Bank Hapoalim

Report on Risks

Pillar 3 Disclosure and Additional Information Regarding Risks

As at March 31, 2016

Q1

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This is a translation of the Hebrew report and has been prepared for convenience only.
In case of any discrepancy, the Hebrew will prevail.

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Introduction

This publication of the Report on Risks serves as a supplement and expansion of information accompanying the financial reporting of Bank Hapoalim B.M. on the subjects of risk and capital management. The information presented below in the Report on Risks, as required by the reporting directives of the Bank of Israel, includes disclosure requirements issued by the Basel Committee and risk disclosure requirements based on other sources, including disclosure requirements issued by the Financial Stability Forum (FSF) and disclosure requirements issued by a task force established by the Financial Stability Board (FSB) in order to improve risk disclosure at banking corporations. Additional information concerning risks, as specified in the reporting directives, which is not based on the disclosure requirements published by the Basel Committee is marked **AI** next to the heading of the paragraph.

Forward-Looking Information

Most of the information in this report that does not refer to historical facts (even if it is based on processing of historical data) constitutes forward-looking information, as defined in the Securities Law, 1968. The actual results of the Bank may differ materially from those included in forward-looking information, including, among other factors, as a result of changes in capital markets in Israel and globally, macro-economic changes, changes in geopolitical conditions, regulatory changes, accounting changes, changes in taxation rules, and other changes not under the Bank's control, which may lead to the failure of estimates to materialize and/or changes in the Bank's business plans. Forward-looking information is marked by words or phrases such as "forecast," "plan," "objective," "risk estimate," "scenario," "stress scenario," "risk assessment," "correlation," "distribution," "we believe," "expect," "predict," "estimate," "intend," "plan," "aim," "may change," "should," "can," "will," or similar expressions. Such forward-looking expressions involve risk and uncertainty, because they are based on management's estimates regarding future events, which include changes in the following parameters, among others: economic conditions, public tastes, interest rates in Israel and overseas, inflation rates, new legislation and regulation in the area of banking and the capital market, exposure to financial risks, the financial stability of borrowers, the behavior of competitors, aspects related to the Bank's image, technological developments, manpower-related matters, and other areas that affect the activity of the Bank and the environment in which it operates, the materialization of which is uncertain by nature. The information presented below is based, among other things, on information known to the Bank and based, among other things, on publications by various entities, such as the Central Bureau of Statistics, the Ministry of Finance, the Bank of Israel, the Ministry of Housing, and other entities that publish data and estimates regarding the Israeli and global capital markets.
This information reflects the Bank's current viewpoint with regard to future events, which is based on estimates, and is therefore subject to risks and uncertainty, as well as to the possibility that expected events or developments may not materialize at all or may only partially materialize, or that actual developments may be the opposite of expectations.

A. General Disclosure Principle

Pursuant to the instructions of the Bank of Israel, the disclosure declarations in the periodic financial report of the Bank are also valid for the Report on Risks – Pillar 3 Disclosure and Additional Information Regarding Risks.

Within the discussions of the financial statements of the Bank, the Board of Directors of the Bank approved the publication of the Report on Risks – Pillar 3 Disclosure and Additional Information Regarding Risks.

B. Applicability of Implementation

The applicability of implementation refers to the working framework for the capital measurement and adequacy of Bank Hapoalim.

In general, the capital requirements of the Bank are based on its consolidated financial statements, which are prepared according to Israeli GAAP and the directives and guidelines of the Supervisor of Banks.

According to Israeli GAAP, subsidiaries controlled directly or indirectly by the Bank are consolidated in the financial statements, but different consolidation rules sometimes apply for the purposes of the supervision of capital. However, as at March 31, 2016, there are no differences between the consolidation base according to GAAP and the supervisory consolidation base for the purposes of capital adequacy.

There are no significant prohibitions or restrictions on the transfer of supervisory capital within the Group, with the exception of Bank Pozitif, for which any capital beyond the Pillar 1 requirements is not available at the level of the Group, and against which capital is therefore allocated within Pillar 2 calculations. With regard to the limits established in the Bank of Israel's permit for the acquisition of control of the Bank in connection with the distribution of retained earnings, see Note 25 to the Annual Financial Statements for 2015.

For further details regarding the principal subsidiary and affiliated companies of the Bank, see Note 15C to the Annual Financial Statements for 2015.

C. Capital – Structure and Capital Adequacy

Structure of Supervisory Capital and Composition of Capital

Capital measurement is based on the division of capital into Tier 1 capital (which includes common equity Tier 1 capital and additional Tier 1 capital) and Tier 2 capital.

Common equity Tier 1 capital includes the components of shareholders' equity and minority interests in the capital of consolidated companies, net of surplus capital in respect thereof. The main supervisory adjustments and deductions from common equity Tier 1 capital are intangible assets and goodwill; net deferred taxes receivable, the realization of which is based on future profitability of the banking corporation; net deferred taxes receivable in respect of timing differences; unrealized profits and losses resulting from changes in the fair value of liabilities, arising from changes in the own credit risk of the banking corporation; investment in own ordinary shares, including commitment to acquire own shares subject to contractual agreements; and investments in the share capital of financial corporations not consolidated in the public reports of the banking corporation.

Additional Tier 1 capital includes innovative hybrid capital instruments that do not qualify for recognition in supervisory capital under the Basel 3 directives, which are therefore deducted gradually, in accordance with the transitional directives. Non-innovative hybrid capital instruments have characteristics such as: a maturity date of no less than 49 years; not secured by any form of collateral; rights under the instruments are subordinated relative to all creditors of the Bank; the instruments include mechanisms for the absorption of losses on a current basis (suspension of interest and principal payments, and forced conversion into shares under circumstances established for those instruments); and they do not accrue interest and principal not paid on time, in any way (except in the case of payment in the form of shares), including in cases in which interest and principal payments are suspended. Innovative hybrid capital instruments are those that meet the definition of non-innovative capital instruments but also include an incentive for the Bank to carry out redemptions, such as a mechanism for an increase in the interest rate after a certain number of years.

Tier 2 capital includes the collective allowance for credit losses, innovative hybrid capital instruments, and subordinated notes. The capital instruments and subordinated notes do not qualify for recognition in supervisory capital under the Basel 3 directives, and are therefore being deducted gradually, in accordance with the transitional directives. The innovative hybrid capital instruments have the characteristics of innovative capital instruments included in additional Tier 1 capital, with the following exceptions: they can be cumulative; there is no requirement to convert them into shares; and the rights arising from the instruments are subordinated to all creditors of the Bank except holders of additional Tier 1 capital instruments.

The main characteristics of the subordinated notes are: a term to maturity of no less than five years; issued without collateral; rights under the instruments are subordinated to the claims of other creditors of the Bank, except creditors holding Tier 1 capital and Tier 2 capital instruments; and of the amount thereof recognized as Tier 2 capital, as noted, 20% shall be deducted at the beginning of each year in the last five years before their maturity date (in the case of a subordinated note settled in installments, such a deduction shall be made from each installment).

The capital instruments and subordinated notes that no longer qualify as supervisory capital are recognized as of January 1, 2014, up to a ceiling of 80% of the balance thereof in supervisory capital as at December 31, 2013. In each subsequent year, this ceiling shall be lowered by an additional 10%, up to January 1, 2022. In 2016, the capital instruments and subordinated notes are recognized up to a ceiling of 60% of the balance thereof in supervisory capital as at December 31, 2013.

Limits on the Structure of Capital

Proper Conduct of Banking Business Directive 202 sets limits on the structure of capital:

1. Tier 2 capital shall not exceed 100% of Tier 1 capital, after the required deductions from this capital.
2. Capital instruments that qualify for inclusion in Tier 2 capital shall not exceed 50% of Tier 1 capital, after the required deductions from this capital. This limit does not include capital instruments included in Upper Tier 2 capital prior to the inception of this directive, in the amount of the balance of such instruments as at December 31, 2013, and in accordance with the transitional directives established in Proper Conduct of Banking Business Directive 299 (Supervisory Capital – Transitional Directives).

Hybrid capital instruments recognized as Tier 1 capital are issued by the Bank. Capital instruments recognized as Tier 2 capital are issued by the Bank and through its wholly-owned subsidiaries Hapoalim Hanpakot and Hapoalim International N.V.

For details regarding subordinated notes, see Note 21 to the Annual Financial Statements for 2015.

Calculation of the Capital Ratio

Table C-1: Calculation of the ratio of capital to risk-adjusted assets

	March 31, 2016	March 31, 2015	December 31, 2015
	NIS millions		
1. Capital for the calculation of the capital ratio after supervisory adjustments and deductions			
Common equity Tier 1 capital	**33,602**	32,069	33,246
Additional Tier 1 capital	**1,465**	1,709	1,709
Total Tier 1 capital	**35,067**	33,778	34,955
Tier 2 capital	**13,012**	14,483	14,593
Total overall capital	**48,079**	48,261	49,548
2. Weighted balances of risk-adjusted assets			
Credit risk	**316,977**	312,751	317,891
Market risks	**5,120**	5,194	4,562
Operational risk	**22,772**	22,273	22,671
Total weighted balances of risk-adjusted assets	**344,869**	340,218	345,124
	%		
3. Ratio of capital to risk-adjusted assets			
Ratio of common equity Tier 1 capital to risk-adjusted assets	**9.74%**	9.43%	9.63%
Ratio of Tier 1 capital to risk-adjusted assets	**10.17%**	9.93%	10.13%
Ratio of total capital to risk-adjusted assets	**13.94%**	14.19%	14.36%
Minimum common equity Tier 1 capital ratio required by the Supervisor of Banks	**(1)9.09%**	(1)9.00%	(1)9.07%
Minimum total capital ratio required by the Supervisor of Banks	**(1)12.59%**	(1)12.50%	(1)12.57%

(1) The minimum required common equity Tier 1 capital ratio and the minimum required total capital ratio are 9% and 12.5%, respectively, from January 1, 2015, to December 31, 2016; and 10% and 13.5%, respectively, beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to these ratios at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum common equity Tier 1 capital ratio and the minimum total capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 10.2% and 13.7%, respectively. With regard to the balance of housing loans, see Note 13A(2) to the Condensed Financial Statements as at March 31, 2016.

Table C-1: Calculation of the ratio of capital to risk-adjusted assets (continued)

	March 31, 2016	March 31, 2015	December 31, 2015
		%	
4. Significant subsidiaries			
Isracard			
Ratio of common equity Tier 1 capital to risk-adjusted assets	**20.13%**	*18.90%	19.94%
Ratio of Tier 1 capital to risk-adjusted assets	**20.13%**	*18.90%	19.94%
Ratio of total capital to risk-adjusted assets	**21.18%**	*19.90%	20.96%
Minimum common equity Tier 1 capital ratio required by the Supervisor of Banks	**(1)9.00%**	(1)9.00%	(1)9.00%
Minimum total capital ratio required by the Supervisor of Banks	**(1)12.50%**	(1)12.50%	(1)12.50%
Bank Hapoalim Switzerland			
Ratio of common equity Tier 1 capital to risk-adjusted assets	**21.57%**	20.90%	24.11%
Ratio of Tier 1 capital to risk-adjusted assets	**21.57%**	20.90%	24.11%
Ratio of total capital to risk-adjusted assets	**21.64%**	20.98%	24.20%
Minimum common equity Tier 1 capital ratio required by local regulation	**8.00%**	8.00%	8.00%
Minimum total capital ratio required by local regulation	**11.20%**	11.20%	11.20%
Bank Pozitif		Basel 2(2)	
Ratio of Tier 1 capital to risk-adjusted assets	**18.52%**	15.82%	16.34%
Ratio of total capital to risk-adjusted assets	**19.34%**	16.46%	17.10%
Minimum total capital ratio required by local regulation	**12.00%**	12.00%	12.00%

* Retrospective implementation of the guidelines of the Supervisor of Banks concerning capitalization of software costs.
(1) Minimum capital ratio required according to the directives of the Supervisor of Banks as of January 1, 2015.
(2) Bank Pozitif has not implemented the Basel 3 directives; the data are therefore presented according to the Basel 2 directives.

Table C-2: Composition of capital for the purpose of calculating the ratio of capital to risk-adjusted assets

	March 31, 2016	March 31, 2015	December 31, 2015
	NIS millions		
Tier 1 capital			
Paid-up common share capital and premium	**8,128**	8,041	8,094
Retained earnings	**25,279**	22,945	24,720
Non-controlling interests in equity of consolidated subsidiaries	**124**	193	148
Unrealized profits from adjustments of securities available for sale to fair value	**372**	1,266	451
Other capital instruments	**(239)**	(76)	(34)
Amounts deducted from Tier 1 capital	**(62)**	(300)	(133)
Total common equity Tier 1 capital	**33,602**	32,069	33,246
Innovative hybrid instruments	**1,465**	1,709	1,709
Total Tier 1 capital	**35,067**	33,778	34,955
Tier 2 capital			
Hybrid capital instruments and subordinated notes	**1,091**	1,207	1,150
Collective allowances for credit losses before the effect of related tax	**3,859**	3,805	3,915
Tier 2 capital instruments issued by subsidiaries of the banking corporation to third-party investors	**8,062**	9,471	9,528
Amounts deducted from Tier 2 capital	**-**	-	-
Total Tier 2 capital	**13,012**	14,483	14,593
Total qualifying capital	**48,079**	48,261	49,548

For further details, see Note 9 to the Condensed Financial Statements as at March 31, 2016.

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Common equity Tier 1 capital							
Common equity Tier 1 capital – instruments and retained earnings							
Ordinary share capital issued by the banking corporation and premium on ordinary shares included in common equity Tier 1 capital	**8,128**		8,041		8,094		1+2
Retained earnings, including dividends proposed or declared after the balance sheet date	**25,279**	**2**	22,945	4	24,720	4	3
Accumulated other comprehensive income and disclosed retained earnings	**133**	**(206)**	1,190	(335)	417	(203)	4A + 4B
Common equity Tier 1 capital instruments issued by the corporation, which qualify for inclusion in supervisory capital during the transitional period	**-**		-		-		
Ordinary shares issued by subsidiaries of the banking corporation which were consolidated and are held by a third party (non-controlling interests)	**124**	**42**	193	72	148	58	5
Common equity Tier 1 capital before supervisory adjustments and deductions	**33,664**		32,369		33,379		
Common equity Tier 1 capital – supervisory adjustments and deductions							
Stabilization adjustments of valuations	**-**	**-**	-	-	-	-	
Goodwill, net of deferred taxes payable	**-**	**-**	-	-	-	-	
Other intangible assets, excluding mortgage service rights, net of deferred taxes payable	**-**	**-**	4	-	-	-	6+7
Deferred tax assets, realization of which depends on future profitability of the banking corporation, excluding deferred tax assets arising from timing differences	**29**	**19**	23	35	19	29	8
Total accumulated other comprehensive income in respect of cash flow hedges of items not presented in the balance sheet at fair value	**(2)**	**(1)**	(2)	(4)	(2)	(2)	9
Negative difference between provisions and expected losses	**-**	**-**	-	-	-	-	

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Increase in equity capital due to securitization transactions	**-**	**-**	-	-	-	-	
Unrealized profits and losses resulting from changes in the fair value of liabilities due to changes in the own credit risk of the banking corporation	**4**	**2**	10	14	7	10	10
Surplus of amount funded over provision, net of deferred taxes payable to be extinguished if the asset becomes impaired or is deducted, in accordance with the Public Reporting Directives	**-**	**-**	-	-	-	-	
Investment in own ordinary shares held directly or indirectly (including commitments to purchase shares under contractual agreements)	**31**	**20**	16	25	20	31	
Mutual cross-holdings in ordinary shares of financial corporations	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding does not exceed 10% of the ordinary share capital issued by the financial corporation (in an amount greater than 10% of common equity Tier 1 capital)	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding exceeds 10% of the ordinary share capital issued by the financial corporation	**-**	**-**	-	-	-	-	
Mortgage service rights in amounts exceeding 10% of common equity Tier 1 capital	**-**	**-**	-	-	-	-	
Deferred tax assets arising from timing differences in amounts exceeding 10% of common equity Tier 1 capital	**-**	**-**	249	373	89	134	13

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Amounts of mortgage service rights, deferred taxes receivable arising from timing differences, and investments at a rate greater than 10% of the ordinary share capital issued by financial corporations, exceeding 15% of the common equity Tier 1 capital of the banking corporation	**-**	**-**	-	-	-	-	
Of which: in respect of investments at a rate greater than 10% of the ordinary share capital issued by financial corporations	**-**	**-**	-	-	-	-	
Of which: in respect of mortgage service rights	**-**	**-**	-	-	-	-	
Of which: deferred taxes receivable arising from timing differences	**-**	**-**	-	-	-	-	
Additional supervisory adjustments and deductions established by the Supervisor of Banks	**-**	**-**	-	-	-	-	
Of which: in respect of investments in the capital of financial corporations	**-**	**-**	-	-	-	-	
Of which: in respect of mortgage service rights	**-**	**-**	-	-	-	-	
Of which: additional supervisory adjustments to common equity Tier 1 capital	**-**	**-**	-	-	-	-	
Supervisory adjustments to common equity Tier 1 capital subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	**-**		-		-		
Deductions applicable to common equity Tier 1 capital because the additional Tier 1 capital and Tier 2 capital are insufficient to cover the deductions	**-**		-		-		
Total supervisory adjustments and deductions in common equity Tier 1 capital	**62**	**40**	300	443	133	202	
Common equity Tier 1 capital	**33,602**		32,069		33,246		

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Additional Tier I capital							
Additional Tier I capital – instruments							
Additional Tier I share capital instruments issued by the banking corporation, and premium on such instruments	**-**		-		-		
Of which: classified as equity in accordance with the Public Reporting Directives	**-**		-		-		
Of which: classified as a liability in accordance with the Public Reporting Directives	**-**		-		-		
Additional Tier I capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	**1,465**		1,709		1,709		11B
Additional Tier I capital instruments issued by subsidiaries of the banking corporation and held by third-party investors	**-**		-		-		
Of which: additional Tier I capital instruments issued by subsidiaries of the banking corporation and held by third-party investors, which are gradually deducted from additional Tier I capital	**-**		-		-		
Additional Tier I capital before deductions	**1,465**		1,709		1,709		

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Additional Tier 1 capital – deductions							
Own investment in capital instruments included in additional Tier 1 capital, held directly or indirectly (including commitments to purchase instruments under contractual agreements)	**-**	**-**	-	-	-	-	
Mutual cross-holdings in capital instruments included in additional Tier 1 capital	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding does not exceed 10% of the ordinary share capital issued by the financial corporation	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding exceeds 10% of the ordinary share capital issued by the financial corporation	**-**	**-**	-	-	-	-	
Additional deductions established by the Supervisor of Banks	**-**	**-**	-	-	-	-	
Of which: in respect of investments in the capital of financial corporations	**-**	**-**	-	-	-	-	
Of which: additional deductions from Tier 1 capital	**-**	**-**	-	-	-	-	
Deductions from additional Tier 1 capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	**-**		-		-		
Deductions applicable to additional Tier 1 capital because Tier 2 capital is insufficient to cover the deductions	**-**		-		-		
Total deductions from additional Tier 1 capital	**-**		-		-		
Additional Tier 1 capital	**1,465**		1,709		1,709		
Tier 1 capital	**35,067**		33,778		34,955		

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Tier 2 capital							
Tier 2 capital – instruments and provisions							
Instruments issued by the banking corporation (not included in Tier 1 capital) and premium on such instruments	**-**		-		-		11A
Tier 2 capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	**1,091**		1,207		1,150		11B
Tier 2 capital instruments issued by subsidiaries of the banking corporation to third-party investors	**8,062**		9,471		9,528		
Of which: Tier 2 capital instruments issued by subsidiaries of the banking corporation and held by third-party investors, which are gradually deducted from Tier 2 capital	**8,062**		9,471		9,528		11B
Collective allowances for credit losses before the effect of related tax	**3,859**		3,805		3,915		12
Tier 2 capital before deductions	**13,012**		14,483		14,593		
Tier 2 capital – deductions							
Own investment in Tier 2 capital instruments, held directly or indirectly (including commitments to purchase instruments under contractual agreements)	**-**	**-**	-	-	-	-	
Mutual cross-holdings in Tier 2 capital instruments of financial corporations	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding does not exceed 10% of the ordinary share capital issued by the financial corporation	**-**	**-**	-	-	-	-	
Investments in capital of financial corporations not consolidated in the banking corporation's reports to the public, where the banking corporation's holding exceeds 10% of the ordinary share capital issued by the financial corporation	**-**	**-**	-	-	-	-	

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Additional deductions established by the Supervisor of Banks	**-**	**-**	-	-	-	-	
Of which: investments in the capital of financial corporations	**-**	**-**	-	-	-	-	
Of which: additional deductions from Tier 2 capital	**-**	**-**	-	-	-	-	
Supervisory adjustments to Tier 2 capital subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	**-**		-		-		
Total supervisory adjustments to Tier 2 capital	**-**		-		-		
Tier 2 capital	**13,012**		14,483		14,593		
Total capital	**48,079**		48,261		49,548		
Weighted risk-adjusted assets							
Total weighted risk-adjusted assets according to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	**343,979**		339,134		344,152		
Of which: credit risk assets	**316,087**		311,667		316,919		
Of which: market risk assets	**5,120**		5,194		4,562		
Of which: operational risk assets	**22,772**		22,273		22,671		
Total weighted risk-adjusted assets	**344,869**		340,218		345,124		

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance/ percent	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance/ percent	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance/ percent	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions/percent						
Capital ratios and capital preservation cushions							
Common equity Tier 1 capital	**9.74%**		9.43%		9.63%		
Tier 1 capital	**10.17%**		9.93%		10.13%		
Total capital	**13.94%**		14.19%		14.36%		
Minimum requirements established by the Supervisor of Banks							
The minimum required common equity Tier 1 capital ratio is 9% from January 1, 2015, to December 31, 2016, and 10% beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to this ratio at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum common equity Tier 1 capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 10.2%.	**9.09%**		9.00%		9.07%		
The minimum required total capital ratio is 12.5% from January 1, 2015, to December 31, 2016, and 13.5% beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to this ratio at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum total capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 13.7%.	**12.59%**		12.50%		12.57%		
Amounts below the deduction threshold (before risk weighting)							
Investments in the capital of financial corporations which do not exceed 10% of the ordinary share capital issued by the financial corporation and which are below the deduction threshold	**1,187**		1,498		1,437		

Table C-3: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	March 31, 2016		March 31, 2015		December 31, 2015		References
	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	Balance	Amounts not deducted from capital which are subject to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	
	NIS millions						
Investments in the capital of financial corporations which exceed 10% of the ordinary share capital issued by the financial corporation and which are below the deduction threshold	**557**		134		553		
Mortgage service rights (net of deferred taxes payable)	**-**		-		-		
Deferred tax assets arising from timing differences, below the deduction threshold	**3,036**		3,232		3,333		
Ceiling for inclusion of provisions in Tier 2							
Provision eligible for inclusion in Tier 2, with reference to exposures under the standardized approach, before application of the ceiling	**3,859**		3,805		3,915		
Ceiling for inclusion of provision in Tier 2 under the standardized approach	**3,962**		3,909		3,974		
Provision eligible for inclusion in Tier 2, with reference to exposures based on the internal ratings approach, before application of the ceiling	**-**		-		-		
Ceiling for inclusion of provision in Tier 2 based on the internal ratings approach	**-**		-		-		
Capital instruments not eligible as supervisory capital, which are subject to the transitional directives							
Current ceiling amount for instruments included in common equity Tier 1 capital subject to the transitional directives	**-**		-		-		
Amount deducted from common equity Tier 1 capital due to the ceiling	**-**		-		-		
Current ceiling amount for instruments included in additional Tier 1 capital subject to the transitional directives	**1,465**		1,709		1,709		
Amount deducted from additional Tier 1 capital due to the ceiling	**930**		691		708		
Current ceiling amount for instruments included in Tier 2 capital subject to the transitional directives	**9,153**		10,678		10,678		
Amount deducted from Tier 2 capital due to the ceiling	**570**		1,323		426		

Table C-4: Composition of the supervisory balance sheet, with references to the components of supervisory capital

	March 31, 2016	March 31, 2015	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet			
	NIS millions			
Assets				
Cash and deposits with banks*	**63,086**	70,443	64,976	
* Of which: collective allowance for credit losses included in Tier 2 capital	**(7)**	(5)	(3)	12
Securities*	**66,154**	54,328	62,884	
* Of which: investments in capital of financial corporations that do not exceed 10% of the share capital of the financial corporation	**1,187**	1,498	1,437	
* Of which: other securities	**64,967**	52,830	61,447	
Securities borrowed or purchased under agreements to resell	**39**	523	119	
Credit to the public	**284,219**	272,987	282,911	
* Of which: investments in capital of financial corporations that exceed 10% of the share capital of the financial corporation, and do not exceed the deduction threshold	**421**	-	421	
Allowance for credit losses*	**(4,369)**	(4,066)	(4,414)	
* Of which: collective allowance for credit losses included in Tier 2 capital	**(3,282)**	(3,196)	(3,318)	12
* Of which: allowance for credit losses not included in supervisory capital	**(1,087)**	(870)	(1,096)	
Net credit to the public	**279,850**	268,921	278,497	
Credit to governments	**2,620**	2,243	2,564	
Investment in equity-basis investees*	**149**	139	143	
* Of which: investments in capital of financial corporations that exceed 10% of the share capital of the financial corporation, and do not exceed the deduction threshold	**136**	134	132	
Buildings and equipment	**3,349**	3,435	3,409	
Intangible assets and goodwill*	**-**	4	-	
* Of which: goodwill	**-**	-	-	
* Of which: other intangible assets	**-**	4	-	6
Assets in respect of derivative instruments	**13,974**	18,312	12,789	
Other assets*	**5,684**	8,078	6,257	
* Of which: deferred tax assets**	**3,561**	3,912	3,604	
** Of which: deferred tax assets attributed to timing differences, over 10% of common equity Tier 1 capital	**-**	622	223	13
** Of which: deferred tax assets excluding those attributed to timing differences	**48**	58	48	8
** Of which: other deferred tax assets	**3,513**	3,232	3,333	
* Of which: surplus of amount funded over provision	**-**	-	-	
* Of which: additional other assets	**2,123**	4,166	2,653	
Total assets	**434,905**	426,426	431,638	

Table C-4: Composition of the supervisory balance sheet, with references to the components of supervisory capital (continued)

	March 31, 2016	March 31, 2015	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet			
	NIS millions			
Liabilities and capital				
Deposits from the public	**321,576**	307,895	321,727	
Deposits from banks	**3,817**	5,421	4,773	
Government deposits	**431**	560	354	
Securities lent or sold under agreements to repurchase	**511**	43	83	
Bonds and subordinated notes*	**36,836**	34,808	34,475	
* Of which: subordinated notes not recognized as supervisory capital	**8,912**	7,853	7,498	
* Of which: subordinated notes recognized as supervisory capital**	**10,618**	12,387	12,387	
** Of which: eligible as supervisory capital components	**-**	-	-	11A
** Of which: ineligible as supervisory capital components and subject to transitional directives	**10,618**	12,387	12,387	11B
Liabilities in respect of derivative instruments*	**15,401**	19,715	13,806	
* Of which: in respect of own credit risk	**6**	24	17	10
Other liabilities	**22,810**	25,898	23,201	
* Of which: collective allowance for credit losses included in Tier 2 capital	**570**	604	594	12
* Of which: liability in respect of deferred tax attributed to pensions	**-**	-	-	
* Of which: liability in respect of deferred tax on intangible assets	**-**	-	-	7
Total liabilities	**401,382**	394,340	398,419	

Table C-4: Composition of the supervisory balance sheet, with references to the components of supervisory capital (continued)

	March 31, 2016	March 31, 2015	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet			
	NIS millions			
Shareholders' equity*	**33,336**	31,845	33,032	
* Of which: ordinary share capital and premium, retained earnings, other comprehensive income, and capital reserves**	**33,336**	31,845	33,032	
** Of which: ordinary share capital	**1,332**	1,326	1,329	1
** Of which: premium on ordinary shares	**6,796**	6,715	6,765	2
** Of which: retained earnings	**25,281**	22,949	24,724	3
** Of which: accumulated other comprehensive income (loss)***	**(154)**	717	101	4A
*** Of which: adjustments for presentation of securities available for sale at fair value	**372**	1,266	451	
*** Of which: net losses in respect of cash-flow hedges	**(3)**	(6)	(4)	9
*** Of which: net adjustments from translation, after hedge effects	**(8)**	16	(8)	
** Of which: capital reserves from a benefit due to share-based payment transactions	**81**	138	113	4B
* Of which: senior share capital	**-**	-	-	
** Of which: eligible as supervisory capital components	**-**	-	-	
** Of which: ineligible as supervisory capital components and subject to transitional directives	**-**	-	-	
* Of which: other capital instruments	**-**	-	-	
** Of which: eligible as supervisory capital components	**-**	-	-	
** Of which: ineligible as supervisory capital components and subject to transitional directives	**-**	-	-	
Non-controlling interests*	**187**	241	187	
* Of which: non-controlling interests attributable to common equity Tier 1 capital	**124**	193	148	5
* Of which: non-controlling interests attributable to additional Tier 1 capital	**-**	-	-	
* Of which: non-controlling interests attributable to Tier 2 capital	**-**	-	-	
* Of which: non-controlling interests not attributable to supervisory capital	**63**	48	39	
Total capital	**33,523**	32,086	33,219	
Total liabilities and capital	**434,905**	426,426	431,638	

Table C-5: Statement of changes in components of supervisory capital

	For the three months ended March 31, 2016				
	Common equity Tier 1 capital	Additional Tier 1 capital	Total Tier 1 capital	Tier 2 capital	Total capital
	NIS millions				
Balance as at December 31, 2015	**33,246**	**1,709**	**34,955**	**14,593**	**49,548**
Changes in capital components					
Ordinary share capital	**3**	**-**	**3**	**-**	**3**
Premium on ordinary shares	**31**	**-**	**31**	**-**	**31**
Net profit for the period attributed to shareholders of the Bank	**674**	**-**	**674**	**-**	**674**
Dividend	**(117)**	**-**	**(117)**	**-**	**(117)**
Effect of adoption of accounting rules concerning employee benefits, included in retained earnings*	**2**	**-**	**2**	**-**	**2**
Unrealized losses from adjustments of securities available for sale to fair value	**(79)**	**-**	**(79)**	**-**	**(79)**
Unrealized gains in respect of cash-flow hedges	**1**	**-**	**1**	**-**	**1**
Translation adjustments of autonomous affiliated units overseas	**-**	**-**	**-**	**-**	**-**
Benefit due to share-based payment transactions	**(32)**	**-**	**(32)**	**-**	**(32)**
Proceeds on shares and amounts received in consideration for options to purchase shares	**-**	**-**	**-**	**-**	**-**
Effect of adoption of accounting rules concerning employee benefits, included in other comprehensive income*	**(174)**	**-**	**(174)**	**-**	**(174)**
Non-controlling interests in share capital of consolidated subsidiaries*	**(24)**	**-**	**(24)**	**-**	**(24)**
Other	**-**	**-**	**-**	**-**	**-**
Total change before supervisory adjustments and deductions	**285**	**-**	**285**	**-**	**285**

* After adjustments, as required in the transitional directives in Directive 299.

