high support from the state. The rating of subordinated debts which are eligible for Basel III (CoCo) will not, in our assessment, benefit from state support, and will bear losses if necessary, as will be detailed later under the "Structural considerations and external support" chapter.

BCA development direction and rating forecast

The stable development direction of the financial strength and the stable outlook for the Bank's ratings reflect Midroog's assessment that the Bank will maintain an adequate financial profile in the forecast years. It should be noted that at this stage, there is uncertainty regarding the economy's recovery, due to the characteristics of the economic crisis deriving from the spread of the coronavirus, and hence the consequences that may be expected for the economic environment and for the Bank in particular. Midroog will continue to monitor the corona crisis' economic ramifications, particularly in terms of the Bank's financial profile.

Factors that could lead to raising the baseline credit assessment and the Bank's ratings:

- A significant improvement in the dispersion of the activity mix
- A significant improvement in the capital adequacy ratios

Factors that could lead to lowering the baseline credit assessment and the Bank's ratings:

- Substantial damage to the Bank's business status
- A significant worsening of the credit portfolio's quality
- An erosion of the capital buffer, profitability and the stability thereof

Mizrahi Tefahot Bank Ltd, financial data and main ratios, in millions (ILS) and in percentages:

₪ Million	June 30 2021	June 30 2020	2019	2018	2017	2016
Loans to the public	256,441	216,538	206,401	195,956	182,602	172,779
Deposits from the public	294,391	231,784	210,984	199,492	183,573	178,252
Total equity attributed to the shareholders	20,444	16,653	16,033	14,681	13,685	12,714
Total assets	374,370	291,560	273,244	257,873	239,572	230,455
Revenue before taxes and credit loss expenses	2,394	1,771	3,318	2,505	2,389	2,341
Net profit attributed to the Bank's shareholders	1,664	717	1,842	1,206	1,347	1,266
(%)						
Exposure to largest industry to tier 1 shareholders' capital	115%	120%	118%	126%	113%	104%
Exposure to major borrowers to tier 1 shareholders' capital [1]	0%	0%	2%	0%	0%	0%
Problem debts from gross loans to the public	1.4%	1.9%	1.9%	1.5%	1.4%	1.4%
Problem debts to total shareholders' capital and provision for credit losses	14.7%	20.8%	21.0%	17.5%	16.0%	16.9%
Credit loss expenditure [income] to average loan to the public [2]	(0.2%)	0.6%	0.2%	0.2%	0.1%	0.1%
Net profit to asset average [2]	0.9%	0.5%	0.7%	0.5%	0.6%	0.6%
Revenue before taxes and credit loss expenses to risk weighted asset average [2]	2.4%	2.1%	2.1%	1.7%	1.8%	1.8%
Efficiency ratio	52.8%	52.6%	54.6%	63.6%	60.2%	58.5%
Tier 1 capital adequacy	10.5%	10.0%	10.1%	10.0%	10.2%	10.1%
Total shareholders' capital to asset total	5.5%	6.0%	6.2%	6.0%	6.0%	5.8%
Less stable finance resources [3] to asset total	17.5%	15.0%	19.0%	16.5%	17.1%	16.3%
Liquidity balances [4] to deposits from the public	37%	30%	29%	28%	28%	29%

[1] Total balance sheet credit over 5% of the Bank's shareholders' capital; [2] Calculated on an annual basis; [3] Financial institutions' deposits (wholesale), bonds and bonds deferred by up to one year and deposits from banks; [4] Cash and deposits at banks, US and Israel government bonds and assets backed by the US government

Details of the key considerations in the Bank's baseline credit assessment

An appropriate business profile which supports the Bank's income generation capability throughout the cycle due to the substantial weight of retail income, but with a bias to the housing loans sector

Over time, Mizrahi Tefahot Bank is the leading banking group by size in the housing loan sector, with a market share of approx. 37% of total credit; and the third largest in the local economy, with a market share of approx. 18.7% of all assets in the system and approx. 21.4% of total credit, as of March 31, 2021. The business profile, as is the case with the rest of the major banks, is supported by it being a universal bank, which provides a wide range of financial and banking services, leaning on a broad and dispersed customer base alongside a comprehensive value proposition that appeals to a variety of public tastes. The Bank is characterized by a strong brand in the housing credit sector, which in our assessment constitutes a platform to achieve growth in market shares, the retail customer base and as a derivative in the income base, which support the establishment of its position as a leader in the retail field. Unlike its primary competitors, in recent years, the Bank had implemented a strategy of branch expansions and a hybrid operation model, which provide the Bank's customers with a personal, human banking service alongside a direct banking service. All of these support the value proposition to the Bank's customers, and contribute, in our assessment, to the Bank's growth potential and profitability, as well as its ability to cope with changes in the business environment. In addition, we are of the opinion that in light of the changes in the banking industry's operation environment, particularly in view of the restrictions on movement resulting from the eradication policy against the spread of the coronavirus in the past year, customer needs for a fast, flexible and digital response have increased. We estimate that we will continue to observe a trend of expansion in all that concerns providing digital services in the banking system; and that banks which will not adopt technological innovation, nor adjust their business model over time, might experience a substantial erosion of the business position in the medium-long term.