Table C-5: Statement of changes in components of supervisory capital (continued)

	For the three months ended March 31, 2016				
	Common equity Tier 1 capital	Additional Tier 1 capital	Total Tier 1 capital	Tier 2 capital	Total capital
	NIS millions				
Change with the effect of supervisory adjustments and deductions					
Goodwill and intangible assets	-	-	-	-	-
Deferred taxes, realization of which is based on the future profitability of the banking corporation*	**10**	-	**10**	-	**10**
Deferred tax assets attributed to timing differences (over 10% of common equity Tier 1 capital)*	**(89)**	-	**(89)**	-	**(89)**
Pension fund with defined benefits recorded in the balance sheet as an asset	-	-	-	-	-
Total accumulated other comprehensive income in respect of cash flows of items not presented in the balance sheet at fair value*	-	-	-	-	-
Increase in capital due to securitization exposures	-	-	-	-	-
Unrealized gains and losses resulting from changes in the fair value of liabilities due to changes in the own credit risk of the Bank*	**(3)**	-	**(3)**	-	**(3)**
Self investment in ordinary shares (held directly or indirectly)*	**11**	-	**11**	-	**11**
Mutual cross-holdings in ordinary shares of financial corporations	-	-	-	-	-
Investments in share capital of financial corporations, where the investment does not exceed 10% of the capital of the financial corporation	-	-	-	-	-
Investments in share capital of financial corporations, where the investment exceeds 10% of the capital of the financial corporation	-	-	-	-	-
Threshold deduction – amount in excess of 15% of common equity Tier 1 capital	-	-	-	-	-
Others	-	-	-	-	-
Total change in supervisory adjustments and deductions	**(71)**	-	**(71)**	-	**(71)**
Decrease in supervisory capital instruments	-	**(244)**	**(244)**	**(1,525)**	**(1,769)**
Capital instruments issued	-	-	-	-	-
Change in collective allowances for credit losses before the effect of related tax	-	-	-	**(56)**	**(56)**
Other	-	-	-	-	-
Balance as at March 31, 2016	**33,602**	**1,465**	**35,067**	**13,012**	**48,079**

* After adjustments, as required in the transitional directives in Directive 299.

Table C-5: Statement of changes in components of supervisory capital (continued)

	For the year ended December 31, 2015				
	Common equity Tier 1 capital	Additional Tier 1 capital	Total Tier 1 capital	Tier 2 capital	Total capital
	NIS millions				
Balance as at December 31, 2014*	31,482	1,954	33,436	16,041	49,477
Change in capital components					
Ordinary share capital	6	-	6	-	6
Premium on ordinary shares	84	-	84	-	84
Net profit for the period attributed to shareholders of the Bank	3,082	-	3,082	-	3,082
Dividend	(569)	-	(569)	-	(569)
Effect of adoption of accounting rules concerning employee benefits, included in retained earnings**	(36)	-	(36)	-	(36)
Unrealized losses from adjustments of securities available for sale to fair value	(510)	-	(510)	-	(510)
Unrealized gains in respect of cash-flow hedges	2	-	2	-	2
Translation adjustments of autonomous affiliated units overseas	2	-	2	-	2
Benefit due to share-based payment transactions	(56)	-	(56)	-	(56)
Proceeds on shares and amounts received in consideration for options to purchase shares	-	-	-	-	-
Effect of adoption of accounting rules concerning employee benefits, included in other comprehensive income**	(135)	-	(135)	-	(135)
Non-controlling interests in share capital of consolidated subsidiaries**	(76)	-	(76)	-	(76)
Other	-	-	-	-	-
Total change before supervisory adjustments and deductions	1,794	-	1,794	-	1,794

* As reported excluding the effect of the adoption of US GAAP regarding employee benefits, which took effect on January 1, 2015.
** After adjustments, as required in the transitional directives in Directive 299.

Table C-5: Statement of changes in components of supervisory capital (continued)

	For the year ended December 31, 2015				
	Common equity Tier 1 capital	Additional Tier 1 capital	Total Tier 1 capital	Tier 2 capital	Total capital
	NIS millions				
Change with the effect of supervisory adjustments and deductions					
Goodwill and intangible assets	(7)	-	(7)	-	(7)
Deferred taxes, realization of which is based on the future profitability of the banking corporation*	8	-	8	-	8
Deferred tax assets attributed to timing differences (over 10% of common equity Tier 1 capital)*	12	-	12	-	12
Pension fund with defined benefits recorded in the balance sheet as an asset	-	-	-	-	-
Total accumulated other comprehensive income in respect of cash flows of items not presented in the balance sheet at fair value*	(1)	-	(1)	-	(1)
Increase in capital due to securitization exposures	-	-	-	-	-
Unrealized gains and losses resulting from changes in the fair value of liabilities due to changes in the own credit risk of the Bank*	7	-	7	-	7
Self investment in ordinary shares (held directly or indirectly)*	11	-	11	-	11
Mutual cross-holdings in ordinary shares of financial corporations	-	-	-	-	-
Investments in share capital of financial corporations, where the investment does not exceed 10% of the capital of the financial corporation	-	-	-	-	-
Investments in share capital of financial corporations, where the investment exceeds 10% of the capital of the financial corporation	-	-	-	-	-
Threshold deduction – amount in excess of 15% of common equity Tier 1 capital	-	-	-	-	-
Others	-	-	-	-	-
Total change in supervisory adjustments and deductions	30	-	30	-	30
Decrease in supervisory capital instruments	-	(245)	(245)	(1,526)	(1,771)
Capital instruments issued	-	-	-	-	-
Change in collective allowances for credit losses before the effect of related tax	-	-	-	78	78
Other	-	-	-	-	-
Balance as at December 31, 2015	33,246	1,709	34,955	14,593	49,548

* After adjustments, as required in the transitional directives in Directive 299.

Most of the changes in the components of supervisory capital in the first quarter of 2016 resulted primarily from net profit for the period, in the amount of NIS 674 million, which was offset by dividend distribution in the amount of NIS 117 million and by a decrease in supervisory capital instruments, in the amount of NIS 1,769 million, due to the effect of the decrease in the ceiling for recognition of such instruments from 70% to 60%, in accordance with the transitional directives.

Most of the changes in the components of supervisory capital in 2015 resulted primarily from net profit for the period, in the amount of NIS 3,082 million, which was offset by dividend distribution in the amount of NIS 569 million; unrealized losses from securities available for sale, in the amount of NIS 510 million; and a decrease in supervisory capital instruments, in the amount of NIS 1,771 million, due to the effect of the decrease in the ceiling for recognition of such instruments from 80% to 70%, in accordance with the transitional directives

Capital Adequacy

The Bank's Approach to Capital Adequacy Assessment

The Bank applies the capital measurement and adequacy directives based on the Basel 2 and 3 directives, as published by the Supervisor of Banks and as integrated into Proper Conduct of Banking Business Directives 201-211 and the file of questions and answers.

The Basel 2 directives are based on three pillars:

- Pillar 1 – Includes the manner of calculation of the supervisory minimum capital requirements in respect of credit risks, operational risk, and market risk.
- Pillar 2 – Sets forth internal processes (ICAAP – Internal Capital Adequacy Assessment Process) to be used by banks to assess the required capital in respect of risks in aggregate, including those not covered by Pillar 1 (such as credit concentration, interest-rate risk in the banking book, liquidity risks, settlement risks, and strategic risks), as well as a review process to be performed by the Supervisor of Banks.
- Pillar 3 – Market discipline; establishes the type and extent of information to be presented in reporting to the public on the risks to which banks are exposed. This pillar requires the disclosure of both quantitative and qualitative information, in order to enable the market to estimate the extent of the bank's exposure to risk factors.

Basel 3 Directives

The Basel 3 directives took effect on January 1, 2014. Implementation is gradual, in accordance with the transitional directives established in Proper Conduct of Banking Business Directive 299, Capital Measurement and Adequacy – Supervisory Capital – Transitional Directives, in order to make it possible to comply with the new requirements regarding supervisory capital within the process of implementation of Basel 3 and establish a transitional period until full implementation. Among other matters, the transitional directives concern supervisory adjustments and deductions from capital, as well as capital instruments that do not qualify for inclusion in supervisory capital according to the new criteria established in the Basel directives. Specifically, pursuant to the transitional directives, the supervisory adjustments and deductions from capital, as well as non-controlling interests that do not qualify for inclusion in supervisory capital, shall be deducted from capital gradually, at a rate of 20% per annum, from January 1, 2014 to January 1, 2018. Capital instruments that no longer qualify as supervisory capital were recognized as of January 1, 2014, up to a ceiling of 80% of their balance in the supervisory capital as at December 31, 2013; this ceiling is being lowered by an additional 10% in each subsequent year, until January 1, 2022. From January 1, 2016, to December 31, 2016, the rate of deductions from supervisory capital is 60%, and the ceiling for instruments qualifying as supervisory capital is 60%.

Within the implementation of the Basel directives, on April 28, 2015, the Supervisor of Banks issued Proper Conduct of Banking Business Directive 218, Leverage Ratio (hereinafter: the "Directive"). The Directive establishes a simple, transparent, non-risk-based leverage ratio, which will serve as a reliable measurement complementary to risk-based capital requirements, and which is designed to limit the accumulation of leverage at banking corporations.

Implementation and Effect of New Regulatory Directives Regarding Capital Measurement and Adequacy

Housing Loans

Proper Conduct of Banking Business Directive 329, Limits on Housing Loans (hereinafter: the "Directive"), consolidates the guidelines and limits concerning housing loans into a single binding document. The Directive redefines the term "payment as a percentage of income." The Directive states that housing loans with payment as a percentage of income exceeding 50% shall not be approved or executed. In cases in which payment as a percentage of income exceeds 40%, the loan shall be assigned a risk weight of 100%. In addition, the Directive limits the amount of loans for which a reduced risk weight may be assigned, pursuant to Section 72 of Proper Conduct of Banking Business Directive 203, to NIS 5 million. Loans in an amount greater than NIS 5 million shall be weighted at 100%. When the amount of a loan is lower than NIS 5 million, the risk weight may be reduced, in accordance with Section 72 of Directive 203, based on the LTV ratio as calculated when the loan was granted.

A capital requirement at a rate representing 1% of the balance of housing loans at the reporting date has been added to minimum capital ratios as of January 1, 2015, as detailed in the capital-adequacy target.

Capital Requirements and Deduction from Capital in Respect of Deferred Tax Assets

An update of the Supervisor of Banks' file of questions and answers for the implementation of the Proper Conduct of Banking Business Directives concerning capital measurement and adequacy was released in April 2016. The purpose of the update is to clarify the treatment of the wage tax component, in all matters related to the calculation of capital requirements and the deduction from capital in respect of deferred tax assets. According to the clarification, when a banking corporation concludes that, under the circumstances prevailing at the reporting date, a deferred tax asset in the amount of the wage tax included in the Bank's books is virtually certain, it is possible to refrain from applying the threshold deduction noted in Section 13 of the directive to that part of the deferred tax asset. For that purpose, the Bank will be permitted to apply the threshold deduction test to the net amount of deferred tax assets, after deduction of the wage tax, as noted above. The aforesaid deferred tax asset not deducted from capital shall be weighted as a risk asset, at a rate of 250%. The Bank has implemented these instructions beginning with the Financial Statements as at March 31, 2016, prospectively, without adjusting comparative figures, subject to the transitional directives established in Proper Conduct of Banking Business Directive 299 of the Supervisor of Banks.

As at the reporting date, the effect of the implementation of the instructions is an increase of 0.02% in the common equity Tier 1 capital ratio, an increase of 0.02% in the Tier 1 capital ratio, and an increase of 0.01% in the total capital ratio.

Implementation and Effect of New Regulatory Directives Concerning Capital Measurement and Adequacy to be Applied in the Future

Capital Requirements in Respect of Exposures to Central Counterparties (Inception July 1, 2016)

On October 22, 2015, the Supervisor of Banks issued the circular, Capital Requirements in Respect of Exposure to Central Counterparties (hereinafter: the "Circular"). The Circular amends Proper Conduct of Banking Business Directives 203 and 204, with the aim of adjusting these directives to the recommendations of the Basel Committee, in all matters related to capital requirements in respect of exposures of banking corporations to central counterparties. The Circular details the new guidelines that will apply to exposures to central counterparties caused by OTC derivatives, transactions in marketable derivatives on the stock exchange, and securities financing transactions. The guidelines draw a distinction between unqualified central counterparties and qualified central counterparties, and set reduced capital requirements for the latter. Among other matters, the guidelines address the following types of exposures:

- Exposures of a banking corporation that is a member of a clearing house to a central counterparty. In general, these exposures should be assigned a risk weight of 2% (versus an exposure value of zero prior to the amendment).
- Exposures of a banking corporation to a client active on the stock exchange. Pursuant to the amendment, the capital requirement for such exposures should be calculated as though referring to a bilateral transaction, including an allocation of capital in respect of CVA risk. The calculation method used pursuant to the directive up to this point – calculation according to the rules of the stock exchange – will be discontinued.
- Exposures of a banking corporation to a client operating through a clearing-house member.
- Transfers by a banking corporation that is a clearing-house member to a risk fund.
- Collateral deposited by a banking corporation with a clearing-house member or with a central counterparty.
- Exposures to an unqualified central counterparty shall be weighted according to the relevant risk weight for the counterparty, while transfers to a risk fund shall be weighted at 1,250%.

The Circular will apply as of July 1, 2016. The Tel Aviv Stock Exchange can be treated as a qualified central counterparty until June 30, 2017.

The Bank is working to update its method of calculating capital ratios and the leverage ratio in accordance with the aforesaid update of the directive. The Bank is also examining the effect of this update on its capital planning, capital targets, and leverage target.

According to the Bank's estimates, the expected effect of the adoption of the Circular, as at the reporting date, is immaterial.

Improving Operational Efficiency

In January 2016, the Supervisor of Banks issued a letter on the subject, "Improving the operational efficiency of the banking system in Israel" (hereinafter: the "Letter"). Pursuant to the Letter, the board of directors of banking corporations shall formulate a multi-year plan to improve efficiency. Banking corporations that meet the conditions established in the Letter will be granted a concession allowing them to spread the effects of the plan over a period of up to five years in a straight line, for the purposes of the calculation of capital adequacy.

Implementation of the Basel Directives

Implementation of Pillar 1

The implementation of the directives of Pillar 1 includes measurement of the risk exposures used to calculate the required allocation of supervisory capital for these risks.

Table C-6: Methods used by the Bank to calculate supervisory capital for each of the major risk categories

Category	Method used by the Bank
Credit risks	Standardized approach
Market risks	Standardized approach
Operational risk	Standardized approach
Counterparty credit risk	Current exposure approach
Securitization exposures	Standardized approach
Other assets	Based on risk weighting set forth in the Proper Conduct of Banking Business Directives

Implementation of Pillar 2 and the Bank's Approach to the Assessment of its Capital Adequacy

Within the second pillar, the Bank is required to carry out an internal process to assess capital adequacy and establish strategy for ensuring capital adequacy: the Internal Capital Adequacy Assessment Process (hereinafter: "ICAAP"). This process is aimed at ensuring an adequate level of capital in order to support all risks inherent in the Bank's activity, in accordance with the risk appetite policy established and approved by the Board of Directors of the Bank, and in accordance with future plans for development and growth, while developing and applying appropriate risk-management processes. Elements of the process include establishing risk appetite, capital objectives, and capital planning and management processes under a variety of scenarios, including extreme scenarios.

Concurrently, the Supervisor of Banks is required to review and evaluate the ICAAP of the banking corporations, within the Supervisory Review and Evaluation Process (SREP), in order to determine whether the capital and capital objectives are adequate and to require corrective measures where necessary, including through strengthening of corporate governance, risk management, and internal controls. Within this review, the Supervisor may also require corporations to add capital. The supervisory minimum capital ratio required of the bank is established as part of the SREP. The examination of the ICAAP by the Supervisor of Banks constitutes part of the Risk Based Supervision (RBS) working framework, in which the risk profile and quality of risk management at banking corporations are assessed, among other matters.

The Bank submitted its ICAAP document for 2015 to the Bank of Israel at the end of December 2015. In this document, the Bank evaluated risks and the potential effect of its asset mix on its risk profile, and set internal capital objectives based on these evaluations, taking into consideration the supervisory requirements received within the SREP.

Capital Adequacy Target[AI]

On May 30, 2013, the Supervisor of Banks issued a circular to all banking corporations concerning minimum capital ratios, as part of the process of preparation for implementation of the Basel 3 directives. Pursuant to the circular, all banking corporations were required to comply with a minimum common equity Tier 1 capital ratio of 9% by January 1, 2015. In addition, banking corporations of significant importance whose total balance sheet assets on a consolidated basis constitute at least 20% of the total balance sheet assets of the banking system in Israel will be required to maintain a minimum common equity Tier 1 capital ratio of 10%, by January 1, 2017.

The Supervisor also determined that minimum total capital ratios of all banking corporations would stand at 12.5% beginning January 1, 2015, and that in addition, minimum total capital ratios of banking corporations of significant importance shall stand at 13.5% beginning January 1, 2017. The Bank meets the conditions for the definition of a banking corporation of significant importance.

The Supervisor of Banks issued an additional directive on September 28, 2014; pursuant to this directive and the transitional directives for 2014, a capital requirement at a rate representing 1% of the balance of housing loans at the reporting date is added to minimum capital ratios as of January 1, 2015. This requirement is being implemented gradually, over eight quarters, until January 1, 2017. The total effect of this directive, based on the balance of housing loans at the date of the Financial Statements, is estimated at approximately 0.2%.

Accordingly, the minimum common equity Tier 1 capital ratio and the minimum total capital ratio required by the Supervisor of Banks as at January 1, 2017, on a consolidated basis, based on data at the reporting date, will stand at 10.2% and 13.7%, respectively.

On April 20, 2015, the Board of Directors of the Bank resolved to increase the planned common equity Tier 1 capital ratio of the Bank, such that it stands at 10.75% as of December 31, 2017. This objective is congruent with the risk appetite, risk profile, and development and growth plans, as approved for the planned range.

Capital Planning and Management[AI]

Capital planning is an annual process with a rolling planning horizon of three years. Capital management is performed routinely.

Capital planning and management are considered an integral part of the Bank's strategic and financial plan. Capital planning and management are based on the growth plans of the various business units, with the aim of assessing capital requirements during the period of the plan, and are used in the strategic planning process, in connection with feasibility and capital allocation to units, and in alignment with the detailed risk appetite definitions (see Section D below), as established by the Board of Directors of the Bank, subject to regulatory directives. An effective capital-management approach means:

- Efficient allocation of capital during the ordinary course of business of the Bank.
- A robust capital base serving as a cushion against unexpected risks to which the Bank is exposed, supporting business strategy, and allowing compliance at all times with the regulatory minimum capital requirement. For this purpose, the Bank takes into account not only the current status of capital but also future developments in the capital base and in capital requirements.
- The Bank routinely examines its ability to meet the minimum regulatory capital and leverage targets, as well as the internal objectives that have been set while planning and developing its business. Towards that end, planning of balances of risk-adjusted assets and capital movements (including a net profit forecast, a dividend distribution forecast, changes in capital reserves and deductions from capital, the effect of changes in regulation on the capital base, and a plan for the issuance of various capital instruments, among other matters) is performed each year, for a three-year range. This planning takes the business objectives of the Bank into consideration, and includes an examination of the business environment, including several economic scenarios (extreme scenarios and single-factor scenarios). To the best of the Bank's judgment, the Bank is capable of meeting the capital targets that have been established. Each quarter, the Bank performs an evaluation of the changes in the various parameters that affect its ability to comply with its capital targets in the long term, and carries out changes as necessary.

Capital Management Committee[AI]

Capital is managed via a senior management committee, headed by the CFO, with the participation of the heads of the Financial Markets, Corporate Banking, Strategy, Comptrolling, and Risk Management Areas, and other senior officers. Objectives of the committee:

A. To supervise the definition of methodology and construction of infrastructure for advanced capital management at the Bank. The committee formulates methodology and methods of action, and serves as a steering committee for the various initiatives involved in the Bank's transition to advanced capital management. The committee also receives routine updates on the progress of these initiatives and resolves decisions regarding the manner of implementation of advanced capital management concepts at the Bank. Pursuant to the advanced capital management approach, the Bank will:
   - Plan for the long term and formulate recommendations regarding the quantity of capital, structure of capital, and manner of capital allocation and usage.
   - Maximize economic profit and return on equity over time, subject to its strategy, business needs, and risk appetite, taking into consideration the requirements of the various stakeholders.

B. To routinely monitor the capital-adequacy status of the Bank and formulate recommendations for action as necessary. The committee holds regular discussions of the capital-adequacy status and the outlook for the coming months. Periodically, the committee also discusses long-term forecasts. In view of current and long-term needs, the committee formulates recommendations for courses of action for the Board of Management and the Board of Directors in the area of capital raising, optimization of capital usage, and adjustment of the quantity of risk-adjusted assets due to capital limits.

In order to maintain a thorough and effective capital-management process at the Bank, a specialized department manages the Bank's capital, reporting to the CFO. The department oversees routine administration and control of all matters related to the management and planning of capital at the Bank. Within this role, the department's responsibilities include capital planning, control over capital adequacy and compliance with risk-adjusted asset objectives, contingency plans for extreme scenarios, and proactive capital management according to needs. For that purpose, the department is responsible for monitoring developments in regulation in connection with capital management, in Israel and globally, and advanced capital-management methods at banks worldwide. The unit is also responsible for the implementation of methodologies for the measurement of economic capital and economic profitability. These methodologies are used to make decisions according to risk-adjusted returns at the various levels of management at the Bank.

Measurement of Risk Exposures and Capital Requirements

The measurement of exposures to the various risks may change, according to the volume and quality of the portfolio, methodological and regulatory changes, and changes in exchange rates, among other factors, and depending on the definition of the exposure: financial reporting according to GAAP, establishment of supervisory capital, or the Bank's internal exposure management needs. Risk exposures presented below are based on the rules defined for the calculation of the supervisory capital required in order to support these risks.

Table C-7: Information regarding risk-adjusted assets and regulatory capital requirements in respect of credit risk, market risk, and operational risk (as noted in Proper Conduct of Banking Business Directives 201-209)

	March 31, 2016		March 31, 2015		December 31, 2015	
	Risk-adjusted assets	Capital requirements(1)	Risk-adjusted assets	Capital requirements(1)	Risk-adjusted assets	Capital requirements(1)
	NIS millions					
Credit risk						
Sovereign debt	**1,959**	**247**	2,601	325	2,115	266
Debts of public-sector entities	**3,233**	**407**	3,120	390	3,138	394
Debts of banking corporations	**5,607**	**706**	7,397	925	5,535	696
Debts of corporations	**127,461**	**16,047**	135,316	16,915	131,054	16,473
Debts secured by commercial real estate	**63,656**	**8,014**	58,426	7,303	63,500	7,982
Retail exposures to individuals	**46,337**	**5,834**	41,611	5,201	45,427	5,710
Loans to small businesses	**7,483**	**942**	6,320	790	7,219	907
Housing loans	**37,337**	**4,701**	32,773	4,097	35,849	4,506
Securitization	**94**	**12**	100	13	98	12
Other assets	**19,222**	**2,420**	20,115	2,514	19,431	2,442
CVA risk	**4,588**	**578**	4,972	622	4,525	569
Total in respect of credit risk	**316,977**	**39,908**	312,751	39,095	317,891	39,957
Market risks	**5,120**	**645**	5,194	649	4,562	573
Operational risk	**22,772**	**2,867**	22,273	2,784	22,671	2,850
Total risk-adjusted assets in respect of the various risks	**344,869**	**43,420**	340,218	42,528	345,124	43,380
Common equity Tier 1 capital	**33,602**		32,069		33,246	
Tier 1 capital	**35,067**		33,778		34,955	
Total capital	**48,079**		48,261		49,548	
	%					
Ratio of common equity Tier 1 capital to risk-adjusted assets	**9.74%**		9.43%		9.63%	
Ratio of Tier 1 capital to risk-adjusted assets	**10.17%**		9.93%		10.13%	
Ratio of total capital to risk-adjusted assets	**13.94%**		14.19%		14.36%	
Minimum common equity Tier 1 capital ratio required by the Supervisor of Banks	**(2)9.09%**		(2)9.00%		(2)9.07%	
Minimum total capital ratio required by the Supervisor of Banks	**(2)12.59%**		(2)12.50%		(2)12.57%	

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Supervisor of Banks, at 12.59% as at March 31, 2016; 12.57% as at December 31, 2015; and 12.5% as at March 31, 2015.

(2) The minimum required common equity Tier 1 capital ratio and the minimum required total capital ratio are 9% and 12.5%, respectively, from January 1, 2015, to December 31, 2016; and 10% and 13.5%, respectively, beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to these ratios at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum common equity Tier 1 capital ratio and the minimum total capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 10.2% and 13.7%, respectively. With regard to the balance of housing loans, see Note 13A(2) to the Condensed Financial Statements as at March 31, 2016.

Table C-8: Risk-adjusted assets by segment of activity[AI]

	March 31, 2016										
	Households	Private banking	Small businesses and microbusinesses	Mid-sized businesses	Large businesses	Institutional entities	Financial management	Private individuals - overseas	Corporate activity - overseas	Other	Total
	NIS millions										
Credit risk											
Activity in Israel	**82,155**	**3,204**	**53,098**	**32,976**	**91,103**	**5,599**	**17,983**	**-**	**-**	**4,070**	**290,188**
Activity abroad	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5,360**	**21,429**	**-**	**26,789**
Total credit risk assets	**82,155**	**3,204**	**53,098**	**32,976**	**91,103**	**5,599**	**17,983**	**5,360**	**21,429**	**4,070**	**316,977**
Market risk	**-**	**-**	**-**	**-**	**-**	**-**	**5,120**	**-**	**-**	**-**	**5,120**
Operational risk	**7,195**	**495**	**4,305**	**1,413**	**3,584**	**372**	**2,351**	**777**	**1,053**	**1,227**	**22,772**
Total risk-adjusted assets	**89,350**	**3,699**	**57,403**	**34,389**	**94,687**	**5,971**	**25,454**	**6,137**	**22,482**	**5,297**	**344,869**

	December 31, 2015										
	Households	Private banking	Small businesses and microbusinesses	Mid-sized businesses	Large businesses	Institutional entities	Financial management	Private individuals - overseas	Corporate activity - overseas	Other	Total
	NIS millions										
Credit risk											
Activity in Israel	79,812	2,929	51,340	33,292	92,539	5,978	20,731	-	-	3,794	290,415
Activity abroad	-	-	-	-	-	-	-	5,843	21,633	-	27,476
Total credit risk assets	79,812	2,929	51,340	33,292	92,539	5,978	20,731	5,843	21,633	3,794	317,891
Market risk	-	-	-	-	-	-	4,562	-	-	-	4,562
Operational risk	6,872	503	4,251	1,434	3,113	247	3,260	777	848	1,366	22,671
Total risk-adjusted assets	86,684	3,432	55,591	34,726	95,652	6,225	28,553	6,620	22,481	5,160	345,124

Change in Risk-Weighted Assets During the Period[AI]

Table C-9: Statement of changes in risk-weighted assets during the period[AI]

	For the three months ended March 31, 2016			
	Credit risk	Market risk	Operational risk	Total risk-adjusted assets
	NIS millions			
Balance as at December 31, 2015	**317,891**	**4,562**	**22,671**	**345,124**
Changes in portfolio volume[(1)]	**1,164**	**558**	**101**	**1,823**
Changes in portfolio quality[(2)]	**(196)**	**-**	**-**	**(196)**
Changes in methodology and policy[(3)]	**63**	**-**	**-**	**63**
Sales[(4)]	**-**	**-**	**-**	**-**
Effect of changes in exchange rates	**(1,945)**	**-**	**-**	**(1,945)**
Balance as at March 31, 2016	**316,977**	**5,120**	**22,772**	**344,869**

	For the year ended December 31, 2015			
	Credit risk	Market risk	Operational risk	Total risk-adjusted assets
	NIS millions			
Balance as at December 31, 2014*	311,329	5,269	22,275	338,873
Changes in portfolio volume[(1)]	8,933	(707)	396	8,622
Changes in portfolio quality[(2)]	(284)	-	-	(284)
Changes in methodology and policy[(3)]	(1,364)	-	-	(1,364)
Sales[(4)]	(349)	-	-	(349)
Effect of changes in exchange rates	(374)	-	-	(374)
Balance as at December 31, 2015	317,891	4,562	22,671	345,124

* As reported excluding the effect of the adoption of US GAAP regarding employee benefits, which took effect on January 1, 2015.

(1) The category "changes in portfolio volume" refers to changes in the size of the portfolio, excluding changes resulting from change in the quality of the portfolio.

(2) The category "changes in portfolio quality" mainly refers to changes in the risk weight of transactions and customers resulting from changes in credit rating or classification.

(3) The category "changes in methodology and policy" mainly refers to the effect of changes in regulatory directives and changes in methodologies.

(4) For the year ended December 31, 2015, the category "sales" refers to the effect of the sale of 100% of the share capital of Bank Pozitiv Kazakhstan JSC, which was a fully consolidated subsidiary until December 30, 2015.

Leverage Ratio

On April 28, 2015, the Supervisor of Banks issued Proper Conduct of Banking Business Directive 218, Leverage Ratio (hereinafter: the "Directive"). The Directive establishes a simple, transparent, non-risk-based leverage ratio, which will serve as a reliable measurement complementary to risk-based capital requirements, and which is designed to limit the accumulation of leverage at banking corporations.

The leverage ratio is expressed as a percentage, and is defined as the ratio of the capital measurement to the exposure measurement. Capital, for the purpose of measurement of the leverage ratio, is Tier 1 capital, as defined in Proper Conduct of Banking Business Directive 202, taking into consideration the transitional arrangements that have been established. The total exposure measurement is the total of balance sheet exposures, exposures to derivatives and to securities financing transactions, and off-balance sheet items. In general, the measurement is consistent with accounting values, and risk weights are not taken into account. In addition, physical or financial collateral, guarantees, or other credit risk mitigation techniques cannot be used to reduce the exposure measurement, unless otherwise noted in the Directive. Balance sheet assets deducted from Tier 1 capital (in accordance with Proper Conduct of Banking Business Directive 202) are deducted from the exposure measurement. Pursuant to the Directive, exposure in respect of derivatives is calculated in accordance with Appendix C to Proper Conduct of Banking Business Directive 203; exposures in respect of off-balance sheet items are calculated by converting the notional amount of the items using credit conversion coefficients, as established in Proper Conduct of Banking Business Directive 203.

Pursuant to the Directive, banking corporations shall maintain a leverage ratio of no less than 5% on a consolidated basis. Banking corporations whose total balance sheet assets on a consolidated basis constitute 20% or more of the total balance sheet assets in the banking system shall maintain a leverage ratio of no less than 6%. Based on the foregoing, the minimum required leverage ratio for the Bank will be 6%.

Banking corporations are required to maintain this leverage ratio as of January 1, 2018. Banking corporations that comply with the applicable minimum leverage ratio requirement at the date of publication of the Directive shall not lower the ratio below the threshold established in the Directive.

The leverage ratio of the Bank and of significant subsidiaries in Israel is calculated according to Proper Conduct of Banking Business Directive 218, Leverage Ratio. The leverage ratio of banking subsidiaries overseas is stated according to the regulatory directives and required ratios in each jurisdiction, where applicable.

Table C-10: Leverage ratio

	March 31, 2016	December 31, 2015
	NIS millions	
A. Consolidated data		
Tier 1 capital	**35,067**	34,955
Total exposures	**493,049**	492,192
	%	
Leverage ratio	**7.11%**	7.10%
Minimum leverage ratio required by the Supervisor of Banks	**6.00%**	6.00%
B. Significant subsidiaries		
Isracard		
Leverage ratio	**12.35%**	12.11%
Minimum leverage ratio required by the Supervisor of Banks	**5.00%**	5.00%
Bank Hapoalim Switzerland*		
Leverage ratio	**9.63%**	10.00%
Bank Pozitif		
Leverage ratio	**13.38%**	12.60%
Minimum required leverage ratio according to local regulation	**3.00%**	3.00%

* Local regulation in Switzerland does not impose a minimum leverage ratio requirement.

Table C-11: Comparison of balance sheet assets to exposure measurement, for the purposes of the leverage ratio

	March 31, 2016	December 31, 2015
	NIS millions	
Total consolidated assets as per published financial statements	**434,905**	431,638
Adjustment for investments in banking, financial, insurance, or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	**-**	-
Adjustment for fiduciary assets recognized on the balance sheet pursuant to the Public Reporting Directives, but excluded from the leverage ratio exposure measurement	**-**	-
Adjustments for derivative financial instruments	**(6,650)**	(5,454)
Adjustments for securities financing transactions	**-**	-
Adjustments for off-balance sheet items	**61,541**	62,798
Other adjustments	**3,253**	3,210
Exposure for the purposes of the leverage ratio	**493,049**	492,192

Table C-12: Leverage ratio disclosure

	March 31, 2016	December 31, 2015
	NIS millions/percent	
On-balance sheet exposures		
On-balance sheet items (excluding derivatives and securities financing transactions, but including collateral)	**424,165**	422,040
Asset amounts deducted in determining Tier 1 capital	**(29)**	(108)
Total on-balance sheet exposures (excluding derivatives and securities financing transactions)	**424,136**	421,932
Derivative exposures		
Replacement cost associated with all derivatives transactions	**3,896**	3,578
Add-on amounts for potential future exposure associated with all derivatives transactions	**5,554**	5,813
Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the Public Reporting Directives	**-**	-
Deductions of receivables assets for cash variation margin provided in derivatives transactions	**(2,249)**	(2,185)
Exempted central counterparty leg of client-cleared trade exposures	**-**	-
Adjusted effective notional amount of written credit derivatives	**132**	137
Adjusted effective notional offsets and add-on deductions for written credit derivatives	**-**	-
Total derivative exposures	**7,333**	7,343
Securities financing transaction exposures		
Gross securities financing transaction assets (with no recognition of netting), after adjusting for sale accounting transactions	**39**	119
Netted amounts of cash payables and cash receivables of gross securities financing transaction assets	**-**	-
Central counterparty credit risk exposure for securities financing transaction assets	**-**	-
Agent transaction exposures	**-**	-
Total securities financing transaction exposures	**39**	119
Other off-balance sheet exposures		
Off-balance sheet exposure at gross notional amount	**183,915**	191,347
Adjustments for conversion to credit equivalent amounts	**(122,374)**	(128,549)
Off-balance sheet items	**61,541**	62,798
Capital and total exposures		
Tier 1 capital	**35,067**	34,955
Total exposures	**493,049**	492,192
Leverage ratio		
Leverage ratio pursuant to Proper Conduct of Banking Business Directive 218	**7.11%**	7.10%

D. Risk Assessment and Management

The Bank's activity is accompanied by the following financial risks: credit risks (including concentration risk and counterparty risk), market risks (including exchange-rate risk and interest-rate risk in the banking book), investment risk (share and credit spread risk), and liquidity risk (including financing risk).

Other non-financial risks are mainly compliance risk, legal risk, and operational risks. Additional risks to which the Bank is exposed are handled directly as part of the management of its business: reputational risk, competitive risk, regulatory and legislative risk, economic risk, strategic risk, and environmental risk. The risk-management strategy of the Bank Group is designed to support the achievement of the strategic objectives of the Group as a whole, while identifying and quantifying risks, establishing risk ownership, and maximizing business value, taking into consideration costs in terms of risk, by every responsible function at all levels of the organization. Risk management at the Bank is based on a uniform methodology, from a comprehensive perspective, adapted to regulatory requirements, with the aim of supporting rational risk-taking in order to maximize the Group's profitability at a risk level aligned with its risk appetite. The Bank has defined the following risks as material risks: credit risk, market risk, investment risk, compliance risk, operational risk, concentration risk, counterparty risk, interest-rate risk in the banking book, liquidity risk, reputational risk, strategic risk, and regulatory risk.

Risk Management System Structure and Organization

Risk management is performed based on a global view of the Bank's activity in Israel and of activity at the Bank's branches abroad, with due attention to the activity of subsidiaries with significant exposure for the Group. Risks are managed separately by each subsidiary in the Bank Group, according to policy formulated by each company's board of directors and presented to the Board of Directors of the Bank. The Bank manages the various risks, using hedges for some risks, as detailed below. Risk control and the assessment of financial risks and operational risks are performed based on a uniform methodology at the Group level, under the direction of the Risk Management Area, taking into account the unique characteristics of the activity of each subsidiary.

The Supervisor of Banks has set forth guidelines concerning risk management in the Proper Conduct of Banking Business Directives. The directives detail the requirements of the Supervisor for the management of the various risks to which a banking corporation is exposed, and stipulate basic principles for the management and control of risks, including suitable involvement in and thorough understanding of risk management by the board of directors of the banking corporation, the management of risks by a risk manager who is a member of the board of management, the employment of tools for the identification and measurement of risks, and the creation of means for supervision and control, including the existence of an independent risk-control function. The Bank operates in accordance with the guidelines of the Supervisor of Banks.

The approach taken with regard to control of all financial and operational risks at the Bank involves identification and assessment of the risks, and control of compliance with risk-appetite limits and with additional limits stipulated in the various internal regulations, through three lines of defense:

1. The first line of defense includes the business units within the Areas, including supporting and operational units, that create or take risks, as well as the internal control units within the Areas that provide internal control over the risk creators and risk takers. The management of the business line bears the initial responsibility for routine risk management, aimed at managing risks while striving to achieve strategic goals and business objectives, within the established risk appetite and in accordance with the internal risk regulations and regulatory directives. Controls in the first line of defense are formalized in working procedures.
2. The second line of defense consists of the control units at the Risk Management Area, which is independent of the business Areas. This line is also responsible for presenting an overview of risks; formulating methodologies for risk assessment and for economic capital allocation; independent risk assessment; analysis of the congruence of products and activities with the level of risk appetite and risk capacity established by the Board of Directors; and validating models. The second line of defense contains additional independent control functions, such as accountancy, legal counsel, the secretariat of the Bank, and human resources.
3. The third line of defense consists of the Internal Audit system, which operates independently and objectively. Its goals include assisting the organization in achieving its goals through supervision and through ensuring that the instructions of the Board of Management and of the Board of Directors are implemented, and making recommendations for the reduction of risks through improved controls.

The Board of Directors of the Bank is responsible for delineating the overarching risk strategy and supervising the risk-management framework of the Group, directly or through the Risk Management and Control Committee. Main duties of the Board of Directors in the area of risk management:

- Setting limits for the risk appetite and risk capacity of the Group.
- Approving a risk-management policy consistent with the risk appetite limit, including the establishment of risk limits in the various areas of activity and main risk areas.
- Approving the control philosophy structure for the Group and ensuring that it meets risk-management needs.
- Providing clear guidance to senior management with regard to risk management, based on the recommendations of the Board of Management Risk Management Committee, headed by the CEO, and ensuring that senior management takes the necessary actions in order to identify, measure, monitor, and control risks.
- Approving methodologies for risk assessment and control, and for the allocation of economic capital in respect of risks.
- Supervising and monitoring the implementation of the established risk-management policy, examining the actual risk profile, and examining the processes and actions that the Bank must apply in order to comply with all regulatory directives concerning risk management.

The Board of Management is responsible for formulating, instilling, and implementing the risk-management framework of the Group, directly or through committees acting on its behalf. Main duties of the Board of Management in the area of risk management:

- Designing a risk-management policy consistent with the risk-appetite framework established by the Board of Directors, including risk limits in the various areas of activity and key risk areas, and submitting this policy to the Board of Directors for approval.
- Establishing internal regulations and risk limits aligned with the policy, appropriate work methods for risk assessment, and decision-making processes based on an analysis of return / business benefit and risk, and receiving the appropriate reports, while ensuring compliance with risk-management policy objectives.
- Ensuring the existence of an internal process for capital assessment and for setting capital targets consistent with the risk profile of the corporation and with its control environment.
- Ensuring the existence of adequate resources for risk management at the corporation, including a framework of internal controls, and the existence of comprehensive, effective, independent control and reporting systems for risks.

The Chief Risk Officer (CRO) and the member of the Board of Management responsible for the Risk Management Area is Mr. T. Cohen.

Financial risks are managed by designated members of the Board of Management and under their responsibility. The members of the Board of Management responsible for managing credit risks are Mr. J. Orbach, Head of Corporate Banking, and Mr. R. Stein, Head of Retail Banking. The member of the Board of Management responsible for managing market, investment, and liquidity risks is Mr. D. Koller.

Legal risk is managed by the Chief Legal Advisor, Attorney I. Mazur. Technological risk is managed by Ms. E. Ben-Zeev, Head of Information Technology.

Operational risk, excluding legal risk and technological risk, is managed by each member of the Board of Management in the area of activity for which he or she is responsible.

For further information regarding changes in the structure of the Board of Management of the Bank, see the section "Other Matters" in the Corporate Governance Report.

Diagram D-1: Risk management governance diagram of the Bank[AI]

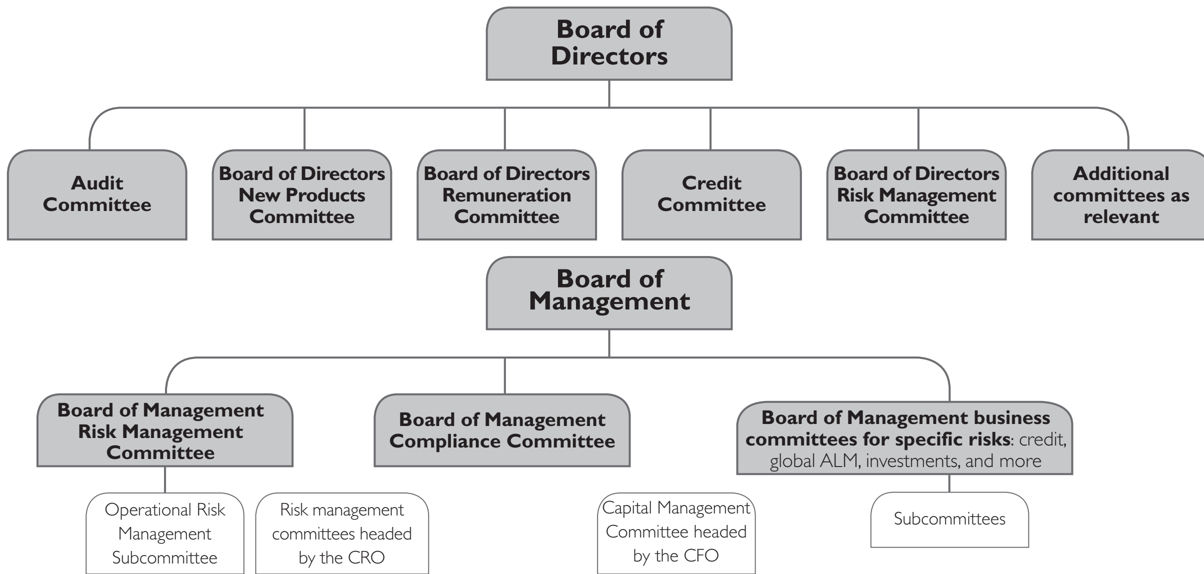
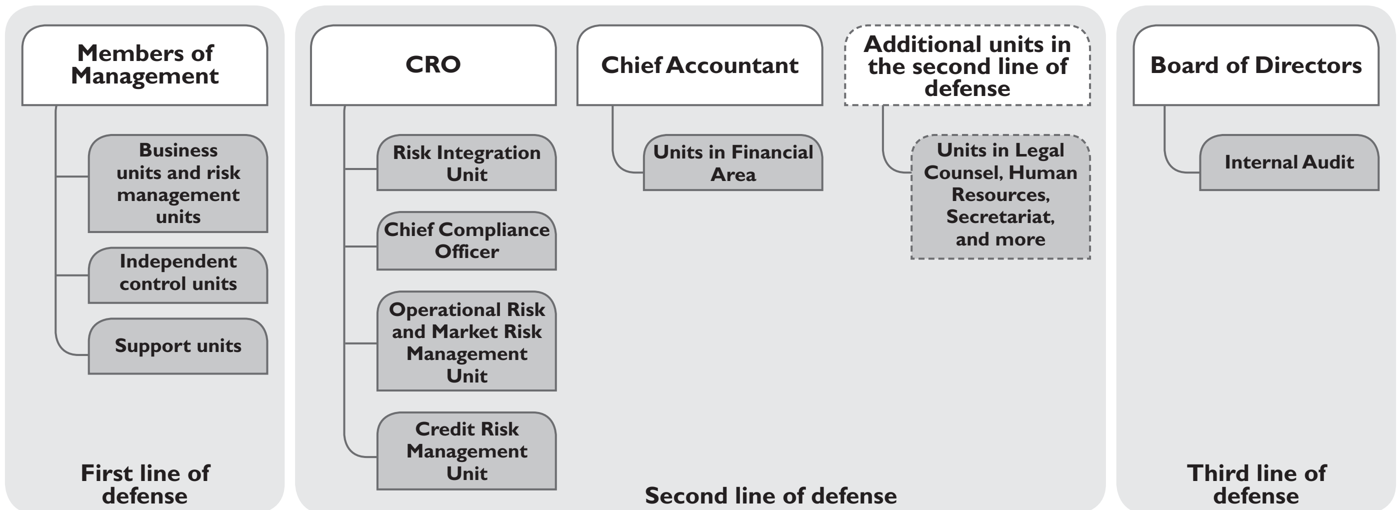


Diagram D-2: Risk management organizational structure of the Bank[AI]



The Board of Directors' Committee on Risk Management and Control – A Board of Directors' Committee on Risk Management is in operation at the Bank. The committee's mission is to formulate the Bank's risk-management policy, including establishing risk limits in the various areas of activity, examining the Bank's risk profile, monitoring the implementation of the established risk-management policy, and examining the processes and actions to be implemented by the Bank in order to comply with all regulatory directives concerning risk management. The Board of Directors' Committee on Risk Management and Control and the plenum of the Board of Directors receive reports on risks and on the execution of approved policies at least once each quarter.

The Credit Committee – Among its other responsibilities, the committee makes recommendations to the Board of Directors with regard to the Bank's credit policy; assists the Board of Directors in supervising and monitoring various matters in the area of credit; and examines and approves credit classifications and the allowance for credit losses, in accordance with a hierarchy of authority. The committee also approves certain credits, according to the hierarchy of authority at the Bank.

Additional committees of the Board of Directors are engaged in matters related to risk management, most notably the Board of Directors' Remuneration Committee, the Audit Committee, and the Board of Directors' New Products Committee. For further details regarding the activity of the Board of Directors and of the Board Committees, see the Corporate Governance Report.

The Board of Management Committee on Risk Management Headed by the CEO – Responsible for planning the Bank's risk-management policy, risk limits, and reporting and control procedures, and for examining the Bank's overall risk profile and the interactions among the various risk types and factors. The committee submits its reports or recommendations for approval to the committees of the Board of Directors and/or to the plenum of the Board of Directors, as relevant.

The Board of Management Committee on Compliance Headed by the CEO – The committee works to strengthen compliance at the Bank Hapoalim Group and ensure it is accorded high priority. The committee discusses the compliance policy established by the Board of Directors, the implementation of the policy in practice, and the closure of gaps.

The committees of the Board of Management listed in the diagram above operate in specific areas of risk, within the risk policies and limits established by the Board of Directors and the Board Committees.

Risk Management Area – The activities and responsibilities of the Area are consistent with Proper Conduct of Banking Business Directive 310. The primary objective of the Risk Management Area at Bank Hapoalim is to instill an advanced culture of risk management and monitoring at the Bank Group, while formulating risk-management policies and methodologies in line with the goals of the Group and with the Basel directives and the relevant local regulation. The Area ensures the existence and quality of the key risk-management processes of the Group: identification and assessment of risks, establishment of risk capacity and risk appetite limits, establishment of control mechanisms, monitoring of risks, and reporting. The Area leads and coordinates the ICAAP (the annual Internal Capital Adequacy Assessment Process, taking risks into account) and is an active participant in capital management.

The Risk Management Area also operates several committees, headed by the Chief Risk Officer:

Stress Scenarios and Risk Concentrations Committee – The committee's role is to approve methodologies in the area of stress scenarios and concentration risk, and to manage the process of testing stress scenarios and concentration risk at the Bank.

Operational Risk Management Subcommittee – The subcommittee coordinates the activities necessary in order for the Group to comply with the Proper Conduct of Banking Business Directives of the Bank of Israel and with the recommendations of the Basel Committee in the area of operational risk, and reviews the operational risk profile of the Group, with due attention to findings, surveys, reports, and related activities.

Credit Review Committee – The committee discusses credit review reports prepared for major borrowers of Bank Hapoalim and for risk-based samples of the overall credit portfolio of the Bank, and examines the reliability of the credit rating and the fairness of the classifications and allowances of the Group.

Validation Committee – The committee is responsible for monitoring the status of progress on the plan for validation and improvement of the models in use, related validation studies, and monitoring and approval of the set of material models in use.

Board of Management Committee on Debt Classification and Determination of Allowance for Credit Losses – The committee is engaged in formulating a methodology for the collective allowance, formulating policy for classifications and individual allowances, credit classifications, and determining individual allowances for credit losses, subject to the hierarchy of authority.

Policy Steering Committee – The committee formulates the credit policy of the Bank.

Board of Management Specialized Committee for Financial Crises – Whenever focused treatment is necessary for a material financial crisis with organization-wide consequences, pursuant to a resolution of the Board of Management, this committee shall convene to address and monitor the crisis and its consequences.

Risk Management Culture[AI]

The Group develops and maintains a risk-management culture that supports awareness of risk, appropriate behavior and judgment in connection with risk taking in the context of corporate governance, and effective risk management; promotes appropriate risk taking; and ensures that emerging risks or risk-taking activities are identified, assessed, escalated, and addressed in a timely manner.

The risk culture instilled at the Bank Group emphasizes the importance of: achieving the proper balance between risk and compensation, in alignment with the risk appetite of the Bank; an effective system of controls congruent with the scale and complexity of the Bank; the ability to challenge the quality of risk models, the level of accuracy of the data, the ability of the available tools to measure risks correctly, and the justifications for taking risks; monitoring violation of limits and divergence from established policies, and application of proportional disciplinary proceedings, as necessary; cultivating integrity, with a focus on fair service to customers.

The essential principles of the Bank's risk culture are also expressed in the implementation of the following guidelines:

- The members of the Board of Directors and senior management delineate the core values of the Bank and the expectations for its risk culture, and their conduct reflects the values that have been adopted: integrity, and rapidly addressing any instances of noncompliance that come to light.
- The members of the Board of Directors and Board of Management develop and apply an effective framework of risk appetite, backed by a clear declaration of risk appetite, as detailed below, which is the cornerstone of the Bank's risk-management strategy and is integrated with its overall business strategy.

Risk appetite: Risk appetite at the Bank constitutes an effective framework for risk management and a key tool linking the organization's strategy, capital allocation, and risk management. The risk appetite document declares the risk appetite of the Bank and of the Group. The Board of Directors establishes the risk appetite framework, taking into consideration the recommendations of the Chief Executive Officer, the Chief Risk Officer, and the Chief Financial Officer, who translate these expectations into targets and limits for the business lines. The risk appetite document also establishes the roles and responsibilities of the Board of Directors and senior management in formulating the risk appetite statement. The risk appetite framework includes policies, processes, controls, and systems used to implement, communicate, and supervise risk appetite.

The risk appetite framework includes a statement of risk appetite and risk capacity, risk limits, and descriptions of the roles and responsibilities of those charged with the implementation and control of the risk appetite framework. The risk appetite framework refers to the material risks to the Bank, and establishes the risk profile in alignment with the Bank's business strategy and risk capacity. An effective risk appetite framework provides a shared structure and means for senior management and the Board of Directors to communicate, understand, and evaluate the level of risk that they are willing to accept. The framework explicitly defines the boundaries within which the Board of Management is expected to operate in order to realize the business strategy of the Bank.

The framework includes the following main components:

- Risk appetite statement: Written formulation of the size and types of aggregate risk that the Bank is interested in bearing in order to achieve its business objectives, including qualitative reports as well as quantitative metrics of profits, capital, risk indicators, liquidity, and other relevant means, as necessary.
  - Risk capacity: The maximum level of risk that the Bank is able to sustain without violating capital limits relevant to stress tests, including from the perspective of shareholders and customers. Compliance with the risk capacity shall be examined, among other matters, by applying stress tests designed to estimate the impact on the Bank's profit and capital adequacy as a result of the materialization of a stress scenario.
  - Risk appetite: The maximum total aggregate risk that the banking corporation is willing to bear, within its defined risk capacity, in order to achieve its business objectives in accordance with the strategic plan, under various constraints (such as sources of capital and liquidity, regulatory requirements, risk/return attributes, etc.).
  - Risk limits: Quantitative metrics based on forward-looking assumptions, which give practical expression to the aggregate risk appetite statement of the Bank.
- Remuneration: Documents of principles and standards for remuneration practices are aimed at ensuring effective remuneration management; correlation between remuneration, cautious risk taking, and effective supervision; and involvement of interested parties in remuneration. The remuneration of employees in general, and of senior executives in particular, takes into consideration the risks taken by the employee on behalf of the Bank, and the employee's performance in terms of fulfillment of the risk policy, compliance, and other important policy rules of the Group. The Risk Management Area is involved in establishing remuneration policies and incentives, such as to encourage performance and talent management, and reinforce the desired risk-management behavior (see the section "Remuneration of Employees" in the Report on Risks as at December 31, 2015).
- Responsibility: The risk regime is aimed at achieving full clarity regarding risk ownership, at all levels and in all processes.
- Effective communication and criticism: The risk culture of the Group promotes an environment of effective, open, critical communication, and encourages an environment of open, constructive involvement.

- An orderly system of internal regulations of the Bank, including limits, authorizations, and escalation processes supporting risk management. Appropriate procedures exist for anonymous reports of suspicions, and employees can use these channels without concern in order to support effective compliance with the risk-management framework.
- The ethical conduct code of the Bank summarizes standards, morals, colleague relationships, relationships with customers and suppliers, contribution to the community, and social and environmental responsibility.

The following risk management policy documents establish, among other matters, corporate governance, including the duties and responsibilities of the Board of Directors, the Chief Risk Officer, and the risk-management function; the corporate-governance framework for risk management; and the status, resources, authority, and independence of the risk management and internal audit functions, and their reports to the committees and to the Board of Directors.

- Risk appetite document;
- Group risk management policy;
- Credit risk management policy document;
- Treasury risk management policy document;
- Operational risk management policy document;
- Policy document – control approach;
- Policy document – compliance officer;
- Counterparty risk management policy document;
- Charter of the Risk Management Area;
- Charters of the committees of the Board of Directors and committees of the Board of Management.

The structure and organization of the risk system and the risk culture described in this section are applicable to all types of risks and to all units of the Bank. Each type of risk is addressed further, separately, as relevant, later in this report.

Credit Risk

Credit risk is the risk that a borrower or debtor may default on obligations to the Bank under a credit agreement. The credit portfolio is a major component of the asset portfolio of the Bank Group; therefore, deterioration in the stability of the various borrowers may have an adverse effect on the Group's asset value and profitability.

Activities that create credit risk include:

1. Balance sheet exposures:
   Current liabilities to the Bank, such as credit and mortgages to the public, credit to banks and deposits with banks, credit to governments, investment in bonds (corporate and other), and the balance sheet part (present value) of derivatives and financial instruments.
2. Off-balance sheet exposures:
   Potential (unrealized) liabilities to the Bank, such as guarantees, unutilized commitments to grant credit, unutilized credit facilities, and potential liabilities arising from changes in the value of transactions in derivatives and financial instruments.

Another risk arising from the portfolio of credit exposures is concentration risk. Concentration risk arises from non-optimal diversification of specific risks in the credit portfolio, such that the credit portfolio is insufficiently diversified across the various risk factors; for example, when the credit portfolio is composed of a small number of borrowers (borrower concentration) or has high exposure to a particular sector (sector concentration).

Management of Credit Risks

The goal of credit-risk management is to allow the Group to operate, and to ensure that it operates, in accordance with the policies and strategic objectives established and within the risk appetite defined in the area of credit, from the level of the single transaction to the overview of the credit portfolio.

The Bank's credit risk management policy is based on diversification of the credit portfolio and controlled management of risks. Risk diversification is reflected by the distribution of the Bank's credit portfolio among a large number of borrowers in different sectors of the economy, among the different linkage segments, and among different geographical regions overseas. The policy of distributing risks among economic sectors is based on an evaluation of anticipated developments in the different sectors. For this purpose, the Bank conducts industry-level surveys and economic feasibility studies to evaluate the risk and business potential related to activity in the various economic sectors. The Bank's business objectives are determined in accordance with these surveys and studies.

The credit management system monitors customers' credit exposure. Credit review systems identify, monitor, and report to the responsible function and to managers on negative signs related to borrowers.

Credit risk management is based on the following principles:

1. Independence – The principle of independence is an essential element of proper corporate governance, in order to prevent conflicts of interest and create a system of checks and balances. The goal of this principle is to ensure that the information regarding risks reported to management functions, and in particular to senior management and the Board of Directors, is objective and is not influenced by other considerations, in particular considerations of business success and remuneration for such success.
2. Hierarchy of authority – The Bank has a hierarchy of authority that outlines a sequence of credit authorizations, according to the level of debt of the borrower or group, the risk rating, and problematic debt classifications, allowing control over the process of approving new credit transactions. The hierarchy of authority provides a definition of individual credit approval thresholds and thresholds for transfer to approval committees, as well as the composition of such committees.
3. Comprehensive view of the customer/group – Management of risk groups encompassing several borrowers who are related in terms of risk, such as a company and its subsidiaries, a married couple, etc. The activity of customers and groups is overseen by a customer manager who is responsible for all activities of that borrower/group. Information systems continuously provide customer managers and their staff with a comprehensive view of the activity of the customer/group, including the level of credit risk, and in accordance with Proper Conduct of Banking Business Directive 313.
4. Credit policies – The Board of Directors of the Bank sets forth the credit policy, which is examined and updated routinely, according to changes in the financial markets and in the economy. This policy includes various limits on the credit portfolio, in accordance with the risk appetite of the Bank, including exposure limits by economic sector, country, or financial institution, as a function of the risk level assessed by the Bank. Limits are also imposed on the maximum exposure to a single borrower, according to the credit rating assigned to the borrower, which reflects the borrower's risk level, as well as a maximum limit for a group of borrowers. Credit policy includes the credit risk management policy of the corporation; it formalizes and defines the rules applicable to all parties at the Bank involved with credit risk, and is designed to serve the business goals of Bank Hapoalim, in alignment with its risk policy and risk appetite, and in compliance with regulatory directives.

Credit policy documents delineate the aspects relevant to each Area (customer type, economic sector, purpose of the loan, etc.), taking risk levels into consideration. Adherence to the guidelines of the credit policy in carrying out business operations allows rational management of credit and credit exposures, and serves as a tool for the management of credit risks. The credit policies and procedures are binding for everyone involved in the area of credit at the Bank. The policy specifies the principles and considerations related to credit granting, the authority to grant credit, prohibitions and limits applied to credit granting, and the internal regulations that establish the Bank's practices and principles in the areas of credit and collateral. The Risk Management Area is responsible for the overall policy of the Bank, and for formulating and coordinating the policies of the business units.

5. Controls and risk identification – The process of reviewing and identifying credit risks is conducted by the three lines of defense. Controls are applied from the level of each individual credit item to the level of the portfolio, in the first and second lines of defense, according to materiality thresholds. The Credit Risk Management Unit leads and coordinates reports to the Board of Management and Board of Directors regarding trends and changes in the credit portfolio, including the level of credit risk in the portfolio, compliance with limits, special events, analysis of concentration, stress scenarios, and a presentation of general risk indicators, in Israel and globally.

   In the third line of defense, Internal Audit is responsible, among other matters, for reviewing the implementation and effectiveness of risk-management procedures and risk-assessment methodologies, including the implementation of risk management and control policies at the Bank. The identification of credit risk in existing products is based on risk management, measurement, and control processes at the various levels. The identification of risk in new products relies on the policy for new products, which specifies the processes to be followed for each new product at the Bank in order to identify all risks involved in the product, assess the extent and materiality of such risk, and provide solutions for the measurement, control, and hedging of the risk. A quarterly and annual process has been designed in order to identify risk concentrations and examine the potential implications of various shocks (financial, political, and others) for the financial robustness of the Bank. This process includes definition, examination, and reporting of the results of stress scenarios, and mapping of the effects on profit and on capital adequacy.
6. Credit risk is quantified and measured on several levels: the level of the individual borrower, borrower groups by area of activity, sectors of the economy, segments of borrowers, products, and the overall portfolio of the Bank and of the Group. Processes for risk quantification and measurement and for the ranking of borrowers and of credit have been developed and implemented for each area of activity and type of credit. These processes combine assessments by credit experts with decision-making processes and advanced statistical models.
7. Identification and treatment of borrowers in distress – The Bank has established policies and procedures for the identification and handling of borrowers in distress, including work processes for the identification and treatment of problematic credit, and examination of the fairness of the classification and allowance for such borrowers (for details, see the section "Problematic Debts and Borrowers in Distress").
8. Uniform instruction and training – Employees involved in the area of credit undergo training and instruction on credit, foreign trade, and mortgages. These sessions provide uniform training to all those involved in this area, imparting professional tools and teaching the Bank's policies and principles in the area of credit. Lessons-learned processes based on various credit events are conducted by the units and communicated to the relevant functions, in accordance with the internal regulations of the Bank.
9. Hedging and risk mitigation – see below.

Structure and Organization of Credit Risk Management Function

Corporate governance for risk management relies on three lines of defense, which are clearly separated from one another. The approach taken with regard to control of all financial risks at Bank Hapoalim involves identification and assessment of the risks, and control of compliance with the limits established in the various internal regulations, through three lines of defense. The lines of defense are presented below, according to the degree of their independence from the professional function responsible for taking the risk.

First Line of Defense

The business units are responsible for identifying, assessing, measuring, monitoring, mitigating, and reporting all risks inherent in products, activities, processes, and systems under their responsibility, as well as for managing an appropriate control environment in the context of risk management.

The first level of the first line of defense includes the units that manage business activity and create credit risks, in Israel and overseas. Further controls are performed at the second level of the first line of defense, in addition to those carried out in the units that create risk as part of the routine management of their business. This line of defense includes the internal credit and control units within the business areas and at the bank's overseas offices:

- Credit System Operation Division – Corporate Banking Area;
- Division administrations and Corporate Credit Unit – Corporate Banking Area;
- Retail Credit and Mortgages Division – Retail Banking Area;
- Overseas Credit Department – Financial Markets and International Banking Area;
- Banks and Financial Institutions Department – Financial Markets and International Banking Area;
- Exposure and Risk Management System – Financial Markets and International Banking Area.

Second Line of Defense

The second line of defense supplements the risk-management activities of the business lines. This function has a reporting structure that is independent of the business lines that generate risk; it is responsible for planning, maintaining, and continually developing the working framework for risk management at the banking corporation.

This line of defense includes:

- The Credit Risk Management Unit, which serves as the independent oversight unit for the management and analysis of credit risks, as part of the second line of defense. The unit reports to the head of the Risk Management Area and is independent of credit underwriting and approval processes. The unit is responsible for the following areas:
  - Monitoring credit exposure, the level of credit risk, and compliance with the credit limits of the Group.
  - Running extreme scenarios at the level of the Bank and the Group.
  - Monitoring, measuring, and managing credit concentration risk.
  - Formulating the credit policy of the Bank.
  - Applying controls and tests of various credit focus areas at the Bank, selected using risk-based samples; credit review activities at the branches and subsidiaries of the Bank overseas.
  - Challenging the business function and writing an independent opinion in accordance with Proper Conduct of Banking Business Directive 311 in the approval of substantial credit exposures, in substantial changes in terms of credit, in substantial additions to credit, and in decisions regarding debt arrangements for problematic credit.

- Overseeing credit classifications and credit losses.
- Developing methodologies for the calculation of allowances.
- Development of models for measuring and monitoring credit risk ratings.

- Credit risk management and credit review units at subsidiaries and at the Bank's offices overseas. These units operate in a similar format to the Credit Risk Management Unit at the Bank, in accordance with the Bank's policy on credit risk management.