The stability of the Bank's revenues, as assessed by Midroog, stands out positively relative to the BCA and positively affected by its focus on mortgage credit. Thus, the weight of the Bank's retail revenues⁵ is significant, constituting approx. 82% on average between 2018 and 2020 – outstandingly positive relative to the comparison group, contributing to the revenue generation ability and moderating activities' volatility.

⁵ Gross revenues from interest and non-interest revenues in accordance with the supervisory operation segments, and including the household and private banking (including housing) segments, as well as small and micro businesses, excluding financial management income.

However, the Bank is characterized by a low rate of commission revenues (approx. 21% in 2020) - which we have characterized as stable throughout the cycle, which is low relative to the comparison group (approx. 27.6% on average in 2020), which hinders the stability of the Bank's revenues.

The dispersion of the Bank's sources of income is limited, in our assessment, and stands on two primary legs⁶ over time, as reflected by the revenue mix in 2020, which included approx. 53% of the housing loans sector and approx. 20% from small and micro businesses. It should be noted that the Bank implements a strategy which is supportive of income source dispersal through increasing focus on the business-commercial sector. In our assessment, the dispersion of revenues may improve somewhat within the forecast's range, in view of the implementation of the strategic plan alongside maintaining its business positioning in the mortgage sector, while the weight of housing credit revenues will remain substantial within the credit portfolio. We are of the opinion that the merging of Union Bank into the Bank will contribute to operational and business synergy, as well as a diversification of revenue sources.

The risk management policy supports the Bank's risk profile; on the other hand, the industry concentration relative to the capital buffer is still relatively high

The Bank's risk management system is encompassing and includes a number of anchors and control circles, which support the formulation of risk management policies, in determining the Bank's risk appetite (in consistence with its strategy) and in monitoring and controlling risks. Credit risks are managed using statistical rating models (consumer credit) and expert evaluations (business credit). In our assessment, the Bank takes a conservative credit policy in the housing credit segment, which includes relatively strict restrictions on the business credit portfolio, underwriting processes, monitoring and management of collaterals, while this policy is also expressed by good risk indicators relative to the credit portfolio, that support the BCA. The Bank has no exposure over time to large borrowers, who constitute over 5% of the Bank's tier 1 shareholders' capital (over ILS 1,089 million) (approx. 20% on average in the comparison group for December 31, 2020). On the other hand, the Bank is characterized by a high industry credit concentration relative to the BCA, as measured in relation to the capital buffer, which weighs down the Bank's risk profile. Thus, the largest industry out of the Bank's tier 1 shareholders' capital is the real estate and construction industry, which constituted 115% on June 30, 2021, but which is low relative to the comparison group (approx. 165%).

⁶ An operating segment which constitutes over 15% of net revenues (interest and non-interest revenues from outsiders), excluding financial management income.

The Bank's market risks are estimated by the VaR model under conservative assumptions, similar to the entire banking system, and as a complementary action to the risk assessment, a number of stress scenarios (including holistic scenarios) at varying degrees of severity are examined. In Midroog's assessment, the Bank's market risk appetite is adequate, as reflected in the VaR limit of the Bank's total activity to a one-month investment prospect, established by the Board of Directors, that does not exceed 9% of the shareholders' capital, which is reasonable but high relative to the other major banks.

The quality of the credit portfolio is outstanding relative to the BCA and the comparison group

The Bank is characterized by a high-quality credit portfolio, which supports its future profitability, as well as the capital buffer's construction potential, as reflected in the risk indicators which are outstanding relative to the BCA and the system. Thus, on June 30, 2021, the proportion of impaired debts relative to the credit to the public amounted to a favourable rate of approx. 1.4% (vs. approx. 1.7% on average between 2019 and 2020), compared with a rate of approx. 2.7% in the comparison group on that date. Furthermore, as of June 30, 2021, the rate of debts which are impaired or in arrears for over 90 days out of the total gross credit to the public has declined to approx. 1.1% (and approx. 1.2% in the comparison group on that date), vs. approx. 1.4% on December 31, 2019 (and approx. 1.3% in the comparison group on that date).

However, we estimate that the credit risk subsequent to the economic crisis is not fully reflected in the Bank's risk metrics, in light of the Banking Supervision's outline for the deferment of loan payments, to support household and business ability to overcome the crisis. As of July 31, 2021, the debt balance of deferred loans on record was at approx. ILS 7.3 billion, of which approx. ILS 6.5 billion were partially deferred and approx. ILS 0.8 billion were fully deferred loans. The Bank increased the provision buffer against this increased risk, due to the crisis, mainly through group provision, as expressed by the increase in the credit loss expenditure rate out of the Bank's total credit portfolio, which had amounted to approx. 0.5% in 2020, vs. approx. 0.2% in 2019. Nevertheless, the more certainty grew regarding the nature of the crisis and customer behaviour, the Bank decreased group provision during the first half of 2021, so that the provision balance out of the total gross credit to the public stood at approx. 0.9% on June 30, 2021, vs. approx. 1% at the end of 2020. Thus, as of June 30, 2021, the Bank's coverage ratio⁷ improved and amounted to approx. 80% (vs. approx. 71% on average between 2019 and 2020) – albeit that this rate is still low relative to the comparison group on that date (approx. 127%).

⁷ The provision balance to the total of impaired debts and debts in arrears for over 90 days.

We are of the opinion that the Bank's exposure to the mortgage and real estate industries is relatively high and amounts in aggregate at approx. 72% of the Bank's liabilities⁸ on June 30, 2021, while the comparison group had a much lower exposure rate of approx. 47% on that date. Exposure to the real estate industry alone (without mortgages) in Israel – which is characterized by us as relatively high level of risk, in view of homogeneous characteristics and due to high exposure relative to the capital absorption buffer, constitutes approx. 8.7% of the Bank's total liabilities (approx. 9.5% including credit to foreign operations) and substantially low relative to the comparison group. The exposure to the mortgage portfolio constitutes approx. 62% for that date, and it is characterized by the Bank's conservative underwriting processes, as reflected in the maintenance of a high repayment capability, which supports a low probability of failure. Thus, the average LTV rate in the Bank's housing loans portfolio amounted to approx. 53.2% on June 30, 2021 (a rate reflecting the LTV when the credit was granted), with the share of the loans that had a relatively high leveraging rate (an LTV rate of over 75% of the total housing credit) being low and amounting to 1.5% of the portfolio for that period. In addition, the average repayment rate from disposable income in the housing credit portfolio⁹ amounted to approx. 25.4% on June 30, 2021 – likewise a low rate, reflecting a relatively low level of risk.

Midroog's base scenario regarding the quality of the Bank's credit portfolio is based on a number of exogenous macroeconomic influences¹⁰, including: (1) A GDP growth rate of approx. 5.5% and approx. 6.0% in 2021 and 2022, respectively; (2) The unemployment rate declining to a level in the range between 6.4%-10.8%; (3) An interest environment on par with its current level in the forecast years; (4) An inflationary environment in the mid-range of the Bol's target limit; (5) Continued competition on the part of the non-bank debt market in the consumer and business portfolio. It should be noted that the above macroeconomic forecasts contain, as a component, some uncertainty regarding the extent and impact of the economic crisis on the volume of activity in the local economy.

In this scenario, Midroog projects that the Bank's credit portfolio will grow in the range between 5%-6% in the years 2021-2022. In addition, the Bank will continue to focus on retail and business credit, in accordance with its strategy in recent years, but we estimate that the bulk of the growth will manifest itself in the housing credit sector,

Midroog is examining the development of the Bank's credit portfolio quality in the short and medium term, based also on a number of leading macroeconomic indicators, which point to some worsening in the portfolio's quality (varying between the different segments of the credit portfolio) within the base forecast range.

⁸ Credit to the public, credit to governments, bank deposits and other debts, excluding bonds and borrowed securities.

⁹ Payments to income.

¹⁰ Bank of Israel, the Research Department's macro-economic forecast, July 2021.

The rate of problem debts in the portfolio is expected to rise, but still remain at a level standing out positively relative to the BCA, given the characteristics of the portfolio's quality on the eve of the crisis. As such, the rate of problem debts in the portfolio is projected to be in the range between 1.6%-1.7% in the forecast years (vs. approx. 1.6% on average between 2018 and 2020), with the rate of problem debts out of the absorption buffers (shareholders' capital and provision for credit losses) projected to be in the range between 18%-19% in the forecast range (vs. approx. 18% on average between 2018 and 2020). Moreover, the rate of the Bank's credit loss expenses in 2020 was affected by an increase in group provision, which is extraordinary in its scope and reflects a possible increase in individual provision in 2021. In light of this, we are assuming a credit loss expenditure rate in the range between 0.1%-0.2% out of the credit portfolio, in the forecast year, affected *inter alia* by the Bank of Israel's loan deferment outline and the cessation of unemployment benefit payments, but also due to some absorption, in our assessment, of individual provisions at the expense of group provisions during the forecast period. This scenario takes into account moderation in the recovery rates and increase in the write-off rate relative to past years.