Third Line of Defense

Internal Audit operates independently and objectively as a third line of defense. Its goals include helping the organization achieve its objectives by recommending risk mitigation through improved controls. Internal audit operates under laws, regulations, the Banking Rules (Internal Audit), Proper Conduct of Banking Business Directives, professional guidelines of the Institute of Internal Auditors in Israel, guidelines of the Board of Directors' Audit Committee and of the Board of Directors, and management needs.

Credit Risk Management Tools

Credit exposures are automated, allowing analysis and reporting on various dimensions. Information systems continuously provide a comprehensive view of the activity of the customer/group, including the level of credit risk. The comprehensive view of corporate clients is overseen in accordance with Directive 313 of the Bank of Israel and the internal regulations of the Bank, in order to obtain a full picture of risk groups reflecting ownership relationships and economic dependency relationships. With regard to retail clients, the Bank has defined risk groups in order to also reflect family connections, joint banking activity, etc.

Alerts of events that may indicate worsening of the customer's condition are sent to the desktop of the officer responsible for that customer, based on internal systems and external information.

Credit risk management processes include models for estimating credit risk. Credit risk rating is used to identify changes in the risk level of the borrower and of the portfolio. The Credit Risk Management Unit has developed and implemented models for estimating credit risk, which establish ratings for borrowers and for credit. These models combine assessments by credit experts with advanced statistical models. The rating models are embedded in credit processes at the various Areas and integrated with the processes of making credit decisions, pricing credit, credit policy, identifying customers in distress, and monitoring the quality of the portfolio and of borrowers.

Risk at the level of the overall portfolio of the Group is monitored by the Credit Risk Management Unit. A summary report including credit exposures, risk in the portfolio, trends and changes, special events, and various indicators of risk levels is presented for discussion to the Board of Management of the Bank, the Credit Committee of the Board of Directors, and the Risk Management and Control Committee of the Board of Directors.

Additional credit risk management tools include analyses of concentration of the portfolio of exposures and analysis of extreme scenarios.

Hedges and Risk Mitigation

Bank Hapoalim manages credit collateral through a collateral system that includes conservative safety margins. Within collateral policy, principles and rules have been set forth to determine the value of collateral with respect to its type and the type of credit that it secures, such as: the estimated time range and expenses necessary for realization of the collateral, type of indexation, volatility in the value of the collateral, etc. Procedures have also been defined for the processing of collateral and for monitoring changes in collateral and in the value thereof.

Collateral received by the Bank to secure credit includes financial assets, real-estate assets, and other assets. Against credit granted to companies, the Bank also receives collateral in the form of general floating liens on the companies' assets.

The Bank examines the use of additional risk mitigation tools, as necessary, including loan sales, acquisition of insurance, and use of credit derivatives. See "Credit Risk Mitigation" later in this section.

Problematic Debts and Borrowers in Distress

The policy for debt classifications and allowances includes indicators for the identification of customers who, according to the Bank's evaluation, may default on their obligations to the Bank. In addition, the Credit Analysis Department and the Credit Review Department in the Risk Management Area determine, in the opinion they prepare, whether the specific customer should be included in the Bank's watch list, whether the customer's rating requires classification, and whether an allowance for credit losses is necessary. Customers identified for supervision and existing watch list customers are discussed as part of the quarterly process of examining the fairness of classifications. These borrowers are supervised and monitored more closely, and the Bank works to reduce its exposure to them by redeeming credit from the borrowers' resources and/or by obtaining additional collateral from them. In certain cases, customers are transferred to a division specializing in monitoring and restructuring of customers' debt, or to debt collection units. In addition, the Bank regularly reviews the level of credit risk in borrower portfolios on the basis of conservative assumptions, classifies problematic credit risk according to the directives of the Bank of Israel and according to the established classification guidelines (under special supervision, substandard, or impaired), and records a sufficient allowance for credit losses in respect of the total credit risk at the Bank.

Classification Definitions

Special Supervision

Credit risk under special supervision includes balance sheet and off-balance sheet credit risk with potential weaknesses that should be given special attention by management. If not addressed, these potential weaknesses could result in deterioration of the probability of repayment of the credit or of the status of the Bank as a creditor at a certain future date. Off-balance sheet credit risk is classified as under special supervision if there is at least a possibility that the contingent liability in respect of the off-balance sheet item will be realized, and in addition, the debts that may be acquired as a result of the realization of the contingent liability fit the classification of debts under special supervision.

Substandard

Substandard credit risk includes balance sheet and off-balance sheet credit risk insufficiently protected by the current established value and repayment capability of the borrower or of the pledged collateral, if available. Credit risk assigned this classification must have well-defined weaknesses that jeopardize the realization of the debt, such that there is a clear possibility that the Bank may incur a certain loss if the deficiencies are not remedied. Off-balance sheet credit risk is classified as substandard if there is at least a possibility that the contingent liability in respect of the off-balance sheet item will be realized, and in addition, the debts that may be acquired as a result of the realization of the contingent liability fit the classification of substandard debts. Credit not examined individually, in respect of which an allowance for credit losses is recognized on a collective basis, is classified as substandard when it becomes debt in arrears of 90 days or more.

Impaired Debt

Credit risk is classified as impaired when, based on current information and events, the Bank expects to be unable to collect the full amounts owed to it according to the original contractual terms with the client. The decision to classify credit as impaired is based, among other factors, on the arrears of the debt; an assessment of the financial condition and repayment capability of the borrower; the existence and condition of collateral; the financial condition of guarantors, if any, and their commitment to support the debt; and the borrower's ability to obtain third-party financing. In any case, debt assessed on an individual basis is classified as impaired when the principal or interest in respect of the debt is in arrears of 90 days or more. In addition, any debt the terms of which have been changed in the course of troubled debt restructuring is classified as impaired debt, unless a minimum allowance for credit losses was recorded before and after the restructuring, according to the method of the extent of arrears, pursuant to the appendix to Proper Conduct of Banking Business 314 concerning fair assessment of credit risks and fair measurement of debts.

Impaired debt returns to the status of unimpaired debt only when there are no principal or interest components in respect of the debt that are due but have not been paid, and the Bank expects the remaining principal and interest to be repaid in full, in accordance with the terms of the contract.

Definition of Debt in Arrears

Debt in Arrears

Debt in which principal or interest have not been paid on time, in reference to the contractual repayment terms. A current account or a current drawing account shall be reported as a debt in arrears when the account remains continuously at a negative balance (in the absence of an approved credit facility), or in deviation from the approved credit facility, for 30 days or more; or if, within the credit facility, amounts are credited to the account that are lower than the negative balance and the credit facility, for a period of 180 days. Loans shall be reported as debt in arrears when the principal or interest have not been paid after 30 days have elapsed from the scheduled date of payment according to the contractual repayment terms of the debt.

Allowance for Credit Losses

Individual Allowance

With regard to credit classified as "impaired," the allowance for credit losses is derived from an individual examination of the amount collectible from the customer (cash flows and/or expected realization of collateral), after discounting the amounts according to the expected time of collection and realization. The recoverable amount is determined by applying safety margins aimed at addressing situations of uncertainty regarding the ability to repay the debt. However, because economic variables are involved, there is no certainty that the recoverable amount will not be lower than the established estimate, due to worsening of economic parameters or for any other reason. Debts not expected to be collected within a reasonable period are charged off, in accordance with the rules established in the Bank of Israel's directives.

Customers under supervision and/or customers classified as problematic are examined individually on a quarterly basis, to determine the fairness of the classification and the fairness of the individually examined allowance for credit losses. This examination is performed by the Credit Risk Management Unit and approved by the Head of Risk Management. The Bank applies orderly work processes for this purpose, according to approved authorizations. If a debt is classified as impaired, a recoverable amount is established, and the individual allowance is derived from this amount. These processes are consistent with Proper Conduct of Banking Business Directives 311 and 314.

Collective Allowance

With regard to sound credit or unimpaired problematic credit (substandard or under special supervision), a "collective allowance" is calculated based on the economic sector to which the customer belongs. In order to calculate the collective allowance, the Bank sets two allowance rates for each economic sector, for problematic and sound credit risk, on a quarterly basis, based on an analysis of historical credit losses, net charge-offs, the quality of the credit portfolio in the sector, and an analysis of market trends, in accordance with the instructions of the Bank of Israel.

The process of establishing allowance rates consists of three stages, in accordance with the instructions of the Bank of Israel: calculation of a multi-year average of charge-off rates; adjustment in the event of significant changes over the last year; and establishment of adjustment coefficients. The adjustment coefficients are used to cause the collective allowance rates to reflect changes in the quality of the credit portfolio in the sector, macro-economic trends, and changes in the Bank's procedures and policies for granting credit. The Bank has developed an advanced model for establishing adjustment coefficients, in accordance with the instructions of the Bank of Israel. This model allows the expression of a wide range of environmental risk factors that may affect the rate of credit losses at the Bank, in an automated, consistent, controlled process. Pursuant to the instructions of the Bank of Israel, the adjustment coefficient of sound balance sheet debt in the sector of credit to private individuals shall not be less than 0.75%, and the balance of the collective allowance in respect of housing loans shall not be less than 0.35% of the balance of loans.

Credit Risk Exposures

Table D-3: Segmentation of credit-risk exposures by counterparty and by main types of credit exposures, before allowance for credit losses[(1)]

	March 31, 2016											
	Sovereigns	Public sector	Banking corporations	Corporations	Secured by commercial real estate	Retail to individuals	Small businesses	Housing loans	Securitization	Others	Gross credit exposure[(2)]	Average gross credit exposure
	NIS millions											
Loans[(3)]	**56,422**	**4,622**	**6,514**	**101,212**	**37,724**	**61,474**	**9,995**	**66,727**	**-**	**-**	**344,690**	**345,014**
Bonds[(4)]	**45,073**	**1,057**	**4,493**	**4,559**	**410**	**-**	**-**	**-**	**-**	**-**	**55,592**	**54,436**
Derivatives[(5)]	**37**	**1,008**	**2,440**	**6,152**	**273**	**35**	**11**	**9**	**-**	**-**	**9,965**	**9,963**
Other off-balance sheet exposures	**412**	**1,915**	**2,217**	**65,983**	**55,947**	**50,471**	**3,852**	**2,496**	**188**	**-**	**183,481**	**187,270**
Other assets[(6)]	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**15,703**	**15,703**	**15,968**
Total	**101,944**	**8,602**	**15,664**	**177,906**	**94,354**	**111,980**	**13,858**	**69,232**	**188**	**15,703**	**609,431**	**612,651**

	March 31, 2015											
	Sovereigns	Public sector	Banking corporations	Corporations	Secured by commercial real estate	Retail to individuals	Small businesses	Housing loans	Securitization	Others	Gross credit exposure[(2)]	Average gross credit exposure
	NIS millions											
Loans[(3)]	61,178	4,673	9,413	103,233	36,960	55,743	8,648	61,696	-	-	341,544	330,843
Bonds[(4)]	31,715	1,278	5,352	5,371	509	-	-	-	-	-	44,225	48,206
Derivatives[(5)]	30	894	3,682	7,148	325	42	26	9	-	-	12,156	12,121
Other off-balance sheet exposures	1,821	2,473	2,442	73,871	47,575	49,102	3,337	2,509	199	-	183,329	185,715
Other assets[(6)]	-	-	-	-	-	-	-	-	-	17,470	17,470	17,266
Total	94,744	9,318	20,889	189,623	85,369	104,887	12,011	64,214	199	17,470	598,724	594,151

	December 31, 2015											
	Sovereigns	Public sector	Banking corporations	Corporations	Secured by commercial real estate	Retail to individuals	Small businesses	Housing loans	Securitization	Others	Gross credit exposure[(2)]	Average gross credit exposure
	NIS millions											
Loans[(3)]	59,351	4,549	5,490	100,821	38,527	60,447	9,657	66,495	-	-	345,337	335,661
Bonds[(4)]	42,091	1,055	4,668	4,958	508	-	-	-	-	-	53,280	49,426
Derivatives[(5)]	33	868	2,617	5,915	413	34	73	8	-	-	9,961	11,150
Other off-balance sheet exposures	488	2,387	2,228	73,729	54,373	51,572	3,757	2,330	195	-	191,059	187,966
Other assets[(6)]	-	-	-	-	-	-	-	-	-	16,233	16,233	16,708
Total	101,963	8,859	15,003	185,423	93,821	112,053	13,487	68,833	195	16,233	615,870	600,911

(1) After deduction of charge-offs, and before deduction of the allowance for credit losses on an individual and collective basis.
(2) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation as a result of the execution of certain actions (e.g. use of guarantees), and after offsetting of transactions in derivatives (netting).
(3) Including credit to the public, credit to the government, and deposits with central banks; after deduction of liabilities in respect of transactions in derivative instruments subject to CSA agreements.
(4) Not including bonds in the trading portfolio, and not including investments in capital of financial corporations.
(5) Positive fair value of derivatives, including the add-on reflecting the amount of the future potential exposure to credit in respect of the balance of the face value of derivative instruments, after offsetting of transactions in derivatives (netting).
(6) Including cash, investments in financial corporations not deducted from capital, advance payments to tax authorities, shares, and other assets with no counterparty, such as buildings and equipment.

Table D-4: Total principal exposures to foreign countries[1]

	March 31, 2016												
	Balance sheet exposure[4]									Off-balance sheet exposure[2][4]			
	Cross-border balance sheet exposure			Balance sheet exposure of the banking corporation's branches/subsidiaries in foreign countries to local residents			Total balance sheet exposure	Problematic balance sheet credit risk[4]	Impaired debts[4]	Total off-balance sheet exposure	Of which: problematic off-balance sheet credit risk[4]	Cross-border balance sheet exposure	
	To governments[3]	To banks	To others	Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities						Maturity up to one year	Maturity over one year
	NIS millions												
Country													
A. United States	**3,682**	**2,269**	**3,160**	**26,846**	**12,622**	**14,224**	**23,335**	**306**	**37**	**8,922**	**141**	**2,181**	**6,930**
B. Switzerland	**-**	**411**	**32**	**7,897**	**-**	**7,897**	**8,340**	**-**	**-**	**240**	**-**	**179**	**264**
C. England	**125**	**4,898**	**4,706**	**57**	**-**	**57**	**9,786**	**-**	**-**	**3,145**	**-**	**2,582**	**7,147**
D. Turkey	**-**	**4**	**53**	**1,852**	**797**	**1,055**	**1,112**	**127**	**93**	**17**	**-**	**53**	**4**
E. Germany	**255**	**1,050**	**432**	**-**	**-**	**-**	**1,737**	**-**	**-**	**123**	**-**	**877**	**860**
F. France	**111**	**2,069**	**804**	**-**	**-**	**-**	**2,984**	**34**	**25**	**1,164**	**-**	**808**	**2,176**
G. Ireland	**-**	**2**	**151**	**-**	**-**	**-**	**153**	**-**	**-**	**199**	**-**	**121**	**32**
H. Spain	**-**	**139**	**71**	**-**	**-**	**-**	**210**	**-**	**-**	**32**	**-**	**36**	**174**
I. Portugal	**-**	**-**	**11**	**-**	**-**	**-**	**11**	**-**	**-**	**-**	**-**	**10**	**1**
J. Greece	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1**	**-**	**-**	**-**
K. Italy	**-**	**135**	**27**	**-**	**-**	**-**	**162**	**-**	**-**	**105**	**-**	**147**	**15**
L. Others	**1,437**	**3,141**	**7,158**	**50**	**1**	**49**	**11,785**	**95**	**38**	**2,609**	**15**	**4,958**	**6,778**
Total exposures to foreign countries	**5,610**	**14,118**	**16,605**	**36,702**	**13,420**	**23,282**	**59,615**	**562**	**193**	**16,557**	**156**	**11,952**	**24,381**
Of which: total exposure to LDCs	**24**	**286**	**949**	**1,852**	**797**	**1,055**	**2,314**	**138**	**102**	**489**	**-**	**491**	**768**

The line "total LDCs" includes the total exposure to countries defined as Less Developed Countries (LDCs) in Proper Conduct of Banking Business Directive 315, "Supplementary Provision for Doubtful Debts." This amount includes data for Turkey, as detailed in the table above.

Balance sheet exposure to a foreign country includes cross-border balance sheet exposure and balance sheet exposure of the branches/subsidiaries of the banking corporation in the foreign country to local residents. Cross-border balance sheet exposure includes balance sheet exposure of the branches/subsidiaries of the banking corporation in Israel to residents of the foreign country, and balance sheet exposure of the overseas branches/subsidiaries of the banking corporation to non-residents of the country in which the branch/subsidiary is located.

Balance sheet exposure of the banking corporation's branches/subsidiaries in a foreign country to local residents includes balance sheet exposure of the branches/subsidiaries of the banking corporation in that foreign country to the residents of the country, less liabilities of those branches/subsidiaries (the deduction is performed up to the level of the exposure).

(1) Based on the final risk, after the effect of guarantees, liquid collateral, and credit derivatives.
(2) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limits on indebtedness of a borrower, according to Proper Conduct of Banking Business Directive 313.
(3) Governments, official institutions, and central banks.
(4) Balance sheet and off-balance sheet credit risk, problematic credit risk, and impaired debts are presented before the effect of the allowance for credit losses, and before the effect of collateral deductible for the indebtedness of a borrower and of a group of borrowers.

Table D-4: Total principal exposures to foreign countries[1] (continued)

	March 31, 2015												
	Balance sheet exposure[4]									Off-balance sheet exposure[2][4]			
	Cross-border balance sheet exposure			Balance sheet exposure of the banking corporation's branches/subsidiaries in foreign countries to local residents			Total balance sheet exposure	Problematic balance sheet credit risk[4]	Impaired debts[4]	Total off-balance sheet exposure	Of which: problematic off-balance sheet credit risk[4]	Cross-border balance sheet exposure	
	To governments[3]	To banks	To others	Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities						Maturity up to one year	Maturity over one year
	NIS millions												
Country													
A. United States	289	2,979	4,344	44,734	12,200	32,534	40,146	119	67	9,360	91	3,140	4,472
B. Switzerland	-	1,118	48	6,026	-	6,026	7,192	-	-	326	-	774	392
C. England	-	6,436	4,317	92	-	92	10,845	2	-	2,821	-	2,894	7,859
D. Turkey	1	21	48	2,481	1,177	1,304	1,374	106	103	1,339	-	50	20
E. Germany	146	997	690	-	-	-	1,833	-	-	84	-	822	1,011
F. France	-	2,268	743	-	-	-	3,011	29	26	928	-	828	2,183
G. Ireland	-	4	210	-	-	-	214	-	-	221	-	185	29
H. Spain	-	115	64	-	-	-	179	-	-	33	-	33	146
I. Portugal	1	-	12	-	-	-	13	-	-	2	-	12	1
J. Greece	-	-	-	-	-	-	-	-	-	1	-	-	-
K. Italy	-	3	47	-	-	-	50	-	-	113	-	23	27
L. Others	1,053	4,816	8,123	303	-	303	14,295	113	40	2,753	18	6,148	7,844
Total exposures to foreign countries	1,490	18,757	18,646	53,636	13,377	40,259	79,152	369	236	17,981	109	14,909	23,984
Of which: total exposure to LDCs	142	458	1,036	2,737	1,177	1,560	3,196	118	113	2,092	-	545	1,091

The line "total LDCs" includes the total exposure to countries defined as Less Developed Countries (LDCs) in Proper Conduct of Banking Business Directive 315, "Supplementary Provision for Doubtful Debts." This amount includes data for Turkey, as detailed in the table above.

Balance sheet exposure to a foreign country includes cross-border balance sheet exposure and balance sheet exposure of the branches/subsidiaries of the banking corporation in the foreign country to local residents. Cross-border balance sheet exposure includes balance sheet exposure of the branches/subsidiaries of the banking corporation in Israel to residents of the foreign country, and balance sheet exposure of the overseas branches/subsidiaries of the banking corporation to non-residents of the country in which the branch/subsidiary is located.

Balance sheet exposure of the banking corporation's branches/subsidiaries in a foreign country to local residents includes balance sheet exposure of the branches/subsidiaries of the banking corporation in that foreign country to the residents of the country, less liabilities of those branches/subsidiaries (the deduction is performed up to the level of the exposure).

(1) Based on the final risk, after the effect of guarantees, liquid collateral, and credit derivatives.
(2) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limits on indebtedness of a borrower, according to Proper Conduct of Banking Business Directive 313.
(3) Governments, official institutions, and central banks.
(4) Balance sheet and off-balance sheet credit risk, problematic credit risk, and impaired debts are presented before the effect of the allowance for credit losses, and before the effect of collateral deductible for the indebtedness of a borrower and of a group of borrowers.

Table D-4: Total principal exposures to foreign countries(1) (continued)

	December 31, 2015												
	Balance sheet exposure(4)									Off-balance sheet exposure(2)(4)			
	Cross-border balance sheet exposure			Balance sheet exposure of the banking corporation's branches/subsidiaries in foreign countries to local residents			Total balance sheet exposure	Problematic balance sheet credit risk(4)	Impaired debts(4)	Total off-balance sheet exposure	Of which: problematic off-balance sheet credit risk(4)	Cross-border balance sheet exposure	
	To governments(3)	To banks	To others	Balance sheet exposure before deduction of local liabilities	Deduction in respect of local liabilities	Net balance sheet exposure after deduction of local liabilities						Maturity up to one year	Maturity over one year
	NIS millions												
Country													
A. United States	3,583	2,055	3,826	27,190	12,808	14,382	23,846	129	41	9,194	55	2,096	7,368
B. Switzerland	-	504	32	7,050	-	7,050	7,586	1	-	229	-	163	373
C. England	129	4,850	3,509	75	-	75	8,563	1	-	2,637	-	1,988	6,500
D. Turkey	-	6	13	2,055	935	1,120	1,139	80	84	976	-	16	3
E. Germany	280	1,022	297	-	-	-	1,599	-	-	155	-	844	755
F. France	115	2,005	612	-	-	-	2,732	29	26	1,262	-	825	1,907
G. Ireland	-	3	152	-	-	-	155	-	-	206	-	129	26
H. Spain	-	158	65	-	-	-	223	-	-	33	-	28	195
I. Portugal	-	-	13	-	-	-	13	-	-	-	-	12	1
J. Greece	-	-	-	-	-	-	-	-	-	1	-	-	-
K. Italy	-	5	48	-	-	-	53	-	-	154	-	41	12
L. Others	1,522	2,603	7,940	66	1	65	12,130	125	45	2,660	14	4,668	7,397
Total exposures to foreign countries	5,629	13,211	16,507	36,436	13,744	22,692	58,039	365	196	17,507	69	10,810	24,537
Of which: total exposure to LDCs	67	269	1,012	2,055	935	1,120	2,468	92	94	1,627	-	456	892

The line "total LDCs" includes the total exposure to countries defined as Less Developed Countries (LDCs) in Proper Conduct of Banking Business Directive 315, "Supplementary Provision for Doubtful Debts." This amount includes data for Turkey, as detailed in the table above.
Balance sheet exposure to a foreign country includes cross-border balance sheet exposure and balance sheet exposure of the branches/subsidiaries of the banking corporation in the foreign country to local residents. Cross-border balance sheet exposure includes balance sheet exposure of the branches/subsidiaries of the banking corporation in Israel to residents of the foreign country, and balance sheet exposure of the overseas branches/subsidiaries of the banking corporation to non-residents of the country in which the branch/subsidiary is located.
Balance sheet exposure of the banking corporation's branches/subsidiaries in a foreign country to local residents includes balance sheet exposure of the branches/subsidiaries of the banking corporation in that foreign country to the residents of the country, less liabilities of those branches/subsidiaries (the deduction is performed up to the level of the exposure).

(1) Based on the final risk, after the effect of guarantees, liquid collateral, and credit derivatives.
(2) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limits on indebtedness of a borrower, according to Proper Conduct of Banking Business Directive 313.
(3) Governments, official institutions, and central banks.
(4) Balance sheet and off-balance sheet credit risk, problematic credit risk, and impaired debts are presented before the effect of the allowance for credit losses, and before the effect of collateral deductible for the indebtedness of a borrower and of a group of borrowers.

Exposure to foreign countries: Balance sheet exposure to foreign countries as at March 31, 2016 amounted to approximately NIS 59.6 billion, compared with approximately NIS 79.2 billion in the same quarter last year. Off-balance sheet exposure to foreign countries as at March 31, 2016 amounted to NIS 16.6 billion, compared with NIS 18.0 billion in the same quarter last year. The Bank operates in accordance with an ordered policy that sets limits and terms for the exposure to foreign countries.

Table D-5: Segmentation of the portfolio by term to maturity and by principal type of credit exposure(1)

	March 31, 2016					
	Up to 1 year	1 year to 5 years	Over 5 years	Other	Effect of netting agreements	Gross credit exposure(2)
	NIS millions					
Loans(3)	**160,077**	**81,807**	**102,806**	**-**	**-**	**344,690**
Bonds(4)	**18,782**	**24,233**	**12,577**	**-**	**-**	**55,592**
Derivatives(5)	**6,579**	**7,852**	**8,626**	**-**	**(13,092)**	**9,965**
Other off-balance sheet exposures	**34,287**	**145,438**	**3,756**	**-**	**-**	**183,481**
Other assets(6)	**2,595**	**-**	**-**	**13,108**	**-**	**15,703**
Total	**222,320**	**259,330**	**127,765**	**13,108**	**(13,092)**	**609,431**

	March 31, 2015					
	Up to 1 year	1 year to 5 years	Over 5 years	Other	Effect of netting agreements	Gross credit exposure(2)
	NIS millions					
Loans(3)	161,150	82,666	97,728	-	-	341,544
Bonds(4)	1,420	22,310	20,495	-	-	44,225
Derivatives(5)	10,075	7,939	9,825	-	(15,683)	12,156
Other off-balance sheet exposures	32,750	146,339	4,240	-	-	183,329
Other assets(6)	2,488	-	-	14,982	-	17,470
Total	207,883	259,254	132,288	14,982	(15,683)	598,724

	December 31, 2015					
	Up to 1 year	1 year to 5 years	Over 5 years	Other	Effect of netting agreements	Gross credit exposure(2)
	NIS millions					
Loans(3)	158,600	84,504	102,233	-	-	345,337
Bonds(4)	13,249	25,084	14,947	-	-	53,280
Derivatives(5)	6,103	7,682	8,302	-	(12,126)	9,961
Other off-balance sheet exposures	25,883	161,556	3,620	-	-	191,059
Other assets(6)	2,619	-	-	13,614	-	16,233
Total	206,454	278,826	129,102	13,614	(12,126)	615,870

(1) After deduction of charge-offs, and before deduction of the allowance for credit losses on an individual and collective basis.
(2) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation as a result of the execution of certain actions (e.g. use of guarantees), and after offsetting of transactions in derivatives (netting).
(3) Including credit to the public, credit to the government, and deposits with central banks; after deduction of liabilities in respect of transactions in derivative instruments subject to CSA agreements.
(4) Not including bonds in the trading portfolio, and not including investments in capital of financial corporations.
(5) Positive fair value of derivatives, including the add-on reflecting the amount of the future potential exposure to credit in respect of the balance of the face value of derivative instruments, after offsetting of transactions in derivatives (netting).
(6) Including cash, investments in financial corporations not deducted from capital, advance payments to tax authorities, shares, and other assets with no counterparty, such as buildings and equipment.

Table D-6: Amount of impaired loans, amount of loans in arrears, individual and collective allowances and provision for credit losses recognized in the statement of profit and loss, and net charge-offs during the period, by principal sector and by principal type of counterparty

	March 31, 2016									
	Total credit risk[1]			Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]						
	Total	Credit execution rating[5]	Problematic[6]	Total*	* Of which: debts[2]	Problematic[6]	Impaired	Credit losses for the period ended March 31, 2016[4]		
								Provision (income) for credit losses	Net charge-offs	Allowance for credit losses
	NIS millions									
In respect of borrower activity in Israel										
Public - commercial										
Agriculture	**2,763**	**2,494**	**40**	**2,753**	**2,095**	**40**	**23**	**(3)**	**(3)**	**24**
Mining and quarrying	**3,078**	**3,038**	**18**	**2,644**	**2,201**	**18**	**-**	**4**	**-**	**5**
Industry	**37,308**	**34,881**	**1,982**	**35,980**	**17,208**	**1,964**	**748**	**(27)**	**4**	**436**
Construction and real estate - construction[7]	**57,274**	**54,834**	**1,187**	**57,092**	**20,360**	**1,167**	**571**	**(34)**	**2**	**604**
Construction and real estate - real-estate activities	**25,627**	**24,390**	**950**	**24,961**	**20,427**	**950**	**498**	**(56)**	**(31)**	**502**
Electricity and water supply	**10,765**	**10,472**	**3**	**9,286**	**6,030**	**3**	**2**	**1**	**-**	**64**
Commerce	**36,490**	**32,214**	**2,219**	**36,083**	**27,185**	**2,210**	**1,507**	**144**	**65**	**1,259**
Hotels, hospitality, and food services	**10,674**	**9,552**	**258**	**10,626**	**9,319**	**258**	**227**	**1**	**14**	**65**
Transportation and storage	**9,069**	**8,197**	**116**	**8,787**	**6,633**	**116**	**70**	**(2)**	**2**	**42**
Information and communications	**6,322**	**5,188**	**877**	**5,903**	**3,917**	**873**	**698**	**(28)**	**(3)**	**210**
Financial services	**29,449**	**28,925**	**340**	**25,269**	**14,739**	**340**	**334**	**(63)**	**(36)**	**184**
Other business services	**12,569**	**11,534**	**145**	**12,549**	**8,486**	**145**	**77**	**7**	**8**	**106**
Public and community services	**7,887**	**7,605**	**57**	**7,879**	**5,908**	**57**	**44**	**3**	**2**	**53**
Total commercial[8]	**249,275**	**233,324**	**8,192**	**239,812**	**144,508**	**8,141**	**4,799**	**(53)**	**24**	**3,554**
Private individuals - housing loans	**62,965**	**61,814**	**601**	**62,965**	**60,640**	**601**	**-**	**(5)**	**-**	**385**
Private individuals - other	**90,549**	**87,177**	**989**	**90,527**	**52,629**	**989**	**689**	**103**	**76**	**834**
Total public - activity in Israel	**402,789**	**382,315**	**9,782**	**393,304**	**257,777**	**9,731**	**5,488**	**45**	**100**	**4,773**
Banks in Israel[9]	**4,643**	**4,643**	**-**	**1,457**	**182**	**-**	**-**	**-**	**-**	**-**
Israeli government	**48,467**	**48,467**	**-**	**1,055**	**812**	**-**	**-**	**-**	**-**	**-**
Total activity in Israel	**[1]455,899**	**435,425**	**9,782**	**395,816**	**258,771**	**9,731**	**5,488**	**45**	**100**	**4,773**

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts[2], bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 258,771, 49,308, 39, 5,963, and 141,818 million, respectively.
(2) Credit to the public, credit to governments, and deposits with banks (excluding deposits with the Bank of Israel), excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").
(3) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness (excluding unutilized credit-card facilities under the responsibility of other banks, in the amount of approximately NIS 10,966 million), excluding in respect of derivative instruments.
(4) Including in respect of off-balance sheet credit instruments (presented in the balance sheet under the item "other liabilities").
(5) Credit risk wherein the credit rating at the date of the report is congruent with the credit rating for the execution of new credit, according to the policy of the Bank.
(6) Balance sheet and off-balance sheet credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist which are in arrears of 90 days or more.
(7) Including balance sheet credit risk in the amount of approximately NIS 881 million and off-balance sheet credit risk in the amount of approximately NIS 887 million extended to certain purchasing groups, which are currently in the process of construction.
(8) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 6,181 million, of commercial borrowers, or those extended to purchasing groups currently in the process of construction.
(9) Excluding cash balances of the Bank and deposits with the Bank of Israel, and before deducting the allowance for credit losses.

Table D-6: Amount of impaired loans, amount of loans in arrears, individual and collective allowances and provision for credit losses recognized in the statement of profit and loss, and net charge-offs during the period, by principal sector and by principal type of counterparty (continued)

	March 31, 2016									
	Total credit risk[1]			Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]						
	Total	Credit execution rating[5]	Problematic[6]	Total*	* Of which: debts[2]	Problematic[6]	Impaired	Credit losses for the period ended March 31, 2016[4]		
								Provision (income) for credit losses	Net charge-offs	Allowance for credit losses
	NIS millions									
In respect of borrower activity overseas										
Public - commercial										
Agriculture	**454**	**454**	**-**	**454**	**138**	**-**	**-**	**-**	**-**	**-**
Mining and quarrying	**973**	**964**	**100**	**336**	**152**	**100**	**-**	**-**	**-**	**6**
Industry	**6,751**	**6,417**	**36**	**5,315**	**3,261**	**36**	**11**	**-**	**-**	**9**
Construction and real estate	**8,177**	**7,850**	**159**	**8,025**	**5,757**	**159**	**122**	**2**	**-**	**74**
Electricity and water supply	**1,981**	**1,954**	**36**	**1,801**	**612**	**36**	**-**	**1**	**-**	**6**
Commerce	**2,991**	**2,657**	**25**	**2,859**	**2,262**	**25**	**7**	**1**	**(1)**	**10**
Hotels, hospitality, and food services	**2,150**	**2,021**	**61**	**2,122**	**1,781**	**61**	**53**	**(3)**	**-**	**12**
Transportation and storage	**643**	**628**	**14**	**466**	**408**	**14**	**8**	**1**	**-**	**3**
Information and communications	**1,742**	**1,476**	**196**	**1,321**	**803**	**196**	**-**	**(3)**	**-**	**28**
Financial services	**17,865**	**17,751**	**141**	**13,147**	**7,773**	**141**	**29**	**(5)**	**(1)**	**43**
Other business services	**1,073**	**1,070**	**1**	**911**	**657**	**1**	**1**	**1**	**-**	**5**
Public and community services	**734**	**716**	**16**	**585**	**358**	**16**	**16**	**-**	**-**	**17**
Total commercial[7]	**45,534**	**43,958**	**785**	**37,342**	**23,962**	**785**	**247**	**(5)**	**(2)**	**213**
Private individuals - housing loans	**577**	**560**	**10**	**577**	**558**	**10**	**-**	**-**	**-**	**2**
Private individuals - other	**3,144**	**3,091**	**42**	**3,103**	**1,922**	**42**	**32**	**2**	**(1)**	**40**
Total public - activity overseas	**49,255**	**47,609**	**837**	**41,022**	**26,442**	**837**	**279**	**(3)**	**(3)**	**255**
Banks overseas[8]	**38,112**	**38,112**	**-**	**25,825**	**24,551**	**-**	**-**	**1**	**-**	**4**
Governments overseas	**8,204**	**8,204**	**-**	**1,978**	**1,811**	**-**	**-**	**3**	**-**	**3**
Total activity overseas	**(1)95,571**	**93,925**	**837**	**68,825**	**52,804**	**837**	**279**	**1**	**(3)**	**262**
Total in Israel and overseas	**551,470**	**529,350**	**10,619**	**464,641**	**311,575**	**10,568**	**5,767**	**46**	**97**	**5,035**

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts[2], bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 52,804, 14,388, 0, 8,009, and 20,370 million, respectively.
(2) Credit to the public, credit to governments, and deposits with banks, excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").
(3) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, excluding in respect of derivative instruments.
(4) Including in respect of off-balance sheet credit instruments (presented in the balance sheet under the item "other liabilities").
(5) Credit risk wherein the credit rating at the date of the report is congruent with the credit rating for the execution of new credit, according to the policy of the Bank.
(6) Balance sheet and off-balance sheet credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist which are in arrears of 90 days or more.
(7) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 59 million, of commercial borrowers, or those extended to purchasing groups currently in the process of construction.
(8) Excluding cash balances of the Bank, and before deducting the allowance for credit losses.

Table D-6: Amount of impaired loans, amount of loans in arrears, individual and collective allowances and provision for credit losses recognized in the statement of profit and loss, and net charge-offs during the period, by principal sector and by principal type of counterparty (continued)

	March 31, 2015									
	Total credit risk[1]			Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]						
	Total	Credit execution rating[5]	Problematic[6]	Total*	* Of which: debts[2]	Problematic[6]	Impaired	Credit losses for the period ended March 31, 2015[4]		
								Provision (income) for credit losses	Net charge-offs	Allowance for credit losses
	NIS millions									
In respect of borrower activity in Israel										
Public - commercial										
Agriculture	2,758	2,516	38	2,745	2,052	38	28	(3)	(5)	19
Mining and quarrying	3,210	3,169	8	2,766	2,119	8	-	(1)	-	14
Industry	42,384	38,062	3,962	40,624	19,378	3,757	1,015	81	11	545
Construction and real estate - construction[7]	53,236	50,536	1,497	52,702	20,548	1,465	919	15	(27)	635
Construction and real estate - real-estate activities	23,697	22,337	1,226	23,375	19,463	1,226	704	(14)	(13)	538
Electricity and water supply	10,466	10,407	1	9,019	5,480	1	1	(10)	(2)	49
Commerce	36,714	33,064	2,344	35,975	26,939	2,344	1,273	11	70	761
Hotels, hospitality, and food services	10,387	9,241	425	10,273	8,747	425	389	(11)	(3)	70
Transportation and storage	8,705	8,088	123	8,412	6,329	123	89	8	3	41
Information and communications	7,772	6,477	1,208	7,211	4,916	1,208	969	47	(4)	210
Financial services	31,376	30,567	745	25,831	13,205	745	705	(49)	45	232
Other business services	10,963	10,177	150	10,788	7,231	150	81	(4)	5	91
Public and community services	7,633	7,322	116	7,600	5,753	116	51	(25)	(9)	47
Total commercial[8]	249,301	231,963	11,843	237,321	142,160	11,606	6,224	45	71	3,252
Private individuals - housing loans	58,908	57,632	671	58,908	56,226	671	-	-	-	385
Private individuals - other	85,949	83,139	903	85,884	48,718	903	645	19	45	858
Total public - activity in Israel	394,158	372,734	13,417	382,113	247,104	13,180	6,869	64	116	4,495
Banks in Israel[9]	6,103	6,103	-	1,592	224	-	-	-	-	-
Israeli government	37,740	37,740	-	1,582	599	-	-	-	-	-
Total activity in Israel	[1]438,001	416,577	13,417	385,287	247,927	13,180	6,869	64	116	4,495

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts[2], bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 247,927, 39,179, 121, 8,190, and 142,584 million, respectively.
(2) Credit to the public, credit to governments, and deposits with banks (excluding deposits with the Bank of Israel), excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").
(3) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness (excluding unutilized credit-card facilities under the responsibility of other banks, in the amount of approximately NIS 11,016 million), excluding in respect of derivative instruments.
(4) Including in respect of off-balance sheet credit instruments (presented in the balance sheet under the item "other liabilities").
(5) Credit risk wherein the credit rating at the date of the report is congruent with the credit rating for the execution of new credit, according to the policy of the Bank.
(6) Balance sheet and off-balance sheet credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist which are in arrears of 90 days or more.
(7) Including balance sheet credit risk in the amount of approximately NIS 965 million and off-balance sheet credit risk in the amount of approximately NIS 1,170 million extended to certain purchasing groups, which are currently in the process of construction.
(8) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 5,723 million, of commercial borrowers, or those extended to purchasing groups currently in the process of construction.
(9) Excluding cash balances of the Bank and deposits with the Bank of Israel, and before deducting the allowance for credit losses.

Table D-6: Amount of impaired loans, amount of loans in arrears, individual and collective allowances and provision for credit losses recognized in the statement of profit and loss, and net charge-offs during the period, by principal sector and by principal type of counterparty (continued)

	March 31, 2015									
	Total credit risk[1]			Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]						
	Total	Credit execution rating[5]	Problematic[6]	Total*	* Of which: debts[2]	Problematic[6]	Impaired	Credit losses for the period ended March 31, 2015[4]		
								Provision (income) for credit losses	Net charge-offs	Allowance for credit losses
	NIS millions									
In respect of borrower activity overseas										
Public - commercial										
Agriculture	62	34	28	62	43	28	28	-	-	17
Mining and quarrying	659	659	-	255	141	-	-	-	-	-
Industry	7,276	7,215	20	5,640	3,438	20	6	4	6	15
Construction and real estate	8,495	7,506	170	8,042	5,753	170	170	(9)	1	65
Electricity and water supply	2,202	2,202	-	1,901	472	-	-	(1)	-	5
Commerce	2,446	2,118	56	2,340	1,691	56	9	-	31	12
Hotels, hospitality, and food services	2,927	2,864	72	2,889	2,161	72	52	-	-	8
Transportation and storage	712	697	14	568	461	14	14	-	-	4
Information and communications	1,352	1,153	199	899	593	199	-	1	(5)	22
Financial services	18,323	18,271	51	12,993	7,427	51	50	-	1	38
Other business services	1,002	914	81	845	557	81	-	3	-	8
Public and community services	978	954	23	726	498	23	23	(5)	(4)	21
Total commercial[7]	46,434	44,587	714	37,160	23,235	714	352	(7)	30	215
Private individuals - housing loans	555	534	4	555	540	4	-	-	-	2
Private individuals - other	3,278	3,201	59	3,136	2,108	59	47	2	3	51
Total public - activity overseas	50,267	48,322	777	40,851	25,883	777	399	(5)	33	268
Banks overseas[8]	61,246	61,246	-	46,109	44,889	-	-	1	-	5
Governments overseas	5,068	5,068	-	2,481	1,644	-	-	-	-	-
Total activity overseas	[1] 116,581	114,636	777	89,441	72,416	777	399	(4)	33	273
Total in Israel and overseas	554,582	531,213	14,194	474,728	320,343	13,957	7,268	60	149	4,768

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts[2], bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 72,416, 12,252, 402, 10,119, and 21,392 million, respectively.

(2) Credit to the public, credit to governments, and deposits with banks, excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").

(3) Credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, excluding in respect of derivative instruments.

(4) Including in respect of off-balance sheet credit instruments (presented in the balance sheet under the item "other liabilities").

(5) Credit risk wherein the credit rating at the date of the report is congruent with the credit rating for the execution of new credit, according to the policy of the Bank.

(6) Balance sheet and off-balance sheet credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist which are in arrears of 90 days or more.

(7) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 79 million, of commercial borrowers, or those extended to purchasing groups currently in the process of construction.

(8) Excluding cash balances of the Bank, and before deducting the allowance for credit losses.

Table D-7: Credit quality and arrears

	March 31, 2016					
	Non-problematic	Problematic[1]		Total	Unimpaired debts* – additional information	
		Unimpaired	Impaired[2]		In arrears of 90 days or more[3]	In arrears of 30 to 89 days[4]
	NIS millions					
Borrower activity in Israel						
Public - commercial						
Construction and real estate - construction	**19,679**	**323**	**358**	**20,360**	**37**	**79**
Construction and real estate - real-estate activities	**19,624**	**395**	**408**	**20,427**	**6**	**27**
Financial services	**14,400**	**6**	**333**	**14,739**	**-**	**5**
Commercial - other	**84,141**	**1,705**	**3,136**	**88,982**	**87**	**150**
Total commercial	**137,844**	**2,429**	**4,235**	**144,508**	**130**	**261**
Private individuals - housing loans[5]	**60,039**	**601**		**60,640**	**601**	**378**
Private individuals - other	**51,651**	**296**	**682**	**52,629**	**66**	**193**
Total public - activity in Israel	**249,534**	**3,326**	**4,917**	**257,777**	**797**	**832**
Banks in Israel	**182**	**-**	**-**	**182**	**-**	**-**
Israeli government	**812**	**-**	**-**	**812**	**-**	**-**
Total activity in Israel	**250,528**	**3,326**	**4,917**	**258,771**	**797**	**832**
Borrower activity overseas						
Public - commercial						
Construction and real estate	**5,598**	**37**	**122**	**5,757**	**-**	**31**
Commercial - other	**17,684**	**396**	**125**	**18,205**	**1**	**25**
Total commercial	**23,282**	**433**	**247**	**23,962**	**1**	**56**
Private individuals	**2,428**	**20**	**32**	**2,480**	**11**	**17**
Total public - activity overseas	**25,710**	**453**	**279**	**26,442**	**12**	**73**
Banks overseas	**24,551**	**-**	**-**	**24,551**	**-**	**-**
Governments overseas	**1,811**	**-**	**-**	**1,811**	**-**	**-**
Total activity overseas	**52,072**	**453**	**279**	**52,804**	**12**	**73**
Total public	**275,244**	**3,779**	**5,196**	**284,219**	**809**	**905**
Total banks	**24,733**	**-**	**-**	**24,733**	**-**	**-**
Total governments	**2,623**	**-**	**-**	**2,623**	**-**	**-**
Total	**302,600**	**3,779**	**5,196**	**311,575**	**809**	**905**

* For this purpose, "unimpaired debts" include non-problematic debts.

(1) Credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist, which are in arrears of 90 days or more.

(2) In general, impaired debts do not accrue interest income. For information regarding certain impaired debts restructured in troubled debt restructuring, see Note 13B(2)(c) below.

(3) Classified as unimpaired problematic debts (with the exception of housing loans in arrears of up to 3 months), accruing interest income.

(4) Accruing interest income. Debts in arrears of 30 to 89 days, in the amount of approximately NIS 130 million (March 31, 2015: NIS 147 million; December 31, 2015: NIS 132 million) were classified as unimpaired problematic debts.

(5) Includes a balance of housing loans, in the amount of approximately NIS 103 million (March 31, 2015: NIS 87 million; December 31, 2015: NIS 110 million) with allowance based on the extent of arrears, for which an arrangement has been signed for the borrower's repayment of the amounts in arrears, where a change has been made in the repayment schedule with regard to the balance of the loan not yet due for repayment.

Table D-7: Credit quality and arrears (continued)

	March 31, 2015					
	Non-problematic	Problematic[1]		Total	Unimpaired debts** – additional information	
		Unimpaired	Impaired[2]		In arrears of 90 days or more[3]	In arrears of 30 to 89 days[4]
	NIS millions					
Borrower activity in Israel						
Public - commercial						
Construction and real estate - construction	19,634	245	669	20,548	40	188
Construction and real estate - real-estate activities	18,372	470	621	19,463	16	49
Financial services	12,466	37	702	13,205	1	17
Commercial - other	82,465	2,972	3,507	88,944	87	156
Total commercial	132,937	3,724	5,499	142,160	144	410
Private individuals - housing loans[5]	55,555	671	-	56,226	*671	*385
Private individuals - other	47,825	254	639	48,718	69	207
Total public - activity in Israel	236,317	4,649	6,138	247,104	*884	*1,002
Banks in Israel	224	-	-	224	-	-
Israeli government	599	-	-	599	-	-
Total activity in Israel	237,140	4,649	6,138	247,927	*884	*1,002
Borrower activity overseas						
Public - commercial						
Construction and real estate	5,583	-	170	5,753	-	-
Commercial - other	17,055	245	182	17,482	11	17
Total commercial	22,638	245	352	23,235	11	17
Private individuals	2,585	16	47	2,648	*6	*18
Total public - activity overseas	25,223	261	399	25,883	*17	*35
Banks overseas	44,889	-	-	44,889	-	-
Governments overseas	1,644	-	-	1,644	-	-
Total activity overseas	71,756	261	399	72,416	*17	*35
Total public	261,540	4,910	6,537	272,987	*901	*1,037
Total banks	45,113	-	-	45,113	-	-
Total governments	2,243	-	-	2,243	-	-
Total	308,896	4,910	6,537	320,343	*901	*1,037

* Restated.

** For this purpose, "unimpaired debts" include non-problematic debts.

(1) Credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist, which are in arrears of 90 days or more.

(2) In general, impaired debts do not accrue interest income. For information regarding certain impaired debts restructured in troubled debt restructuring, see Note 13B(2)(c) below.

(3) Classified as unimpaired problematic debts (with the exception of housing loans in arrears of up to 3 months), accruing interest income.

(4) Accruing interest income. Debts in arrears of 30 to 89 days, in the amount of approximately NIS 130 million (March 31, 2015: NIS 147 million; December 31, 2015: NIS 132 million) were classified as unimpaired problematic debts.

(5) Includes a balance of housing loans, in the amount of approximately NIS 103 million (March 31, 2015: NIS 87 million; December 31, 2015: NIS 110 million) with allowance based on the extent of arrears, for which an arrangement has been signed for the borrower's repayment of the amounts in arrears, where a change has been made in the repayment schedule with regard to the balance of the loan not yet due for repayment.

Table D-7: Credit quality and arrears (continued)

	December 31, 2015					
	Non-problematic	Problematic[1]		Total	Unimpaired debts* – additional information	
		Unimpaired	Impaired[2]		In arrears of 90 days or more[3]	In arrears of 30 to 89 days[4]
	NIS millions					
Borrower activity in Israel						
Public - commercial						
Construction and real estate - construction	19,835	308	433	20,576	42	64
Construction and real estate - real-estate activities	18,956	445	490	19,891	5	16
Financial services	13,424	11	452	13,887	-	1
Commercial - other	83,743	2,339	3,018	89,100	86	167
Total commercial	135,958	3,103	4,393	143,454	133	248
Private individuals - housing loans[5]	59,935	634	-	60,569	634	388
Private individuals - other	50,839	322	664	51,825	84	194
Total public - activity in Israel	246,732	4,059	5,057	255,848	851	830
Banks in Israel	51	-	-	51	-	-
Israeli government	813	-	-	813	-	-
Total activity in Israel	247,596	4,059	5,057	256,712	851	830
Borrower activity overseas						
Public - commercial						
Construction and real estate	6,175	40	123	6,338	-	33
Commercial - other	17,840	241	124	18,205	-	53
Total commercial	24,015	281	247	24,543	-	86
Private individuals	2,468	20	32	2,520	6	34
Total public - activity overseas	26,483	301	279	27,063	6	120
Banks overseas	24,186	-	-	24,186	-	-
Governments overseas	1,751	-	-	1,751	-	-
Total activity overseas	52,420	301	279	53,000	6	120
Total public	273,215	4,360	5,336	282,911	857	950
Total banks	24,237	-	-	24,237	-	-
Total governments	2,564	-	-	2,564	-	-
Total	300,016	4,360	5,336	309,712	857	950

* For this purpose, "unimpaired debts" include non-problematic debts.

(1) Credit risk that is impaired, substandard, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and housing loans for which an allowance based on the extent of arrears does not exist, which are in arrears of 90 days or more.

(2) In general, impaired debts do not accrue interest income. For information regarding certain impaired debts restructured in troubled debt restructuring, see Note 13B(2)(c) below.

(3) Classified as unimpaired problematic debts (with the exception of housing loans in arrears of up to 3 months), accruing interest income.

(4) Accruing interest income. Debts in arrears of 30 to 89 days, in the amount of approximately NIS 130 million (March 31, 2015: NIS 147 million; December 31, 2015: NIS 132 million) were classified as unimpaired problematic debts.

(5) Includes a balance of housing loans, in the amount of approximately NIS 103 million (March 31, 2015: NIS 87 million; December 31, 2015: NIS 110 million) with allowance based on the extent of arrears, for which an arrangement has been signed for the borrower's repayment of the amounts in arrears, where a change has been made in the repayment schedule with regard to the balance of the loan not yet due for repayment.

Table D-8: Allowance for credit losses

	March 31, 2016					
	Credit to the public				Banks and governments	Total
	Commercial***	Housing	Other private	Total		
	NIS millions					
Recorded debt balance of debts**:						
Examined on an individual basis	**142,129**	**-**	**3,202**	**145,331**	**27,356**	**172,687**
Examined on a collective basis(1)	**26,341**	**61,198**	**51,349**	**138,888**	**-**	**138,888**
Total debts**	**168,470**	**61,198**	**54,551**	**284,219**	**27,356**	**311,575**
(1) Of which: allowance for which was calculated according to the extent of arrears	**6,240**	**60,947**	**-**	**67,187**	**-**	**67,187**
Allowance for credit losses in respect of debts**:						
Examined on an individual basis	**2,782**	**-**	**123**	**2,905**	**7**	**2,912**
Examined on a collective basis(2)	**384**	**387**	**693**	**1,464**	**-**	**1,464**
Total allowance for credit losses	**3,166**	**387**	**816**	**4,369**	**7**	**4,376**
(2) Of which: allowance for which was calculated according to the extent of arrears****	**64**	**387**	**-**	**451**	**-**	**451**

	March 31, 2015					
	Credit to the public				Banks and governments	Total
	Commercial***	Housing	Other private	Total		
	NIS millions					
Recorded debt balance of debts**:						
Examined on an individual basis	140,579	-	3,335	143,914	47,356	191,270
Examined on a collective basis(1)	24,816	56,766	47,491	129,073	-	129,073
Total debts**	165,395	56,766	50,826	272,987	47,356	320,343
(1) Of which: allowance for which was calculated according to the extent of arrears	5,802	56,504	-	62,306	-	62,306
Allowance for credit losses in respect of debts**:						
Examined on an individual basis	2,546	-	162	2,708	5	2,713
Examined on a collective basis(2)	293	387	678	1,358	-	1,358
Total allowance for credit losses	2,839	387	840	4,066	5	4,071
(2) Of which: allowance for which was calculated according to the extent of arrears****	55	387	-	442	-	442

* Restated.

** Credit to the public, credit to governments, and deposits with banks (excluding deposits with the Bank of Israel), excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").

*** The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 6,240 million, of commercial borrowers, or granted to purchasing groups in the process of construction (March 31, 2015: NIS 5,802 million; December 31, 2015: NIS 6,126 million).

**** Includes the allowance beyond the amount required according to the method of the extent of arrears, calculated on a collective basis, in the amount of approximately NIS 235 million (March 31, 2015: NIS 218 million; December 31, 2015: NIS 235 million).
Includes the allowance beyond the amount required according to the method of the extent of arrears, in the amount of approximately NIS 31 million (March 31, 2015: NIS 24 million; December 31, 2015: NIS 28 million).

Table D-8: Allowance for credit losses (continued)

	December 31, 2015					
	Credit to the public				Banks and governments	Total
	Commercial**	Housing	Other private	Total		
	NIS millions					
Recorded debt balance of debts*						
Examined on an individual basis	142,300	-	3,159	145,459	26,801	172,260
Examined on a collective basis(1)	25,697	61,120	50,635	137,452	-	137,452
Total debts*	167,997	61,120	53,794	282,911	26,801	309,712
(1) Of which: allowance for which was calculated according to the extent of arrears	6,126	60,863	-	66,989	-	66,989
Allowance for credit losses in respect of debts*						
Examined on an individual basis	2,856	-	126	2,982	3	2,985
Examined on a collective basis(2)	375	392	665	1,432	-	1,432
Total allowance for credit losses	3,231	392	791	4,414	3	4,417
(2) Of which: allowance for which was calculated according to the extent of arrears***	61	392	-	453	-	453

* Credit to the public, credit to governments, and deposits with banks (excluding deposits with the Bank of Israel), excluding bonds, securities borrowed or purchased under agreements to resell, and assets in respect of activity in the Maof market (presented under the item "other assets").

** The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 6,240 million, of commercial borrowers, or granted to purchasing groups in the process of construction (March 31, 2015: NIS 5,802 million; December 31, 2015: NIS 6,126 million).

*** Includes the allowance beyond the amount required according to the method of the extent of arrears, calculated on a collective basis, in the amount of approximately NIS 235 million (March 31, 2015: NIS 218 million; December 31, 2015: NIS 235 million). Includes the allowance beyond the amount required according to the method of the extent of arrears, in the amount of approximately NIS 31 million (March 31, 2015: NIS 24 million; December 31, 2015: NIS 28 million).

Table D-9: Change in allowance for credit losses

	For the three months ended March 31, 2016					
	Credit to the public				**Banks and governments**	**Total**
	Commercial	**Housing**	**Other private**	**Total**		
	NIS millions					
Allowance for credit losses at beginning of year	**3,847**	**392**	**844**	**5,083**	**3**	**5,086**
Provision for credit losses[1]	**(58)**	**(5)**	**105**	**42**	**4**	**46**
Charge-offs	**(154)**	**-**	**(156)**	**(310)**	**-**	**(310)**
Recoveries of debts charged off in previous years	**132**	**-**	**81**	**213**	**-**	**213**
Net charge-offs	**(22)**	**-**	**(75)**	**(97)**	**-**	**(97)**
Allowance for credit losses as at March 31, 2016[2] (unaudited)	**3,767**	**387**	**874**	**5,028**	**7**	**5,035**
(1) Of which: in respect of off-balance sheet credit instruments	**(27)**	**-**	**(11)**	**(38)**	**-**	**(38)**
(2) Of which: in respect of off-balance sheet credit instruments	**601**	**-**	**58**	**659**	**-**	**659**

	For the three months ended March 31, 2015					
	Credit to the public				Banks and governments	Total
	Commercial	Housing	Other private	Total		
	NIS millions					
Allowance for credit losses at beginning of year	3,530	387	935	4,852	4	4,856
Provision for credit losses[1]	38	-	21	59	1	60
Charge-offs	(228)	-	(126)	(354)	-	(354)
Recoveries of debts charged off in previous years	127	-	78	205	-	205
Net charge-offs	(101)	-	(48)	(149)	-	(149)
Adjustments from translation of financial statements	-	-	1	1	-	1
Allowance for credit losses as at March 31, 2015[2] (unaudited)	3,467	387	909	4,763	5	4,768
(1) Of which: in respect of off-balance sheet credit instruments	24	-	1	25	-	25
(2) Of which: in respect of off-balance sheet credit instruments	628	-	69	697	-	697

Construction and Real Estate[AI]

Overall credit risk in the construction and real-estate sectors totaled approximately NIS 91 billion as at March 31, 2016.

Table D-10: Segmentation of credit risk of the Bank Group in the construction and real-estate sectors, by principal areas of activity[AI]

	Balance as at March 31, 2016		
	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions		
Construction for commerce and services	**1,702**	**738**	**2,440**
Construction for industry	**453**	**201**	**654**
Housing construction	**11,109**	**28,175**	**39,284**
Yield-generating properties	**22,462**	**5,732**	**28,194**
Other	**11,424**	**9,082**	**20,506**
Total construction and real-estate sectors	**47,150**	**43,928**	**91,078**

Credit Risk in Respect of Exposures to Borrowers and to Groups of Borrowers[AI]

Table D-11: Details of balances of balance sheet credit and off-balance sheet credit risk to borrowers whose indebtedness exceeds NIS 1,200 million, by sector of the economy[AI]

	March 31, 2016			
	Number of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total
		NIS millions		
Economic sector				
Industry	**3**	**695**	**6,026**	**6,721**
Construction and real estate - construction	**1**	**224**	**1,332**	**1,556**
Construction and real estate - real-estate activities	**2**	**1,743**	**1,174**	**2,917**
Electricity and water supply	**1**	**1,871**	**1,895**	**3,766**
Hotels, hospitality, and food services	**1**	**1,120**	**201**	**1,321**
Financial services	**3**	**5,002**	**1,090**	**6,092**
Total	**11**	**10,655**	**11,718**	**22,373**

Table D-12: Of which – balances of balance sheet credit and off-balance sheet credit risk to the 6 largest borrowers, by sector of the economy[A1]

	March 31, 2016		
	Balance sheet credit risk	Off-balance sheet credit risk	Total
	NIS millions		
Economic sector			
Industry	**164**	**3,594**	**3,758**
Electricity and water supply	**1,871**	**1,895**	**3,766**
Financial services	**2,314**	**264**	**2,578**
Financial services	**1,163**	**650**	**1,813**
Financial services	**1,525**	**176**	**1,701**
Construction and real estate - real-estate activities	**986**	**404**	**1,390**
Total	**8,023**	**6,983**	**15,006**

Pursuant to Proper Conduct of Banking Business Directive 313, "Limits on the Indebtedness of Borrowers and Groups of Borrowers," a limit is imposed on the Bank, among other matters, under which the rate of "indebtedness" of a "borrower" and of a "group of borrowers," as defined in the directive, after deducting certain permitted amounts as specified in the directive, shall not exceed 15% and 25%, respectively, of the capital of the Bank, calculated according to Proper Conduct of Banking Business Directive 202, "Capital Components." The directive further states that the total indebtedness (after deducting the permitted amounts) of the borrowers, borrower groups, and banking borrower groups, each of whose indebtedness exceeds 10% of the capital of the Bank, shall not exceed 120% of the capital of the Bank.

An update of Proper Conduct of Banking Business Directive 313, "Limits on the Indebtedness of Borrowers and Groups of Borrowers," was issued in June 2015. Among other matters, the update restricts the definition of capital to Tier 1 capital (after supervisory adjustments and deductions), as defined in Proper Conduct of Banking Business Directive 202, and updates the limit on the indebtedness of a banking borrower group to a banking corporation, which previously stood at 25% of capital, to 15% of capital. The amendments to the directive took effect on January 1, 2016. With regard to the definition of capital, the following will apply: Tier 1 capital, as in the definition of capital, supplemented by Tier 2 capital, as published in the financial statements as at December 31, 2015. The supplement will be reduced in equal installments over twelve quarters, until it reaches zero on December 31, 2018.

See details in the Board of Directors' Report, in the section "Description of the Bank Group's Business by Segment of Activity – Corporate Segment." The Bank conducts monitoring and control processes in order to examine compliance with the limits set forth in Directive 313 with regard to exposure to the indebtedness of borrower groups.

In addition, the Bank performs periodic surveys of credit risk in such borrower groups, with an individual examination of the borrowers belonging to the borrower groups, the nature of these borrowers' activities, and the correlations between the borrowers that can affect group-level risk.

Table D-13: Details of credit risk balances for each group of borrowers whose net indebtedness on a consolidated basis, in accordance with Proper Conduct of Banking Business Directive 313, "Limits on the Indebtedness of Borrowers and Groups of Borrowers" (hereinafter: Directive 313), exceeds 15% of the capital of the banking corporation (as defined in Directive 313)[AI]

	March 31, 2016						
	Balance sheet credit risk[1]	Off-balance sheet credit risk[1]	Of which: Off-balance sheet credit risk in respect of derivative instruments[2]	Gross indebtedness[3]	Deductions[4]	Net indebtedness[5]	Percentage of regulatory capital
	NIS millions						
Borrower group A	**5,024**	**3,342**	**342**	**8,374**	**471**	**7,903**	**16.44%**

1. After deduction of the balance of charge-offs and the allowance for credit losses calculated on an individual basis.
2. Off-balance sheet credit risk in respect of derivative instruments, as calculated for the purposes of the limits on indebtedness of borrowers and of borrower groups.
3. This amount includes third-party guarantees outside the group.
4. Deductions permitted under Directive 313, mainly including deposits deposited at the Bank, bonds issued by the State of Israel, and deductible indemnity letters of the State of Israel or financial institutions.
5. The data presented above represent exposure to borrower groups, and are stated after the permitted deductions pursuant to Directive 313, and after deduction of the allowance for credit losses calculated on an individual basis. These data are therefore not comparable with data regarding borrowers' indebtedness provided in other disclosures in the report.

Risks in the Housing Loan Portfolio[AI]

Table D-14: Development of the balance in the housing credit portfolio, by linkage base and as a percentage of the balance in the credit portfolio of the Bank[AI]

	Unlinked segment				CPI-linked segment				Foreign currency segment		Total	Rate of change during the period
	Fixed interest rate		Floating interest rate		Fixed interest rate		Floating interest rate		Floating interest rate		Recorded debt balance in NIS millions	
	Balance in NIS millions	Rate in %	Balance in NIS millions	Rate in %	Balance in NIS millions	Rate in %	Balance in NIS millions	Rate in %	Balance in NIS millions	Rate in %		
March 31, 2016	**9,317**	**13.8%**	**24,225**	**35.9%**	**12,961**	**19.2%**	**20,306**	**30.1%**	**629**	**0.9%**	**67,438**	**0.3%**
December 31, 2015	8,785	13.1%	23,880	35.5%	13,179	19.6%	20,724	30.8%	678	1.0%	67,246	8.3%

The Bank routinely monitors developments in the housing credit portfolio, and applies various measures to manage risk. Housing credit risks are examined individually, based on the policies and objectives established in the risk appetite set for housing credit, from the level of the individual transaction to an overview of the housing credit portfolio of the Bank.