The Bank's profitability is appropriate for the BCA and projected to improve in the forecast range, as a result of an anticipated improvement in economic activity and a decrease in credit loss expenses

The Bank's profitability metrics reflected an improvement trend in 2017-2019, which, among other things, was the result of a moderate rate of credit loss expenses, which stood at approx. 0.2% on average during these years; outstanding operational efficiency over time, stemming from the credit portfolio mix; the business model; and improvement in the Bank's financial margin as a result of the strategic plan's implementation, which includes increased focus on the business sector, which is characterized by excess financial margins.

Profitability was also supported by the implementation of the Bank's efficiency processes starting in 2017, which included employees' early retirement, an organization of assets (asset realization and transitioning into a leasing model) and the signing of collective employment agreements for the Bank and Yahav Bank. Moreover, the Bank is expected to concentrate headquarter units' operations into a single central site, as part of a strategic move by the Bank, which supports further optimizing potential in the medium-long term. As such, the Bank's operating efficiency ratio improved from approx. 60% in 2017 to approx. 53% in the first half of 2021. In addition, the Bank has worked to establish collaborations with financial institutions over the past few years, through the sale of housing loan portfolios, as part of its credit portfolio and regulatory capital management strategy, as well as increasing operating revenues from the management of sold portfolios.

However, in 2020 the impact of the economic crisis caused risk to increase, as expressed by the rise in credit loss expenditure for the 2020 report period, which had amounted to approx. ILS 1,050 million, or approx. 0.5% of the gross credit to the public (most of which was group). The core return on risk weighted assets and return on assets stood at approx. 2.0% and 0.5%, respectively, in 2020; and at approx. 2.4% and 0.9%, respectively, in the first half of 2021.

The main assumptions regarding the Bank's profitability, on which Midroog's baseline scenario for the years 2021-2022 is based, are as follows: (1) Annual credit portfolio growth in the range of 5%-6%, primarily in the housing loans sector, and utilization of the potential of the Bank's existing retail sector customer base alongside high competition in the business sector, while utilizing the advantages arising from the merger with Union Bank; (2) An interest environment similar to its current level, and an inflation environment in the mid-range of the Bank of Israel's target limit, which will support the financial margin; (3) Further focus on commercial-business credit; (4) Credit loss expenses at a rate of 0.1%-0.2%, due to the consequences of the economic crisis; and (5) A continued "creeping" of wage expenses, per the Bank's wage agreements and an increase in the number of positions on a monthly average compared to 2020, alongside an offsetting effect caused by early retirement and branch closure.

In this scenario, Midroog anticipates that during the forecast years, the Bank's profitability ratios will continue to support the ongoing construction of the capital and the financial profile. The core yield on risk weighted assets and ROA are expected to move between approx. 1.9%-2.2% and 0.6%-0.7%, respectively.

The capital buffer is adequate for the BCA, despite a relatively high balance sheet leverage and a low margin over the regulatory barrier; the capital buffer is anticipated to continue its construction within the forecast range

The Bank is characterized by a capital buffer which is adequate for the BCA, that had been constructed over the years through the accumulation of profits minus dividend distribution (a policy of 40% of the quarterly net profit), optimization and management of risk weighted assets and the asset mix. The Bank's tier 1 capital adequacy, which is the central absorption buffer for unexpected losses, amounted to approx. 10.5% on June 30, 2021, vs. an average of 10.1% between 2017 and 2019. This ratio's increase was due, *inter alia*, to the non-distribution of dividends beginning in the second quarter of 2020. It should be noted that as part of the Bank's capital management strategy, the Bank had, in these years, been characterized by a narrow margin over the regulatory capital requirements – tier 1 capital and total capital (approx. 0.3% and approx. 0.5% on average between the years 2017-2019, respectively) - which may occasionally limit the Bank's business flexibility.

It should be noted that further to the temporary ordinances below, as of June 30, 2021, the margin is higher and stands at approx. 190 basis points above the regulatory Tier 1 capital requirements, which occurred, among other things, due to a 100 basis point reduction of the Bank's Tier 1 capital requirement under the Banking Supervision's temporary ordinance¹¹, so that the minimum Tier 1 capital ratio of the Bank will be 8.8% in lieu 9.8%.

The Bank's leveraging level is high relative to the BCA and the comparison group's average, and hinders the Bank's risk profile, as reflected by a capital to balance sheet ratio of approx. 5.5%, as of June 30, 2021, compared with an average of approx. 6.6% in the comparison group. We are of the opinion that in light of the volatility in the capital market, the total profit of the Bank - and that of the banking system in general - might be affected from adjusting securities available for sale according to fair value.