Risk hedging: The Bank manages and hedges risk, including through limits on various segments, as established in policy discussions of the Board of Management and the Board of Directors, overseen and led by the Risk Management Area. The limits address LTV rates, repayment capability, distribution of credit products in the portfolio, volume of problematic debt, loan durations, geographical distribution, rate of arrears, etc. These indicators are also monitored in comparison to the data of the banking system as a whole.

The Bank tracks macro-economic conditions and changes in general, and in the business environment of the industry in particular. Some events require a reexamination of policy, such as a sharp increase in the floating interest rate, steep inflation, an increase in unemployment in the Israeli economy, and a material change in housing prices.

Data are reported on a monthly basis in an Area-level risk forum headed by the Head of Retail Banking, with the participation of the Head of Risk Management, and on a quarterly basis as part of the report on developments in the credit portfolio and in credit risk to the Board of Management and Board of Directors.

The Bank uses a statistical model to measure the probability of default and the economic allocation in the mortgage portfolio. In addition, stress scenarios are applied to the mortgage portfolio, and the effect on the portfolio and on the Bank as a whole is analyzed. These scenarios include a sharp decline in prices of homes, an increase in the interest rate, and an increase in the unemployment rate.

In addition, insurance arrangements are in place (life insurance and building insurance). For loans approved up to November 1, 2012, the Bank also required credit insurance when the LTV ratio was greater than 75%. As of November 1, 2012, loans with an LTV ratio greater than 75% can no longer be approved.

Risk Quantification and Measurement – Housing Credit Execution

Housing loans are approved based on a hierarchy of authorizations reflecting the nature of the credit application and its inherent risk.

Housing-credit risk is quantified and measured on several levels, including the level of the individual customer and the level of the overall credit portfolio of the Bank.

For that purpose, quantification and measurement processes have been developed and implemented, combining assessments by housing-credit experts with statistical models. As part of the quantification of risk, a focused examination of repayment capability is executed, including a test of sensitivity to possible changes in repayment capability as a result of possible changes in the interest rate.

Characteristics of Housing Credit Granted by the Bank

Table D-15: Housing loan data – percentage of total new loans executed[AI]

	For the three months ended				
	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015
Characteristics					
Financing rate over 60%	**31.2%**	34.9%	33.1%	30.4%	35.1%
Ratio of repayment to income greater than 40% (for acquisition and in monthly payments)	**0.3%**	0.5%	0.4%	0.7%	1.5%
Financing rate over 60% and repayment rate over 40%	**0.2%**	0.1%	0.1%	0.2%	0.6%
Percentage of execution of floating-rate loans with interest varying at a frequency of less than 5 years (Bank of Israel limit 33.3%)	**30.3%**	29.5%	30.1%	28.9%	29.9%
Percentage of all-purpose loans	**3.3%**	3.0%	2.5%	2.7%	2.8%
Loans for investment purposes as a percentage of acquisition	**15.3%**	14.8%	18.2%	16.4%	17.5%
Average loan per acquisition (in NIS thousands), excluding refinancing of Ministry of Finance loans	**613**	663	689	658	619
Average original term to maturity per acquisition, in years (excluding bridge loans)	**22.8**	22.5	21.9	21.2	21.0
Percentage over 25 years (including refinancing)	**30.8%**	29.2%	26.5%	21.5%	22.2%
Marginal rate of borrower balances over NIS 5 million	**1.19%**	1.23%	1.29%	1.31%	1.42%

Note that financing rates were calculated pursuant to Reporting Directive No. 876 of the Supervisor of Banks, "Report on Housing Loans."

Financing rates over 60%, repayment rates over 40% of income, and the marginal rate of borrower balances over NIS 5 million decreased in the first quarter of 2016 (values are low relative to recent years). By contrast, the rate of executions over 25 years and the average term to maturity per acquisition increased (values are high relative to recent years). The percentage of all-purpose loans and the average loan per acquisition were volatile.

Credit Risk Mitigation: Standardized Approach Disclosures

Implementation of External Credit Ratings

According to the external rating based standardized approach implemented at the Bank, credit-risk weightings are determined by methods including the attribution of exposure to the counterparty to a transaction, as stated in the directive, taking into account the external credit ratings established by external credit assessment institutions (ECAI), which are used for standardized measurement of credit risk.

ECAI ratings are used to determine the risk weights of the following counterparties:

- Sovereigns
- Public sector
- Corporations
- Banking corporations

For this purpose, the Bank uses data from two rating agencies: Moody's Investor Service and Standard & Poor's Rating Group.

Table D-16: Mapping of ratings of the major international rating agencies

	Ratings by rating agencies		Risk weight		
	Moody's	S&P	Corporations	Banks	Sovereign
1	Aaa to Aa3	AAA to AA-	20%	20%	0%
2	A1 to A3	A+ to A-	50%	50%	20%
3	Baa1 to Baa3	BBB+ to BBB-	100%	100%	50%
4	Ba1 to Ba3	BB+ to BB-	100%	100%	100%
5	B1 to B3	B+ to B-	150%	100%	100%
6	Caa1 or lower	CCC+ or lower	150%	150%	150%

During the rating process, customers are identified and the appropriate rating is determined by matching the files of the ECAIs with the data of the counterparties. The data are entered into the calculation system, and the appropriate risk weight is assigned based on the rules established by the Supervisor of Banks. Accordingly, the lower of the credit ratings assigned by either of the two rating agencies noted above is selected. When there is no rating for the counterparty, the risk weight is calculated according to the defaults defined in the directives of the Bank of Israel.

The risk weight for debts of Israeli banks with an original term to maturity of three months or less, denominated and financed in NIS, is 20%. The risk weight for banks is determined by the risk weight of the country in which the bank is incorporated, and is one level below the risk weight derived from the sovereign rating.

For investments in issuances that have a specific issuance rating, the risk weight of the debt is based on such rating, except when the issuer is a banking corporation or a public-sector entity. In these cases, the risk weight is based on the issuer rating, rather than on the specific issuance rating.

Credit Risk Mitigation

The Bank applies the comprehensive standardized approach in order to determine risk weightings to apply to the counterparty. The standardized approach requires the use of independent ratings prepared by international rating agencies.

The following tables present details of gross credit exposure, after deducting the allowance for credit losses on an individual basis, by risk weightings, with segmentation of the exposure by counterparty (segments), before and after credit risk mitigation in respect of recognized collateral.

Table D-17: Amount of gross credit exposures before credit risk mitigation

	March 31, 2016								
	0%	20%	35%	50%	75%	100%	150%	250%	Gross credit exposure[1]
	NIS millions								
Sovereigns	**94,086**	**5,847**	**-**	**123**	**-**	**1,888**	**-**	**-**	**101,944**
Public sector	**-**	**2,724**	**-**	**5,877**	**-**	**-**	**-**	**-**	**8,601**
Banking corporations	**311**	**12,474**	**-**	**2,526**	**-**	**352**	**-**	**-**	**15,663**
Corporations	**-**	**2,082**	**-**	**3,347**	**-**	**170,045**	**1,562**	**-**	**177,036**
Secured by commercial real estate	**-**	**-**	**-**	**-**	**-**	**93,640**	**563**	**-**	**94,203**
Retail to individuals	**-**	**-**	**-**	**-**	**111,058**	**134**	**684**	**-**	**111,876**
Small businesses	**-**	**-**	**-**	**-**	**13,680**	**40**	**90**	**-**	**13,810**
Housing loans	**-**	**-**	**28,184**	**12,128**	**22,387**	**6,305**	**227**	**-**	**69,231**
Securitization	**-**	**-**	**-**	**-**	**-**	**188**	**-**	**-**	**188**
Others	**2,690**	**-**	**-**	**-**	**-**	**7,951**	**992**	**4,070**	**15,703**
Total	**97,087**	**23,127**	**28,184**	**24,001**	**147,125**	**280,543**	**4,118**	**4,070**	**608,255**

	March 31, 2015								
	0%	20%	35%	50%	75%	100%	150%	250%	Gross credit exposure[1]
	NIS millions								
Sovereigns	84,658	7,313	-	466	-	2,307	-	-	94,744
Public sector	-	2,739	-	6,573	-	6	-	-	9,318
Banking corporations	-	15,534	-	4,822	-	533	-	-	20,889
Corporations	-	1,980	-	4,325	-	179,621	3,087	-	189,013
Secured by commercial real estate	-	-	-	-	-	84,436	755	-	85,191
Retail to individuals	-	-	-	-	104,028	173	557	-	104,758
Small businesses	-	-	-	-	11,843	49	74	-	11,966
Housing loans	-	-	31,734	8,600	17,692	5,970	217	-	64,213
Securitization	-	-	-	-	-	199	-	-	199
Others	2,524	-	-	-	-	10,828	752	3,366	17,470
Total	87,182	27,566	31,734	24,786	133,563	284,122	5,442	3,366	597,761

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation as a result of the execution of certain actions (e.g. use of guarantees), and after offsetting of transactions in derivatives (netting).

Table D-17: Amount of gross credit exposures before credit risk mitigation (continued)

	December 31, 2015								
	0%	20%	35%	50%	75%	100%	150%	250%	Gross credit exposure[(1)]
	NIS millions								
Sovereigns	93,626	6,178	-	296	-	1,863	-	-	101,963
Public sector	-	3,190	-	5,668	-	-	-	-	8,858
Banking corporations	318	11,685	-	2,570	-	429	-	-	15,002
Corporations	-	2,182	-	3,237	-	177,639	1,538	-	184,596
Secured by commercial real estate	-	-	-	-	-	93,092	551	-	93,643
Retail to individuals	-	-	-	-	111,138	138	669	-	111,945
Small businesses	-	-	-	-	13,245	97	89	-	13,431
Housing loans	-	-	30,710	12,348	19,687	5,853	235	-	68,833
Securitization	-	-	-	-	-	195	-	-	195
Others	2,768	-	-	-	-	8,763	815	3,887	16,233
Total	96,712	23,235	30,710	24,119	144,070	288,069	3,897	3,887	614,699

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation as a result of the execution of certain actions (e.g. use of guarantees), and after offsetting of transactions in derivatives (netting).

Table D-18: Amount of net credit exposures after credit risk mitigation

	March 31, 2016								
	0%	20%	35%	50%	75%	100%	150%	250%	Net credit exposure[(1)]
	NIS millions								
Sovereigns	**94,086**	**5,847**	**-**	**123**	**-**	**850**	**-**	**-**	**100,906**
Public sector	**1,863**	**2,724**	**-**	**5,978**	**-**	**-**	**-**	**-**	**10,565**
Banking corporations	**311**	**14,500**	**-**	**15,641**	**-**	**275**	**-**	**-**	**30,727**
Corporations	**-**	**2,077**	**-**	**3,180**	**-**	**162,109**	**1,464**	**-**	**168,830**
Secured by commercial real estate	**-**	**-**	**-**	**-**	**-**	**93,174**	**561**	**-**	**93,735**
Retail to individuals	**-**	**-**	**-**	**-**	**94,669**	**133**	**682**	**-**	**95,484**
Small businesses	**-**	**-**	**-**	**-**	**12,409**	**39**	**87**	**-**	**12,535**
Housing loans	**-**	**-**	**28,184**	**12,128**	**22,387**	**6,305**	**227**	**-**	**69,231**
Securitization	**-**	**-**	**-**	**-**	**-**	**188**	**-**	**-**	**188**
Others	**2,690**	**-**	**-**	**-**	**-**	**7,951**	**992**	**4,070**	**15,703**
Total	**98,950**	**25,148**	**28,184**	**37,050**	**129,465**	**271,024**	**4,013**	**4,070**	**597,904**

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), after credit risk mitigation, and after offsetting of transactions in derivatives (netting).

Table D-18: Amount of net credit exposures after credit risk mitigation (continued)

	March 31, 2015								
	0%	20%	35%	50%	75%	100%	150%	250%	Net credit exposure[(1)]
	NIS millions								
Sovereigns	85,408	7,313	-	466	-	1,414	-	-	94,601
Public sector	1,440	2,739	-	5,823	-	6	-	-	10,008
Banking corporations	-	17,226	-	17,981	-	429	-	-	35,636
Corporations	-	1,980	-	4,278	-	171,716	2,964	-	180,938
Secured by commercial real estate	-	-	-	-	-	83,790	750	-	84,540
Retail to individuals	-	-	-	-	87,303	172	556	-	88,031
Small businesses	-	-	-	-	10,496	48	71	-	10,615
Housing loans	-	-	31,734	8,600	17,692	5,970	217	-	64,213
Securitization	-	-	-	-	-	199	-	-	199
Others	2,524	-	-	-	-	10,828	752	3,366	17,470
Total	89,372	29,258	31,734	37,148	115,491	274,572	5,310	3,366	586,251

	December 31, 2015								
	0%	20%	35%	50%	75%	100%	150%	250%	Net credit exposure[(1)]
	NIS millions								
Sovereigns	93,626	6,178	-	192	-	943	-	-	100,939
Public sector	1,811	3,190	-	5,668	-	-	-	-	10,669
Banking corporations	318	13,644	-	16,424	-	329	-	-	30,715
Corporations	-	2,179	-	3,142	-	171,014	1,438	-	177,773
Secured by commercial real estate	-	-	-	-	-	92,601	551	-	93,152
Retail to individuals	-	-	-	-	93,781	138	666	-	94,585
Small businesses	-	-	-	-	11,896	96	87	-	12,079
Housing loans	-	-	30,710	12,348	19,687	5,853	235	-	68,833
Securitization	-	-	-	-	-	195	-	-	195
Others	2,768	-	-	-	-	8,763	815	3,887	16,233
Total	98,523	25,191	30,710	37,774	125,364	279,932	3,792	3,887	605,173

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), after credit risk mitigation, and after offsetting of transactions in derivatives (netting).

Credit Risk Mitigation: Standardized Approach Disclosures

Collateral management at the Bank is described in the section "Hedging and Risk Mitigation," above. Pursuant to the Basel 3 directives, under certain conditions, certain collateral such as guarantees, credit derivatives, and financial assets held as collateral can be deducted from risk-adjusted assets for the purpose of calculating the capital-adequacy ratio.

The deduction of collateral for the calculation of the capital ratio is performed after using safety margins established in the directive. These margins take into account factors including the term to maturity of the collateral, any lack of congruity between the linkage terms of the collateral and of the credit that it secures, and volatility in the value of the collateral.

The qualifying financial collateral used by the Bank to calculate capital adequacy and risk mitigation includes deposits that constitute collateral by way of liens, bonds of banking corporations and governments under permanent liens, and shares under lien traded on the primary index. In addition, the Bank uses guarantees of banking corporations, which transfer the exposure from the segment of the guaranteed party to exposure to banking corporations.

Table D-19: Details of types of collateral used, with presentation of exposures covered by guarantees, exposures covered by credit derivatives, and exposures covered by qualifying financial collateral, by counterparty

	March 31, 2016						
	Gross credit exposure(1)	Exposure covered by guarantees	Exposure covered by derivatives	Total amounts subtracted	Total amounts added(2)	Exposure covered by financial collateral(3)	Net credit exposure(4)
	NIS millions						
Sovereigns	**101,944**	**(1,038)**	**-**	**(1,038)**	**-**	**-**	**100,906**
Public sector	**8,601**	**-**	**-**	**-**	**1,964**	**-**	**10,565**
Banking corporations	**15,663**	**(762)**	**-**	**(762)**	**16,153**	**(327)**	**30,727**
Corporations	**177,036**	**(1,361)**	**-**	**(1,361)**	**14**	**(6,859)**	**168,830**
Secured by commercial real estate	**94,203**	**(46)**	**-**	**(46)**	**-**	**(422)**	**93,735**
Retail to individuals	**111,876**	**(14,675)**	**-**	**(14,675)**	**-**	**(1,717)**	**95,484**
Small businesses	**13,810**	**(235)**	**-**	**(235)**	**-**	**(1,040)**	**12,535**
Housing loans	**69,231**	**-**	**-**	**-**	**-**	**-**	**69,231**
Securitization	**188**	**-**	**-**	**-**	**-**	**-**	**188**
Others	**15,703**	**-**	**-**	**-**	**-**	**-**	**15,703**
Total	**608,255**	**(18,117)**	**-**	**(18,117)**	**18,131**	**(10,365)**	**597,904**

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation, and after offsetting of transactions in derivatives (netting).
(2) Including an additional safety coefficient appropriate for exposure to borrowed securities.
(3) After taking safety coefficients into account.
(4) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), after credit risk mitigation, and after offsetting of transactions in derivatives (netting).

Table D-19: Details of types of collateral used, with presentation of exposures covered by guarantees, exposures covered by credit derivatives, and exposures covered by qualifying financial collateral, by counterparty (continued)

	March 31, 2015						
	Gross credit exposure[1]	Exposure covered by guarantees	Exposure covered by derivatives	Total amounts subtracted	Total amounts added[2]	Exposure covered by financial collateral[3]	Net credit exposure[4]
	NIS millions						
Sovereigns	94,744	(893)	-	(893)	750	-	94,601
Public sector	9,318	(750)	-	(750)	1,440	-	10,008
Banking corporations	20,889	(547)	-	(547)	16,020	(726)	35,636
Corporations	189,013	(1,110)	-	(1,110)	50	(7,015)	180,938
Secured by commercial real estate	85,191	(40)	-	(40)	-	(611)	84,540
Retail to individuals	104,758	(14,641)	-	(14,641)	-	(2,086)	88,031
Small businesses	11,966	(229)	-	(229)	-	(1,122)	10,615
Housing loans	64,213	-	-	-	-	-	64,213
Securitization	199	-	-	-	-	-	199
Others	17,470	-	-	-	-	-	17,470
Total	597,761	(18,210)	-	(18,210)	18,260	(11,560)	586,251

	December 31, 2015						
	Gross credit exposure[1]	Exposure covered by guarantees	Exposure covered by derivatives	Total amounts subtracted	Total amounts added[2]	Exposure covered by financial collateral[3]	Net credit exposure[4]
	NIS millions						
Sovereigns	101,963	(1,024)	-	(1,024)	-	-	100,939
Public sector	8,858	-	-	-	1,811	-	10,669
Banking corporations	15,002	(754)	-	(754)	16,923	(456)	30,715
Corporations	184,596	(1,198)	-	(1,198)	46	(5,671)	177,773
Secured by commercial real estate	93,643	(14)	-	(14)	-	(477)	93,152
Retail to individuals	111,945	(15,486)	-	(15,486)	-	(1,874)	94,585
Small businesses	13,431	(258)	-	(258)	-	(1,094)	12,079
Housing loans	68,833	-	-	-	-	-	68,833
Securitization	195	-	-	-	-	-	195
Others	16,233	-	-	-	-	-	16,233
Total	614,699	(18,734)	-	(18,734)	18,780	(9,572)	605,173

(1) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), before credit risk mitigation, and after offsetting of transactions in derivatives (netting).
(2) Including an additional safety coefficient appropriate for exposure to borrowed securities.
(3) After taking safety coefficients into account.
(4) Before conversion to credit of off-balance sheet components (e.g. weighting of unutilized credit facilities as credit), after credit risk mitigation, and after offsetting of transactions in derivatives (netting).

Credit Risks in Respect of Derivative Financial Instruments

Counterparty credit risk arising from transactions in derivative financial instruments is measured by applying the coefficients stipulated in Proper Conduct of Banking Business Directive 203 to the face value of the transactions, according to the risk weight of the counterparty.

For the activity of Bank customers involving derivative financial instruments, the Bank has developed computerized models for assessing and controlling counterparty risk at the transaction level and the customer level. These models allow the Bank to regularly monitor customers' financial situation. In this activity, credit risk at a particular date is defined as the total of the value of the present position plus potential risk of future losses arising from volatility of the underlying assets in the position of the counterparty, taking into account offsets and correlation between the transactions; this represents the Bank's potential loss in the event of default by the counterparty.

Counterparty credit risk arising from transactions in derivative financial instruments is measured by applying conservative coefficients to the nominal value of the transactions, or using the scenarios approach, in which the maximum potential exposure of the customer is calculated in a range of different market situations, or using an internal model developed at the Bank. The measurement method is matched to the customer, according to the nature of activity in the customer's derivatives portfolio.

Rules and working procedures have been established in order to determine the required level of collateral for such transactions, as well as rules regarding the actions necessary in order to close exposures, with regard to transactions and customers. Collateral policy is matched to the type of borrower and activity in the area of derivatives. Counterparty exposure limits are set by the appropriate credit authorities at the Bank.

The Bank's policy for activity in derivatives with financial institutions obligated to comply with capital-adequacy requirements is to operate within Credit Support Annex (CSA) agreements to limit exposure. Operational aspects arising from this activity are examined and controlled routinely by a specialized unit.

In order to calculate credit risk exposure in respect of derivative financial instruments, the Bank implements the present exposure method, as established in the directive. In this method, credit risk in respect of derivative financial instruments includes the amounts of the positive fair value of derivatives in the balance sheet, plus add-on values in respect of potential credit risk, calculated by multiplying the face values of the derivatives by the coefficients stated in the directive, taking into account the underlying asset and term to maturity of the instrument.

Pursuant to the directive, transactions in derivatives can be offset for capital-adequacy purposes, provided that the following conditions are fulfilled, among others:

- Existence of a netting contract or agreement with the counterparty creating a single legal obligation covering all of the included transactions, such that the banking corporation has the right to receive, or the obligation to pay, only the net amount of the positive and negative values, revalued to the market, of the single transactions included, in the event that the counterparty fails to meet its obligations due to one of the following reasons: default, bankruptcy, liquidation, or similar circumstances.
- Existence of written, reasoned legal opinions according to which, if the matter were brought to a legal test, the courts and the relevant administrative agencies would find that the banking corporation's exposure is a net amount, based on:
  - The law in the jurisdiction in which the counterparty is registered, and in the case of involvement of a foreign office of the counterparty, also the law in the jurisdiction in which the office is located;
  - The law applicable to the individual transactions;
  - The law applicable to any contract or agreement necessary in order to execute the actual offset.

- Existence of internal regulations aimed at ensuring that the legal characteristics of netting arrangements are examined in light of the possibility of changes in the relevant law. Among other matters, the regulations shall ensure the performance of recurring legal reviews.
- Existence of internal regulations aimed at ensuring that before the transaction is included in the netting set, the transaction is covered by legal opinions that fulfill the criteria established above.
- In addition to counterparty credit risk in respect of the risk of default, the Bank is required to allocate capital to cover the risk of credit valuation adjustment (CVA) losses, in respect of expected counterparty risk in over-the-counter (OTC) derivatives.

Table D-20: Details of credit exposures of the bank arising from derivatives

	March 31, 2016					
	Interest-rate derivatives	Foreign-currency and gold derivatives	Equity derivatives	Precious metals	Commodity derivatives	Total
	NIS millions					
Positive gross fair value	**9,091**	**4,088**	**883**	**11**	**65**	**14,138**
Add-on values	**3,030**	**4,993**	**804**	**2**	**90**	**8,919**
Effect of netting agreements	**-**	**-**	**-**	**-**	**-**	**(13,092)**
Eligible collateral	**-**	**-**	**-**	**-**	**-**	**(1,034)**
Net credit exposure	**12,121**	**9,081**	**1,687**	**13**	**155**	**8,931**

	March 31, 2015					
	Interest-rate derivatives	Foreign-currency and gold derivatives	Equity derivatives	Precious metals	Commodity derivatives	Total
	NIS millions					
Positive gross fair value	10,486	6,630	1,732	19	78	18,945
Add-on values	2,949	5,059	851	4	31	8,894
Effect of netting agreements	-	-	-	-	-	(15,683)
Eligible collateral	-	-	-	-	-	(2,136)
Net credit exposure	13,435	11,689	2,583	23	109	10,020

	December 31, 2015					
	Interest-rate derivatives	Foreign-currency and gold derivatives	Equity derivatives	Precious metals	Commodity derivatives	Total
	NIS millions					
Positive gross fair value	8,244	3,483	1,171	11	79	12,988
Add-on values	3,268	4,896	858	3	74	9,099
Effect of netting agreements	-	-	-	-	-	(12,126)
Eligible collateral	-	-	-	-	-	(1,219)
Net credit exposure	11,512	8,379	2,029	14	153	8,742

Table D-21: Details of face value of the Bank's credit-derivatives portfolio, used for risk management in the Bank's credit portfolio (the Bank is not a party to CDS transactions originating in intermediary activities)

	March 31, 2016		
	Face value in NIS millions		
	Banking book		Total face value of credit derivatives
	Protection acquired	Protection sold	
Credit derivatives	**50**	**132**	**182**

	March 31, 2015		
	Face value in NIS millions		
	Banking book		Total face value of credit derivatives
	Protection acquired	Protection sold	
Credit derivatives	50	139	189

	December 31, 2015		
	Face value in NIS millions		
	Banking book		Total face value of credit derivatives
	Protection acquired	Protection sold	
Credit derivatives	50	137	187

Securitization Exposures

The volume of the Bank's exposure in respect of securitization is approximately NIS 188 million, arising from liquidity lines.

The Bank supplies liquidity lines to securitization entities in which third parties serve as the sponsors. The lines supplied by the Bank constitute a relatively small share of the total liquidity lines of these securitization entities. The Bank does not supply credit reinforcement to these entities. The total liquidity lines supplied to securitization entities, as described above, as at March 31, 2016, amounted to NIS 188 million (approximately USD 50 million), compared with NIS 195 million (approximately USD 50 million) at the end of 2015. No withdrawals were performed on any of these lines up to March 31, 2016.

The risk weight applied to the amount of the exposure is determined according to the highest risk weight assigned to a single exposure covered by the instrument.

For further information regarding credit risk and the management thereof, see the Board of Directors' Review within the financial report to the public.

Market Risk

Management of Market Risks

Market risk – The risk of loss or decline in value arising from change in the economic value of a financial instrument, or of a particular portfolio or group of portfolios; and on the general level, a change in the economic value of the Bank due to changes in prices, rates, spreads, and other market parameters, including the following:

- Interest-rate risk – The risk of loss or decline in value as a result of changes in interest rates in the various currencies.
- Currency risk – The risk of loss as a result of changes in exchange rates.
- Inflation risk – The risk of loss as a result of changes in the curve of CPI expectations.
- Share price risk – The risk of loss as a result of changes in stock prices or in stock indices.
- Credit spread risk – The risk of loss as a result of change in the spread between the yield to maturity of corporate bonds traded in the markets and the relevant risk-free interest rate.
- Volatility risk – The risk of loss as a result of changes in the volatility rates quoted in the market.
- Basis spread risk – The risk of loss as a result of changes in the spreads between different interest-rate curves or different interest bases.

The main market risk factors to which the Bank is exposed are NIS interest rates in the linked and unlinked segments, inflation, the NIS/USD exchange rate, and spreads between different interest-rate curves.

Interest-rate risk in the banking book and investment risk (exposure to share prices and credit spreads) are described in this report in separate sections.

Market risks are managed separately by each subsidiary in the Bank Group, according to policy established by each company's board of directors and in accordance with Group policy. The Bank has set risk limits for the Group that also apply to subsidiaries in which the risk level has been defined as significant for the Group. Market risks are assessed and controlled based on a uniform methodology at the Group level, under the direction of the Risk Management Area, taking into account the size of capital and the unique characteristics of the activity of each subsidiary. Exposures to market risks of the subsidiaries are examined by the Market and Liquidity Risk Management Department in the Risk Management Area, and reported to the Board of Management and the Board of Directors of the Bank at an appropriate frequency based on the risk level.

Structure and Organization

Market risk management is controlled by the Board of Management Global Asset and Liability Management Committee. Policies, including the established limits, are submitted for discussion and approval to the committees of the Board of Management, the committees of the Board of Directors, or the plenum of the Board of Directors, as relevant.

Ongoing activity is conducted by secondary committees, with the participation of senior officers of the Bank; one secondary committee is headed by the Head of Financial Markets and International Banking and another is headed by the Head of the ALM Division. A local committee also operates in New York. The committees operate on the basis of resolutions passed by the Board of Directors and by its committees regarding exposure to market risks, subject to the directives issued by the Supervisor of Banks or by the local regulator, as relevant.

Risk limits reflect the Bank's risk appetite for market risks – the level of risk which the Board of Management and the Board of Directors are willing to bear in the course of business operations in order to achieve returns or value. The limits are approved by the Board of Directors and fixed in procedures, including, among other things, limits on the sensitivity of the Bank's economic value to changes in the principal risk factors and specific limits for each of the various activities. The Bank's risk appetite is established in terms of VaR and/or sensitivities and/or scenarios.

Market risks at Bank Hapoalim are managed at the Financial Markets and International Banking Area. Market risks in the banking book are managed by the ALM Division, and market risks in the trading book are managed by the Dealing Rooms and Brokerage Division (see details and extensive information below).

Market risk assessment and the complementary controls are executed by the Market and Liquidity Risk Management Department, independently and in addition to the monitoring and analysis performed as part of the activity of the Financial Markets and International Banking Area. This is one of two departments in the Operational and Market Risk Management Unit within the Risk Management Area.

Market risk exposures are identified methodically, by collecting information from trading and non-trading product management systems. This information is analyzed in order to manage and assess the risk, using advanced automated systems adapted to each need, based on commonly accepted pricing models. The models are tested in an orderly validation procedure.

Trading activity is routinely managed and measured using specialized automated systems commonly used in the international markets for these purposes, such as Opics, Summit, and Derivatech, as well as automated systems developed by the Bank. Market risks arising from this activity are also measured using the Algorithmics system.

Market Risk Management Policy[AI]

Market risk management policy in the Bank Group is reflected in the Group risk-management policy and in the quantitative limits detailed later in this section. Activity in the markets is intended both for hedging exposures that arise from the Bank's activity and service to its customers, and for managing positions within limits. In general, market risk management at the Group is aimed at increasing expected profits, while maintaining approved, controlled risk levels. Exposure to these risks is not a primary source of revenue for Bank Hapoalim.

In the area of the activity of Bank customers involving derivative financial instruments, the Bank has developed computerized models for assessing and controlling counterparty risk at the transaction level and the customer level. These models allow the Bank to regularly monitor customers' situation. In this activity, credit risk at a particular date is defined as the total of the value of the present position plus potential risk of future losses; the potential loss is calculated taking into account the volatility of the underlying assets in the position of the counterparty, and taking into account offsets and correlation between the transactions; this represents the Bank's potential loss in the event of default by the counterparty.

Counterparty credit risk arising from transactions in derivative financial instruments is measured by applying conservative coefficients to the nominal value of the transactions, or using the scenarios approach, in which the maximum potential exposure of the customer is calculated in a range of different market situations, or using an internal model developed at the Bank. The measurement method is matched to the customer, according to the nature of activity in the customer's derivatives portfolio.

Rules and working procedures have been established in order to determine the required level of collateral for such transactions, as well as rules regarding the actions in order to close exposures, with regard to transactions and customers, if necessary. Counterparty exposure limits are set by the appropriate credit authorities at the Bank. For further information, see the section "Credit Risk," above.

The Bank's policy for activity in derivatives with financial institutions obligated to comply with capital-adequacy requirements is to operate within Credit Support Annex (CSA) agreements to limit exposure. Operational aspects arising from this activity are examined and controlled routinely by a specialized unit.

Market Risk Exposure Procedures

A policy document for treasury risk management in the Group is presented to the Board of Directors for approval each year, for the coming year of activity. As part of the policy, risk procedures are approved, which include an overall framework for the risk estimate in the banking book and at Bank Hapoalim, limits on the overall sensitivity of the Bank to risk factors, and risk limits for the various trading activities. The annual document reflects the work plan of the Financial Markets and International Banking Area.

The policy documents address events that require reporting, including unusual developments in the markets or other material events, with a procedure for escalation to the Chief Executive Officer and to the Chairman of the Board of Directors, as relevant.