Midroog tested a holistic stress scenario for one year ahead on the Bank's loss absorption buffers relative to its risk profile, while assuming various PD and LGD rates in the main sectors of the economy, losses from the securities portfolio, erosion in the financial margin and the loss of commission income, along with the construction of the shareholders' capital through current profitability and the non-distribution of a dividend. The Bank's tier 1 capital ratio would amount to approx. 9.9% at the end of the scenario - a level that reflects the good ability of the Bank to absorb unforeseen losses, in our assessment, and supports its stability during the economic cycle.

Midroog's base scenario anticipates that the capital buffer will continue to be accumulated, while the capital adequacy ratios will marginally erode in the forecast range, so that the capital adequacy ratio will be in the range between 10.0% and 10.2%. This ratio will be affected by the following factors: (1) Accrued profits; (2) Dividend distribution to the extent of 30% from the net revenues for 2020, and a dividend distribution to the extent of 40% of the net revenues in the forecast years; and (3) A growth in risk weighted assets, similar to the credit portfolio's increase rate.

¹¹ As of this report's date, the temporary ordinance reducing banks' capital requirements is in effect until September 30, 2021.

An outstanding liquidity profile relative to the BCA supported by a comfortable resource structure and a substantial liquid asset inventory

The Bank's resource structure, similarly to the entire local banking system, mainly relies on a broad retail deposit base, which is characterized by a relatively high stability throughout the economic cycle. The Bank's resource structure contains a substantial proportion of widely-dispersed stable (retail) deposits (approx. 47% households and private banking and approx. 16% small and micro businesses, as of June 30, 2021), which are appropriate for the Bank's risk profile, in Midroog's assessment. The Bank has a relatively moderate rate of financing sources which are less stable¹² out of the total assets, per our definition, which amounted to approx. 17.5% on that date. Moreover, the Bank is characterized by a relatively high ratio between credit to the public and deposits from the public, which on June 30, 2021, amounted to 87% vs. a comparison group average of approx. 71%. The Bank's NSFR ratio on March 31, 2021, as calculated by us¹³, is high and amounts to approx. 138%, which supports its financing profile.

The Bank's liquidity buffer includes an inventory of liquid assets¹⁴ relative to the total deposit, which amounted to approximately 37% on June 30, 2021 - a high rate relative to the BCA, and supports the Bank's outstanding liquidity. This inventory mainly includes cash and deposits at banks; and the securities portfolio, which constituted approximately 5% of the total assets on that date and which is characterised by a risk level (credit) that is low in view of Israel and US government bonds constituting substantial components thereof (approx. 84% and approx. 5%, respectively). The portfolio serves as a tool to absorb excess resources and manage the Bank's various market exposures, but exposes it to an interest rate risk. The liquidity management is also supported by a high regulatory liquidity coverage ratio (LCR) which amounted to approx. 132% on June 30, 2021 - significantly higher than the regulatory bar (100%). This rate also supports the liquidity profile and business flexibility.

Midroog anticipates that the Bank's resource structure and good liquidity will be preserved throughout the forecast range, *inter alia* in view of our no-change assessment regarding the market's savings culture, and in light of the credit portfolio's growth potential.

¹² Deposits from banks, deposits from financial institutions, and bonds and debentures to be paid within the next 12 months

¹³ Calculated by us based on the definitions of the Basel Committee.

¹⁴ Cash and deposits at banks, Israeli government bonds, US government bonds and bonds backed by the US government

Structural considerations and external support

A review of the relative projected loss ranking

According to Midroog's methodology, the rating of the Bank's subordinated debts (deferred bonds) is based on the Bank's baseline credit assessment (BCA), which is the anchor for rating the Bank's liabilities and reflects the risk of failure and the Bank's ability to serve its liabilities independently, without the assumption of external support. Midroog adjusts the rating relative to the BCA to the credit risk of the subordinated debt instrument, according to its specific characteristics – taking into consideration the extent of the instrument's structural subordination, the loss absorption mechanisms per the instrument's conditions and the uncertainty regarding their point of activation (at the contractual trigger and/or at the discretion of the Supervisor of Banks). Midroog is removing one rating level (notch) off the Bank's BCA for the rating of the deferred bonds with contractual loss absorption (CoCo).