Table D-22: Main limits on exposures to market risks in the overall activity of the Bank, and separately for trading activity

	March 31, 2016		
	Limit	NIS millions	% of active financial capital
Overall Bank activity	Overall risk estimate (VaR)	**950**	
	Sensitivity of economic value to parallel changes of 1% in interest-rate curves:		
	Unlinked NIS	**620**	
	CPI-linked NIS	**620**	
	Foreign currency	**500**	
	Linkage-base exposures by segment:		
	CPI-linked NIS		**100-/+**
	Foreign currency, including foreign-currency linked		**30-/+**
	Sensitivity to 10% change in NIS/USD exchange rate	**500**	
Of which: trading book	Overall risk estimate (VaR)	**150**	
	Sensitivity of economic value to parallel changes of 1% in interest-rate curves:		
	Unlinked NIS	**120**	
	Foreign currency	**70**	
	Parallel and non-parallel change in NIS/USD basis spread curve	**180**	
	CPI exposure - net position limit	**4,000**	
	NIS/foreign-currency exposure		**10-/+**

Means for Policy Supervision and Realization[AI]

The Board of Directors and the Risk Management and Control Committee receive reports on activity, exposures, results of operations, and execution of approved policy, at least once each quarter. These reports include: a review of topics discussed and reported in committees, including main resolutions; main exposures and risk levels utilized out of approved limits; results of operations; summary of events requiring a report (losses, exceptions from procedures, exceptional events); applications for and approvals of expansion of activities and authorizations for the various activities, according to the hierarchy of authorizations; overview of market risk in the activity of the Bank and at subsidiaries with significant exposures for the Group; and a quarterly report on the control of market risks.

Risk Assessment and Control

First line of defense – the Financial Markets and International Banking Area and the overseas offices: In addition to risk assessment, examination of results, and routine controls over compliance with limits, operational controls are applied by various units in the Financial Markets and International Banking Area and at the overseas offices. The additional goals of these controls are to examine the correctness, completeness, and congruence of different databases in different reporting systems, and to identify operational errors.

Second line of defense – identification and assessment of risks, control of limits on the extent of risks, and reporting on findings are performed or controlled by the Risk Management Area, independently of the routine analyses and reports performed as part of the activity of the first line of defense.

The Market and Liquidity Risk Management Department in the Risk Management Area is responsible for the formulation of the market risk assessment methodology of the Bank Group, and for independent complementary control over market risks in the Group.

Management of Positions[AI]

Market risks in the trading book arise from the Bank's activity as a market maker, trader, and manager of positions on its own behalf. This activity is based on dynamic management of positions, mainly by means of tradable, liquid financial instruments. Changes in the extent of exposures may be rapid, as a function of changes in the markets and of customers' activity. The extent of exposures can usually be changed quickly and adjusted to the desired position.

The Bank's risk level is measured and controlled according to procedures that include, among other things, limits on the sensitivity of economic value to changes in the primary risk factors. In addition, a risk estimate is calculated using the VaR (value at risk) method. The VaR method is used to estimate the maximum potential loss to a corporation resulting from the materialization of market risks within a given period of time and at a level of statistical significance predefined by the Bank and approved by the Board of Directors. The principal limits are detailed in the subsection "Main Limits on Exposure to Market Risks," above. Risk assessments as well as limit control of trading positions are performed at least once daily, both by control units within the Area and by units in the second line of defense.

Portfolio Management Models[AI]

Market Risk Assessment Methodology

The methodology used by the Bank to assess market risks has been approved by the Board of Directors and by the Board of Management. This methodology includes both VaR calculations and the application of extreme scenarios (stress tests) to all trading portfolios and to the banking book. The market risk assessment methodology is congruent with the strategic objectives of the Bank and with the requirements of the Basel Committee, and complies with international standards.

The estimate of risk in trading activity is calculated at least once daily, for a horizon of ten business days, at a significance level of 99%. The higher of the risk-level outcomes of two commonly accepted risk-assessment methods (historical simulation, in which all observations are assigned equal weights; and Monte Carlo simulation, in which recent observations are assigned greater weight) is taken into account. This methodology is compatible with the relevant recommendations of the Basel Committee following the crisis in US markets. The estimate provides a relatively prompt alert of the level of market risk during periods of rising volatility. Full revaluation of the trading book is performed at least once daily, under various scenarios, in order to generate an estimate.

In addition, a backtest procedure is performed routinely in order to examine the validity of the risk-assessment model in the trading book. The number of deviations is examined based on criteria established in the recommendations of the Basel Committee; up to four deviations in approximately 250 observations annually is considered the "green zone" (at a significance level of 99%). The results of this test are reported annually to the Board of Management and to the Board of Directors. According to the results of the test, the model meets the acceptance criteria established by the Basel Committee.

Risk assessment of activity in the banking book, as a complementary control using the VaR method, is performed on a monthly basis, using the historical method, with a one-month horizon.

Limitations of the Methodology for Assessing Risk in Trading Activity at the Bank

1. The Monte Carlo simulation assumes a normal distribution of risk factors. This assumption does not always apply in reality.
2. The historical simulation assumes that the historical behavior of the risk factors will recur in the future, which may not be the case.
3. It is not possible to forecast a sudden change in a risk factor using either of the two methods.
4. With the use of a 99% significance level, losses that could occur beyond that level are ignored.
5. The use of a horizon of ten business days assumes that it is possible to hedge and sell positions within ten business days. In special products, at large market volumes, or during crisis periods, liquidity problems in the market may make it impossible to close or fully hedge positions within this timeframe.
6. The risk estimate is calculated on positions only a few times in the course of the business day.

To mitigate the effect of the said limitations, in addition, stress scenarios are applied in order to examine the potential loss in extreme cases, for all areas of trading activity, as detailed below.

Limitations of the Methodology for Assessing Risk in the Banking Book

1. The credit risk inherent in assets does not constitute a parameter in the calculations, which focus on quantifying the market risks in the banking book.
2. The information used for the risk estimates is assembled from various automated systems.
3. The use of behavioral models to reflect the optionality of various products.
4. The historical simulation assumes that the historical behavior of the risk factors will recur in the future, which may not be the case.
5. With the use of a 99% significance level, losses that could occur beyond that level are ignored.

To mitigate the effect of the said limitations, in addition, stress scenarios are applied in order to examine the potential loss in extreme cases, as detailed below, and collapse of the behavioral assumptions is tested.

Table D-23: Risk estimates of trading activity (VaR)

	March 31, 2016	Average in 2016
	NIS millions	
Total trading in dealing rooms	**16**	**18**

	December 31, 2015	Average in 2015
	NIS millions	
Total trading in dealing rooms	17	23

Methodology for the Application of Stress Tests

The market risk assessment methodology of the Bank includes the application of stress tests to trading portfolios and to the banking book, in addition to VaR calculations.

1. Sensitivity analysis – The sensitivity of the portfolio/activity to the various risk factors is tested by applying scenarios to one risk factor while the other risk factors are held constant. This allows an examination of the effect of the major risk factors on the portfolio. In option portfolios, the combined effect of more than one risk factor is also examined.
2. Worst historical scenario – Based on the history of the last five years. The calculation is performed with a horizon of ten business days for the trading book and one month for the banking book and for the Bank as a whole
3. Macro-economic scenarios – Subjective scenarios developed in collaboration with the Economics Department of the Bank.
4. Fixed interest-rate scenarios – A set of scenarios in which the principal interest rates to which the Bank is exposed are stressed through parallel and non-parallel changes.
5. Extreme scenarios based on a methodology similar to that used to create VaR scenarios, based on the volatility of risk factors during periods of stress in the markets.

The principles guiding the establishment and application of the scenarios have been approved by the Board of Management Committee and by the Board of Directors.

Capital Requirements in Respect of Market Risks

The Bank is required to maintain a minimum capital ratio in respect of market risks, on the basis of a standardized model defined by the Bank of Israel. The regulatory capital adequacy is calculated for interest-rate and share risks in the areas of trading alone, as defined above, and for currency risks in the banking book and in the trading book.

Table D-24: Capital requirements in respect of market risks

	March 31, 2016[(1)]			March 31, 2015[(1)]			December 31, 2015[(1)]		
	Specific risk	General risk	Total	Specific risk	General risk	Total	Specific risk	General risk	Total
	NIS millions								
Interest-rate risk	**3**	**381**	**384**	108	366	474	17	387	404
Share risk	**6**	**6**	**12**	7	7	14	6	6	12
Foreign currency exchange-rate risk	**-**	**153**	**153**	-	86	86	-	108	108
Option risk	**-**	**96**	**96**	-	75	75	-	49	49
Total	**9**	**636**	**645**	115	534	649	23	550	573

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Supervisor of Banks, at 12.59% as at March 31, 2016; 12.57% as at December 31, 2015; and 12.5% as at March 31, 2015. The minimum required total capital ratio is 12.5% from January 1, 2015, to December 31, 2016, and 13.5% beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to this ratio at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum total capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 13.7%.

Operational Risk

Operational risk is defined as the risk of loss that may be caused by failed or faulty internal processes, human actions, system malfunctions, or external events. The definition includes legal risk, but does not include strategic risk or reputational risk. Failures related to one of the aforesaid factors may cause damage to profitability. The Bank operates control units, including Information Systems Security and Cyber Defense, Business Continuity, Security, the Compliance Officer, and Anti-Money Laundering and Terrorism Financing Prevention, as well as comprehensive procedures and systems in areas related to banking activity, management of human resources, process control, emergency operation, and more.

Management of Operational Risks

Operational risk management strategy is aimed at supporting the achievement of the Group's strategic objectives and maximizing business value, while taking into consideration the costs in terms of risk, by all responsible parties at all levels of the organization. The managerial process is oriented towards execution based on the designation of risk ownership. The goal is for communication and rational treatment of operational risks to contribute to managerial decision making, based on considerations of business value versus cost in terms of risk, both at the level of the management of the organization and at the level of the various units.

The goals of operational risk management are:

- To ensure effective supervision and management of operational risks in all units of the Group, including risk ownership and decision making based on cost-benefit considerations.
- To ensure effective identification and communication of operational risks in all substantial business operations of the Group and the supporting units, with the aim of establishing operational risk appetite congruent with the approved strategic objectives of each unit in the Group.

- To establish an internal control structure promoting appropriate values of a culture of awareness, transparency, and efficiency with respect to operational risks within the Group.
- To optimally manage and allocate regulatory capital and economic capital for operational risks.

Responsibility for routine management of operational risk and for activities aimed at mitigating the risk lies with the Area managers and the managers of subsidiaries in the Bank Group. These activities are overseen by the Operational Risk Management Department in the Operational Risk and Market Risk Management Unit, within the Risk Management Area. Routine activity is conducted in the Bank's units and in the Group by a network of operational risk controllers, based on the matrix management principle; controllers report organizationally to Area managers or CEOs of subsidiaries, and receive methodology guidance from the Operational Risk Management Department.

Operational risk management activity is supervised and directed by three forums:

- The Board of Directors' Committee on Risk Management and Control;
- The Board of Management Committee on Risk Management, headed by the CEO;
- The Subcommittee on Operational Risk Management, headed by the Head of Risk Management.

The operational risk management policy was approved by the Board of Management and the Board of Directors of the Bank. The policy document serves as a framework for operational risk management within the Group, in accordance with uniform principles and reporting duties aimed at complying with the Basel 2 standards on Sound Practices. The Bank's activity in this area is conducted according to the rules of Proper Conduct of Banking Business Directive 206, "Capital Measurement and Adequacy – Operational Risk," which refers among other matters to regulatory capital allocation in respect of operational risks, and Proper Conduct of Banking Business Directive 350, "Operational Risk Management," which is congruent with the updated guidelines in the Basel document of June 2011 on sound practice for operational risk management.

The Bank has operated in accordance with the Basel 2 standardized approach and the corresponding requirements of the Proper Conduct of Banking Business Directives since 2010. The strategic plan for the coming years includes, among other matters, extension and expansion of some of the activities, and adjustment for updates of the relevant documents and regulatory guidelines. The following projects and activities, among others, are underway as part of the standardized approach:

1. Quarterly reports are part of the consolidated risk document, pursuant to the requirements of Proper Conduct of Banking Business Directive 310, "Risk Management." The reports are submitted to the Subcommittee on Operational Risk Management, the Board of Management Committee on Risk Management, the Board of Directors' Committee on Risk Management and Control, and the plenum of the Board of Directors. The reports include updates on the implementation of the standardized approach in the Group, work plans, the status of projects in progress, information about operational events, assessments of potential risks, trends, changes in the risk profile, and comparative external information.
2. Collection of information regarding operational events in the Bank Group. A database for this purpose was established in late 2002, and is used, among other things, to analyze events, trends, and patterns and to support the mapping and assessment of operational risks to which the Group is exposed.
3. Key risk indicators (KRIs) for operational risks have been specified, as part of the development of a monitoring and control infrastructure, with respect to products, processes, or institutional risks. The KRI is a metric that can be measured in quantitative terms, and may also include qualitative information indicating the presence of a particular factor or trend. Thresholds have been set for follow-up, escalation, and treatment, as relevant.
4. Lessons-learned processes applied to operational events; relevant information shared among units; organizational learning.

Routine procedures are performed to identify, map, and assess operational risks and controls at the units of the Bank and the Group, including mapping of the risk of embezzlement and fraud. This activity is conducted based on a uniform methodology in line with the requirements of the Basel Committee and the directives of the Bank of Israel on this matter, including monitoring of the implementation of the recommendations. A comprehensive mapping process of operational risks in all units of the Group is performed every three years. Subsequently, the findings are maintained, updated, and expanded through additional analyses, depth analyses, and risk analyses regarding new products and activities.

The goal of this activity is to identify material risk areas, define risk ownership, assess risks (average and extreme), assess the existing controls, and differentiate low risks from material risks that require additional examination and action, based on cost-benefit considerations, according to the following main ways of coping with risks:

- Minimization of the risk through the application of additional controls.
- Transfer of the risk to a third party (e.g. insurance, outsourcing).
- Absorption of the risk, with appropriate quantification.
- Reduction of the activity that creates the risk.

Additional related activities:

- An automated operational risk management system (Basel 2 – PAMELA) has been implemented at the units of the Group. The system operates in the areas of collection of information regarding operational events, mapping and assessment of risks and controls, collection of KRIs (key risk indicators), action items, lessons learned, and reports.
- A comprehensive framework of principles and standards has been formulated for the implementation of a uniform control philosophy within the Bank Group. Within this framework, a periodic process is conducted to evaluate the effectiveness of controls.
- Launches of new products or activities, in accordance with the defined policy for the launch of a new product in the Bank Group, are accompanied by examination and analysis of the relevant operational risks involved in the product or activity.
- A methodological infrastructure has been defined for the management of operational risks in material IT processes.
- A special requirement has been established in the policy for advance examination prior to outsourcing of an activity, taking into consideration the risks unique to outsourcing.

Information Security and Cyber Incident Risks

Activity in the area of information security is conducted as required in the directives of the Bank of Israel, the Protection of Privacy Law, 1981, and other laws, as relevant, with the aim of protecting the information-technology system and minimizing information-security risks.

The goal of cyber attacks is to abuse computer systems and networks in technology-based organizations, to destabilize or damage computer-based systems, or to monitor the electronic activity of individuals without their consent. Such attacks can be carried out without the knowledge of the users, and can disrupt routine operations; damage computer services to the point of preventing them from functioning, shutting them down, or slowing them significantly; or collect intelligence and information.

The frequency and severity of cyber incidents to which the Bank is exposed has increased in recent years. There is a possibility that the Bank may incur costs and suffer negative consequences as a result of cyber attacks, such as disruption of the Bank's operations, theft of financial assets of the Bank or of its customers, or damage to reputation, affecting the confidence of customers or of investors. The Bank invests extensive (human and technological) resources to minimize and prevent this risk, but absolute protection cannot be ensured.

Proper Conduct of Banking Business Directive 361, "Cyber Defense Management," was issued in March 2015. This directive sets forth basic principles for cyber defense management. Upon publication of the directive, the Bank prepared an action plan for the integration of the requirements of the new directive, in addition to the other directives to which it is subject in this area, such as those concerning business continuity and risk management, all in accordance with the clarifications provided by the Bank of Israel with respect to the manner and dates of implementation.

Cloud Computing Risks

In June 2015, the Supervisor of Banks issued a letter concerning risk management in a cloud computing environment. The letter sets forth rules aimed at reducing the risks inherent in the use of cloud technology. The letter provides guidance regarding the use of cloud computing while hedging the inherent risks. Pursuant to the regulatory guidance, the Bank has prepared and is implementing a policy document in this area, including processes and controls designed to address the relevant risks.

Emergency Preparedness

The Bank maintains and implements a continuous plan for emergency preparedness and business continuity (BCMP – business continuity management plan), in accordance with the Bank of Israel's Directive 355, "Business Continuity Management"; Directive 357, "Information Technology Management"; and additional expansions. The Bank's preparedness is based on detailed action plans, working procedures, and periodic tests and drills, defined in a system of emergency procedures. As part of its emergency preparedness, the Bank conducted a lateral process to establish policies, define reference scenarios, map and analyze critical processes and the resources required for the recovery of such processes during an emergency (BIA), and update its action plans based on the prevalent methodologies globally. The action plan involves all Areas of the Bank, through Area-level business continuity officers and designated teams. The BCP is led by a specialized Business Continuity Management Unit, which reports to the Head of Business Continuity of the Bank and to the Head of the Emergency Committee of the Bank (the CTO).

The business continuity policy has also been adopted by the subsidiaries in Israel and globally, and at the Bank's overseas branches, with adjustments, based on the corporate-governance policy and on the guidelines of the Bank of Israel.

In addition, the Bank holds periodic emergency drills covering operational scenarios as well as complex business scenarios, with the participation of the various units, from branches, regional managements, units, and Areas, to the Board of Management of the Bank. The Bank has a new remote central IT site, to ensure the availability and protection of its central information systems. Activity is being transferred to the site in accordance with the established work plan, with ongoing management of the non-routine risks arising from the migration of the systems and data.

The Israel Standards Institute has affirmed that the business continuity management system of the Bank complies with the requirements of the international standard ISO 22301.

As part of its preparedness for business continuity, the Bank is prepared to handle a range of possible scenarios. With respect to emergency scenarios that may cause the Bank to incur significant damage, red-alert systems are monitored and detailed business continuity contingency plans are in place. Extreme scenarios are reviewed and discussed periodically by the Committee on Extreme Scenarios and Risk Concentrations. The activation of a contingency plan is under the responsibility of the Board of Management or of the designated Board of Management committee responsible for the financial aspects of crisis situations; note that a charter for the establishment of such a committee is also part of the contingency plans.

Insurance

The Bank has a banking insurance policy to hedge risks, which includes: (1) banking insurance to cover damages that may arise from embezzlement by employees, loss of documents, forged documents, etc.; (2) professional liability insurance, to protect against claims filed by customers regarding damage caused by negligent banking actions; (3) computer crimes insurance, to cover damages to the Bank and to customers of the Bank as a result of malicious penetration of the Bank's computer systems. The banking insurance policies are subject to exclusions common in insurance policies of banking corporations in Israel (including an exclusion of damage arising from violation of the directives related to money laundering and terrorism financing).

In addition, the insurance structure of the Bank also includes property insurance, third-party insurance, employers' liability, directors' and officers' insurance, and additional insurance policies.

The liability limits in the policies were established by the Bank according to its needs, as part of its overall risk-management policy. Within the fulfillment of the Sound Practice requirements under the Basel guidelines, cooperation and exchanges of information are maintained between the Operational Risk Management Department and the unit that handles banking insurance.

Share and Credit Spread Risk: Investment Risk

Management of Investment Risk

"Investment risk" is defined at the Bank as exposure to the stock market, to credit spreads, and to credit risk in the bond and stock markets in the banking book of the Group (as a result of holdings in these products, the Bank may also be exposed to interest-rate risks and/or currency risks and/or liquidity risks, which are managed separately).

Investment portfolio management is a tool for the management of liquidity surpluses, and one of the tools for the management of exposures to interest rates, linkage bases, and liquidity in the banking book. In general, the investment portfolio consists of products traded on the financial markets, for which price quotes can be obtained.

The overall investment framework was established from a global, systemic perspective, with the approval of the Board of Directors of the Bank, which has set limits on the volume of the investment and on risk indicators, including limits on risk appetite and on risk capacity in terms of stress scenarios, and individual limits for the various investment segments, including volume limits by type, geographical diversification limits, rating limits, and more. Investments are performed through instruments defined as permitted.

Risk is managed under the overarching responsibility of the Financial Markets and International Banking Area, with respect to the implementation of policy in the Group, allocation of the limits approved by the Board of Management and Board of Directors, monitoring, guidance, and reporting. This activity is managed by designated units established for this purpose in the Financial Markets and International Banking Area, using specialized systems. In addition, investment activity is permitted at a limited number of subsidiaries. Managerial responsibility for the activity of each subsidiary rests with the member of the Board of Management who oversees that company.

In the second line of defense, the Market and Liquidity Risk Management Department in the Risk Management Area is responsible for formulating methodology for the assessment of investment risks and for independent risk assessment and control. This department also challenges the business unit and provides an independent opinion, pursuant to Proper Conduct of Banking Business Directive 311, prior to material investments.

The activity is subject to all relevant directives and laws in this area, in Israel and in the country in which the branch/subsidiary conducting the activity is located. Due to the complexity of the regulatory directives, specific regulatory procedures have been established for this activity.

Investment risks are identified and measured methodically, by collecting information from the Bank's systems. This information is analyzed using the Bank's risk-management systems, and reported periodically to the committees of the Board of Management and of the Board of Directors.

In the management of the investment portfolio, the Bank is also exposed to credit risks and credit spreads, due to its investments in bonds of companies and of foreign governments. According to the definitions of the Bank, Israeli government bonds in NIS and in foreign currency and government bonds of the sovereignty in which a branch/subsidiary operates do not bear investment risk, and are therefore not included in the measurement of investment risk at the Bank.

Investment risk at the Bank Hapoalim Group arises in three frameworks:

1. Investment in tradable products in the investment portfolio, managed under the responsibility of the Financial Markets and International Banking Area;
2. Non-tradable investments through the subsidiary Poalim Capital Markets (PCM), managed according to the policy of PCM, under the responsibility of the PCM board of directors;
3. Equity-basis investees.

The Group holds shares and bonds primarily for investment purposes (rather than for trading), recorded following accounting policy in the portfolio available for sale; a decrease in the value of these shares and bonds may damage the capital of the Bank. Note that strategic holdings in shares of subsidiaries appear in the balance sheet in reports on related companies.

Shares for which a fair value is available and bonds are included in the balance sheet at their fair value on the reporting date. Shares for which no fair value is available are measured in the balance sheet at cost. Unrealized profits or losses from adjustments to fair value are not included in the statement of profit and loss, and are reported net, deducting an appropriate reserve for tax, in a separate item of equity within accumulated other comprehensive income.

Impairment of securities available for sale: Each reporting period, the Board of Management of the Bank determines whether declines in the fair value of securities classified into the available-for-sale portfolio are other than temporary. This examination includes several stages and principles, in accordance with the policy established at the Bank. When other-than-temporary impairment occurs in a security, the cost of the security is written down to its fair value at the balance sheet date and used as the new cost base. The amount of the write-down is charged to the statement of profit and loss.

Positions in Shares in the Banking Book

Table D-25: Details of the Bank's investments in shares in the banking book

	March 31, 2016		March 31, 2015		December 31, 2015	
	Balance sheet value and fair value	Capital requirements[1]	Balance sheet value and fair value	Capital requirements[1]	Balance sheet value and fair value	Capital requirements[1]
	NIS millions					
Investments classified into the trading portfolio	**46**	**[2]12**	52	[2]14	48	[2]12
Investments classified into the available-for-sale portfolio	**2,412**	**334**	2,845	381	2,486	341
Total investments in shares	**2,458**	**346**	2,897	395	2,534	353
Of which: traded on the stock exchange	**1,738**		2,288		1,891	
Privately held	**720**		609		643	
Unrealized gains included in supervisory capital	**169**		414		224	

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Supervisor of Banks, at 12.59% as at March 31, 2016; 12.57% as at December 31, 2015; and 12.5% as at March 31, 2015. The minimum required total capital ratio is 12.5% from January 1, 2015, to December 31, 2016, and 13.5% beginning January 1, 2017. Beginning January 1, 2015, a capital requirement is added to this ratio at a rate representing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually, over the course of eight quarters, up to January 1, 2017. Accordingly, the minimum total capital ratio required by the Supervisor of Banks as of January 1, 2017, on a consolidated basis, according to data at the reporting date, will be 13.7%.

(2) Including capital allocation with respect to specific market risk and general market risk.

For details regarding investments of the Bank, see Note 5 to the quarterly Financial Statements.

Interest-Rate Risk in the Banking Book

Interest-rate risk in the banking book refers to the potential effect of changes in the various interest-rate curves on the economic value of the Bank (i.e. change in the present value of assets and liabilities) and/or on net interest income (accounting income sensitivity). The risk emerges during the routine and proactive banking activity of the Bank, as a result of the provision of routine services to the general public and to the business and financial sectors, and from other activities; this includes interest-rate exposure arising from the management of investment portfolios. The risk arises from differences in the structure of assets and liabilities – gaps between segments, durations, interest bases, interest-rate renewal dates, and more. The Bank focuses on management of the sensitivity of the economic value of the capital of the Bank. Limits apply both to the sensitivity of economic value (including financial subsidiaries under the Bank's management and subsidiaries with material risk to the Group), and to the sensitivity of income to scenarios of change in the shekel, CPI-linked, and dollar interest-rate curves, as well as measurements of other interest-rate effects. In order to calculate the sensitivity of economic value to changes in interest rates, the Bank refers to all financial assets and liabilities, while treating part of the balances of current-account deposits of the public as a long-term liability spread over several years, in accordance with a model approved by management and by the Board of Directors each year. Assumptions regarding early repayment of mortgages are also used, in accordance with a model based on statistical analyses and approved by management and by the Board of Directors. Interest-rate exposure management policy is aimed, in congruence with the objectives of the Bank, at achieving the desired structure of exposures in each segment (unlinked shekel; CPI-linked shekel; foreign currency and foreign-currency-linked), in accordance with estimates concerning market variables, and subject to limits. Sensitivity to interest rates is measured, in a controlled manner, at least once each month, with more frequent measurements for exposure management purposes. In general, the goal of interest-rate risk management in the Group is to allow service to customers while taking controlled risks.
Interest-rate risk in the banking book (non-trading market risk) at Bank Hapoalim is managed in the Financial Markets and International Banking Area by the Asset and Liability Management Division, and separately by each subsidiary in the Bank Group, according to policy established by each company's board of directors and in accordance with Group policy. The risk is assessed and controlled based on a uniform methodology at the Group level, under the direction of the Risk Management Area and the Financial Markets and International Banking Area, taking into account the size of capital and the unique characteristics of the activity of each subsidiary. The subsidiaries' exposure to risk is examined by units at the Head Office and reported to the Board of Management and the Board of Directors of the Bank at an appropriate frequency based on the risk level. The Bank has set risk limits for the Group that also apply to subsidiaries in which the risk level has been defined as significant for the Group.
Market risk exposures are identified methodically, by collecting information from product management systems. This information is analyzed in order to manage and assess the risk, using advanced automated systems adapted to each need, based on commonly accepted models. The models are tested in an orderly validation procedure.
In the banking book in Israel, flows arising from assets and liabilities are produced and analyzed by a designated interest-rate risk management system for all banking products, according to dates of changes in interest rates. Data are also received in separate files from the New York branch and from the subsidiaries with significant exposure for the Group. Concurrently, sensitivity calculations are performed at the Market and Liquidity Risk Management Department in the Risk Management Area, using the risk-management system.

Tools for the management and hedging of exposures in the banking book include pricing policy, bond portfolio management, issuance of debt instruments, off-balance sheet transactions, and more. The Bank's management of non-trading exposures is based, among other things, on forecasts and working assumptions regarding expected developments in financial and capital markets in Israel and worldwide. The Bank uses derivatives and applies hedge accounting rules to hedge part of the interest-rate sensitivity of long-term bonds in foreign currency. The effect of transactions executed in the markets are examined on a weekly basis by the Asset and Liquidity Management Division; the change in economic value arising from changes in markets on the banking book, including hedges, is also examined on a monthly basis.

Table D-26: Data regarding the sensitivity of the capital of the Bank to parallel changes in interest-rate curves (theoretical change in economic value as a result of each scenario)

	March 31, 2016			**Maximum in 2016**		**Minimum in 2016**	
	1% increase	1% decrease	0.1% increase	1% increase	1% decrease	1% increase	1% decrease
Scenario	NIS millions						
Change in CPI-linked interest rate	**(119)**	**163**	**(14)**	**(256)**	**310**	**(118)**	**163**
Change in unlinked interest rate:	**(112)**	**144**	**(13)**	**(144)**	**178**	**(112)**	**144**
Change in foreign-currency interest rates:	**92**	**(94)**	**9**	**153**	**(159)**	**92**	**(94)**

	December 31, 2015			Maximum in 2015		Minimum in 2015	
	1% increase	1% decrease	0.1% increase	1% increase	1% decrease	1% increase	1% decrease
Scenario	NIS millions						
Change in CPI-linked interest rate	(174)	217	(19)	(229)	262	(32)	54
Change in unlinked interest rate:	(165)	200	(18)	(192)	229	-	-
Change in foreign-currency interest rates:	33	(39)	4	249	(265)	27	(31)

The above table presents an analysis of the sensitivity of the Bank's economic value to changes in interest-rate curves, based, among other factors, on the discounting of expected cash flows by an interest-rate curve, which generally does not take into account the credit risk spread of the counterparty, with the use of internal models for some products. This differs from a fair-value calculation, which is based on factors including the discounting of expected cash flows by interest rates reflecting the risk levels, according to the accepted practice in financial statements, without internal models for some products.

Top and Emerging Risks[AI]

Based on the recommendations of the FSB (Financial Stability Board), a top risk is defined as a development currently occurring in the business environment of the Bank that may adversely affect the Bank's results over the course of the coming year. By contrast, with respect to an emerging risk, there is greater uncertainty regarding the timing of materialization of the risk as an occurrence with a material effect on the strategy of the Bank.

Details and descriptions of top and emerging risks were included in the Annual Report for 2015. There were no material changes in these risks during the reported period.

On March 28, 2016, the Knesset passed the Financial Corporations Officer Remuneration Law, which imposes restrictions on amounts of remuneration of employees of financial corporations. This law is expected to cause direct or indirect damage to the remuneration of the group of senior executives at the Bank; the manner of implementation of the law is unclear. For further details, see Note 8 to the Condensed Financial Statements.

An initial analysis of the directives of the law indicates the risks listed below. At this stage, it is too early to estimate the effect of these risks.

- In the short term, there is a risk of resignation of executives employed under personal contracts at various levels of management.
- A certain degree of ambiguity in the wording of the legislation may lead to legal claims in connection with its implementation by the Bank.
- The Bank's ability to retain executives and senior employees may be impaired, in Israel and overseas, including its ability to compete with the terms of employment offered by companies in industries unaffected by the law.
- There may be damage to the Bank's ability to recruit employees with special skills from outside the Bank, such as technological and other professionals, whose potential for compensation and promotion in other industries will remain significantly higher than in the financial field following the inception of the law restricting remuneration.

Compliance Risk[AI]

Compliance risk is risk arising from noncompliance of the Bank or of any of its employees, in any place relevant to the activity of the Bank, with laws and regulations. Compliance risk also includes the reputational risk that accompanies failure to comply with such directives.

Although compliance risk may materialize in any case of such noncompliance, and the Bank applies a policy of compliance with all legal and regulatory directives, for the purposes of risk management the main compliance risks against which the Bank endeavors to defend itself can be defined as the following:

- The risk of material damage arising from a regulatory order of any government agency due to noncompliance of the Bank or of any of its employees with directives concerning the prohibition of money laundering and terrorism financing, or deficiencies in processes designed to ensure such compliance, or the absence of such processes (including risk related to the correspondent activities of the Bank).
- The risk of material damage arising from a regulatory order of any government agency due to improper activity of the Bank or of any of its employees in relation to customers of the Bank, tax issues, or noncompliance with specific legal directives in this area.
- The risk of material damage arising from a regulatory order of any government agency due to noncompliance of the Bank or of any of its employees with securities laws.
- The risk of material damage arising from a class-action suit due to noncompliance with directives that regulate the relationship between the Bank and its customers.
- The risk of a criminal suit against the Bank or against its senior executives due to noncompliance in one of the areas noted above.

Risk indicators are used, among other means, to identify key areas of compliance risk and to monitor their development. The key risk areas and the magnitude of the risks stemming from these areas may change in accordance with changes in regulation, enforcement, customer activity, market developments, etc. The Bank uses quantitative and qualitative indicators to measure this risk. These include developments in regulation and enforcement, changes in customers and in certain products, findings of controls and audits, gap surveys, and more.

The Chief Compliance Officer of the Bank serves as the compliance officer pursuant to Proper Conduct of Banking Business Directive 308, the officer responsible for the duties set forth in the Prohibition of Money Laundering and Prevention of Terrorism Financing Law, the supervisor of securities enforcement pursuant to the Law for More Efficient Enforcement Procedures at the Israel Securities Authority, and as the responsible officer pursuant to FATCA. The Chief Compliance Officer and Securities Enforcement Unit consists of the Anti-Money Laundering Department, the Securities Enforcement and Consumer Protection Directives Compliance Department, the International Compliance and Subsidiaries Department, the FATCA Department, and the Administrative Unit.

The mission of the Chief Compliance Officer Unit is to support the achievement of the strategic and business objectives of the Group, while minimizing exposure to compliance and reputational risks. The objectives of the Chief Compliance Officer Unit are:

- To attain full implementation of legislation at all units of the Bank, in Israel and worldwide, with an understanding of the needs of the business units and support for their activity;
- To promote the adoption of professional, values-driven, fair business conduct by the Bank's employees and managers;
- To provide maximum protection to the Bank, its managers, its employees, and its reputation, with full realization of the professional capabilities of the Bank's employees and enhancement of these abilities.

The responsibility for routine management of the compliance aspects of risk at the Bank and for the execution of activities aimed at minimizing this risk lies with the Area managers and the managers of subsidiaries in the Bank Group. Professional responsibility in this field rests with the Chief Compliance Officer Unit in the Risk Management Area. Routine activity is conducted at the Bank's units and in the Group by a network of compliance officers, based on the matrix management principle, with organizational subordination to Area heads or CEOs of subsidiaries, and guidance and control by the Chief Compliance Officer Unit.

The activity of the Chief Compliance Officer and Securities Enforcement Unit is supervised under corporate governance, through:

- The Board of Directors' Committee on Risk Management and Control and Basel 2 Implementation;
- The Board of Management Committee on Compliance, headed by the CEO;
- Quarterly and annual reports to the Board of Directors of the Bank, the CEO, and the Area managers.

The compliance policy of the Group sets rules regarding all of the component areas of the compliance issues described above. This policy includes rules regarding corporate governance and the interaction with subsidiaries and branches outside Israel, and is based on legislation and regulation in Israel. The Bank Group has established an infrastructure to oversee the disclosure requirements with respect to individuals and corporations in the context of FATCA, and is continuing to prepare to comply with the full range of requirements arising from this legislation and from the Israeli regulation in this area. As part of this process, in accordance with the FATCA requirements, the Bank and the relevant subsidiaries have registered on the IRS website, received a Global Intermediary Identification Number (GIIN), and appointed a FATCA officer, as is also required by the agreement between the states. In addition, adjustments were made to work processes and operational systems, and training sessions were provided to all ranks of managers and employees in units that manage customers' funds. The Bank is preparing for the reporting date required according to the agreement between Israel and the United States, subject to legislation and standards to be established in this area (see the Draft Law for the Amendment of the Income Tax Ordinance (Amendment 221), 2016).

The Bank has also established an overall policy of declared money, including with regard to all foreign-resident customers, aimed at ensuring that only reported funds exist in the accounts of foreign residents throughout the Bank Group.

Proper Conduct of Banking Business Directive 308 amendments took effect on January 1, 2016. The directive expands the responsibilities of the compliance officer in connection with several additional matters, such as taxation of products and customers, protection of privacy, consulting for customers, and conflicts of interest, and requires the Bank to appoint a second-tier function responsible for the applicable legal and regulatory directives. The Bank is preparing for this directive; within this process, a new compliance policy has been established, a charter has been approved for the Compliance Officer, and a plan has been prepared for implementation of the directive.

The activity of the Bank with banks located in the Palestinian Authority requires compliance with various regulatory requirements, in particular in connection with the prevention of money laundering and terrorism financing, and involves monitoring of fund transfers to and from residents of the Palestinian Authority. In June 2006, the Bank decided to terminate services to banks operating within the territory of the Palestinian Authority. Following this decision, the Governor of the Bank of Israel and representatives of the Ministry of Finance requested that the Bank refrain from implementing the decision and continue to provide certain services, subject to certain restrictions set by the Bank. Further to talks on this subject between the Bank, the Bank of Israel, and the Ministry of Finance, a permit was granted in in November 2006 pursuant to Section 9(D) of the Terrorism Financing Prohibition Law, the significance of which is that the directives of the Terrorism Financing Prohibition Law concerning the "prohibition of transactions in terrorism property" shall not apply to the transactions noted in the permit.
The Bank terminated its activity with banks and branches located in the Gaza Strip at the beginning of 2009, after the government declared Gaza a hostile entity.
Over the years, the Bank repeatedly notified the Bank of Israel and the Ministry of Finance that in view of the problems involved in the provision of banking services to Palestinian banks, the Bank wished to cease providing such services. The Bank is conducting talks with the Bank of Israel and the Ministry of Finance on this subject. During the course of these talks, the Bank received a letter from the Ministry of Finance stating that the ministry is working to arrange protection for the Bank in respect of this activity.

Legal Risk[AI]

Risk to the Group's income and capital resulting from unexpected events such as legal claims, including class-action suits, inability to enforce contracts, or rulings against the Group, which may cause damage to the Group's profitability. The Group has a structure of internal and external legal counsel.
According to the Bank of Israel's definition, legal risk is "the risk of a loss due to the inability to enforce an agreement by legal actions." Risks of this kind in the Bank's activity may arise from a wide range of diverse circumstances. Thus, for example, risks may arise from the absence of written documentation of contractual engagements between the Bank and its customers, or between the Bank and its suppliers or others, deficient signatures, and/or a lack of details in written agreements; from improperly phrased agreements and/or agreements open to interpretation that does not reflect the Bank's intentions; or from agreements that are subject to cancellation (in full or in part) and/or that include unenforceable provisions or other legal flaws.
The Bank takes a broad approach towards legal risks, and includes in them risks arising from primary and secondary legislative and regulatory directives; rulings of courts, tribunals, and other entities with quasi-judicial authority; risks arising from actions that are not backed by legal counsel or from flawed legal counsel; and risks arising from legal proceedings.
Legal risks are naturally integrated with operational risks, as for example in the case of the possible absence of a full, written, legally signed agreement in a particular transaction, despite the fact that an agreement of the same type exists at the Bank and is used in the ordinary course of its business.

A legal risk management policy document has been approved at the Bank, emphasizing the following points:

- Identifying and addressing areas of material legal risk and appointing the function responsible for implementing the directives.
- Preparing suitable agreements, guidelines, and procedures in order to ensure that risk-prevention measures are implemented.
- Examining the effect of legislative directives (including court rulings) and directives of government agencies, and their implications for the Bank's operation.
- Lesson learning from legislative changes (including court rulings) and applying the conclusions in the legal documents customarily used at the Bank; delivering legal opinions on such matters to the relevant units of the Bank.

With regard to subsidiaries in Israel and abroad, the document draws a general risk-management policy that each subsidiary must adapt and accommodate to its circumstances and operations; mechanisms for reporting to the Head of Legal Risk are also required of these subsidiaries.

Legal counsel submits a quarterly report to the Risk Management Committee of the Board of Management and to the Risk Management Committee of the Board of Directors regarding legal risks that have materialized, in comparison to prior estimates on this matter, as well as statistical information regarding the various types of legal proceedings opened or concluded during the relevant period.

Reputational Risk[AI]

Reputational risk is defined as present or future risk of damage to income or capital as a result of a negative image in the eyes of relevant stakeholders, such as customers, parties to transactions, shareholders, investors, or regulatory agencies. The reputational risk management policy of the Bank Group has been approved by the Board of Management and the Board of Directors, and is implemented by the units of the Group.

The reputational risk management strategy of the Bank Hapoalim Group states that reputational risks should be prevented, minimized, and controlled. Accordingly, the following objectives have been set at the level of the Group with respect to reputational risk:

- To ensure effective supervision and management of reputational risk.
- To ensure effective communication and identification of reputational risk, with the aim of establishing a reputational risk appetite, in accordance with the strategic goals approved for each unit.
- To establish an internal control structure, with the aim of promoting a culture and values of awareness, transparency, and effectiveness in coping with reputational risks.

The Board of Directors and the Board of Management are responsible for promoting high standards of ethics and integrity and for establishing a culture that emphasizes the importance of internal controls.

Regulatory and Legislative Risk[AI]

Regulatory risk is risk to the Group's income and/or capital arising from legislative processes and/or draft directives of various regulatory agencies that cause changes in the Group's business environment. Such changes may occasionally influence the Group's ability to offer certain services and/or may obligate the Group to carry out technological and other investments at considerable cost, while disrupting schedules for development of other planned services.

Restrictions and Supervision of the Activity of the Banking Corporation

The Bank operates under laws, regulations, and directives, some of which are unique to the banking system, and some of which, even if not unique, affect material parts of its activity. The Banking Ordinance, the various banking laws, and the Proper Conduct of Banking Business Directives issued from time to time by the Supervisor of Banks constitute the central legal foundation for the Bank Group's activity. Among other matters, they define the boundaries of the activities permitted to the Bank, the activities permitted to the subsidiaries and related companies of the Bank Group, the terms of control and ownership of such companies, the relationships between the Bank and its customers, the usage of the Bank's assets, and the manner of reporting such activity to the Supervisor of Banks and to the public.

In addition, the Bank is subject to extensive legislation regulating its activity in the capital market, both on behalf of its customers and on its own behalf (e.g. in the areas of investment advising and customer portfolio management, pension advising, securities laws, and restrictions on insurance activity).

Other laws on specific topics impose specific duties and rules on banks, including the Bank. Examples include the legislation related to the prohibition of money laundering and terrorism financing, the Credit Data Law, legislation related to housing loans, guarantee laws, etc.

Additional legislation related to the Bank's activity has a strong influence on its conduct. Noteworthy in this area are execution laws, liquidation and receivership laws, laws referring to specific segments (local authorities, mortgage takers, home buyers, the agricultural sector), and various tax laws.

The Bank's activity is subject to supervision and auditing by the Supervisor of Banks as well as other supervisory agencies in specific areas of activity, such as the Israel Securities Authority; the Supervisor of the Capital Market, Insurance, and Savings at the Ministry of Finance; and the Antitrust Commissioner. These agencies carry out audits at the Bank, from time to time, concerning the various areas of activity.

The Bank and its subsidiaries work to comply with the duties imposed upon them under the said legal provisions.

Regulatory Risk Management Methods

The Regulation Unit assesses and manages regulatory risks by monitoring, identifying, collecting information, assessing, reporting, conducting follow-ups, and applying controls with respect to regulatory developments, as they emerge. The department also supplies opinions, as relevant, with regard to the effect of the forthcoming regulation on the expected business conduct of the various units of the Bank. The unit operates in full cooperation with the relevant professional units of the Bank and at the subsidiaries and offices in Israel and overseas, in order to ensure that regulation is implemented fully and in an effective manner in business terms. With regard to compliance with regulatory directives, see "Compliance Risk," above.

Economic Risk[AI]

Risk factors in the economic environment are identified by the Economics Department, which tracks current economic and financial data in Israel and worldwide and professionally evaluates the implications of the data. The department maps potential risks in the economy and in the financial markets, and reports to the relevant teams and committees. Concurrently, the department prepares a set of extreme scenarios with a low probability of future materialization, which in its opinion have significant economic and financial consequences for the economy and for the Bank. The extreme scenarios are updated annually, according to the risk map, and approved by the authorized parties, in accordance with procedures. Concurrently, the Economics Department examines a series of warning indicators that may signal an increase in the probability of an extreme scenario. Warning indicators are reported routinely to the Board of Management Committee on Risk Management.

The Bank translates the market conditions in each scenario into an impact on its business activity, according to the various risk areas, and examines the effect on profitability, capital, and capital adequacy.

Economic Risk – Condition of the Israeli Economy

Risk to the Group's income and capital arising from a slowdown in economic activity or from geopolitical situations, which may have an adverse effect on the condition of some businesses, on income levels, and on unemployment in the Israeli economy. Such a process may cause deterioration in the condition of some of the Group's borrowers, leading to an adverse effect on credit risk. Furthermore, a slowdown in economic activity may cause a decline in non-credit income, such as income from capital-market activity and foreign-trade activity, and may cause a change for the worse in the composition of financial resources, such as an increase in the cost of resources and a decrease in their availability. Economic indicators released to date point to a deceleration in growth during the first quarter. The slowdown was primarily notable in exports of goods, which dropped at a rate of approximately 4%, in terms of US dollars, compared with the preceding quarter. By contrast, recovery has been apparent in real investments, and activity in the residential construction sector remains high. The unemployment rate has remained low, at 5.3%, although the latest figures were also slightly less favorable. The consumer price index fell by 1.0% over the first quarter. The decrease in the CPI was influenced by the lower energy prices and by the government policy of reducing the cost of living. We do not believe that the ongoing decrease in the CPI indicates an increased risk of economic recession. The increase in prices of homes continued, despite the government's efforts to restrain demand.

Economic Risk – Condition of the Global Economy

Risk to the Group's income and capital arising from a significant slowdown in economic activity in the global market, which may have an adverse effect on the condition of some businesses in Israel and on the volume of business activity. This could have a negative impact on the probability of collecting credit and/or reduce income from fees and/or from capital-market activity and/or from the Group's activity abroad and/or from the provision of services related to foreign-trade activity and/or from the activity of foreign investors and/or from the provision of services to Israeli customers with activity abroad.

2016 opened on a negative note in global capital markets, as prices of risky assets dropped sharply. The negative trend in prices was most salient in European banks. Factors underlying the wave of risk aversion likely included worries over a crisis in the Chinese economy, and the steep decline in the price of oil, which weakened the stability of several exporting countries. The trend began to reverse in mid-February, as share prices rose again and risk premiums receded. The growth rate of the global economy remains moderate, and in Europe, the central bank has applied unconventional monetary measures to stimulate growth. Growth in the United States also slowed during the first quarter. Meanwhile, improvements have been noted in several of the emerging markets that evoked concern earlier in the year. The incipient slowdown in the Chinese economy heightened investors' concerns and led to a massive outflow of capital at the beginning of the year. The administration used foreign-currency reserves to moderate pressures towards depreciation of the yuan. Somewhat more positive data were released late in the first quarter, and the capital outflow from China slowed. The price of oil also rose sharply, concurrently with the rebound in capital markets.

Monetary policy in Europe was expanded further, with the interest rate on euro deposits lowered to -0.4%, and even lower rates in some European countries. The negative interest rates have significantly impeded the functioning of commercial banks in the region, and are one of the causes of the deterioration in these banks' profitability.

Accordingly, and in light of the condition of the Israeli economy, the Bank continues to monitor the risks and segments that may be affected by these changes, and adapt its policies and control activities as necessary. Among other factors, the Bank examines the securities in its investment portfolio in Israel and overseas, its exposure to foreign financial institutions, and risk areas in the credit portfolio that may be influenced by such developments. The Bank continuously complies with the liquidity requirements set in the supervisory directives.

Strategic Risk[AI]

Strategic risk is material present or future risk to profits, capital, reputation, or status that may be caused by changes in the business environment; faulty business decisions; improper implementation of strategy or business decisions; or failure to respond to changes in the industry (e.g. competitors' actions), the economy, or technology.

Strategic risk is also a function of the congruence of the organization's strategic objectives with its environment, adaptation of the business plans that it develops to achieve these objectives, resource allocation, and quality of implementation.

The strategic plan of the Bank is a three-year plan approved by the Board of Management and the Board of Directors, and examined and adjusted annually to changes in the business environment in Israel and globally, changes in the Bank's competitive environment, and changes in the Bank's objectives.

The process of formulating the strategic plan encompasses a general examination of the corporation's business and the relevant strategic risks, and a comprehensive planning process. The annual examination of the strategy of the Bank and of the Areas is designed to support the objectives of the Areas and of the Bank as a whole. Within the annual planning process, the Areas and the subsidiaries of the Bank carry out focused strategic projects as part of their strategic plan.

The annual process of managing and assessing strategic risk is an important part of the annual strategic planning process. The annual strategic planning process consists of three main stages, each of which addresses a different aspect of strategic risk management and assessment:

Stage I – Identification of the strategic risks to the Bank in its competitive environment – examination of the factors influencing the Bank's competitive ability and future growth potential, including an examination of global and local trends and the current situation at the Bank.

Stage II – Formulation of objectives and of a high-level work plan, adapted to the business environment and to the strategic trajectory.

Stage III – Construction of detailed plans for all Areas, examination of scenarios, and establishment of risk indicators. This stage involves determining the themes, strategic focus areas of the Bank, and strategic maps for the realization of each theme. In addition, strategic maps are created for the Areas, in congruence with the themes, and strategic risk indicators are established – goals and metrics are established for each map (at the process level and at the level of business results), derived from the strategy. This allows strategy to be translated into measurable steps for the various units, making it possible to identify the extent of the Bank's exposure to strategic risk.

Alongside the routine monitoring of developments in the Bank's business environment, the Bank monitors, measures, and applies controls to strategic risk through the Balanced Score Card (BSC) strategic control process. The Bank routinely monitors its achievement of the goals and objectives in the strategic maps created using the BSC methodology, concurrently with the extent to which it achieves its financial objectives. The Bank thereby ensures that the plan leads to the desired results from a business perspective. The BSC strategic control process is conducted by the Strategic Management Center.

Environmental Risk[AI]

Environmental risk to the Bank is the risk of loss as a result of directives related to the protection of the environment and the enforcement thereof, which may materialize if the Bank bears direct responsibility for an environmental hazard, including the possibility that the Bank may be required to remove an environmental hazard, or may be liable to a third party in respect of an environmental hazard, or as a result of the impairment of realized collateral. This risk may also materialize indirectly as a result of the deterioration of the financial condition of another entity due to environmental costs stemming from directives related to the protection of the environment. Reputational risk may also materialize as a result of the attribution to the Bank of an association with the cause of an environmental hazard. Environmental risks related to large credit portfolios are monitored by the Corporate Banking Area. Environmental risk related to the Bank's own activity is under the responsibility of the Corporate Social Responsibility Division.

In recognition of its social responsibility, and based on an understanding of the importance of maintaining environmentally sustainable policies, the Bank has formulated a comprehensive, ordered environmental policy. This policy is implemented through an organizational structure and job descriptions, procedures, processes, and control systems. As part of the process of formalizing and controlling its environmental conduct, the Bank received certification under the ISO 14001 standard, which is revalidated annually, in a comprehensive review by a licensed international firm. An extensive description of activities in connection with the environment is presented in the Corporate Social Responsibility Report of Bank Hapoalim, published annually in accordance with the most advanced GRI standard.

The Bank has established policies, working procedures, and methodologies for the identification, specification, and management of environmental risks, in order to address the effect of environmental risk on the credit risk of major borrowers. During the formulation of the process of writing the policies and working procedures, prevalent methodologies at banks overseas were examined, and experts in this field were consulted. The methodology for identification of environmental risks includes, among other matters, reference to the potential environmental risk in an industry sector, as well as individual reference to environmental risks that may have a material effect on the corporation, based on its business activity. The management of environmental risks is part of the overall management of credit risks at the Bank; an assessment of environmental risk is included in evaluations of the quality of credit granted to customers by the Bank.

E. Liquidity Risk

Liquidity risk – Liquidity risk is defined as present or future risk to the stability and profits of the Bank arising from an inability to sustain the cash flow required for its needs. Liquidity risk at the Bank is defined as the ability of the Bank to repay its liabilities on schedule, including during times of stress, without damage to its routine operations within the business plan of the Bank and without incurring exceptional losses.

Refinancing risk – The risk of inability to raise new resources to replace resources that have matured, or the risk that the reissue may be performed at durations and terms that damage the Bank's net interest income. This risk is managed as part of liquidity risk. In light of the financing sources described below, the Bank does not view this risk as a material risk in its own right. The Bank accords high importance to raising resources that are stable and highly diversified.

Table E-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period ended March 31, 2016

	Total unweighted value*	Total weighted value**
Total high-quality liquid assets		
Total high-quality liquid assets (HQLA)		**91,165**
Cash outflows		
Retail deposits from individuals and from small business customers, of which:	**185,669**	**14,110**
Stable deposits	**56,451**	**2,823**
Less stable deposits	**87,561**	**10,049**
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	**41,657**	**1,238**
Unsecured wholesale financing, of which:	**110,226**	**66,397**
Operational deposits (all counterparties) and deposits in networks of cooperative banks	**1,523**	**381**
Non-operational deposits (all counterparties)	**108,434**	**65,747**
Unsecured debts	**269**	**269**
Secured wholesale financing	**41**	**-**
Additional liquidity requirements, of which:	**117,259**	**21,891**
Outflows related to derivative exposure and other collateral requirements	**13,275**	**11,472**
Outflows related to loss of funding on debt products	**-**	**-**
Credit and liquidity facilities	**103,984**	**10,419**
Other contractual funding obligations	**10,879**	**10,879**
Other contingent funding obligations	**57,683**	**2,230**
Total cash outflows		**115,507**
Cash inflows		
Secured lending (e.g. reverse repos)	**233**	**233**
Inflows from fully performing exposures	**26,568**	**18,018**
Other cash inflows	**17,334**	**10,354**
Total cash inflows	**44,135**	**28,605**

	Total adjusted value***
Total high-quality liquid assets (HQLA)	**91,165**
Total net cash outflows	**86,902**
Liquidity coverage ratio (%)	**105%**

* Unweighted values shall be calculated as outstanding balances maturing or callable within 30 days (for inflows and outflows), based on three monthly observations, in accordance with the transitional directives.

** Weighted values shall be calculated after the application of respective haircuts or inflow and outflow rates (for inflow and outflow), based on three monthly observations, in accordance with the transitional directives.

*** Adjusted values shall be calculated after the application of: (1) haircuts and inflow and outflow rates; and (2) any applicable caps (i.e. caps on level 2B and level 2 assets for HQLA and cap on inflows).

On September 28, 2014, the Supervisor of Banks issued a circular adding Proper Conduct of Banking Business Directive 221, "Liquidity Coverage Ratio," which adopts the recommendations of the Basel Committee with regard to the liquidity coverage ratio (LCR) in the banking system in Israel. The LCR refers to a horizon of thirty days, in a stress scenario, and is aimed at ensuring that banking corporations maintain a stock of high-quality liquid assets that cover the corporation's liquidity needs during that timeframe, in accordance with the scenario described in the directive. The directive establishes the method of calculation of the LCR, including a definition of characteristics and operational requirements for a stock of "high-quality liquid assets" (the numerator) and the applicable haircuts, and defines the net expected cash outflow in the stress scenario defined in the directive for the coming thirty calendar days (the denominator). This flow includes, among other matters, some withdrawal of various types of deposits, in accordance with the coefficients in the scenario, some utilization of credit facilities provided by the Bank, and more, with the deduction of repayment during the month of credit granted by the Bank, at certain coefficients, etc. Classifications of bonds, types of deposits, types of credit facilities, etc., and the applicable haircut coefficients were established in the directive. Accordingly, a change in the volume or composition of liquid assets, a change in the volume of any of the types of deposits defined in the directive, changes in the volume of credit facilities and guarantees subject to a liquidity requirement, etc., may lead to a change in the ratio.

Pursuant to the transitional directives, the minimum requirement was set at 60% beginning April 1, 2015. This requirement rose to 80% on January 1, 2016, and will be raised to 100% as of January 1, 2017. However, during times of financial stress, banking corporations will be permitted to fall below these minimum requirements. Separate requirements apply in total currencies and in foreign currency, at the level of the standalone banking corporation and consolidated, and the ratio is calculated accordingly. A banking corporation that does not comply with the ratio is required to report immediately to the Supervisor of Banks; after three days of deviation, the corporation must submit a plan for compliance with the minimum requirement.

The standalone ratio for the banking corporation is calculated daily, and reported as an average of daily observations. The consolidated ratio and the ratio for the significant banking subsidiaries is calculated on a monthly basis, in accordance with the transitional directives, and reported as the average of three monthly observations. Credit-card companies are exempt from independent calculations, but are included in the consolidated data.

In general, the rules for calculation of the LCR according to Proper Conduct of Banking Business Directive 221 are more severe than the internal models applied at the Bank. During the quarter, the average consolidated ratio (as noted, an average of three monthly observations) was 105%, and the average standalone ratio (an average of daily observations) for the banking corporation was 98%, versus the minimum requirement of 80%. The ratio rose during the quarter, as compared to the preceding quarter, due to a change in the mix of resources, which led to a decrease in outflow and an increase in liquid assets, as a result of an increase in resources exceeding the increase in credit. There is some volatility from day to day during the month, and some interchange between NIS and foreign currency, mainly due to activity in derivatives.

The liquid assets of the Bank mainly consist of Israeli government bonds in NIS and in foreign currency, US government bonds in foreign currency, and deposits with central banks (the Bank of Israel and the Federal Reserve). Part of the liquid assets are held by the Bank, and part are held by the subsidiaries. The Bank takes into consideration possible restrictions on the transfer of liquidity between some subsidiaries and the Bank, particularly banking subsidiaries overseas. Accordingly, some of the subsidiaries hold liquid assets for times of stress (or a credit line from the parent company), according to need, and the Bank does not rely on these assets. The standalone liquidity ratio is calculated using a stricter assumption, and does not include liquid assets which the Bank estimates it will be able to transfer during a crisis from some of the subsidiaries. The Bank manages the liquidity coverage ratio, and accordingly its liquid assets, with a separation of NIS and foreign currencies. For details of liquid assets by level and for pledged and unpledged assets, see tables below.

The main source of funding of the Bank is deposits from retail customers and small businesses in Israel, which generate low liquidity risk relative to other resources. In addition, the Bank obtains financing through issues, deposits from corporate and financial companies, and more. Funding in foreign currency includes deposits of private customers and corporate customers in Israel, non-residents, Global Private Banking customers, Israeli companies abroad, issues of CDs and other instruments secured by the FDIC in the United States, and issues of bonds abroad (through the subsidiary Hapoalim International). Deposits from corporate and financial entities with a maturity date of up to one month are subject to high outflow coefficients, pursuant to the directive, and therefore have a relatively large contribution to cash outflow. The Bank monitors the concentration of funding sources, in various breakdowns, in both NIS and foreign currency, and complies with the internal limits in this area. The Bank does not rely on funding from the capital market as a major financing source.

Derivatives create a large inflow and a large outflow, and lead to redirection of liquid assets and net cash outflow between NIS and foreign currency, but their net contribution in all currencies is low. The Bank does not consider collateral which it is required to deposit against derivatives activity as liquid assets; volatility in the volume of this deposit is taken into consideration, as required in the directive.

The Bank calculates its standalone liquidity ratio on a daily basis, divided into NIS and foreign currency. The Bank tracks this ratio at the subsidiaries (which are required to comply with internal liquidity limits adjusted to the nature of their operations), and calculates the consolidated ratio on a monthly basis, in accordance with the transitional directives. The calculation of the consolidated ratio takes into consideration limits that may apply to the transfer of liquidity from some of the subsidiaries during a crisis, particularly banking subsidiaries overseas. The standalone banking corporation ratio is reported as an average of daily observations, while the consolidated ratio is reported as the average of three monthly observations. The Board of Directors of the Bank has adopted an internal limit stricter than the regulatory LCR requirement, both for the standalone banking corporation and consolidated.

Liquidity and refinancing risks are managed based on a global view of the Bank's activity in Israel, at its overseas branches, and at subsidiaries with significant liquidity risk for the Group. Liquidity risk at the Bank, in foreign currency and in NIS, is managed and controlled routinely at the ALM Division, in accordance with Group policy, with the aim of ensuring the ability to cope competitively even in exceptional supply and demand situations in the financial markets. Current liquidity management is under the responsibility of the ALM Division, and is executed through NIS and foreign-currency liquidity units, and through corresponding units at the subsidiaries. Reports to Board of Management committees are submitted on a monthly basis; reports to Board of Directors committees are submitted on a quarterly basis. Additional reports to internal functions for monitoring and management purposes are submitted more frequently. The business plan of the Bank takes future liquidity requirements and liquidity risk into consideration. The Market and Liquidity Risk Management Department in the Risk Management Area routinely monitors liquidity using internal and environmental parameters, independently reports the risk level to the committees of the Board of Management and the Board of Directors, and challenges the parameters in the various models related to liquidity. In addition to the measurement of the liquidity ratio according to Proper Conduct of Banking Business Directive 221, as described above, the Bank applies additional tools and monitors additional indicators of liquidity risk, in accordance with Proper Conduct of Banking Business Directive 342. These indicators include, among other matters, an internal liquidity risk model similar to the LCR. This model is based on the proven stability of deposits at the Bank over long periods, and includes various scenarios with respect to rollover and maturity rates of assets and liabilities. A liquidity ratio is calculated in each scenario; this ratio is not to fall below the minimum level specified in the directive. Scenarios applied in the internal model refer to different market conditions, and specifically to a Bank-specific scenario, a systemic scenario, and a combined scenario. In each scenario, the liquidity gap for a period of up to one month is examined against liquid assets. The scenarios differ primarily in the assumptions regarding rollover of deposits and haircut coefficients for liquid assets. The Bank also applies models for longer and shorter periods; an NSFR-based model for a period of one year; depositor concentration indices; an early-warning system (a system that monitors indicators that may point to a risk of a crisis situation); and more. Some of these indices are subject to internal and/or regulatory limits. The Bank also monitors various liquidity ratios at the subsidiaries (which are required to comply with both internal liquidity limits adapted to the nature of their operations, and the limits of the local regulator).

The Bank maintains a liquidity cushion for stress situations; maintains a balance sheet structure, and in particular a resource structure, that brings liquidity risk to a low level; monitors early-warning systems to identify liquidity stress situations as early as possible; and maintain a contingency plan for crisis situations, which includes convening committees, reporting requirements, and a series of steps for coping with possible stress, according to scenarios.

Table E-2: Details of liquid assets, by level, as required in the Basel directives[AI]

	Balance at report date	Average in reported quarter
Level 1 assets	**93,081**	**90,125**
Level 2A assets	**314**	**405**
Level 2B assets	**653**	**635**
Total HQLA	**94,048**	**91,165**

A regulatory limit applies in Switzerland and in New York to the use of the liquidity reserve of these entities. The Bank's scenarios assume the use of liquidity of the subsidiaries / New York branch, taking the limits of each entity into consideration.

Table E-3: Pledged and unpledged available assets*[AI]

	Fair value balance as at March 31, 2016		
	Total balance in the balance sheet	Of which: pledged**	Of which: unpledged
Cash and deposits with banks	**63,086**	**2,708**	**60,378**
Israeli government bonds	**47,314**	**7,924**	**39,390**
Foreign government bonds	**6,226**	**995**	**5,231**
Bonds of financial institutions in Israel	**595**	**-**	**595**
Bonds of foreign financial institutions	**4,438**	**-**	**4,438**
Bonds of others in Israel	**1,750**	**-**	**1,750**
Bonds of foreign others	**3,373**	**41**	**3,332**
Shares of others	**2,458**	**-**	**2,458**
Total securities	**66,154**	**8,960**	**57,194**

* In addition, other assets in the amount of NIS 746 million are pledged.
** Includes surplus pledges.