The removal of the notch embodies the legal-contractual deferral with respect to the rest of the Bank's liabilities (excluding upper tier 2 capital, tier 1 instruments and shareholders' capital) and the contractual loss absorption mechanism. Considering the Bank's BCA (aa2.il) and the current level of capital adequacy – tier 1 capital ratio (of approx. 10.5% on June 30, 2021), as well as the one anticipated in our base scenario (10.0%-10.2%) and the liquidity profile, which is outstanding relative to the BCA, the uncertainty regarding the likelihood of reaching the 'nonviability point'¹⁵ is low; therefore, it was not embodied by the reduction of another notch. Midroog is removing two rating levels (notches) off the Bank's BCA for the rating of the deferred capital notes (upper tier 2 capital). The reduction of the notches embodies the legal-contractual deferral with respect to the rest of the Bank's liabilities (excluding tier 1 instruments and shareholders' capital) and the contractual loss absorption mechanism. Considering the Bank's BCA, current and anticipated capital adequacy levels (in our evaluation) and the liquidity profile which is outstanding relative to the BCA, the uncertainty regarding the likelihood of reaching regulatory intervention is low; therefore, it was not embodied by the reduction of another notch.

¹⁵ Establishing nonviability event: 1. A notice from the Supervisor of Banks that the write-off/conversion of a security is necessary to avoid the nonviability point. 2. The provision of external support, without which the Bank would reach the nonviability point. It should be noted that the Supervisor of Banks has yet to define the term 'nonviability point'.

External support

The rating of the deposits, the senior debt and the subordinated debts, excluding deferred bonds with contractual loss absorption (CoCo) are granted the benefit of two rating levels (notches) due to the high probability of external support from the state, according to Midroog's JDA model. The assumption of external support probability throughout the entire liabilities structure (excluding CoCos) is based on the following considerations: the banking system's high importance to the local economy and the payment system, and the need to maintain its stability; the high concentration of the banking and financial system; the relatively high connectivity between the banking system and financial institutions; the local financial system serving as a central credit provider to the government; some uncertainty regarding the behavior and trust of the different debtors, in terms of bail-ins close to the point of failure, in the absence of previous experience. Furthermore, the State of Israel had, in the past, proved its willingness to support failed banks, and we do not assume any change in this policy.

The assumption of high support for subordinated debts (excluding CoCos) also derives from the fact that no significant change has been observed in Israel's system support paradigm in recent years.

So far, Israeli regulators have not had to deal with significant stress scenarios in the banking system; and unlike other regions in the world, no legislation was enacted and no directives were given that may imply a change has occurred in subordinated debt risk from a legal standpoint. Our base assumption is that the state will not impose bail-ins on old subordinated debts (which are not eligible for Basel III), also in order to preserve the trust of the public, which had previously invested in these instruments under the assumption of support and due to the loss-absorbing containing contractual mechanism bonds (CoCo) being the only funding tool of a subordinated debt, with a periodic repayment of old subordinated debts.

We note that even after external support is weighted, Midroog usually keeps a minimum possible gap between the rating of the Bank's senior debt and its subordinated debts, that is at least one rating level (notch), reflecting the relatively higher loss levels that are likely for these debts compared to the senior debt.

About the bank

Mizrahi Tefahot Bank was among the first banks to be established in Israel (1923) and is one of the five major banking groups in Israel.

In 2005, two banks – United Mizrahi Ltd. and Tefahot Israel Mortgage Bank Ltd. – were merged together into Mizrahi Tefahot Bank Ltd.

The Bank group operates in Israel and abroad and includes Yahav Bank, which is held at 50%. The group engages in commercial (business and retail) banking activities, and mortgage activities in Israel, through a nationwide chain of 232 branches (including 35 Union Bank branches, as of late 2020) and business centers. The Bank's international activities are conducted through 3 banking units¹⁶. In addition to its banking activities, the Bank Group is engaged in various activities related to the capital market, including: Consultancy for capital market activities, management of security portfolios for customers, pension advisory service, trust services, distribution of mutual funds, operation of provident funds and distribution of mortgage insurance. The Bank's controlling shareholders are the Ofer and Wertheim families. On September 30, 2020, the tender offer to purchase the shares of Union Bank was finalized. 100% of Union Bank's issued and outstanding share capital and of the voting rights thereat were purchased under the offer.

¹⁶ As of the report's date, the subsidiary United Mizrahi Bank (Switzerland) Limited has been sold.

The bonds and deferred bonds rated by Midroog*:

Series	Security No.	Rating	Outlook	Final Repayment Date
38	2310142	Aaa.il	Stable	Sep 11 2021
41	2310175	Aaa.il	Stable	Jun 7 2022
58	2310431	Aaa.il	Stable	Sep 15 2022
44	2310209	Aaa.il	Stable	Sep 25 2022
51	2310324	Aaa.il	Stable	Oct 29 2023
Contingent subordinated notes (Coco)	Not tradable	Aa3.il(hyb)	Stable	Jan 31 2024
59	2310449	Aaa.il	Stable	Apr 2 2024
60	2310456	Aaa.il	Stable	Sep 5 2024
45	2310217	Aaa.il	Stable	Sep 28 2024
57	2310423	Aaa.il	Stable	Mar 1 2025
40	2310167	Aaa.il	Stable	Jun 7 2025
49	2310282	Aaa.il	Stable	Jun 23 2026
55	2310407	Aa3.il(hyb)	Stable	Sep 11 2026
61	2310464	Aaa.il	Stable	Dec 4 2026
56	2310415	Aa3.il(hyb)	Stable	Sep 10 2027
46	2310225	Aaa.il	Stable	Sep 28 2027
47	2310233	Aa3.il(hyb)	Stable	Dec 18 2027
48	2310266	Aa3.il(hyb)	Stable	Oct 21 2028
50	2310290	Aa3.il(hyb)	Stable	Dec 23 2029
42	2310183	Aaa.il	Stable	Jun 7 2030
52	2310381	Aaa.il	Stable	Jul 1 2030
53	2310399	Aa3.il(hyb)	Stable	Jun 24 2030
Series A Capital Notes	6950083	Aa2.il(hyb)	Stable	Jan 1 2106

** Issued by the Bank and by Mizrahi Tefahot Issuing Company Ltd – a subsidiary fully owned by the Bank*

Baseline Credit Assessment (BCA) Matrix

Category	Parameter	Sub-parameter	For Jun 30 2021		Midroog's outlook [1]		
			Measure [1]	Score	Measure	Score	Additional considerations
Business profile	Business positioning		-	aa.il	-	aa.il	<i>Market share positioning in housing loan segment</i>
	Income stability	% retail income	90%	aaa.il	>80%	aa.il	<i>Percentage of income from commissions low relative to the system</i>
	Income dispersion	Number of business lines over 15% of total revenues	2	baa.il	2	baa.il	<i>Retail sectors</i>
Risk profile	Corporate governance		-	aa.il	-	aa.il	
	Risk management policy		-	aa.il	-	aa.il	
	Credit portfolio concentration	Largest industry to tier 1 shareholders' capital	115%	aa.il	~115%	aa.il	<i>Real estate sector</i>
	Credit portfolio concentration	Major borrowers to tier 1 shareholders' capital	Approx. 0%*	aaa.il	~0%	aaa.il	

	Market risk appetite	VaR limit on tier 1 shareholders' capital	8.8%*	a.il	~8.8%	a.il
Financial profile	Asset quality	Problem debts to loans to the public	1.4%	aaa.il	1.6%-1.7%	aaa.il
		Problem debts to total shareholders' capital and provision for credit losses	14.7%	aaa.il	18%-19%	aa.il
		Net profit to asset average	0.9%	aa.il	0.6%-0.7%	aa.il
	Profitability	Profit before taxes and credit loss expenses to risk weighted asset average	2.4%	aa.il	1.9%-2.2%	aa.il
		Efficiency ratio	52.8%	aaa.il	52%-55%	aaa.il
	Capital adequacy	Tier 1 shareholders' capital to risk weighted assets	10.5%	aa.il	10.0%-10.2%	aa.il
		Shareholders' capital to total assets	5.5%	baa.il	5.4%	ba.il

Liquidity & financing	Less stable finance resources to total assets	17.5%	aa.il	~17.5%	aa.il	<i>NSFR Ratio</i>
	Liquid assets to deposits from the public	37%	aaa.il	~37%	aaa.il	
Deriving baseline credit assessment					aa2.il	
Actual baseline credit assessment					aa2.il	

[1] The measures presented in the table have been adjusted by Midroog, and are not necessarily identical to those presented by the company. Midroog's forecast includes Midroog's assessments regarding the issuer, per Midroog's base scenario, rather than the issuer's assessments.

**According to the data of December 31st, 2020*

Rating of the Bank's debts

	Baseline credit assessment (BCA)	Owner and/or affiliated party support	Adjusted BCA	Subordination and loss absorption capacity	State support	Rating
Deposits and bonds	aa2.il	0	aa2.il	0	+2	Aaa.il
Deferred capital notes (upper tier 2 capital)	aa2.il	0	aa2.il	-2	+2	Aa2.il(hyb)
Subordinated bonds with a contractual loss absorption capacity (tier 2 capital)	aa2.il	0	aa2.il	-1	0	Aa3.il(hyb)

Related reports

[Mizrahi Tefahot Bank Ltd – Related reports](#)

[Bank Rating – Methodology Report, September 2019](#)

[Banking System – Consequences of the Crisis – Special Report – Industry Note, April 2020](#)

[Connections and Holdings Table](#)

[Midroog Rating Scales and Definitions](#)

The reports are published on Midroog's website: www.midroog.co.il

General information

Rating report date:	August 22, 2021
Last date on which rating was updated:	May 13, 2021
Date on which rating was first published:	September 10, 2017
Name of the rating initiator:	Mizrahi Tefahot Bank Ltd
Name of the party paying for the report:	Mizrahi Tefahot Bank Ltd

Information from the issuer

In its ratings, Midroog relies, inter alia, on information received from authorized parties at the issuer.

Baseline Credit Assessment (BCA) Scale

aaa.il	Issuers and issues assessed at aaa.il are those that, in Midroog's judgment, have the highest internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government.
aa.il	Issuers and issues assessed at aa.il are those that, in Midroog's judgment, have very high internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government.
a.il	Issuers and issues assessed at a.il are those that, in Midroog's judgment, have relatively high internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government.
baa.il	Issuers and issues assessed at baa.il are those that, in Midroog's judgment, have moderate internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and may have certain speculative characteristics.
ba.il	Issuers and issues assessed at ba.il are those that, in Midroog's judgment, have relatively weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have speculative characteristics.
b.il	Issuers and issues assessed at b.il are those that, in Midroog's judgment, have very weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have significant speculative characteristics.
caa.il	Issuers and issues assessed at caa.il are those that, in Midroog's judgment, have excessively weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and have very significant speculative characteristics.
ca.il	Issuers and issues assessed at ca.il are those that, in Midroog's judgment, have extremely weak internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and are very near default, with some prospect of recovery of principal and interest.
c.il	Issuers and issues assessed at c.il are those that, in Midroog's judgment, have the weakest internal or independent financial strength, relative to other local issuers, absent any possibility of external support from an affiliate or the government, and are usually in default, with little prospects of recovery of principal and interest.

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from aa.il to caa.il. The modifier '1' indicates that the debenture ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the debenture ranks in the lower end of that category, denoted by letters.

Midroog does not publish the BCA forecast, unlike the publications that have been made so far, in order to separate the BCA from credit ratings.

Local Long-Term Rating Scale

Aaa.il	Issuers or issues rated Aaa.il are those that, in Midroog's judgment, have the highest creditworthiness relative to other local issuers.
Aa.il	Issuers or issues rated Aa.il are those that, in Midroog's judgment, have very high creditworthiness relative to other local issuers.
A.il	Issuers or issues rated A.il are those that, in Midroog's judgment, have relatively high creditworthiness relative to other local issuers.
Baa.il	Issuers or issues rated Baa.il are those that, in Midroog's judgment, have relatively moderate credit risk relative to other local issuers, and could involve certain speculative characteristics.
Ba.il	Issuers or issues rated Ba.il are those that, in Midroog's judgment, have relatively weak creditworthiness relative to other local issuers, and involve speculative characteristics.
B.il	Issuers or issues rated B.il are those that, in Midroog's judgment, have relatively very weak creditworthiness relative to other local issuers, and involve significant speculative characteristics.
Caa.il	Issuers or issues rated Caa.il are those that, in Midroog's judgment, have excessively weak creditworthiness relative to other local issuers, and involve very significant speculative characteristics.
Ca.il	Issuers or issues rated Ca.il are those that, in Midroog's judgment, have extremely weak creditworthiness and very near default, with some prospect of recovery of principal and interest.
C.il	Issuers or issues rated C are those that, in Midroog's judgment, have the weakest creditworthiness and are usually in a situation of default, with little prospect of recovery of principal and interest.

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from aa.il to caa.il. The modifier '1' indicates that the debenture ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the debenture ranks in the lower end of that category, denoted by letters.

Local Short-Term Rating Scale

P-1.il	Issuers rated Prime-1.il, in Midroog's judgment, have a very good ability to repay short-term obligations relative to other local issuers.
P-2.il	Issuers rated Prime-2.il, in Midroog's judgment, have a good ability to repay short-term obligations relative to other local issuers.
P-3.il	Issuers rated Prime-3.il, in Midroog's judgment, have a moderate ability to repay short-term obligations relative to other local issuers.
NP.il	Issuers rated Not Prime.il do not belong in any of the Prime categories.

The Connection between the Long-Term and Short-Term Rating Scales

The following table shows the long-term ratings consistent with short-term ratings, when such long-term ratings exist⁷.

Long-term rating	Short-term rating
Aaa.il	Prime-1.il
Aa1.il	
Aa2.il	
Aa3.il	
A1.il	
A2.il	
A3.il	Prime-2.il
Baa1.il	
Baa2.il	
Baa3.il	Prime-3.il
Ba1.il, Ba2.il, Ba3.il	
B1.il, B2.il, B3.il	
Caa1.il, Caa2.il, Caa3.il	
Ca.il	
C.il	Not Prime

⁷ Structured finance short-term ratings are usually based on the short-term rating of a liquidity provider for the transaction or an assessment of cash flows available to repay the rated obligation.

[Midroog disclaimer]